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CREDIT OPINION
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Update

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Letshego Holdings Limited

Update to credit analysis

Summary

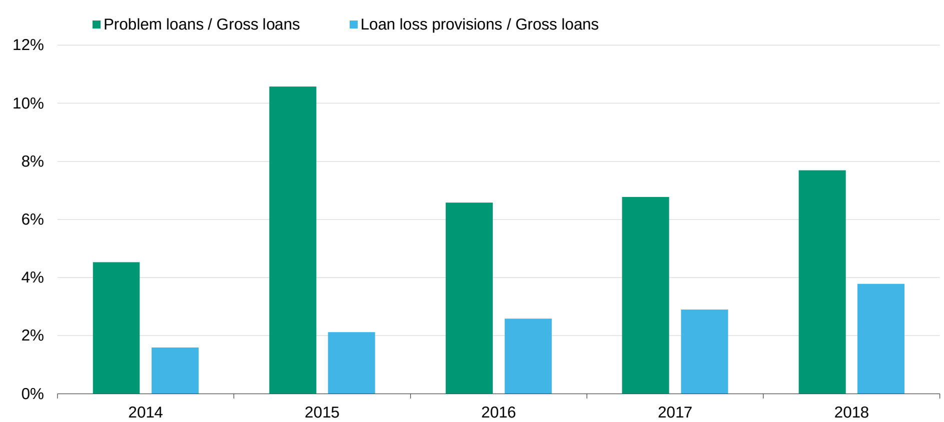
We assign a Ba2 Corporate Family Rating (CFR) and Ba3/Not Prime issuer ratings to Letshego Holdings Limited (Letshego). The outlook on Letshego is stable.

The Ba2 CFR captures the company's solid capitalisation and profitability, supported by its niche, low-cost, franchise. They also capture Letshego's growing diversification across regional countries, which makes the company more resilient to an adverse change in any of its operating markets. These strengths are balanced against Letshego's (1) narrow, albeit gradually diversifying, business model with a high reliance on payroll deductions for loan repayment collections, (2) high exposure to foreign exchange risk, (3) elevated asset quality risks (see Exhibit 1), and (4) dependence on market-sensitive wholesale funding; although actions are being taken to address this weakness.

No external support has been considered in Letshego's ratings given its 1) limited importance to Botswana's (A2, Stable) payment system and (2) its immaterial holdings of customer deposits.

Letshego's Ba3 issuer ratings are positioned one notch below its Ba2 CFR given the structural subordination of unsecured obligations under Moody's Loss Given Default (LGD) model for speculative grade companies.

Exhibit 1
Letshego's asset risk remains elevated



Source: Moody's Investors Service

Credit strengths

» Letshego is gradually diversifying its business model across products and countries

» Solid capitalisation buffers and profitability; supported by high margins

Credit challenges

» The credit profile of Letshego is sensitive to changes in regulatory and legal frameworks

» Capital is sensitive to Letshego's large foreign currency exposures

» Asset quality risks will remain elevated

» High reliance on wholesale market funding and weak liquidity metrics

Rating outlook

Letshego carries a stable outlook. The stable outlook reflects our expectation that the company's financial fundamentals will remain robust over the next 12 to 18 months, despite elevated credit risks from its regional expansion.

Factors that could lead to an upgrade

» An upgrade of the company's ratings would depend on Letshego successfully developing broader African financial services operations, while maintaining strong profitability and capitalisation, and strengthening its liquidity profile.

» Letshego's issuer ratings could be upgraded due to a positive change to its debt capital structure that would increase the recovery rate for senior unsecured debt classes.

Factors that could lead to a downgrade

» Negative rating pressure could be exerted on Letshego's rating if regional authorities in the company's main operating markets change the terms of, or impose restrictions on, the deduction (at source) of loan repayments from the wages of public-sector employees, leading to a sharp rise in bad debts and impairment costs. In addition, negative pressure could be exerted on the rating if (1) Letshego's expansion in other sub-Saharan markets, client segments and products, results in a material weakening of asset quality and profitability metrics; or (2) Letshego's capitalisation metrics were to materially weaken.

» Letshego's issuer ratings could be downgraded due to adverse changes to its debt capital structure that would lower the recovery rate for senior unsecured debt classes.

Key indicators

Exhibit 2

Letshego Holdings Limited (Consolidated Financials) [1]

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Net Income / Average Managed Assets (%)	5.2	7.9	8.0	11.1	12.7	9.0[4]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	34.2	42.8	45.3	52.0	60.8	47.0[4]
Problem Loans / Gross Loans (Finance) (%)	7.7	6.8	6.6	10.6	4.5	7.2[4]
Net Charge-offs / Average Gross Loans and Leases (%)	1.7	1.8	2.4	0.2	0.9	1.4[4]
Debt Maturities Coverage (%)	48.4	20.5	32.5	28.8	21.4	30.3[4]
Secured Debt / Gross Tangible Assets (%)	21.5	23.8	23.2	18.6	19.8	21.4[4]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]IFRS [3]May include rounding differences due to scale of reported amounts. [4]Simple average of periods presented for the latest accounting regime.
Source: Moody's Investors Service; Company Filings

Profile

Letshego was incorporated in 1998 and is headquartered in Gaborone. It has been publicly listed on the Botswana Stock Exchange (BSE) since 2002 and is one of Botswana's largest indigenous BSE-listed companies, with a market capitalisation of 3.0 billion Pula (BWP) and an agenda focused on inclusive finance, that is aligned with government initiatives. Through an 11-country presence across Southern, East and West Africa, the Group's inclusive finance agenda is focused on anticipating and solving the needs of financially under-served customers. Letshego serves a variety of financial needs of three key customer segments: Micro and Small Entrepreneurs (MSEs), public and private sector low and middle income earners and individuals in the informal market.

Detailed credit considerations

Letshego is gradually diversifying its (narrow) business model across products and countries

Letshego has a niche franchise specialising in unsecured loans to government and quasi-government employees under the payroll deduction model (around 86% of total loans). Under this model, loan repayments are taken directly from the employer prior to the distribution of monthly salaries. Letshego's business model benefits from a quick and efficient loan-approval and disbursement process and has historically led to fairly low credit costs and strong profitability.

However, as mentioned above, its concentration to payroll deduction products exposes the company to adverse developments in the regulatory and legal framework that may either (1) hamper the payroll deduction process (although not our base case scenario) and/or (2) impose or lower caps on the effective interest rate the company can charge on loans.

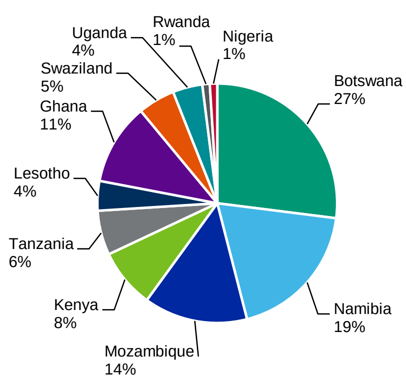
To counter these risks, Letshego has been increasing its geographical diversification and has a strategy to diversify its business model by becoming a pan-African financial services company. As part of this strategy it has completed various acquisitions across Africa (total assets increased by 19% during 2018), acquired banking and deposit taking licenses in several territories including Ghana, Mozambique, Rwanda, Tanzania, Nigeria, and Namibia, and aims to convert its loan-only clients into transactional clients. However, the company has experienced high rotation among top management positions over the last 12 months which may slow down the implementation of its strategy.

Currently, the company has operations in eleven sub-Saharan African countries (Exhibit 3), with a strong niche franchise within Botswana, Namibia and Mozambique (where it offers payroll loans to around 20%, 51% and 22% of all government employees as of June 2018, respectively). Outside these three markets, Letshego currently exhibits a lower franchise sustainability given its weaker brand name and lower market penetration.

Exhibit 3

Letshego's loan book is becoming increasingly diversified across countries

Loan book geographical breakdown (December 2018)



Source: Company reports

Letshego's expansion will gradually reduce its overall dependence on payroll lending by broadening customer segments and products; at the same time supporting its deposit mobilisation capabilities. However, going forward, the company will need to manage potentially elevated credit losses from (1) riskier non-payroll related loans (micro finance loans, micro and small enterprise business loans, and low-income housing loans), albeit compensated by higher margins; (2) higher sub-Saharan Africa country risks; and (3) its relative inexperience in these newer markets and product offerings.

Asset quality risks will likely remain elevated

We assign a weighted average Asset Risk score of B1 to Letshego, one notch below its initial score. Letshego's business model has historically led to fairly low credit costs, reduced collection costs and robust collection statistics. As a consequence, Letshego's overall credit costs (provisions % gross loans) remain manageable at 3.8% as at December 2018 (December 2017: 2.9%). However, with Letshego gradually diversifying into riskier non-payroll loans, non-performing loans (NPLs) will likely increase, although this is countered by the diversification benefits obtained. In addition, the challenging operating environment in many countries where Letshego operates, and the higher provisioning needs under new IFRS 9 guidelines (an issue faced by financial institutions globally), imply further pressure on NPLs and provisioning needs. Letshego's NPL ratio was 7.7%, as at December 2018, up from 6.8% in December 2017.

However, as of December 2018, problem loans coverage (loan loss reserves to NPLs) improved to 115% from 73% in December 2017. Additionally, Letshego has comprehensive credit insurance cover in markets like Namibia and Mozambique that increases the post-default recovery.

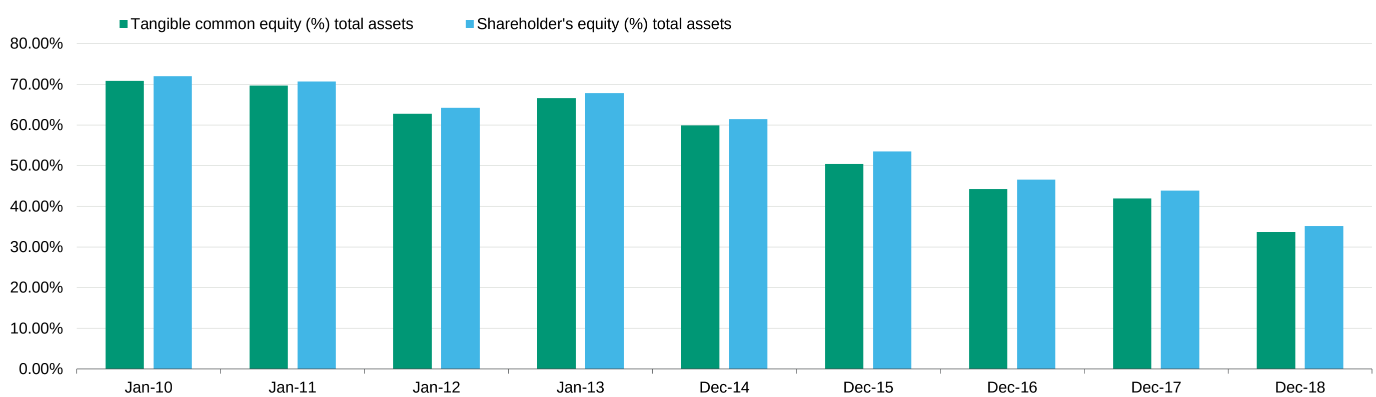
Going forward, we expect elevated asset risks to be moderated by improvements to Letshego's risk management processes and procedures. Letshego is making ongoing investments to improve automation in credit risk management.

Solid capitalisation buffers, although high foreign exchange exposure poses risks

We assign a Capital Adequacy and Leverage score of A1 to Letshego, one notch below its initial score. While we currently anticipate capital levels to drop further, Letshego's capitalisation level is expected to continue to underpin the current ratings. The company is currently well capitalised, with a reported shareholders' equity-to-total assets ratio of 35.1%, as at December 2018 (Exhibit 4), which provides a solid buffer against any adverse changes to both the competitive environment and to its current business model.

To maximise shareholder returns, Letshego plans to increase leverage by acquiring more debt and/or reducing equity levels through share buybacks, hence our negative adjustment to Letshego's Capital Adequacy and Leverage score. Letshego's long-term target equity-to-total assets ratio is 30%, which still represents a robust level of capitalisation.

Exhibit 4
Letshego's capital metrics remain high, although they are on a downward trend



Source: Moody's Financial Metrics, Company's Financial Statements

Letshego's substantial currency risk exposure resulting from its regional operations (72% of loans are denominated in foreign/non-pula currencies) poses a downside risk to its capital levels. An appreciation in the Botswana pula would result in a decrease of its net foreign-currency assets, leading to negative implications for tangible common equity. Letshego is taking steps to reduce its net foreign-currency position, although we expect the progress to be slow. Letshego also has a moderate exposure to interest-rate risk because a portion of its funding is floating rate, while all loans are fixed rate, although large margins allow some room for interest-rate fluctuation.

Strong profitability supported by high margins

We assign a Profitability score of A1 to Letshego, in line with its initial score. We expect that profitability will remain sound despite declining loan yields. Loan yields have fallen on account of lower interest rates and increasing competition. While the company's diversification strategy will put some short-term pressure on profitability (through bank licensing costs and investments in fintech/ information technology), this will be countered by an increased focus on other higher-yielding unsecured lending products and gradually realising diversification benefits that will make profitability more resilient to a downturn in any of its markets.

The pre-provision income-to-average assets ratio remains relatively stable at 14.4% for 2018 (FY2017: 14.5%), and the net income-to-average assets ratio, though declining, remains robust at 5.2% (FY2017: 7.9%). Additionally, the cost-to-income ratio remains strong by global standards at a reported 42% in 2018, supported by Letshego's low-cost business model (the company minimises the use of inefficient branches/bricks and mortar in its operations). However, the ratio is above the company's internal target of 37%, having deteriorated from around 30% since FY2015 following (1) acquisitions in Nigeria and Tanzania and (2) the company's ongoing investment spending in people and systems (operating expenses increased around 17% year on year, driven by increased staff, consultancy, licensing, information technology and travel costs).

It is important to note, as part of its long-term strategy, Letshego plans to derive transactional based income through customer deposit accounts, which has the potential to diversify income sources and support its profitability over time.

Reliance on wholesale market funding and weak liquidity metrics

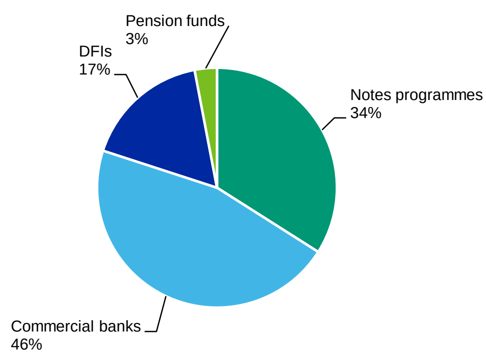
We assign a weighted average Cash Flow and Liquidity score of Ba2 to Letshego, one notch below its initial score. While we acknowledge that a significant source of funding is in the form of equity (which is permanent and of indefinite maturity), Letshego's remaining funding is primarily wholesale, which is inherently confidence-sensitive and vulnerable to disruption.

As of December 2018, bond funding accounted for 34% of total borrowings, commercial bank funding for 46%, Development Finance Institution (DFI) funding for 17% and commercial paper/pensions funds for 3% (Exhibit 5). Letshego's liquidity metrics also remain low with its Debt maturities coverage ratio of around 48%, as of December 2018 (the above ratio is calculated as the level of cash and committed, unsecured bank lines available as a percentage of debt maturing within the next 12 months). We expect Letshego's debt maturities coverage ratio to remain modest for the foreseeable future as it increases leverage as part of it long-term strategy, discussed above.

Exhibit 5

Letshego remains wholesale funded, although increasingly more diversified

Breakdown of total borrowings (December 2018)



Source: Letshego

That said, over the past three years Letshego has diversified its funding structure, and improved its liquidity and asset and liability maturity profile. The group has issued medium term note (MTN) programme of BWP1.8 billion which is partly listed on Johannesburg Stock Exchange, Botswana Stock Exchange and Ghana Stock Exchange. The company plans to reduce borrowing from commercial banks and increase funding via debt capital markets, development finance institutions and customer deposits.

Operating environment

We assign a Ba3 score to Letshego's operating environment, based wholly on its industry risk score. The macro level indicator does not have any weight in the scorecard since this score is higher than the industry risk score.

As a result of its operating environment score, Letshego's financial profile score has been adjusted down to Ba2 from Baa3.

Macro level indicator

Letshego is domiciled in Botswana, and a significant proportion of its revenue is generated there. The A3 Macro-Level Indicator score for Botswana reflects the country's 'Moderate-' economic strength, 'High' institutional strength and 'Low' susceptibility to event risk.

Industry risk

We assign a Ba industry risk score to Letshego. Barriers to entry in Africa's consumer lending business are moderately high as regulatory requirements and investments in loan underwriting and monitoring infrastructure form a barrier to entry for potential new competitors.

However, Letshego's business model may be negatively impacted by adverse developments in the regulatory and legal frameworks of countries in which it operates. As a result, the industry risk score also captures this regulatory/legal risk.

Lastly, our assessment of Letshego's industry risk also reflects the vanilla nature of its loan products, predominantly payroll loans, which carry a low risk of obsolescence.

Notching Considerations

Letshego's Ba3 issuer ratings are one notch lower than its Ba2 CFR due to the structural subordination of unsecured obligations under our LGD model.

Methodology and scorecard

The principal methodology used in this rating is Finance Companies, published in December 2018.

About Moody's scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 6

Letshego Holdings Limited

Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	5.19%	A1	A1	Earnings volatility	
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	34.19%	Aa3	A1	Expected trend	Other adjustments
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.69%	Caa1	Caa1	Rapid growth	
Net Charge-Offs / Average Gross Loans (%)	10%	1.96%	Baa1	Baa3	Expected trend	
Weighted Average Asset Risk Score			**Ba3**	**B1**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	48.42%	B2	Caa3	Expected trend	
FFO / Total Debt (%)	15%	18.16%	Ba1	Ba1		
Secured Debt / Gross Tangible Assets (%)	20%	21.46%	Baa2	Baa2		
Weighted Average Cash Flow and Liquidity Score			**Ba1**	**Ba2**		
Financial Profile Score	**40%**		**Baa2**	**Baa3**		
Operating Environment						
Home Country	Factor Weights	Qualitative Scale	Score			
Macro Level Indicator	0%		A3			
Economic Strength	25%	Moderate -				
Institutional Strength	50%	High				
Susceptibility to Event Risk	25%	Low				
Industry Risk	100%		Ba			
Home Country Operating Environment Score			Ba2			
	Factor Weights			Score	Comment	
Operating Environment Score	**60%**			**Ba3**		
ADJUSTED FINANCIAL PROFILE				Score		
Adjusted Financial Profile Score				**Ba2**		
Financial Profile Weight	40%					
Operating Environment Weight	60%					
Business Profile and Financial Policy				Adjustment	Comment	
Business Diversification, Concentration and Franchise Positioning				0		
Opacity and Complexity				0		
Corporate Behavior / Risk Management				0		
Liquidity Management				0		
Total Business Profile and Financial Policy Adjustments				**Ba2**		
					Comment	
Sovereign or parent constraint				**A2**		
Standalone Assessment Range				ba1 - ba3		
Assigned Standalone Assessment				ba2		

[1]Note: Scorecard extracts figures from annual reports and latest publicly available semi-annual financial statements.
Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
LETSHEGO HOLDINGS LIMITED	
Outlook	Stable
Corporate Family Rating	Ba2
Issuer Rating	Ba3
ST Issuer Rating	NP

Source: Moody's Investors Service

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