MOODY'S
INVESTORS SERVICE

Credit Opinion: Letshego Holdings Limited

Global Credit Research - 19 Aug 2013

Gaborone, Botswana

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Ba3
ST Issuer Rating	NP

Contacts

Analyst	Phone
Christos Theofilou, CFA/Limassol	357.25.586.586
Nondas Nicolaides/Limassol	
Yves Lemay/London	44.20.7772.5454
George Korniliou, CFA/Limassol	357.25.586.586

Key Indicators

Letshego Holdings Limited

	[1]2013	2012	2011	2010	2009
Total Managed Assets (BWP Million)	4,279.2	3,212.7	2,430.2	1,915.4	1,401.0
Total Managed Assets (USD Million)	540.2	448.6	338.6	253.5	175.8
Pretax Preprovision profits / Average Managed Assets	23.40%	26.77%	30.64%	33.49%	22.71%
Net Income/ Average Managed Assets	17.61%	20.48%	21.78%	22.92%	15.64%
ROE (NPATBUI / Avg. Equity) [2]	26.15%	28.74%	30.57%	37.73%	32.84%
Short Term Debt / Total Debt % [3]	18.17%	38.60%	24.04%	33.13%	56.74%
Tangible Common Equity / Tangible Managed Assets % [4]	64.33%	70.40%	71.67%	69.94%	46.61%
Problem Loans/Gross Loans	4.73%	5.28%	1.42%	3.00%	2.15%
Problem Loans/(Shareholder Equity+ Loan Loss Reserve)	5.70%	7.07%	1.87%	3.75%	4.25%
Net Charge-offs / Average Gross Loans & Leases	1.04%	1.96%	1.60%	2.77%	1.44%

[1] For the fiscal year ending January 31, 2013 [2] NPATBUI refers to net profit (loss) after-tax before unusual items [3] Short term debt refers to short term borrowings as reported by the company [4] Tangible managed assets are assets including loan loss reserves, less intangible assets

Opinion

Rating Rationale

The Ba3/Not Prime issuer ratings of Letshego Holdings Limited (Letshego) reflect its standalone credit profile and remain constrained by the company's (1) narrow business model, with a high reliance on payroll deductions for loan repayment collections, that exposes the company to potential regulatory and legal changes in Botswana and elsewhere; and (2) reliance on wholesale market funding, although it has diversified and broadened its funding profile following its bond issuance.

More positively the rating benefits from good profitability (net income-to-average assets stood at 17.6% during the fiscal year ending January 2013) and solid capitalisation (tangible common equity-to-tangible managed assets of 64% as of January 2013), which provide the company with a good buffer to absorb the impact of any adverse changes in the competitive environment and its current business model.

No external support has been imputed in Letshego's ratings because of its limited importance to Botswana's payment system resulting from its small scale and the fact that it does not have any customer deposits.

Rating Drivers

- Established niche, but narrow and potentially vulnerable, franchise

- Regulatory and legal framework remains vulnerable to changes in Botswana and elsewhere, with potential higher credit and operating costs as a result of any imposed change in its loan repayment collections model

- Reliance on wholesale market funding, although it has diversified and broadened its funding profile following its bond issuance

- Good profitability and solid capitalisation buffers, that provide a good buffer for the company to meet any adverse changes to its current business model

Rating Outlook

The outlook on the company's long-term issuer rating is negative which reflects the ongoing risk that governments may cease facilitating Letshego's payroll deduction model, which will lead to higher credit and operating costs.

What Could Change the Rating - Up

There is currently limited upward pressure on Letshego's rating given the negative outlook.

An eventual upgrade on the company's ratings would depend on Letshego successfully developing banking operations in its main operating markets, while maintaining strong financial performance (profitability, asset quality and capitalisation). We expect banking operations to help (1) diversify its funding profile; (2) strengthen its overall franchise; and (3) enhance the regulatory and supervisory framework.

What Could Change the Rating - Down

Negative rating pressure could result if regional authorities in Letshego's main operating markets decide to cease facilitating the deduction at source, of loans and other repayments from public sector employees' wages. This is expected to lead to a sudden rise in bad debts and impairment costs, and an onerous change in its operating model with operational challenges in implementing a new collections mechanism (the company maintains direct debit agreements with all customers).

Even without this development however, Letshego's ratings will likely be downgraded if financial metrics - profitability, asset quality and capitalisation - were to deteriorate to levels below those of similarly rated peers, or following evidence that its operational capacity has been limited by an inability to access wholesale funding in its main operating markets.

DETAILED RATING CONSIDERATIONS

ESTABLISHED NICHE, BUT NARROW AND POTENTIALLY VULNERABLE, FRANCHISE

Letshego is a successful niche consumer finance company operating in sub-Saharan Africa (Botswana, Namibia, Tanzania, Mozambique, Swaziland, Uganda, and Lesotho), offering unsecured loans primarily to government and quasi-government employees (over 98% of the company's clients). The company has a strong niche franchise within Botswana (where it lends to around 24% of all government employees) and Namibia (where it lends to around 50% of all government employees), benefiting from a quick and efficient loan-approval and disbursement process. As of the fiscal year ending January 2013, operations in Botswana contributed 48% of revenue, Namibia 17% and Tanzania 14% (where it lends to around 9% of all government employees). While none of the remaining markets contribute more than 6% of revenue, operations in Mozambique have been growing very aggressively since their launch in 2011 and already contribute 6% of revenue, with the company lending to around 9% of all government employees.

The company has also recently acquired Micro Africa Limited a financial group based in Kenya specialising in small, medium and micro enterprises (SMME) and unsecured consumer lending that also has regional operations in Rwanda, South Sudan and Uganda. While this acquisition and the application for banking licenses in several territories will assist the company in developing its product range and geographical footprint (in line with its strategy to become a pan-African broad-based financial institution), Letshego continues to have a high reliance on its limited product offering and payroll deduction model. This narrow product base, in addition to the currently low barriers to entry in its main markets, exposes the company to potential regulatory and legal changes in Botswana and Letshego.

With short-term franchise growth opportunities within Botswana becoming limited and interest yields more competitive, the company is looking to strengthen its regional expansion. While its geographical diversification provides some operating diversification, we also view the risks as being higher given its fairly weak market position and lower franchise sustainability in most regional markets, and potentially higher credit losses as a result of (1) the potentially riskier operating environment in other Sub-Saharan markets; (2) the rapid growth within its regional loan portfolio; and (3) its inexperience in some of the new markets coupled with new product offerings. Letshego also has substantial currency risk exposure as a result of its regional operations and we estimate that a stress scenario of a 40% appreciation in the Botswana pula would result in a decrease of its net foreign currency assets with around a 90% impact on FY2013 profitability or 21% of tangible common equity.

REGULATORY AND LEGAL FRAMEWORK REMAINS VULNERABLE TO CHANGES, WITH POTENTIAL HIGHER CREDIT AND OPERATING COSTS

While the company's current payroll deduction model in place - facilitated via electronic collections through a Central Registry (CR) - mitigates potential repayment risk as it allows the group to receive monthly loan repayments directly from the employer (mainly the government), the negative outlook on the ratings reflects the ongoing risk that the governments in Botswana and elsewhere may cease facilitating these payroll deductions.

As a result of its payroll deduction model and the group's policy of having credit insurance on each loan, credit costs have historically been maintained at a fairly low 1%-3% per annum, with the loan impairment charges-to-average loan book at 1.1% for the fiscal year ended January 2013, down from 1.6% during FYE2012 and 1.9% during FY2011. Although the company does not have sophisticated underwriting standards, it approves loans to formally employed clients (predominantly government employees) based on its own affordability criteria, as long as Letshego has negotiated a salary deduction code with the employer. Loan repayments are facilitated through a CR, which combines all deductions from the government into one deduction code and also checks that regulatory loan affordability requirements are adhered to. A CR reduces collections costs and improves collection statistics, although a CR is not in place in some of its important markets like Mozambique and Tanzania.

In cases where there is evidence of impairment (e.g., when the debtor loses employment), the company writes-off the loan, resulting in a low level of impaired loans at 0.8% to total loans as of FYE2013 (FYE2012: 0%), while past due but not impaired loans accounted for an additional 4.2% of gross loans as of FYE2013 (FYE2012: 5.3%).

A major risk for Letshego is a change in regulation that would cease facilitating or impair its payroll deduction model. Under such a scenario, Letshego will be faced with a sudden and substantial rise in bad debts and impairment costs (to over 10% of gross loans), and materially higher operating expenses, stemming from an onerous change in its operating model that would require the implementation of a new collections mechanism (the company maintains direct debit agreements with all customers). Furthermore, the company has limited experience in developing underwriting standards that will allow it to manage the higher potential credit costs of alternative deduction models. Letshego is also exposed to other regulatory risks such as a potential lower cap on the effective interest rate it can charge on loans that will lead to lower earnings generation.

RELIANCE ON WHOLESALE MARKET FUNDING, ALTHOUGH IT HAS DIVERSIFIED AND BROADENED ITS FUNDING PROFILE FOLLOWING ITS BOND ISSUANCE

The company relies primarily on wholesale funding to support its activities, which is inherently confidence-sensitive and vulnerable to disruption. Letshego also has a moderate exposure to interest-rate risk, as funding is floating whereas loans are fixed rate; although the large margins allow some room for interest-rate fluctuation.

In late 2012, the company issued ZAR700 million (BWP647 million) senior secured bond under its ZAR2.5 billion MTN program, listed on the Johannesburg Stock Exchange. This was its inaugural debt issuance in South Africa and has broadened and diversified the company's funding sources. The bond issue proceeds also improved Letshego's liquidity profile with cash holdings at a high 19% of total assets or 63% of total borrowings as of FYE2013, and has also improved its asset and liability maturity profile.

Bond issuance notwithstanding, we believe that Letshego should continue to lengthen the duration of its funding profile to better match the duration of its assets and maintain a high amount of liquid assets. Competition from banks has lead to a lengthening in the tenure of loans, which are longer relative to its international peers, at around 50 months; longer tenured loans also carry increased repayment risk.

GOOD PROFITABILITY AND SOLID CAPITALISATION BUFFERS

Good profitability and solid capitalisation provide Letshego with a good buffer to face any adverse changes to the competitive environment and its current business model.

Letshego's historical profitability has been strong, supported by high margins and good, albeit slightly weaker, efficiency amid a low cost structure, as a result of its payroll deduction model with most operations being centralised. We expect that profitability will remain at good levels, although interest yields will likely continue to trend downwards. Pre-provision income-to-average assets was 23.4% during FY2013 (FY2012: 26.8%) and net income-to-average assets was 17.6% (FY2012: 20.5%). The net interest margin was 26% (FY2011: 30%), with margins negatively affected by a lengthening in the tenure of loans, with longer term loans having lower yields. The cost-to-income ratio stood at a solid 26% during FY2013, from 24% during FY2012, but was slightly weaker amid higher technology investments, the higher cost structure of the recently acquired Micro Africa, new regulatory fees in Botswana, license applications and a larger branch network in Mozambique.

With tangible common equity-to-total assets of 64% at FYE2013 (70% at FYE2012) the company is well capitalised. We expect however that capitalisation will fall towards industry norms of around 30%-40% as the company acquires more debt to finance its loan growth.

SOURCES OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, data related to system-wide trends and market shares are sourced from the central bank and the bank's regulator (NBFIRA). Issuer-specific figures originate from the company's reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the documents entitled "Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies" and "Frequently Asked Questions: Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies", both published on 19 July 2012.

RATING METHODOLOGY

The principal methodologies used in this rating were "Finance Company Global Rating Methodology" published in March 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Letshego's assigned rating is in line with the outcome of the finance company scorecard.

Rating Factors

Letshego Holdings Limited

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View		Forward View
Non-Financial Factors						B		B
Factor: Franchise Positioning						B		B
- Market Position and Sustainability			x					
- Operational Diversification				x				
Factor: Risk Positioning						B		B
- Potential Volatility of Assets/Cashflows				x				
- Governance and Management Quality			x					
- Risk Management				x				
- Key Relationship Concentrations	x							
- Liquidity Management				x				
Factor: Operating Environment [1]						B		B
- Economic Strength			x					
- Institutional Strength		x						

- Susceptibility to Event Risk		x						
Financial Factors						Baa		Baa
Factor: Profitability						Aa/A		Aa/A
- PPI / AMA	26.94%							
- Net Income / AMA	19.96%							
- Pre-tax Income Coefficient of Variation		35.39%						
Factor: Liquidity						Baa		Baa
- 24 Month Coverage Ratio		95.06%						
- Secured Debt / Gross Tangible Assets		18.15%						
Factor: Capital Adequacy						Aa/A		Aa/A
Capital Bucket: Traditional Finance Company								
- TCE / TMA	64.33%							
Factor: Asset Quality						Ba		Ba
- Problem Loans / Gross Loans			3.81%					
- Problem Loans / (Shareholders Equity + LLR)	4.88%							
Scorecard estimated stand-alone credit assessment:						Ba3		Ba3
Assigned Rating:							Ba3	

[1] Capped at B; The operating environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.