MOODY'S INVESTORS SERVICE

Credit Opinion: Letshego Holdings Limited

Global Credit Research - 19 Nov 2015

Gaborone, Botswana

Ratings

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

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Key Indicators

Letshego Holdings Limited

	1H 2015	[1]2014	[2]2013	2012	2011	2010
Total Managed Assets (BWP Million)	6,506.9	6,336.9	4,970.2	4,279.2	3,212.7	2,430.2
Total Managed Assets (USD Million)	584.3	654.4	540.5	524.5	433.9	353.6
Pretax Preprovision profits / Average Managed Assets	18.01%	18.78%	20.09%	23.40%	26.77%	30.64%
Net Income/ Average Managed Assets	12.18%	12.77%	14.13%	17.61%	20.48%	21.78%
ROE (NPATBUI / Avg. Equity) [3]	20.06%	19.65%	20.34%	26.15%	28.74%	30.57%
Liquid Assets / Short Term Debt [4]	--	50.74%	151.01%	377.90%	31.56%	53.06%
Tangible Common Equity / Tangible Managed Assets % [5]	59.26%	61.57%	68.17%	64.33%	70.40%	71.67%
Problem Loans/Gross Loans	--	1.09%	0.31%	0.77%	0.00%	0.00%
Problem Loans/(Shareholder Equity+ Loan Loss Reserve)	--	1.57%	0.41%	0.93%	0.00%	0.00%
Net Charge-offs / Average Gross Loans & Leases	--	0.87%	1.37%	1.04%	1.96%	1.60%

[1] For the fiscal year ending 31 December 2014 (11 months) [2] For the fiscal year ending 31 January 2014 [3] NPATBUI refers to net profit (loss) after-tax before unusual items [4] Short term debt refers to short term borrowings as reported by the company [5] Tangible managed assets are assets including loan loss reserves, less intangible assets

Opinion

Rating Rationale

The Ba3/Not Prime issuer ratings assigned to Letshego Holdings Limited (Letshego) capture the company's solid capitalisation and good profitability (supported by its niche, low-cost, franchise), which provide the company with a solid buffer to absorb the negative effect of any adverse changes in the competitive, operating or regulatory environment.

The ratings balance these strengths against Letshego's (1) narrow business model, with a high reliance on payroll deductions for loan repayment collections, which exposes the company to potential regulatory and legal changes, (2) high exposure to foreign exchange risk, and (3) dependence on market-sensitive wholesale funding; although actions are being taken to address these weaknesses.

The Ba3 issuer rating assigned to Letshego reflects its stand-alone credit profile. No external support has been imputed in Letshego's ratings given its limited importance to Botswana's payment system resulting from its small scale, and given that it does not have any material customer deposits.

Rating Drivers

- Despite sound asset quality, Letshego's narrow model exposes it to potential adverse regulatory changes and high foreign exchange risk

- Solid capitalisation buffers

- Profitability is supported by an established niche, albeit narrow, franchise

- Reliance on wholesale market funding, although the company has diversified and broadened its funding profile

Rating Outlook

The company's ratings carry a stable outlook.

What Could Change the Rating - Up

An upgrade on the company's ratings would depend on Letshego successfully developing broader African financial services operations, while maintaining strong financial performance (profitability, asset quality and capitalisation). We expect these 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 be exerted on Letshego's ratings if regional authorities in the company's main operating markets impose restrictions on the deduction (at source) of loans and other 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 ratings if (1) Letshego's expansion in other sub-Saharan markets, client segments and products, results in any material weakening of asset quality and profitability metrics; or (2) Letshego's current sound capitalisation metrics were to materially weaken.

DETAILED RATING CONSIDERATIONS

DESPITE SOUND ASSET QUALITY, LETSHEGO'S NARROW MODEL EXPOSES IT TO POTENTIAL ADVERSE REGULATORY CHANGES AND HIGH FOREIGN EXCHANGE RISK

Letshego specialises in unsecured loans to government and quasi-government employees under the payroll deduction model, whereby loan repayments are taken directly from the employer prior to the monthly salary being distributed (around 93% of total loans). This model has historically lead to fairly low credit costs (loan loss provisions to average gross loans of 1%-3% per annum), reduced collection costs and improved collection statistics. As a consequence, Letshego's overall credit costs remained fairly low at 2.4% for the six months ending June 2015 (1H 2015), although we note potential higher provisioning needs under new IFRS guidelines (an issue faced by financial institutions globally). Impaired loans are relatively low at 1.1% of total loans as of December 2014, because of the policy to immediately write-off a loan on evidence of impairment (e.g., when a debtor becomes unemployed).

However, Letshego's payroll-based narrow business model exposes it to any adverse regulatory or legal changes. While we do not expect any short-term disruption and we note the company's contingency plans in place, under a scenario where authorities cease to facilitate the process, Letshego will be faced with an onerous change in its operating model, a sudden and substantial rise in bad debts and impairment costs (to over 10% of gross loans) and materially higher operating expenses. Letshego is also exposed to other regulatory risks such as a potential lower cap on the effective interest rate it can charge on loans, which will lead to lower earnings generation.

Positively, we note Letshego's increasing geographical diversification and strategy to diversify its business model, by becoming a pan-African broader-based financial services company, operating at the segment space below commercial banking. This is facilitated by various acquisitions across Africa and the acquisition of deposit taking licenses in several territories (it has a deposit-taking license in Mozambique, Rwanda, Tanzania, has received a preliminary banking license in Namibia and will likely acquire a deposit-taking micro finance bank in Nigeria, subject to all regulatory approvals). This expansion will gradually reduce its overall dependence on payroll lending (by broadening customer segments and products) and support its deposit mobilisation capabilities.

In the short-term, however, the company needs to manage potentially elevated credit losses from (1) higher credit costs in non-payroll related loans (micro finance group loans, micro and small enterprise business loans, and low-income housing loans) of around 4%-7% (albeit compensated by higher margins); (2) higher country risks; and (3) its relative inexperience in these newer markets and product offerings.

Letshego also has substantial currency risk exposure as a result of its regional operations, and we estimate that a severe stress scenario of a 40% appreciation in the Botswana pula would result in a decrease of its net foreign-currency assets, leading to a loss equivalent to 31% of tangible common equity. Positively Letshego is taking steps to reduce its net foreign-currency position, although we expect the progress to be gradual. Letshego also has a moderate exposure to interest-rate risk because a portion of funding is floating rate, whereas all loans are fixed rate, although the large margins allow some room for interest-rate fluctuation.

SOLID CAPITALISATION BUFFERS

Letshego's capitalisation levels continue to underpin the current ratings. The company is currently well capitalised, with a tangible common equity-to-total assets ratio of 58% at June 2015, which provides a solid buffer for the company to face any adverse changes both to the competitive environment and to its current business model. While we currently anticipate capital levels to drop slightly (as the company acquires more debt and/or reduces equity levels to grow/ optimize its capital structure), a material drop in capitalization below 50% could weigh on its current ratings. This is because we believe that Letshego should continue to maintain a capitalisation level that is higher than industry norms, given its narrow product offering.

PROFITABILITY IS SUPPORTED BY AN ESTABLISHED NICHE, ALBEIT NARROW, FRANCHISE

We expect that profitability will also remain sound despite declining trends with lower, albeit still strong, loan yields, owing to lower interest rates and increasing competition, and a higher cost base as a consequence of the company's broader financial services offering in certain markets. The pre-provision income-to-average assets ratio was 18.1% during 1H 2015, the net income-to-average assets ratio was 12.2% and the net interest margin was 20.1%. Despite ongoing investment, the cost-to-income ratio remained strong at 28%, supported by Letshego's low-cost business model and strategy.

Profitability is supported by Letshego's successful niche consumer finance franchise. The company is becoming increasingly diversified across geographies with operations in nine sub-Saharan African countries (including Botswana, Namibia, Mozambique, Tanzania). It has a strong niche franchise within Botswana (where it offers payroll loans to around 25% of all government employees) and Namibia (where it offers payroll loans to around 53% of all government employees), benefiting from a quick and efficient loan-approval and disbursement process. For 2014, operations in Botswana contributed 33% of revenue, Namibia 21%, Mozambique 17% (where Letshego offers payroll loans to around 18% of all government employees), Tanzania 7% (where it offers payroll loans to around 9% of all government employees) and Uganda 7% (where it offers payroll loans to around 10% of all government employees). None of the remaining markets contribute more than 5% of revenue, and Letshego generally exhibits a lower franchise sustainability given weaker brand name and market recognition compared to its more established markets like Botswana, Namibia and Mozambique.

RELIANCE ON WHOLESALE MARKET FUNDING, ALTHOUGH THE COMPANY HAS DIVERSIFIED AND BROADENED ITS FUNDING PROFILE

While we acknowledge that Letshego has diversified its funding structure, the company continues to rely primarily on wholesale funding to support its activities, which remains a rating constraint given that this type of funding is inherently confidence-sensitive and vulnerable to disruption.

We note positively that over the past two years Letshego has diversified its funding structure, and improved its liquidity and asset and liability maturity profile through (1) a Johannesburg Stock Exchange listed senior secured bond - denominated in South African rand (amounting to ZAR700 million: Botswana pula equivalent: BWP494 million), and (2) senior unsecured bonds amounting to BWP350 million (listed on the Botswana Stock Exchange), out of which BWP300 million had maturities of at least 10 years. As of June 2015, bond funding accounted for 44% of total borrowings, commercial bank funding for 40%, pension fund funding for 9% and DFI funding for 7%.

However, with the South African rand denominated bond maturing before the end of 2016, this has led to a reduction in its 24 month coverage ratio to around 24% as of December 2014. We use the above ratio to measure liquidity and it is calculated as the level of cash and committed, unsecured bank lines available as a percentage of debt maturating within the next 24 months. Maturing debt also requires Letshego to refinance a significant portion of its total funding. The company continues to broaden its funding profile by tapping an increasing number of local institutional investors and financial institutions, as well as development finance institutions. As mentioned above, the company also aims to gradually tap customer deposits, which has commenced in Mozambique, Rwanda and Tanzania, while Letshego will also likely acquire a deposit-taking micro finance bank in Nigeria, subject to all regulatory approvals.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, we have sourced data relating to system-wide trends and market shares from the central bank. Bank specific figures originate from banks' 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 document: "Financial Statement Adjustments in the Analysis of Financial Institutions" (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_182293) published on 15 June 2015.

RATING METHODOLOGY

The principal methodologies used in this rating were "Finance Company Global Rating Methodology", published in October 2015. 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 - as per the aforementioned methodology.

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						**Ba**		**Ba**
Factor: Profitability						**Aa/A**		**Aa/A**
- PPI / AMA	**20.76%**							
- Net Income / AMA	**14.84%**							
- Pre-tax Income Coefficient of Variation		**34.07%**						
Factor: Liquidity						**B**		**B**
- 24 Month Coverage Ratio					**23.90%**			
- Secured Debt / Gross Tangible Assets		**18.97%**						
Factor: Capital Adequacy						**Aa/A**		**Aa/A**
Capital Bucket: Traditional Finance Company								
- TCE / TMA	**61.57%**							
Factor: Asset Quality						**Baa**		**Baa**

- Problem Loans / Gross Loans		0.72%						
- Problem Loans / (Shareholders Equity + LLR)	0.97%							
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.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.