BPI Capital Africa

Conference Call transcript

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LETSHEGO HOLDINGS H1 2015 RESULTS

Operator
Ladies and gentlemen, good day and welcome to the Letshego Holdings H1 2015 results conference hosted by BPI Africa. All participants are in listen-only mode. There will be an opportunity for you to ask questions later on during the conference call. If you need any assistance during the conference please signal an operator by pressing star then zero. Please note that this call is being recorded. At this time I would like to hand the conference over to Claire te Riele. Please go ahead.

Claire te Riele
Hi. Good afternoon everybody and welcome to today's call with Letshego CEO, Chris Low, and CFO, Colm Patterson. They are also joined by their head of IR, B.K, and head of Corporate Affairs, Mythri. I'm going to hand over to Chris now who is going to talk more about strategy, and he will pass on to Colm to discuss the results that were released yesterday with reference to the presentation that was sent out a little while ago. Once they are through with that – they will probably be done in about 20 minutes – we will move across to the Q&A. Over to you, Chris. Thanks very much.

Chris Low
Thanks, Claire. Good afternoon and good morning everybody, depending on where you're based. As Claire has outlined I intend to take the lead on the agenda slide to cover a strategic update, and Colm will round that off with some highlights of our first half 2015 performance. In summary, we are pleased with the results. to us they are good in the economic scenario we faced, particularly given a number of exchange rate depreciations. We have made good progress in the last six months on implementing our strategic agenda. And we continue our investment in people, technology and capability-building to ensure that we can deliver strong performance growth and returns to shareholders.

So moving to slide two, the growth opportunities for Letshego, I don't intend to go into a lot of detail on this slide. Many of you I'm sure are well aware of the macro position in Africa. Growth predictions for most of the countries in which we operate are at 4% or better. We operate in a number of fairly large populated countries by African standards. And from our perspective as a core lender to government employees there is a growing government employment force despite pressures from IMF to cut back in a number of countries.

If you look at the right-hand side there are a number of key stats which are important to us as our strategy unfolds. Government employees obviously I touched on. But we have two other key focus areas in our diversification strategy which I will talk about a little bit more later. Those are the low and middle income salary earners where we believe there is opportunity to provide a similar basket of payroll-related solutions, and the micro and small enterprise sector which today gets extremely limited attention from the banks and funding from some DFIs and NGOs.

There are a number of other segments out there. we believe that there is also an opportunity given our capabilities in micro finance to support both the health, education and agri sectors. We do have more stats on the agri sector, but again as you would imagine when you look at there being 54 million people working in the informal sector a large number of those will be in the rural space, the agricultural space, which ties back to the focus of our strategy.

Turning back to slide three, clearly our lending to government employees remains core to our business. You can see there is little change in our market penetration since year end. Current penetration rates in terms of customer numbers are shown in the yellow bars. Our current loan book – we have converted everything to dollars although we report in pula – stands at a little over $575 million, of which 93% is still in government payroll business.

There is a slight movement on the micro finance business as the next slide will show. It is growing at a faster rate, but off a much lower base than our core business. You can see there Botswana is now 35% of the book. In a couple of slides you will see what it was a couple of years ago. And we have lifted loan growth in both pula terms in the left-hand column and in local currency terms. So overall you can see that currency has something like a 10% devaluation impact in pula terms on our overall loan growth. I'm sure some of you picked up that there appears to be minimal balance sheet growth since year end. Actually on an underlying basis it is still double digit. It is just the currency depreciation is working against us.

It is also worth mentioning about one or two of our major countries while I'm on this slide. In Botswana we have seen a number of changes in banking statutory requirements and also banks are suffering on the credit side of their portfolios. So they are moving much more aggressively into our space. So we have seen much higher levels of settlement than we are used to. But having said that we've held our rates, so we are still achieving the yield, and we've got a number of new product changes which we will be rolling out during the second half of the year to provide some more stickiness as well as to restart the growth of our Botswana book.

Mozambique, great progress there. It still continues to grow strong double digits. The challenge there is that we are using Mozambique as our pilot country for rolling out of our full financial inclusion capability. That is combination of mobile, USSD, internet and agency banking capability. So management's attention is split between growing the business as well as building the platform for growth going into next year. We are also in the final stages of converting to a full commercial banking license, which we hope will give us further credibility for our capital markets activities there. Those of you who were on the call before will recall that we launched Mozambique's first meticais capital markets instrument, and although we have only had a little uptake at this stage we feel this is a very positive contribution in that market to capital markets development.

Namibia continues the strong growth of last year. Many of you will be aware we have a provisional license which has been issued there. We did extend that when July came along for two reasons primarily. One, we continued to work with the central bank on the legal structure of the three entities we're required to have in Namibia, a holding company which invests into the new bank and the micro lending business. There are different interest rate caps for banks versus micro lenders, and therefore we need to ensure that by converting to a bank we are not throwing away existing revenues.

The second area relates to payments. Without wanting to say the banks are against us entering, it has been a very long and drawn-out process to integrate ourselves into the payments and settlements platforms there. We are making progress, and indeed by head of ops is down there as we talk this week doing some further testing to ensure that we meet the necessary requirements.

Tanzania, our fourth-biggest business, I would like to discuss further under the diversification strategy. And really on the other businesses you can see the growth rates. If you turn to slide four this covers our three micro finance orientated businesses. And you can see good strong growth rates in these countries in the micro finance business. Kenya's micro finance business is growing at 84%, Uganda at 66% and Rwanda at 40%. Now, last year Rwanda grew much faster than that off the back of low-income housing loans. We have actually slowed that down for a period. Our CEO resigned and a new CEO stepped into his shoes. Because we are now a deposit taking institution there as well, with the complexity of our business we felt it prudent to be a lot more cautious on growing our loan book. But we have had quite a lot of success by Rwanda's standards, albeit it relative small scale from a group perspective, in deposit raising. We already have over 4,000 customers there who place money with us, which is a very positive sign for the future.

Again very low market shares. Micro finance to our strategic perspective is the key way going forward. In two slides time I talk to you about the acquisitions that are in progress. These are really to develop our micro finance capability in Tanzania and Nigeria.

To turning to slide five, this gives you a flavour before I talk a little bit more about our diversification successes of how the revenue split has changed. Back in 2009 Botswana was still over 70%. That is now less than a third in both revenue and pre-tax profit. Back in 2009 neither Mozambique nor Namibia really pictured in our revenue and profit before tax contribution. Namibia was around 2% in 2009 and has grown successfully to become 23% of our revenue contribution. And Mozambique from a greenfields start has grown to 19%. So you can see the opportunity in both a lot population density market as well as a much higher one in Mozambique.

Tanzania was there. That has showed some growth, but this is a difficult market to operate in. and meanwhile in Swaziland, which was a major contributor, we have taken quite a prudent view in the last couple of years due to a number of class action suits against micro lenders. We are confident now that that is behind us, and we have started to open the doors for business again and have seen quite positive growth in the last nine months or so.

Turning to slide six, this gives you a map depiction of our geographic presence today and the nature of our business in each country. Mozambique, as I've mentioned, will shortly turn green a la Tanzania. Tanzania is assuming here the bank acquisition that we now have central bank approval for. The last competition clearances should be received we hope in the next few weeks. And that will then give us between FAIDIKA which has around 15 branches and 80 further customer access points and this bank with five branches the third or the fourth largest physical footprint in Tanzania of any of the banks.

And because it is a FAIDIKA driven footprint it is at a fraction of the cost that the banks are running it. And if you combine that with the capability that is already with the bank that we're acquiring of mobile and agency banking this will give us a significant competitive edge from both a cost and a reach perspective. Also we have got as part of the approval process that FAIDIKA becomes an agent of that bank. So FAIDIKA will become the origination business to the bank we've acquired. So quite a neat synergistic acquisition. We have paid about TSh 15 billion when the deal is closed for that business. It has got around 23,000 customers which we can add our own business, which is around 15,000 to. It has a relatively small, clean loan book. Perhaps because it doesn't have critical mass it is making a loss at the moment. We would like to think we can turn that around next year. But assuming the deal goes through there will be some consolidated losses for the rest of the year in our full-year results.

Nigeria is rather a different entry strategy, but with the same objectives. We have been able to sign a sales purchase agreement for one of the major micro finance banks. This has a national license which will enable us to provide financial services in all states within the country. However, today it is only in two states. Most of the branches are Lagos concentrated. It has over 100,000 deposit customers and around 9,000 borrowers. We paid a little over ₦3.5 billion for that. This business is making money at the moment. So we are quite excited that we found a relatively well-managed asset with a lot of upside to our existing diversification strategy.

Turning to slide seven, the left-hand triangle I'm sure is familiar to many of you. As we have refreshed our strategy with our main board this year in July it becomes clear that we are very well positioned to drive a financial inclusion agenda, which is increasingly becoming the focus of governments and regulators across the

African continent and indeed in most emerging markets. We are showing there an analysis on the right-hand table produced by the Alliance for Financial Inclusion, which we increasingly getting closer to, which will position us both profile-wise but more importantly, will ensure that we are kept well abreast of developments in the financial inclusion agenda of governments. As you can see in the top right-hand side there Africa after the Middle East has the least number of adults using formal financial institutions. I think that fact is well known, but the reality is the adoption of mobile wallets or real mobile banking accounts has been very fast in countries like Kenya. We are very much positioned to become part of that space.

Having said that financial inclusion comes with a number of challenges, not least financial literacy. We have already launched a programme in Botswana early this year where we have committed to working with government to provide financial skills training to some 35,000 government employees over the next year to 18 months working with a specialised trainer. And we have a number of other plans for supporting financial literacy programmes which are fundamental to engaging non-banked individuals in financial services. There is also the mistrust of technology which we need to overcome. We have got a phased approach to how we will roll out mobile and agency banking. And we do believe there is a lot of inappropriate products and solutions out there.

Which takes me really to the next slide, slide eight. Today we are very much product-focussed with the government payroll deduction at source model being the core one, with a number of other group and micro enterprise lending products, with low-income housing being the latest add which we have made good progress on. We've got those three segments of government employees, low and middle income and micro enterprise. Tomorrow we want to be able to provide our customers with access anytime, anywhere so that they don't really have to think about how they are going to access their Letshego account. We want to be very much integrated into the payment space. And we've got a number of streams of strategic work working with leading players in payments, in cards and in technology which I hope I will be able to talk more about once some of those are more permanent within our strategic offering. But as I say, pleasing progress there. if you combine that deposit taking, combine that with micro insurance opportunities we are looking at, we truly believe we will be able to offer simple, appropriate and affordable solutions t our target markets going forward.

Turning to slide nine, some of you have seen part of this slide before. at the end of the day while pricing is one tool in your armament in a place like Namibia where the costs of banking are very high we expect our offering, which will be significantly lower than the banks, will be attractive. If you can't surround that with an experience, not just service but an overall experience that is attractive, you will miss out. And experience is everything from brand to product marketing, to how you lay out their branches, to where they are, to the access anytime anywhere approach and so on and so forth. We are looking at a refreshed brand, and again I hope to be able to talk more about that in due course.

We do want to move along this continuum. We are recognised for strong service, for quick turnarounds, for simple account opening and account top-up processes. We need to focus much more on delivering to the needs that are out there, and in due course start to anticipate those needs. So that is the front end of our business in terms of the strategic focus we've got for growing it.

On the support and risk management slide, slide ten, we have given you a little bit of detail of some of the organisational enhancements we've made. We have recently acquired the head of East Africa from MasterCard to head our customer experience. We have recently acquired a Head of Risk, a Head of Treasury & ALM and a credit specialist. So risk is very much at the front of our thoughts at the moment to prepare for a gradual increase in our risk profile. Also operationally last year we brought in a banking operations specialist. This year we have brought in a micro finance operational specialist from Equity Bank.

It is not just the group. Our local subsidiaries we are strengthening. We have appointed Chief Risk Officers now in Mozambique and Namibia and a number of Business Development Managers to drive our agenda forward. And pleasingly we are now starting to see some momentum on our talent investment plan. We now have just moved a Botswanan to head up our payroll consumer finance business in Kenya. We are in the process of moving a Swati from Swaziland to Tanzania. And we have just moved an individual who went on a secondment to Kenya back to his own country in Tanzania. So there is a lot of investment in people and building out our risk.

And lastly I should look at slide 11. Our capital adequacy per se has not been at the forefront of mind, but as we increasingly get deposit licenses we are going to have to manage capital more effectively. Being over-capitalised perhaps is better than being under-capitalised, but we have to be more efficient. We do have a full balance sheet capital exercise undergoing with our bankers which we hope will lead to some additional funding opportunities including as part of our debt equity leverage, where we have made progress as you can see. We are now roughly half debt half equity. We will add some potential dollar debt to our funding. however we continue to stay focussed on local currency funding, and indeed since the half year we have accessed a further 500 million pula in funding. So from a liquidity perspective this half is looking quite positive.

So in summary, good progress against our strategic agenda. And we will continue to invest in people, technology and capabilities. Let me now hand over to Colm who will make some comments on our financials before we open up the floor to questions.

Colm Patterson
Thank you. Good day everybody. I will just take you through the last couple of slides which look at the actual figures for the interim period. On the first slide, number 13, we just really highlight a few things. Overall our margin both in terms of interest income and the overall yield on loans to customers has been maintained. So we are quite happy with that given that it is a very competitive environment. We do acknowledge that going forward there may be some pressure in this area, but we have been able to keep margins quite robust for the period. And we also acknowledge that while there was some forex impact on the cost of funding our actually overall cost of borrowing did not change during the period. So from a margin perspective quite satisfactory.

Similarly from a cost to income perspective we have maintained our cost to income pretty much at the same levels as the prior reporting period. So again this is actually below what our targeted or expected levels will be. And there may be some uptick going forward given some timing issues for some further costs to come through, but overall we are quite satisfied with the level of cost to income.

Lastly on this slide we just touch on our overall cost of risk and impairments. Again we remain within our target area and I suppose within the two segments of our book between payroll and non-payroll. While there has been an increase in the overall percentage and quantum we are quite satisfied that there is no change in the quality of the loan book. Rather what we are looking to do is move over time to position ourselves for pending changes in IFRS accounting standards going forward which will come into play in a few years' time. We are preparing for that now. And also just taking a slightly more conservative approach and outlook. The main message is that the overall quality of the loan book hasn't changed.

If we move on to the last slide, again just to highlight a few areas, in terms of our dividend pay-out ratio that has remained consistent in terms of a 50% pay-out ratio. This will make our interim dividend about $20 million, so hopefully shareholders will be happy with that, and give an annualised dividend yield of approximately 5.7% which hopefully shareholders will be happy with.

I will just note in this area that back in May shareholders did approve a share buyback programme. Since we obtained that shareholder approval in May we have been in a closed period due to trading under cautionary for the transactions in Nigeria and Tanzania and before releasing interim results. We still are in a closed period for certain of those transactions so we haven't done anything around the share buyback today. Going forward the intention of the approval from shareholders was to give us an option to look at further addressing and making our balance sheet a little more efficient, and that remains the case. We will continue to review and see what options we have going forward in the context of our balance sheet structure and the long-term funding requirements of the group.

Linked to that very much is our debt to equity ratio. As Chris mentioned we have put in an extra 500 million pula in new debt post year end in local currency. And we continue to work in this area to get the best funding for the group in terms of liquidity, cost and foreign exchange to be able to deploy any new funding lines that come in so that we don't have a significant carrying cost. So this remains work in progress, but good progress during the period and post period. Chris did note as well that we are looking at some dollar-denominated funding. So with hedging we do expect that the dollar funding would come in pretty close to our current cost of funding, maybe a little cheaper. We will see. It is just the diversification of our funding lines and ads to the pipeline and diversification of funding that we have going forward.

Lastly before I hand back to Chris to wrap up, our return on assets and return on equity remain in line with our target levels. A marginal reduction, but overall we are quite satisfied with those returns to our shareholders. They were the few points I wanted to make on the last few slides. I will hand back over to Chris to wrap up.

Chris Low
Thanks Colm. As I indicated at the start we believe these are a good set of results given the economic environment and indeed in some cases quite rapidly depreciating currencies in a number of our markets. I guess this is a common risk if you're going to invest in Africa. And our challenge, which today we've been successful on, is to grow our books at rates substantially faster than depreciating currencies to get a positive return for investors.

Good progress on the strategic agenda. Assuming we can finalise these two transactions, one in Tanzania and one in Kenya, half of our ten-country presence will have deposit-taking capability which is a good move by year end. And we do believe that the outlook is positive due to current and planned investment for continued strong performance growth and returns for shareholders. Thank you. Claire, I will now ask the operator to step in if there are any questions from yourselves. Thank you very much indeed.

Operator
Thank you, Mr Low. Ladies and gentlemen, if you would like to ask a question please press star then one. To ask a question please press star then one. We will pause to see if there are any questions. We do have our first question from Donatas Uzkurelis of LGM Investments. Please go ahead.

Donatas Uzkurelis
Hello. Thank you for the call. Can you give us more colour on this USD debt you are planning to issue? What is the rationale behind it in dollars and also hedging it? Hedging is extremely expensive.

Colm Patterson
You are exactly on the mark there, which is why we are extremely cautious. All I'm saying is it is one of the options we are looking at. Several DFIs and bilateral agencies, for example OPIC [?] are coming to the table with dollar rates which are well worth considering even with the cost of hedging. So we are doing a full balance sheet and capital review which includes funding options. And clearly as you might expect US dollars would be part of that.

Donates Uzkurelis
Okay. Thank you.

Operator
Ladies and gentlemen, a reminder, if you would like to ask a question please press star then one. We have a question from Tim Raschuk from Frontaura Capital. Please go ahead.

Tim Raschuk
Hi. Do you mind commenting a bit more on asset quality? It looks like the impairment numbers have increased pretty steadily over the past four halves. Any comment you could offer on that would be helpful. Thank you.

Colm Patterson
Tim, thanks for your question. Really from our perspective if you're looking at this area over the past few years there has been a slight impact in terms of the mix of the book from payroll to non-payroll. I think we have given guidance in the past in terms of where we believe acceptable ranges of impairments fall within. So we have looked at this quite closely and we always look at this area quite closely. For the last couple of years our overall cost of risk has ranged from 1.5% to 2%. So in the current period it has increased to 2.5% on an overall blended basis. As I touched on earlier on there are two aspects to that.

One is that there are changes in accounting standards that will come into play in a couple of years' time which will really bring impairment calculations back to where they were a number of years ago. So we are preparing for that now. We are just really refining our judgements and estimates that make up the different parts of the impairment calculation. So we have looked at the changes in the current reporting period and the increase really is due to the fact that we've decided to go a bit more conservative, principally around the accounting standards, but also providing a bit more conformity across the group in terms of how we go about this. So really the message is that the quality of the book hasn't declined, hasn't changed. As we go forward it is just the right time to start preparing for changes that will come in a few years' time.

That's one aspect. The second aspect is as the mix of our book changes between payroll and non-payroll i.e. as the non-payroll element gets higher that will have an impact on the overall cost of risk and it will pick it up slightly. But we still believe we will be well within acceptable ranges.

Tim Raschuk
Got it. Thanks very much.

Operator
Thank you. Our next question is from Godfrey Mwanza of Absa Asset Management. Please go ahead.

Godfrey Mwanza
Thanks, gentlemen, for the call. Colm, could you talk in more detail about what this accounting change will be? I just want to get a sense of how that accounting change will affect how you think about provisioning.

Colm Patterson
Godfrey, thank you. The specific accounting standard is IFRS 9. Excuse me if I don't know the full title of it, but it is number nine. Basically what it does is if you go back years and years ago when the accounting world was a little bit more straightforward you would be able to calculate general provisions based on historical ranges, historical loss actuals, and you could adjust those actual historical losses to expected future events that might impact it. IAS 39 came in years ago which changed that to basically reduce the extent that you could recognise general impairment losses on your portfolio. And there were a number of different areas that organisations

implemented at the time. But by and large it meant that your general provisions reduced. And you couldn't do what you did before, which was basically look at historical loss ratios and use them for what you expect to happen in the future. In very simple terms, because I don't want to try and say I'm explaining IFRS 9 because it's a long document, in simple terms we are going back to where we were a number of years ago. And in simple terms that means that general provisions will pick up over time and a part of the change in our provisioning is positioning ourselves for those changes when they come into effect in a few years' time.

Godfrey Mwanza
So does that mean you're taking general provisioning now? If so what is that quantum?

Colm Patterson
Well no. We are not taking general provisioning now. We continue to take specific and general provisions. What we have done is we've looked at the various areas of that calculation in terms of the different estimates that you can make and we've made them slightly conservative. But it is aligned to what the new standards will ask us to do in a few years' time. So it is repositioning ourselves for that, but also making sure that we continue to be conservative in this area.

Godfrey Mwanza
Thank you.

Operator
Thank you. Ladies and gentlemen, a reminder, if you would like to ask a question please press star then one. We have a follow-up question from Donatas Uzkurelis of LGM. Please go ahead.

Donates Uzkurelis
Can you talk a bit about your cost to income ratio taking into consideration that you hired a lot of people. Where do you see it going forward? Secondly, do you need to make any more hiring's? Do you see any spaces you have to fill in your competence in general or in separate countries?

Chris Low
Let me start on that and maybe Colm can make some comments on the actual cost to income ratio itself. The large numbers of group senior managers in our subsidiaries that we've hired in the last 12 months have been really around ensuring that we have an organisation that has a strong platform and that has a number of skills to be able to provide a more diversified financial services offering than we have in the past. Hence appointments of risk managers, hence appointments of customer experience managers, and as we move into deposit taking and micro finance banking the need to bring in some operational specialists to ensure payment settlements work. Have we completed our hiring? No. I will expect to continue to see some growth in our head count numbers. Clearly these two acquisitions bring with them around 450 or 500 staff. So you are going to see movements in our staff numbers. But today when you bring in our direct sales force we have a pretty healthy front support office ratio of staff. It is something like 1.5 front office to one back office. It could even be as high as two in a couple of countries. Yes, we are up staff, but we will be more selective than perhaps in the past where we've got clear gaps that we need to bridge. The impact of that on cost is starting to kick in now. You haven't got a full six months in terms of the senior positions that I mentioned in my section. I think three out of those five only joined us in the last two months.

Colm Patterson
To add on to that then, the first part of your question was around where we see the cost to income ratio going. I think as we have indicated before over the medium term, over the next few years, we do believe our cost to income ratio will trend up. Our internal target is to cap it at around about the 35% mark. Over time we do

believe it will go up, but it will be in the context of a bigger group, a more diversified group and hopefully a more exciting group. So yes, it will increase but we believe it is part of the overall investment and long-term sustainability of the business.

Donates Uzkurelis
Thanks.

Operator
Thank you. We have a follow-up question from Godfrey Mwanza of Absa Asset Management. Please go ahead.

Godfrey Mwanza
Thanks. Just two more questions from me. The first one is you mentioned that post balance sheet date there was some capital raise. Could you tell us how much that was? And then on share buybacks could you share how you're thinking around valuations? It obviously wouldn't have been in shareholders' interest if the stock was trading at too high a valuation. How do you come up with the limits or the parameters for your buybacks?

Colm Patterson
Thank you. On your first question post period end, so during July, August and even today we have been busy at it. We have raised approximately 500 million pula, so approximately $50 million in new debt. This has been from a variety of new funders or existing ones. So that is part of business as usual as far as we're concerned. This is making sure that we have sufficient funding to continue to grow the business and do what we need to do. Since post period end it has been plus minus 500 million pula.

The second part of your question was about the share buybacks. You are right. There are a number of variables that have to come together for this to make sense. Really where we try to communicate the message is that we obtained the shareholder approval in order to allow us to do a share buyback if it makes sense. We are looking at the balance sheet structure and over time we are looking to improve the efficiency of the balance sheet. Whether the share buyback mechanism will be the optimal way of doing so, we will see. Clearly there has been some movement in the share price. But there are other variables too. All we would say is we continue to ensure the business has sufficient funding to continue to grow. And if over and above that we are able to do something that makes sense from a shareholder return perspective we will pursue it. There is no specific magical share price or cost of borrowing. There are a number of other factors too which we look at closely.

Godfrey Mwanza
Is it fair to say that it was mostly just a signal to the market that you are aware of being over-capitalised so to speak, rather than necessarily have immediate plans to buy back shares?

Colm Patterson
No, it wasn't a signal to the market. It was to allow us to be able to implement the buyback should factors allow us to do so. Since we got shareholder approval in May we have been trading under cautionary and what was included in the shareholder approval was that we cannot do anything while we are in a closed period. If I understand the way you phrased the question correctly, it wasn't a signal of intent. It was an intent that we will action if it makes sense. As I said earlier on, there are a number of factors for it to make sense. One is the share price. Two is our cost of borrowing, availability of borrowing. Three is the liquidity of shares available to purchase. So all those things we will look at. But is it a signal that we are looking at it very closely? Absolutely. Is it a signal that we're not going to do anything? No. we would love to action it if and when it makes sense to do so. If a share buyback mechanism is not the mechanism to assist us in terms of balance sheet management then we will look at other options. But right now it is a tool in our bag that we can use as and when it is appropriate to do so.

Godfrey Mwanza
Understood. Thank you very much.

Operator
Our next question is from Kagiso Sedimo [?] of Investec. Please go ahead.

Kagiso Sedimo
Hi Chris. Hi Colm. I just wanted to know if you could talk a bit more on these new acquisitions, how you plan on extracting value and enhance the return?

Chris Low
Okay. I can give you a little more maybe than what I gave when I was introducing. To start with Tanzania the real synergy that we foresee in Tanzania is the fact that we already have a good customer base and a strong distribution reach across the country. What we are really lacking is an ability to significantly diversify away our product offering from a credit-only business. With the acquisition of a deposit license and the added benefit of that bank having agency and mobile banking in place already it enables us to leapfrog the organic play that I mentioned we are going through in Mozambique and move forward quite quickly in that market to convert our existing government employees to full-service customers of the bank. I hope that captures what I am talking about. With the added benefit that the central bank has already approved that FAIDIKA can be an agent, so we have already started to convert several of our customer access points initially in the larger towns and cities into bank branches so that we've got a good reach across the industry and important cities both north, south, coastal and west Tanzania.

Nigeria is slightly different because clearly that's a new geography for us. So our primary strategy was one we wanted the flexibility to do business in any of the states without having to go through any further approvals. There was when we signed this deal only five micro finance operators with a national license. I believe one has been signed up in the last few weeks. We found as with Namibia that regulatory approval can take a long time. so that was a starting point. I'm not saying we're going to immediately go out and open in every state. That isn't part of the strategy. But this is a business that has not been invested heavily into by its parent. So while it is still relatively small balance sheet we believe that it offers significant upside if we bring some of our product and solution capability from our East African businesses. And clearly we will be working once the deal is closed to look at the opportunity for attracting government business, of which the numbers from our research are multiples of our existing total government employees in our current footprint. We are not the guys that go out and suddenly dash to do this overnight. We will do the research. But I hope we would be able to bring that business to bear, which would again very much change the business model financials of that business as it sits today.

Kagiso Sedimo
And in terms of how quickly you can deploy the strategy and capital that would be needed for that, do you have an idea?

Chris Low
In Tanzania in effect our acquisition of the 75% shareholding will inject capital to recapitalise that business. At the moment it would be in breach of central bank regulations. And we are putting in a couple of million additional capital to ensure that that business can star to grow, start to add business onto its balance sheet, which for the last six to 12 months has really been suspended. So for relatively low capital amounts that business will be back fully capitalised and able to grow. In Nigeria the business is already more than adequately

capitalised. So we do not foresee a need to put in additional capital other than obviously our acquisition price which goes to the seller. So no particular issue on either front from that perspective.

Kagiso Sedimo
Okay. And my last question has to do with operating expenses. In the results there is a line item 'direct cost and provisions' and another one 'other operating expenses'. Colm, can you tell me what those things are?

Colm Patterson
Kagiso, thanks. There are a number of things included in there. Really they range from… Direct costs and provisions would include things like cost of our direct sales agents. That number increases year on year. There are other costs in terms of the sales in terms of support that is needed. And then provisions, as you know in the past we've made some provisions for things like South Sudan. It is a little bit difficult to go through all of the detail because there are quite a number of different things included there. And similarly with other operating expenses there are quite a mix that goes in. Where we're quite satisfied and happy is that while operating expenses have increased it has increased at reasonable levels and is really part of the overall investment in the business that we're making in terms of people, systems etc. So within those expenses as well would be an element of expenses that we are incurring that are not [unclear] to be capitalised. So it is a mixed bag, but it is part of the investment in the business going forward.

Operator
We have a follow-up question from Tim Raschuk from Frontaura Capital. Please go ahead.

Tim Raschuk
Would you mind commenting on the forex losses?

Colm Patterson
Tim, thank you. I think the forex losses that have come through in the period principally relate to two open positions within the group. One is against the Mozambican meticais and one is against the Rand. All of the others we have closed out over the year. I guess I should go back. The reason why we've got an open forex position against the Mozambican meticais is that we've been able to grow the business there over $100 million which has principally been funded by loans from Letshego Holdings given the inability or lack of funding options in-country. In our view it was a necessary risk to grow the business there. Over time we have been able to build up and introduce new meticais funding lines from third-party funders and that has impacted to an extent. But there was still a gap between the funding that has been provided by Letshego Holdings versus from non-group.

So the meticais like a lot of other currencies this year has depreciated quite significantly, and that was the primary driver of the forex losses. What we have done post period end is we've taken a view that we don't believe that the situation is likely to change, so we have taken a more conservative route to convert some of our loans to quasi-equity. It doesn't remove the foreign exposure but it does remove the volatility. So that has been done post year end. The second leg of our open forex position is the Rand. At various stages in the last few years we've been in a net Rand asset or a net Rand liability position. Of the first half of this year we were in a net Rand asset position. We are more comfortable with that, but really we're not in the business of playing the forex game. So we would really like to close it out. One of the positions that Chris alluded to earlier on that has joined us post period end is a group Treasurer. We will continue to work on closing out or mitigating the element of forex risk that goes through our P&L account as much as we can.

Tim Raschuk
Great. Thank you.

Operator
Miss te Riele, I've opened your line. Please go ahead.

Claire te Riele
Hi, sorry. Two quick questions. I understand Kenya is a relatively small market for you right now. But given your entry into SME lending there in the absence of payroll deductions it would appear that it is a higher-risk market to you. What are your expectations in terms of asset quality and your NPL ratio?

Chris Low
You're talking specifically in Kenya?

Claire te Riele
Yes.

Chris Low
Firstly let me correct. There is a payroll deduction available there and actually our business in payroll deduction and source business has grown faster than our micro finance business in the first half of the year because we have given it strong focus. However it is still a relatively small part of our book. Secondly on the issue of the quality of our book naturally our micro finance business has shown a higher delinquency than our payroll business. Generally we say in the 5% to 8% range. That said, through the use of technology, using the well-known world of M-Pesa we've been able to ensure collections are continued. So our experience to date in Kenya has been relatively stable. Colm, I don't know if you want to add anything else?

Claire te Riele
Great. Thanks, Chris. If you could talk broadly on your deposit taking, what are your expectations for growth and what would be the key drivers in terms of branches or agency banking? Thank you.

Chris Low
Our deposit taking, as we have always said, is just to facilitate access to customer wallet and enable us to broaden the range of financial service solutions that we can offer. While in percentage terms we've seen quite good growth in Rwanda and not too fast a growth in Mozambique the numbers are still immaterial from a deposit funding perspective. when you look forward, as I indicated we should have five deposit licenses by the end of the year. We are starting initially through our Mozambique business to evaluate what options are open to us towards building deposit capability. And a first move in Mozambique was the fact that we launched this capital market instrument, not direct retail deposits but in effect local meticais funding.

In the medium to longer term based on what we've seen in other markets – I think Ghana is a good example, as is our small operation in Rwanda – there is clearly room for us to use those deposit licenses quite effectively to gather deposits. I'm not going to say we're going to rely on retail deposits as part of our funding strategy. I think that would be inappropriate until we start to really roll out in a more substantial way, which will be in Mozambique and Tanzania and Nigeria.

Claire te Riele
Thank you.

Operator
Thank you. We have a follow-up question from Kagiso Sedimo from Investec. Please go ahead.

Kagiso Sedimo
Hi Colm. Hi Chris. Just a few questions. In terms of the strategy of the business changing and being more diversified away from payroll deduction. Can you perhaps give us an indication of the split between payroll and non-payroll, where you want to go to in the medium to long term? I see as well that both from an operating income as well as a profit before tax point of view in East Africa the business went backwards. What caused this backwards movement despite a strong increase in advances to customers there? And can you speak a little bit as well about your strategy going forward in terms of micro finance? Where do you see opportunities in this space from a regional presence point of view?

Chris Low
Let me try and answer one and three. Colm, you can answer question two on East Africa. When we say payroll and non-payroll I think we should clarify we really mean government/non-government business. A key segment that I've mentioned is low and middle income employees. To an extent we won't be solely offering loans against deduction at source. To an extent some of the non-government businesses will be payroll related activities. If we do the split of government/non-government in the medium to longer term we are looking at between a quarter and a third of our book being from non-government sources.

On the opportunities in micro finance our focus areas, as I touched on in my opening comment, are going to be driven around three or four key areas. From a segment perspective we've identified health, education and agriculture as three segments. We have already done pilots in Tanzania on two of those. And we are working quite closely in Uganda and Kenya with some agri specialists to identify how we might get into the supply chain at the lower end of agriculture there.

Group lending is a second area which we've had a lot of debate internally on because generally the amounts borrowed by each individual in the group are very small. But what we have found in our businesses there is these groups offer a pipeline for micro and small business loans. And as we diversify through deposit taking our ability to broaden our product range through-cross sell we actually will have the opportunity to do much more with those clients than in the past.

And the third area is the low income housing. You will be well aware of some of the statistics around urbanisation. Actually we look at it the other way. That urbanisation is driving people's ability to remit money home to their villages. So we've got a number of initiatives in low-income housing both in the main capital cities as well as up-country working with housing associations as well as some of the DFIs that are interested in low-income housing. Colm, over to you on East Africa.

Colm Patterson
Kagiso, thanks. You are correct if you look at the segmental aspect of our reporting it does show that. this is East Africa. This is a geographical segment rather than a product segment. There are a few aspects, but the main aspect is really around foreign exchange and exchange rates in place during the period. Obviously when we report our figures from the profit and loss side we use monthly rates. And all of the shillings have depreciated quite significantly over the period. So that was really the main driver to it. So underlying, as we said before, the overall businesses are doing very well, but foreign exchange rates during the period had a slight impact. There were other factors, but that is probably the main one.

Kagiso Sedimo
Chris, I understand your definition of payroll and non-payroll, but in the strict sense of the world right now what would be the current split and where would you look to take that? Payroll I'm assuming is deduction from source, whether corporate or government. And where would you look to take that?

Chris Low
Today it is about 93% of government/non-government. And as I indicated we are looking to grow the non-government business, which is payroll and micro finance business to around 25% to 30% over time.

Kagiso Sedimo
Okay. Thanks.

Operator
Gentlemen, there are no further questions. Would you like to make some closing comments?

Chris Low
Thank you very much everybody for your time this afternoon or this morning, wherever you're ringing from. We will obviously put this pack up on our website. And you will be pleased to know we are in the process of an exercise to improve our website. So hopefully it will become more accessible over time. We do believe that the underlying results continue to show strong performance growth and returns. We are excited about the progress we are making on the strategy in what is quite a fast-moving environment, particularly from a digitisation and technology perspective. and as a result we will continue to drive our investments in people, technology and capabilities to ensure that we are aligned with those opportunities. So thank you all again. I'm sure some of you have got one or two other questions. Please feel free to reach out to B.K and we will do our best to answer those over the coming days and weeks. Thank you very much indeed.

Operator
Thank you. On behalf of BPI Africa and Letshego Holdings that concludes today's call. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT