Letshego

SSA Banks

Buy

Low Risk

12th November 2014

Botswana

From Windhoek to Nairobi

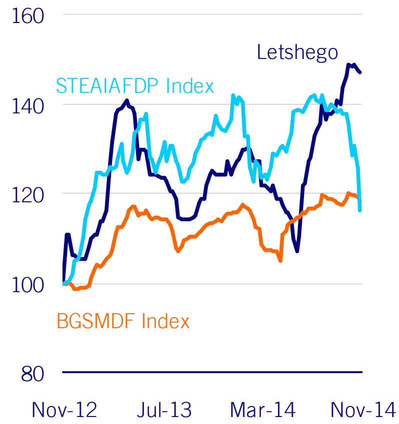
(YE15 PT of BWP3.50 vs YE14 PT of BWP2.70; Buy Recommendation maintained)

- **Letshego remains committed to growing and diversifying revenue, taking advantage of its powerful B/S.** Recent 1H14 results confirmed that earnings are on track, with PBT rising 11% y/y to BWP508mn. This was primarily due to strong loan growth in Namibia and Mozambique, which combined account for 43% of total loans. In contrast, East Africa remains a challenge, as South Sudan is wound-up and Tanzania scaled down. Meanwhile, Letshego revised its pay-out ratio from 25% to 50%, which is positive for achieving higher leverage.

- **Earnings growth sustainable in the MT.** We fine-tuned our estimates to reflect higher fee income contribution, rising pressure on margins, increasing risk to asset quality and higher taxation as operations expand beyond Botswana. We estimate FY14^F PAT growth of 6% y/y to BWP684mn. Importantly, we have also modelled Letshego's deposits strategy, by assuming a 5% contribution to total funding over the MT. We believe that Mozambique will be a key driver of deposits mobilisation, and will follow a strategy akin to Equity Bank's (Kenya) agency banking offering. Overall, we estimate NII and PAT CAGR13-17^F of 18%.

- **Valuation remains attractive.** The share has performed strongly, up 27% (since our initiating report). However, Letshego's YE15-16F P/E multiples remain attractive at 6.7x and 5.7x, and at a discount to the sector average. DY is also attractive on a sustainable basis. In addition, visibility among international investors is improving, as Letshego is an attractive vehicle for exposure to the SSA consumer segment, currently experiencing growth. **Our YE15 PT of BWP3.50** (29% upside), implies a YE15 P/E of 8.9x. Main triggers are: (1) improved performance in key markets; (2) turnaround in East Africa operations, and (3) a successful deposits strategy, which could alter the funding profile. **We therefore reinforce our BUY recommendation.**

Letshego vs. Domestic financial Sector Index vs. S&P Africa frontier



Source: Bloomberg.

Stock data

Price (BWP):	2.72	Price Target (BWP):	3.50
Nº of shares (mn):	2 176	Reuters/Bloomberg:	LET.BT / LETSHEGO BG
Market Cap (BWPmn):	5 919	Market Cap (USDmn):	674
Avg. Daily Vol. (BWP '000):	2 890	Avg. Daily Vol. (USD '000):	327
Debt/Equity '14	0.4	Free-float:	51%
EPS growth ('13-'17^F)	17%	ROE'14:	19.0%
Major shareholders:			Botswana Insurance Holdings (23%)

Estimates	2012	2013	2014^F	2015^F	2016^F	2017^F
Diluted EPS (BWP)	0.33	0.30	0.31	0.40	0.48	0.57
P/E (x)	8.2	9.2	8.7	6.7	5.7	4.8
Dividend yield	3.1%	2.7%	5.8%	7.4%	8.7%	10.4%
Adjusted P/BV (x)	1.9	1.7	1.6	1.3	1.1	0.9

Historical Recommendation

Date	Recommendation
14-May-14[1]	Buy

(1) Initiating Coverage.

Source: BPI Capital Africa.

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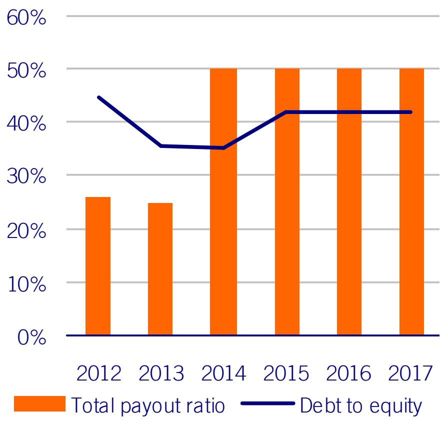
KEY THEMES

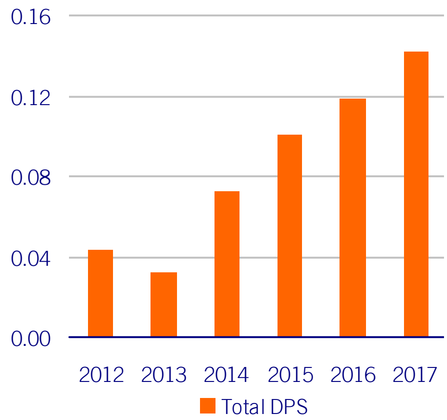
Revised Dividend Policy Increases Leverage

Letshego recently shifted its dividend policy, raising its pay-out ratio from 25% to 50% of earnings. The dividend shift increases leverage on the B/S over the MT, and likewise would improve shareholder returns. Letshego currently has excess equity, following a BWP360mn capital call in YE09 and a recent BWP253mn loan-to-equity conversion. Its historic debt-to-equity ratio is below 0.4x vs a peer average of 2.0x. As such, returning cash to shareholders will improve efficiency of B/S management, and puts Letshego on track to reach its target 1.0x debt-to-equity ratio. Further, the increase in dividend implies that at current price levels, the share has a FY15 DY of 7.4%.

Dividend Pay-out and Gearing



Total DPS (BWP)

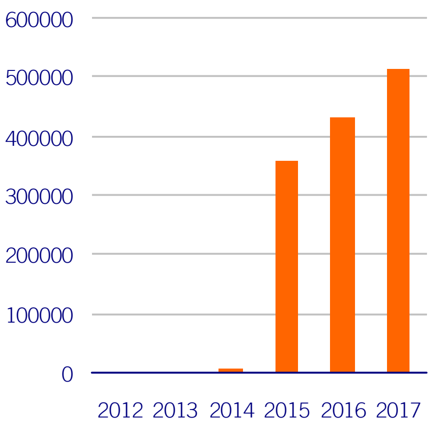


Source: Company report, BPI Capital Africa.

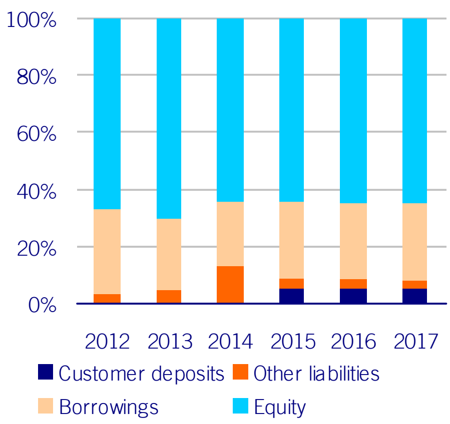
Deposit-Mobilisation Strategy Gearing for Take-Off

We estimate a contribution of customer deposits to total assets of 5% over the MT, as Letshego rolls out a deposit-mobilisation strategy, following the acquisition of banking licences in Mozambique, Rwanda and Namibia. Our 5% deposits contribution assumption implies that there would be a sharp increase in customer deposits in FY15[F] to over BWP350mn. Thereafter, implied growth in deposits would be 20% y/y over the MT. Currently, deposits contribute a negligible 0.04% of total funding; but this is testament to a process which is still at inception. Mozambique commenced deposit-taking in Feb-14 and recorded BWP2.2mn (USD234k) in fixed-term deposits at 1H14. Rwanda is expected to come on-stream before YE14, followed by Namibia, which is finalising its licensing requirements. However, for context we made the following additional assumptions: (1) Letshego mobilises deposits from Mozambique over the next few years; and (2) Mozambique's contribution to total loans is held constant at 20% over a similar period. This would imply that total deposits would represent approximately 30% of the Mozambique loan book. In our opinion, this is justifiable, as Letshego taps into its existing customer base of borrowers, which would improve synergies, and also extends its deposit products to new markets. The deposits strategy is therefore a strong business proposition, which should ultimately alter Letshego's funding structure and risk profile.

Customer Deposits (BWP 000)



Funding Structure



Source: Company report, BPI Capital Africa.

Analysis of Deposits Contribution (BWPmn)

	1H14	FY14F	FY15F	FY16F	FY17F
Total deposits	2	6	358	429	515
Total loans	5 006	5 411	6 380	7 614	9 094
Mozambique loans	980	1 082	1 276	1 523	1 819
Mozambique loans contribution to total loans	20%	20%	20%	20%	20%
Total deposits to Mozambique loans	**0%**	**1%**	**28%**	**28%**	**28%**

Source: Company report, BPI Capital Africa.

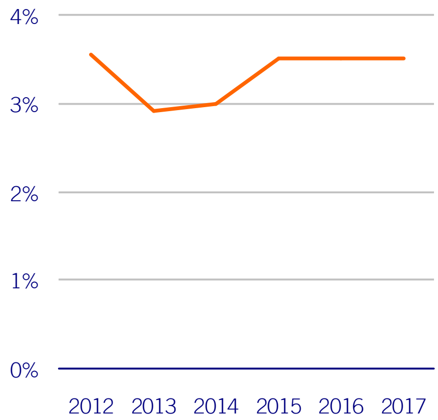
On balance, we believe that Letshego will improve its competitive edge vs peers as the strategy is likely to be operationalised via a low-cost branchless banking initiative. This includes the extensive use of informal distribution agents and a mobile banking platform. Mozambique is of course the entry point and will be pivotal to Letshego's success in increasing leverage via deposits. The country holds significant scope for supporting the strategy, since banking penetration levels are very low vs regional peers and estimated at about 10% of the adult population. Moreover, urban areas in Mozambique have an estimated 4.2 branches per 100k individuals, and in rural areas the situation is worse with just 0.6 branches per 100k inhabitants. Despite such low penetration, Mozambique has 18 banks and is considered among the least difficult for entry by competitors. Similarly, Rwanda has relatively low banking penetration levels, but the entry of Kenyan banks and the existence of microfinance banks, such as Urwego Opportunity Bank and Banque Populaire du Rwanda (BPR) implies that the sector is likely to be more competitive or challenging in the MT.

Importantly, Letshego's deposits strategy is akin to that of Equity Bank (EQBNK KN), which has drawn much success and global accolades as it significantly improved access to finance for the low income segment. Equity Bank distributes via a network of 15 875 agents vs 875 agents when its agency banking concept was piloted in YE10. Its mobile banking platform called Eazzy247, drives a significant share of depositor activity and has recently evolved into a mobile money concept called Equitel. In comparison with Mozambique, the Kenyan banking segment comprises 43 banks and penetration rates are estimated at about 40%. As such, Kenya is deemed to be far ahead of Mozambique, which would imply that the upside for Mozambique, at this stage, is higher. We therefore believe that our 5% deposits contribution assumption holds, given Equity Bank's success in a more competitive environment and the phenomenal growth it achieved in a relatively short period. Moreover, Letshego has achieved rapid growth in its lending business in Mozambique following entry in YE11; and its much improved understanding of the local market, would be a key driver of success in ramping up deposits growth.

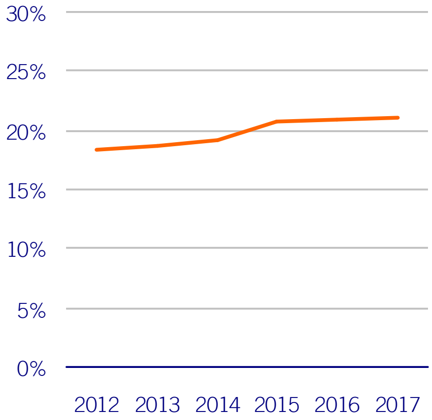
Fee Income Growth will Leverage on the Deposits Strategy

We estimate an increase in fee income contribution to total assets of 3.5% over the MT vs 3.0% currently. As much as Letshego's deposits proposition will drive a stronger funding base, fee income will likely be ramped-up by additional transaction facilitation as Letshego broadens its product offering. Its banking licences in Mozambique, Rwanda and Namibia permit the business to offer debit card facilities to its deposit customers. In addition, Letshego will be able install ATMs and to acquire merchants for distributing via POS terminals. Therefore, transaction fee income will now include deposit and withdrawal fees, transfers fees, account balance checks, and commission from payments at merchant till points. Letshego is therefore likely to increase its NIR contribution to total income over the MT. We estimate an average contribution of 21% from FY15-17F.

Fee Income to Total Assets



NIR Contribution to Total Income



Source: Company report, BPI Capital Africa.

Payroll-based Lending to Civil Servants Remains Pivotal to Strategy

In spite of the recent foray into microfinance via the acquisition of Micro Africa, Letshego remains largely a consumer finance business that specialises in unsecured loans on a deduction-at-source platform. Letshego's largest loan exposures are Botswana (38% of total), Namibia (23%) and Mozambique (20%); which mostly comprises payroll loans to a target market of civil servants. Southern African countries better reflect Letshego's proposition vs East Africa, and Namibia is a particularly successful market where its share of civil servants increased to 51% from 46% previously. This compares with Botswana, which remains stable at 21% and Mozambique, which increased to 12% from 10%. In addition, Namibia and Mozambique remain relatively fast-growing markets, achieving growth of 24% ytd respectively, although Botswana slowed to 6% growth. On balance, the East African business still faces significant challenges in distributing payroll loans, mostly due to a lack of central registers in that region.

Market share of civil servants

	FY13	1H14
Namibia	**46%**	**51%**
Botswana	**21%**	**21%**
Lesotho	9%	20%
Swaziland	12%	12%
Mozambique	**10%**	**12%**
Uganda	12%	11%
Tanzania	10%	8%
Kenya	1%	1%
Rwanda	0%	0%
South Sudan	0%	0%

Source: Company, BPI Capital Africa.

Key Risks

1. Asset Quality Concerns on the East African Portfolio

The absence of functional central registers in East Africa poses a threat to asset quality, even though exposure to the region represents no more than 20% of total loans. We reinforce our view that Letshego's key strength is payroll lending and current efforts to diversify the business via microfinance products will increase its risk profile in the MT. These products include low-cost housing and SME loans. The integration of Micro Africa has thus far proven relatively successful, but opportunities for payroll lending are virtually non-existent. Instead, Letshego has secured credit insurance in Kenya and Rwanda. Tanzania and Uganda loan books are not secured.

2. Cyclical Resources Industry Impacts Mineworkers

In addition to some concerns over East Africa, the expected move to commence lending to mineworkers in Botswana also raises the risk profile of the business in the MT. While Letshego may infact secure a payroll lending mandate, this is a relatively new segment, and mineworkers are at higher risk of retrenchments vs civil servants owing to the cyclical nature of extractive resource industries. As such, we highlight that even though Letshego has a strong opportunity to diversify and defend market share in Botswana, its target market is untested and in a period of low commodity prices, which have a direct impact on industry staff count, asset quality would likely deteriorate. Moreover, the demise of erstwhile African Bank (ABL SJ), which had an aggressive approach to lending to mine workers raises concerns about the profitability of this segment.

Letshego Equity Story

Positives	Negatives
Low risk payroll lending model	Potential increase in regulation on payroll lending
Strong franchise in Southern Africa	East Africa growth still limited due to lack of central registers
Large market share of civil servants in most markets	Targeting of mineworkers in Botswana increases risk to portfolio
High interest spreads on low-risk model	Margins under pressure from rising competition
Agency banking and mobile banking expansion drives efficiency	Integration costs of East African business add pressure to costs
Good corporate governance and financial disclosure	FX translations risk reduces earnings visibility
Attractive price multiples and dividend yield	Declining ROE

Source: BPI Capital Africa.

Valuation and Recommendation Summary

We update our coverage of Letshego with a YE15 Price Target of BWP3.50/share, upside of 29%. The change in dividend policy to 50% of earnings from 25% previously has an obvious impact on our DDM valuation in the ST. As such, we have weighted the contribution of each valuation methodology, placing more emphasis on the P/BV relative valuation. Letshego's growth has remained hugely positive and without any significant deterioration to asset quality, even though there may be some risks due to increased exposure to East Africa and adjacent markets. Nevertheless, it remains a strong player in its traditional markets, which include Botswana, Namibia and Mozambique; where its franchise is first-in-mind for consumer finance targeting civil servants. **Overall, we reinforce our BUY recommendation.**

Valuation Summary

	BWP	Upside
DDM valuation	3.75	38%
P/BV valuation	3.40	24%
YE15 Price Target	**3.50**	**29%**

Source: BPI Capital Africa .

VALUATION

We have valued Letshego using a dividend discount model and P/BV comparative valuation. **We derive a YE15 Price Target of BWP3.50/share, upside of 29% to current market value.**

Price levels

	BWP
YE15 PT	3.50
Current	2.72
30 Jun-14	2.26
Initiating coverage	2.14
12-month high	2.75
12-month low	2.00
Loan-to-equity conversion (YE13)	1.60
Private placement (YE09)	2.50
IPO (YE02)	0.11

Source: Bloomberg, BPI Capital Africa.

Valuation Summary table

	BWP	Upside
DDM valuation (40%)	3.75	38%
P/B valuation (60%)	3.40	24%
YE15 Price Target	**3.50**	**29%**

Valuation 1: Dividend Discount Model

We note that the shift in dividend policy to 50% of earnings from 25% previously has had a significant impact on our valuation. As such, we have used a 40% weighting to the DDM valuation vs 60% for the alternate P/BV model. We make the following assumptions with respect to our DDM model: (1) Weighted average risk-free rate of 8.85% - this is derived from a blend of weighted risk free rates for each of the countries in which Letshego has exposure. (2) Risk premium of 6.0%. (3) Beta of 0.7 vs 0.6 previously - we have adjusted our beta to reflect the increased risk profile of the business due to higher exposure in East Africa via microfinance and increased scope for higher leverage following a change in the dividend policy. (4) Long term growth rate of 5%; and (5) 10-year explicit forecasts of earnings to which we apply the company's revised dividend policy of 50%, to derive annual dividends, net of dividend tax.

Calculation of Risk-free Rate

Country	Risk-free Rate	1H14 Net Loans (BWPmn)	Weight	Calculation
Botswana	6.0%	1 913	0.4	2.30%
Namibia	8.0%	1 160	0.2	1.86%
Mozambique	13.0%	980	0.2	2.55%
Tanzania	13.0%	264	0.1	0.69%
Uganda	13.0%	217	0.0	0.56%
Kenya	12.0%	126	0.0	0.30%
Swaziland	8.0%	130	0.0	0.21%
Lesotho	8.0%	129	0.0	0.21%
Rwanda	11.0%	82	0.0	0.18%
Average	**10.2%**	**5 001[(1)]**		**8.85%**

Source: BPI Capital Africa; (1) excludes South Sudan.

DDM Assumptions

Risk free rate	8.85%
Risk premium	6.0%
Beta	0.7
Cost of equity (Ke)	13.1%
Terminal growth (g)	5%
Dividend payout	50%

Source: BPI Capital Africa.

Dividend model (BWP 000)

	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Terminal
Dividend	375 643	476 211	564 886	675 912	741 926	799 977	915 658	1 048 690	1 201 677	
Net dividend	347 470	440 495	522 519	625 219	686 282	739 979	846 983	970 038	1 111 552	
Period	0	1	2	3	4	5	6	7	8	
Ke	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	
Discount factor	1.00	0.88	0.78	0.69	0.61	0.54	0.48	0.42	0.37	
PV dividends	347 470	389 661	408 879	432 783	420 230	400 821	405 837	411 161	416 773	
g										5%
Perpetuity										14 506 373
PV perpetuity										5 439 119

Source: BPI Capital Africa.

DDM Sensitivity Analysis

				Growth rate		
Values in BWP		3%	4%	5%	6%	7%
	11%	4.16	4.55	5.07	5.80	6.88
	12%	3.67	3.95	4.32	4.80	5.48
Discount rate %	13%	3.27	3.48	**3.75**	4.10	4.55
	14%	2.95	3.11	3.31	3.57	3.89
	15%	2.68	2.81	2.97	3.16	3.39

Source: BPI Capital Africa.

DDM Valuation

	BWPmn
Discounted dividends	3 633 617
Perpetuity	5 439 119
Total	9 072 736
Shares in Issue	2 176 000
YE15 Fair Price (BWP)	4.17
YE15 Price Target (BWP)	**3.75**

Source: BPI Capital Africa.

Valuation 2: P/B Comparative Valuation

We derived our P/B valuation using the same assumptions: (1) a sector 2015^{F} P/B of 1.8x; (2) a subjective discount to sector P/B of 10% to arrive at an exit multiple for Letshego of 1.6x; (3) compute the exit multiple with Letshego's 2015^{F} tangible NAV to derive our YE15 Price Target.

Deriving Market Multiples

We established our sector 2015^{F} P/B multiple of 1.8x using the same criteria. We defined our sample sector by listed microlenders or consumer finance lenders (all focused on emerging or frontier markets) and ran a Bloomberg valuation comparative to determine forward P/B, P/E and ROE ratios. This is set out below:

P/B Comparative

	Dec-15
Sector exit P/B (x)	1.8
Discount to sector P/B	0.90
Exit multiple (x)	1.6
Tangible NAV (BWP)	2.08
YE15 Price Target (BWP)	**3.40**

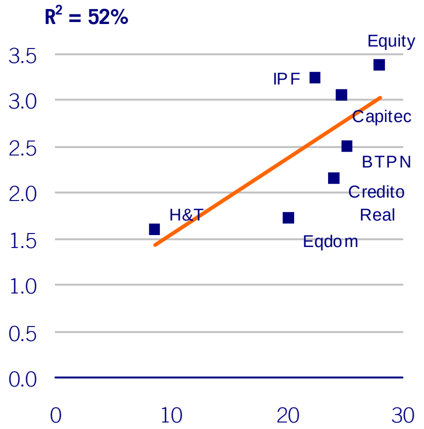
Source: BPI Capital Africa.

Letshego EM & Frontier peers

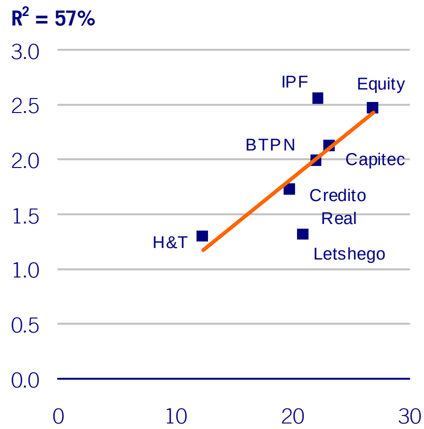
	Country	MCap	P/B (x)				P/E(x)				ROE (%)			
Company	based	(USDmn)	FYE	2014^{F}	2015^{F}	2016^{F}	FYE	2014^{F}	2015^{F}	2016^{F}	FYE	2014^{F}	2015^{F}	2016^{F}
Capitec	SA	2 970	3.2	2.9	2.6	2.2	14.9	14.1	12.1	10.2	22.44	22.7	22.3	23.6
Equity	Kenya	2 001	3.4	2.9	2.5	2.1	12.3	11.7	10.0	8.3	28.11	27.6	26.9	27.3
Int. Personal Finance	UK	1 744	3.1	2.5	2.1	1.9	15.9	12.8	10.4	9.1	24.84	21.1	23.2	23.6
Credito	Mexico	926	2.5	2.4	2.0	1.7	10.7	10.8	9.7	8.7	25.3	23.8	22.0	22.4
BTPN	Indonesia	2 017	2.2	2.1	1.7	1.5	13.9	11.8	9.7	8.0	24.2	19.3	19.8	19.8
GCB	Ghana	434	2.3	2.2	1.7	1.4	4.6	5.7	5.2	4.8	60.2	42.0	37.7	30.6
FI	Mexico	363	1.6	1.4	1.3	1.2	19.4	14.8	11.8	8.4	8.6	10.5	12.4	14.5
Average		**1 304**	**2.4**	**2.2**	**1.8**	**1.6**	**12.3**	**11.0**	**9.1**	**7.7**	**25.9**	**22.8**	**22.9**	**22.6**

Source: Bloomberg, Ranked by 2014F P/B.

FYE P/B (x) vs FYE ROE (%)



2015F P/B (x) vs ROE (%)



Source: Bloomberg; outliers excluded.

Justifying our P/BV Exit Multiple

Since our initiating report (14 May-14), Letshego's forward P/BV multiples have remained at a discount to the comparative sector, despite the share increasing by 27%. This may be partly explained by its sustained decline in margins and relatively low gearing levels, which would imply a ROE that trails the sector average.

P/BV Justification

	P/BV (x)			ROE (%)		
	Letshego	Sector	+/-	Letshego	Sector	+/-
FYE	1.6	2.4	-0.3	20.2	25.9	-0.2
2014F	1.6	2.2	-0.3	18.5	22.8	-0.2
2015F	1.3	1.8	-0.3	20.9	22.9	-0.1
2016F	1.1	1.6	-0.3	20.8	22.6	-0.1
Average	**1.4**	**2.0**		**20.1**	**23.6**	

Source: Bloomberg, BPI Capital Africa.

Valuation Sanity

	2013	2014F	2015F	2016F	2017F
Price Target/EPS (x)	11.9	11.2	8.8	7.4	6.2
P/E (x)	9.2	8.7	6.8	5.7	4.8
Price Target/NAV (x)	2.2	2.0	1.7	1.4	1.2
P/B (x)	1.7	1.6	1.3	1.1	0.9
Dividend/Price Target	2.1%	4.5%	5.7%	6.8%	8.0%
DY	2.7%	5.8%	7.4%	8.7%	10.4%

Source: Company report, BPI Capital; YE changed to December.

Valuation Triggers

(1) Increased leverage via dividend increase to improve returns. In our initiating report, we summed up our view that Letshego had excess equity and would be in a strong position to improve B/S efficiency and consequently leverage by returning cash to shareholders or issuing debt. Our view was recently corroborated by management via an increase in the dividend payout ratio to 50% vs 25% previously. We believe that this is a positive move in addressing concerns over excess equity and will further strengthen impetus on Letshego's valuation.

(2) Quick turnaround of the East Africa business. We reinforce our view that that due to a high cost base in the East African business, Letshego requires a significant ST scaling of the loan book to increase operating efficiency and returns. Current exposure to East Africa is about 14% of total loans vs 16% at FY13. This is partly due to scaling down in Tanzania and South Sudan, while Kenya has struggled to deliver significant growth. We note that the region remains highly competitive and the lack of central registers means that Letshego will have to drive growth of its microfinance book.

(3) Strong growth prospects in Mozambique. This is perhaps the most exciting country in which Letshego has achieved success, since its foray into the region. The recently awarded microfinance bank licence that permits deposits mobilisation is a game-changer which would likely have an impact on valuation as the structure of the business shifts and very likely improve efficiency. Namibia and Rwanda carry similar prospects and would likely improve contribution to earnings in the MT.

Valuation Risks

(1) Margins likely to remain under pressure in the ST. We reiterate our view that increasing competition in Letshego's core target market may have a greater impact on asset yields, which would be a negative for earnings growth.

(2) Altering risk profile. While East Africa holds strong growth opportunities, the lack of central registers would imply that in the ST, Letshego would continue to offer unsecured loans and microfinance products, which typically do not match Letshego's core offering. As such, its risk profile would increase as potential deterioration to asset quality cannot be unexpected.

Share Price Rating and Trading

Since our last update (11 Jul-14), Letshego's share price has increased by 15% to BWP2.72. Its historic P/BV and P/E average ratios increased to 1.4x and 6.0x, respectively vs 1.3x and 5.6x at our last update. On current price of BWP2.72, the share is on a 12-month trailing P/BV of 1.3x, which is below its historic average P/BV; but its 12-month trailing P/E of 7.4x is higher than historic average.

Historic P/BV (x)

Source: Company, BPI Capital Africa.

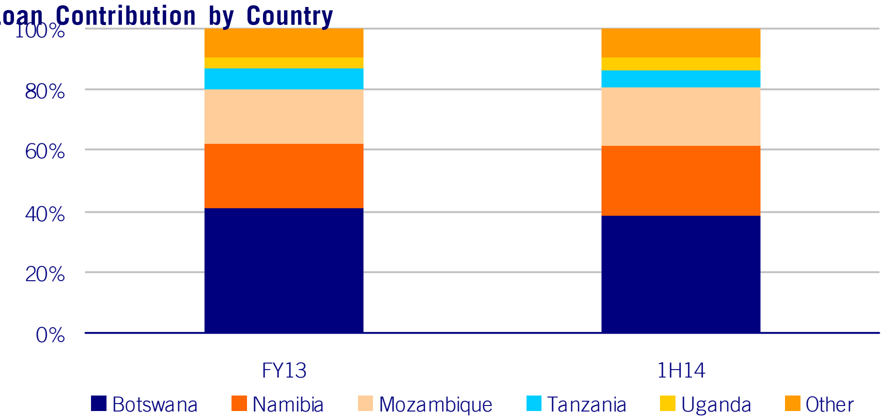
Historic P/E (x)

Source: Company, BPI Capital Africa.

1H14 PERFORMANCE RECAP

Letshego achieved 1H14 EPS of BWP0.18, flat y/y; and the main reasons for this were: (1) an increase in the effective tax rate to 27% vs 21% previously; (2) normalisation of interest expense, which increased by 3x to BWP90mn. The previous year achieved FX translation gains of BWP41mn, which resulted in a significant reduction in interest expense; and (3) pressure on staff costs, which increased by 23% y/y to BWP101mn, owing to integration of the East African business. Nevertheless, the business achieved loan growth in its key markets - Namibia and Mozambique - where it continues to drive a strong payroll lending franchise. In both these markets, Letshego achieved loan growth of 24% ytd to BWP1.1bn and BWP980mn, respectively and their contribution to total loans increased to 43% vs 39% previously. Notably, Letshego has a 51% share of civil servants in Namibia vs 12% in Mozambique. The market in Botswana, which has long been perceived as ex-growth, achieved loan growth of just 6% ytd to BWP1.9bn, albeit off a larger base. Its contribution to total loans declined to 38% from 41% previously; further highlighting Letshego's strategic intent of increasing loan exposure in the region. However, its traditional Botswana market remains relevant to its LT strategy and management is both diversifying and defending its market share by tapping into adjacent customer segments such as mineworkers.

Loan Contribution by Country



Source: Company report.

The East Africa business, which is largely positioned as a growth opportunity contributed 14% of total loans to BWP694mn vs 16% contribution previously. The decline in loan contribution was mostly due to structural changes in the business, that is: (1) Letshego exited a minority stake in a microfinance business (Tujijenge) in Tanzania, which resulted in a reduction in overall exposure to the country to 5.3% of total loans vs 6.9% previously; and (2) winding-up of the South Sudan business, as management believes that country risk persists. As such, contribution declined to 0.1% of total loans vs 0.6% previously. In addition, Letshego faces significant pressure from a highly competitive Kenyan market, and grew its loans in that market by 10% ytd to BWP126mn; which was low relative to other markets. As such, the contribution to total loans by the Kenyan business declined marginally to 2.5% vs 2.6% previously. On the other hand, Uganda and Rwanda reflected some positive momentum as they both increased their contribution to total loans. Importantly, Uganda is likely to have a central register in place in the MT, which would further support good quality loan growth, and Rwanda is likely to commence deposit-taking before YE14, which would likely alter the operating profile of the business. Overall, net loans growth was 13% ytd to BWP5.0bn, driving interest income of BWP720mn, up 23% y/y.

Net interest income increased by 13% y/y to BWP630mn, following a substantial increase in interest expense. However, excluding FX gains in the previous year, underlying interest expense increased by 23% y/y to BWP86mn. This is in contrast with a substantial rise in borrowings of 75% y/y to BWP1.5bn, which were primarily sourced locally and from its fast-growing Mozambique market. NIR grew by 8% y/y to BWP132mn, on the back of an increase in fee income of 16% y/y to BWP76mn. Other operating income was less impressive, as it remained relatively flat BWP58mn. As such NIR contribution declined marginally to 17% vs 18% previously. As a result, total income increased by 12% y/y to BWP762mn. Total opex increased by 17% y/y to BWP212mn, owing to pressure on staff costs as well as depreciation and amortisation charges, which followed the acquisition of fixed assets from the Micro Africa business. However, operating efficiency remained relatively stable, with a CIR of 28% (1H13: 27%). Provisioning increased by 9.1% y/y to BWP41mn, which implies cost of risk of 0.9%.

Overall, PBT grew by 11% y/y to BWP508mn, reflecting some gains on Letshego's operating performance. However, taxation increased by a substantial 41% y/y to BWP135mn, implying an effective tax rate of 27% vs 21% previously. This is likely due to Letshego's increasing business exposure to other countries, which now account for over 60% of total loans and over 50% of total revenue. As such, Letshego's effective tax rate is less likely to reflect its attractive 15% corporate tax rate in Botswana, which is linked to International Financial Services Centre (IFSC) member accreditation. As a result, Letshego achieved lower PAT growth of 3% y/y to BWP 373mn, although FX translation gains resulted in 11% y/y growth in comprehensive income to BWP453mn. Importantly, Letshego increased its dividend payout ratio to 50% from 25% previously. As such, an interim dividend of about BWP0.08 is positive, given the current low gearing (debt to equity: < 40%).

Letshego 1H14 Income Statement

BWP 000	1H13	1H14	Change
Interest income	584 212	719 816	23%
Interest expense	28 541	90 204	216%
Net interest income	555 671	629 612	13%
Fee income	64 338	74 542	16%
Other income	58 461	57 679	-1%
NIR	122 799	132 221	8%
Total income	**678 470**	**761 833**	**12%**
Total opex	**180 940**	**211 993**	**17%**
Operating profit	497 530	549 840	11%
Impairments	37 964	41 432	9%
PBT	**459 566**	**508 408**	**11%**
Taxation	96 051	135 320	41%
PAT	**363 515**	**373 088**	**3%**

Source: Company report.

Corporate taxation

	Rate	Weighting
Botswana	15%	38%
Namibia	33%	23%
Mozambique	32%	20%
Tanzania	30%	5%
Uganda	30%	4%
Swaziland	30%	3%
Lesotho	25%	3%
Kenya	30%	3%
Rwanda	30%	2%
South Sudan	20%	0%
Average	**28%**	
Average (weighted by loans)	**25%**	

Source: KPMG, PwC; BPI Capital Africa.

OUTLOOK

Following 1H14 results, we have fine-tuned our estimates to reflect the following: (1) the impact of declining margins on revenue, (2) improved optimisation of costs and (3) an increase in risk to asset quality as Letshego increases exposure to East Africa, as well as targets adjacent markets such as mineworkers in Botswana.

Earnings Revision

Changes in estimates

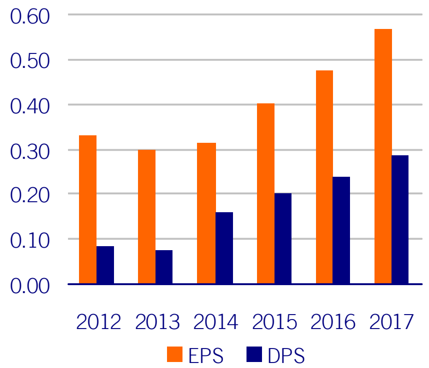
	Previous estimates			New estimates			% change		
(BWP '000)	2014^F	2015^F	2016^F	2014^F	2015^F	2016^F	2014^F	2015^F	2016^F
Total income	1 546 560	1 994 137	2 280 063	1 442 070	1 902 557	2 260 331	-7%	-5%	-1%
Operating expenses	502 293	643 814	740 386	451 042	623 259	747 910	-10%	-3%	1%
Impairment allowance	91 831	110 197	126 727	91 451	114 513	137 415	0%	4%	8%
PBT	952 436	1 240 126	1 412 950	899 577	1 164 786	1 375 006	-6%	-6%	-3%
PAT	723 851	942 496	1 073 842	683 678	873 590	1 031 254	-6%	-7%	-4%
EPS (BWP)	**0.33**	**0.43**	**0.50**	**0.31**	**0.40**	**0.48**	**-6%**	**-7%**	**-4%**
NIM	23%	26%	25%	22%	24%	24%			
CIR	32%	32%	32%	31%	33%	33%			
Cost of risk	1.8%	1.9%	1.9%	1.8%	1.9%	1.9%			

Source: BPI Capital Africa.

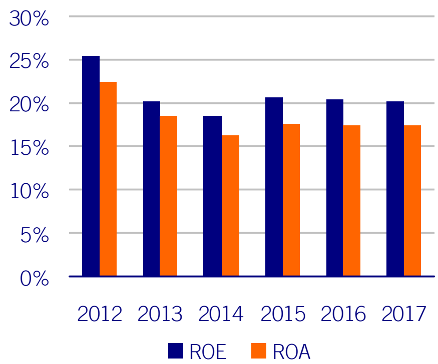
Despite a reduction in ST earnings, we have overall, maintained EPS CAGR13-17^F at about 17%, given the impetus for growth from the deposits strategy, diversification of the loan portfolio and growth in new markets. As such, we believe that Letshego remains in a strong position to continue driving positive earnings growth, and its payroll lending proposition will remain core to its strategy for revenue and loan growth. Management guidance on total dividend payout was increased to 50% from 25% previously, which in our opinion will impact on Letshego's valuation as shareholder returns are optimised.

Nevertheless, we have maintained a relatively conservative average ROE for FY14-17^F of 20%. This is because there is a relative increase in the risk profile of the business, owing to entry to new markets, diversification of its product offering and the potential impact of the deposits strategy on leverage.

EPS and DPS (BWP)



ROE and ROA



Source: Company report, BPI Capital; FY14 is 11-months.

Ratio Estimates

	2012	2013	2014F	2015F	2016F	2017F
Profitability						
ROE (%)	25	20	19	21	20	20
ROA (%)	22	18	16	18	17	17
Efficiency						
CIR (%)	26	33	31	33	33	33
Total costs to assets (%)	8	10	8	9	10	10
Effective tax rate (%)	22	24	24	25	25	25
Cost of Risk (%)	1.1	1.7	1.8	1.9	1.9	1.9
Pricing						
NIM (%)	29	27	22	24	24	24
Asset yield (%)	34	30	29	29	29	29
Cost of funding (%)	11	5	13	13	12	12
NIR to total income (%)	18	19	19	21	21	21
Leverage						
Debt to equity (x)	0.4	0.4	0.4	0.4	0.4	0.4
Loans to equity (x)	1.2	1.3	1.4	1.4	1.4	1.4
Loans to borrowings (X)	2.6	3.5	4.0	3.3	3.3	3.3
Equity to loans (%)	86	79	72	72	73	73
Equity to assets (%)	67	71	64	64	65	65

Source: Company report; BPI Capital Africa.

Income Statement

(BWP 000)	2012	2013	2014F	2015F	2016F	2017F	CAGR 13-17F
Dividends	2 733	3 334	3 583	5 117	6 141	7 369	22%
Commissions	132 907	134 236	150 347	229 622	275 546	330 655	25%
FX and trading	-	-	-	-	-	-	
Other	82 469	118 868	121 706	158 898	190 678	228 813	18%
Net operating revenue	1 184 124	1 370 126	1 442 070	1 902 557	2 260 331	2 700 109	18%
Personnel expenses	123 086	199 658	200 463	295 228	354 273	425 128	21%
Other admin exp	179 137	247 574	242 460	316 812	380 175	456 210	17%
Operating cash flow	881 901	922 894	999 146	1 290 517	1 525 883	1 818 771	18%
Depreciation	5 417	8 198	8 119	11 219	13 462	16 155	18%
Cost-to-income (incl. dep.)	26%	33%	31%	33%	33%	33%	
Operating profit	**876 484**	**914 696**	**991 028**	**1 279 299**	**1 512 421**	**1 802 616**	**18%**
Loan loss impairments	35 097	64 495	91 451	114 513	137 415	164 898	26%
Other provisions	-		-	-	-	-	
Extraordinaries	-	-1 060	-	-	-	-	
Profit before taxes	**841 387**	**849 141**	**899 577**	**1 164 786**	**1 375 006**	**1 637 718**	**18%**
Taxes	181 750	205 511	215 898	291 197	343 751	409 430	19%
Minorities	-	-	-	-	-	-	
Net profit	**659 637**	**643 630**	**683 678**	**873 590**	**1 031 254**	**1 228 289**	**18%**

Balance Sheet

(BWP 000)	2012	2013	2014F	2015F	2016F	2017F	CAGR 13-17F
Cash	316 613	310 525	349 900	465 207	558 249	669 899	21%
Short term deposits	490 641	-	-	-	-	-	
Loans to customers	3 336 204	4 427 757	5 411 202	6 379 787	7 613 661	9 094 309	20%
Tangible & intangible	76 964	115 355	122 266	150 298	180 357	216 429	17%
Other assets	58 756	116 528	136 680	171 769	206 123	247 347	21%
Total assets	**4 279 17**	**4 970 165**	**6 020 047**	**7 167 061**	**8 558 390**	**10 227 983**	**20%**
Customer deposits			5 964	357 852	429 422	515 307	
Total borrowings	1 277 395	1 249 871	1 366 795	1 932 400	2 318 880	2 782 656	22%
Other liabilities	141 340	216 027	773 305	262 488	279 394	276 890	--
Shareholders' equity	2 860 443	3 504 267	3 873 982	4 614 321	5 530 694	6 653 131	17%
Total liabilities & sh. Equity	**4 279 178**	**4 970 165**	**6 020 047**	**7 167 061**	**8 558 390**	**10 227 983**	**20%**

Source: Company report; BPI Capital Africa.

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INVESTMENT RATINGS AND RISK CLASSIFICATION
(TOTAL RETURN IN 12-18 MONTHS):

	Low Risk	Medium Risk	High Risk
Buy	≥15%	≥20%	≥25%
Hold	≥0% and < 15%	≥0% and < 20%	≥0% and < 25%
Sell	< 0%	< 0%	< 0%

These investment ratings are not strict and should be taken as a general rule.

INVESTMENT RATINGS STATISTICS

As of 31st October BPI Capital Africa Equity Research's investment ratings were distributed as follows:

Buy	42%
Hold	40%
Sell	19%
Total	100%

BPI

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BPI is also present in Africa through:

BFA in Angola (50.1% stake)

BCI in Mozambique (30% stake)