Stockbrokers Botswana Ltd.

# Letshego Holdings Limited

## Microlending

**BUY**

**P2.01** **USD 0.30**

February 8, 2011

### Trading & Liquidity

| | |
|---|---|
| Mkt cap (Pm) | 3,388 |
| Mkt cap (US$m) | 506 |
| DCI Mkt weight | 12.2% |
| Shares in issue (bn) | 1.84 |
| Free float | 38% |
| Annual Liquidity | 14.9% |
| 12 month high | 205 |
| 12 month low | 166 |

### Codes

| | |
|---|---|
| BSE | LETSHEGO |
| Reuters | LET.BT |
| Bloomberg | LETSHEGO BG |
| ISIN No | BW 0322 |

### Results

| | |
|---|---|
| Date of last report | October 19, 2009<br>P15.40 BUY |
| Last results | Interim - Oct 10 |
| Expected results | Final - Apr 11 |

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## Overview

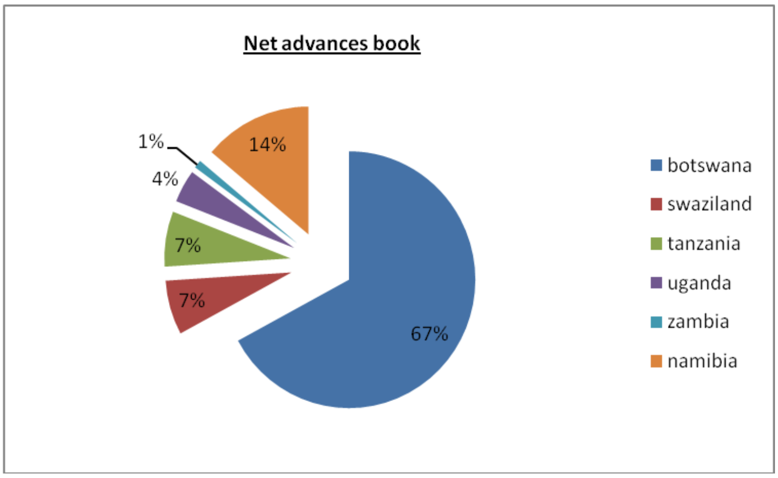
Letshego Holdings Limited remains one of the leading providers of unsecured consumer loans in the region. It has operations in Swaziland, Tanzania, Uganda, Zambia, Botswana, Namibia and Mozambique. The group's strategy is to continue to expand into other African markets that offer prospects for growth. These include Lesotho, Ghana, Kenya, Zimbabwe and Nigeria. The key factor about Letshego's business model that has seen it grow in leaps and bounds since its inception in 1998 has been its recoveries on a payroll deduction, with the primary market being civil servants.

## Sources of business

Over the past five years the group's strategy of expanding into numerous African markets through acquisition of existing businesses and entering green fields has borne fruit. Group revenue has grown steadily from P48m in 2005 to the current level of just under P1bn.

The Botswana operation continues to perform to expectations given the largest market share it currently has and the mature operating environment. Letshego Namibia's performance on the other hand has been phenomenal. Since this business was acquired in August 2008, the loan book has increased from P40m to P259m. Micro Provident Uganda also exhibits loan book and market share growth. This subsidiary has reached the critical mass required to turn profitable.

Other subsidiaries, namely, Swaziland, Tanzania and Zambia are struggling with growth.



## Sale of Legal Guard business

In January 2010 Letshego sold the entire issued share capital of its Legal Guard arm to Botswana Insurance Holdings Limited (BIHL). The move was done in order to aid Letshego to focus on the core business of lending operations as well as inject cash into the group. The sale price was P43m plus approximately P14m in settlement of loan accounts.

**The group sells Legal Guard arm in order to focus on core business**

The sale of Legal Guard, together with other cost reduction measures the group employed saw staff costs drop by 14.6% during the half year period ended July 31, 2010. This caused the cost-to-income ratio to decline by 19.9% (H109: 25.9%).

**A cut in headcount contributes to a lower staff costs**

## Competition

Of late we have seen many players enter the micro lending space. This has stiffened competition for Letshego. While most of these players do not follow the same collection model as Letshego, their presence still eats away at Letshego's market share. This is heightened by the fact that even competitors that initially did not use the payroll deduction model such as Blue Financial Services have since wised up and adopted this model.

**Letshego faces competition from new entrants**

Letshego's approval turnaround of half a day and disbursement within two days is its competitive edge. Its peers take up to a week to disburse funds.

## Impairments curtailed further

The quality of Letshego's loan book continues to be outstanding as evidenced by the group's impairment charge to loan book ratio of 0.8% for the half year ended July 31, 2010. This is an improvement from 1.2% during the previous comparable period. The reduction in delinquencies is mainly attributable to the improvement in collections in the Botswana operation which accounts for 67.1% of the total book. The impairment charge for Botswana fell to P1.4m (H109: P7.8m).

**Good loan book quality**

In comparison to the three listed banks, Letshego's impairments is amongst the lowest. This is due to Letshego's business model that uses the payroll deduction methodology ensuring reduced exposure to credit risk. The most common cause of impairments the company faces is usually due to staff turnover. When the borrower leaves the participating employer, it creates a challenge in terms of finding alternative arrangements for the loan repayments.

**Payroll deduction model reduces credit risk exposure**

| | **Impairments to Loans as at July 31, 2010** |
|---|---|
| Barclays | 1.9% |
| FNBB | 0.8% |
| Stanchart | 0.8% |
| **Letshego** | **0.8%** |

We believe the current charge to the loan book is sustainable and even still leaves room for improvement going forward. More and more of the countries in which Letshego operates in are introducing a central register. This ensures that loan affordability measures are followed. It also aids in the betterment of industry regulation as it helps in the administration and management of non-statutory deductions.

## Investment risks

**Regulation is the biggest risk with payroll model**

Without the payroll deduction model, Letshego faces high risk of loan collection and hence asset quality deterioration. A possible threat to this model is with regards to regulation. In the event that it gets discontinued, we are likely to see a significant increase in bad debts as was the case when South Africa discontinued the payroll deduction in 1998.

A case for the continuance of the payroll deduction model is that governments are aware of the low levels of banking penetration and difficulty in access to credit in the region, especially now after the credit crunch as commercial banks have tightened their credit assessment policies.

The worst case scenario would be for the regulators to place a ceiling on the cost of borrowing. Letshego is currently making good margins with their personal loans. The interest charged on these averages 36% per annum, which is 100 basis points higher than the average interest charged by commercial banks on personal loans.

## Financial leverage

**Debt-to-equity ratio curtailed to 23%**

On the liabilities side, long term borrowings have come down quite significantly with the debt-to-equity ratio currently at 23.1% (H109; 27.0%). This is laudable given that the ratio came off a high base of 97% as at year end to January 2009. Given that Letshego does not take deposits, access to funding is a crucial success factor for the group. The reduced gearing presents a platform for the company to leverage its balance sheet for further borrowing opportunities.

The group still has funds from the US$36m convertible note facility, which is currently 80% drawn. Should borrowings be increased, we do not anticipate the company to be as over-geared as was the case during the previous years.

## Sub-division of share and liquidity

**A 10 for 1 share split applied in April 2010**

In April 2010, Letshego took the decision to effect a 10 for 1 share split on its ordinary shares. The rationale behind this was to promote transferability and liquidity as well as facilitate the acquisition of the company's shares by small investors. Letshego shares had become unaffordable to retail investors due to the increase in demand without a simultaneous increase in supply.

**Shares outstanding increases to 1.84bn**

Before the sub-division, Letshego had 184,142,295 outstanding shares, which then increased by a factor of 10 to 1,841,422,950 post split. Invariably the then share price of P16.00 also went down by a factor of ten to P1.60.

### Effects of the subdivision

| PERIOD | ANNUAL LIQUIDITY FINANCIAL STOCKS (Letshego inclusive) | ANNUAL LIQUIDITY FINANCIAL STOCKS (Excluding Letshego) | ANNUAL LIQUIDITY LETSHEGO |
|---|---|---|---|
| Apr '07 - Mar '08 | 1.7% | 1.6% | 4.7% |
| Apr '08 - Mar'09 | 2.5% | 2.2% | 9.9% |
| Apr'09 - Mar '10 | 1.5% | 1.2% | 8.2% |
| Apr '10 - Jan '11 * | 4.8% | 0.9% | 14.9% |

* Annualised for a 10-month period.

As evident from the above table, there has been a notable improvement in liquidity since the share split was applied in April 2010. The average annual liquidity for the financial stocks for the 12-month period between April 2010 and January 2011 with Letshego included in the composite stands at 4.8%, up from 1.5% pre-split. When we remove Letshego from the composite in order to better appreciate the impact of the split, the annual liquidity for the same period stands at 0.9%, down from 1.2% pre-split.

**Sub-division of shares improves liquidity by 6.7 percentage points**

Currently Letshego leads as the most liquid stock on the BSE, accounting for over 85.2% of all shares traded.

## Outlook

We still hold an optimistic view on the long term benefits of the African markets. Most of the markets in which Letshego operates in have not yet been fully tapped into. Letshego Swaziland has since introduced the Central Registry and completed licensing with the Central Bank, and lending has recommenced. Letshego Tanzania experienced problems with administrative requirements that were put in place by the Central Government and District Authorities. These have also been addressed and we believe, going forward a growth in the loan book will be realized by these markets.

**Good prospects for growth in other countries**

However, we believe that prospects for further volume growth on the Botswana market are approaching their ceiling. The group will have to continue working on finding new ways of transforming the company into a broader based financial services provider in order to further augment their income streams.

**Botswana nearing ex-growth**

## Valuation and recommendation

Relative valuation for Letshego remains a difficult task as there is still no bona fide listed micro lending peer. Letshego is currently trading on a trailing PER of 9.0 times, a discount of 17.4% to the DCI average of 10.9 times. Historically, Letshego has traded at a discount of 20-22% to the DCI. The counter then got relatively expensive during the last 2 years trading at a premium of up to 27% to the market. At the current price, Letshego is trading in line with historic averages. While we realize that the counter may have had its run and unlikely to reach the levels it reached 2 years ago, we believe there is still potential for an upside.

**Upside potential exists for the Letshego**

We derive a dividend discount valuation of P2.01 per share and a discounted cash flow valuation of P2.77. We target P2.01 as fair value. This represents an upside potential of 8.6% to the current trading price of P1.85. **BUY**

**Valued at P2.01 per share**

## Financial Statements

| Income Statement (Pm) | 2009 | 2010 | % change | 2011 (F) | % change |
|---|---|---|---|---|---|
| Interest Income | 398.3 | 588.8 | 48% | 796.1 | 35% |
| Financing costs | 72.2 | 50.9 | -30% | 83.1 | 63% |
| **Net Interest Income** | **326.1** | **537.9** | **65%** | **713.0** | **33%** |
| Other operating income | 92.5 | 165.3 | 79% | 286.7 | 73% |
| Total operating costs | 100.5 | 147.8 | 47% | 209.4 | 42% |
| **EBIT before provisions** | **318.1** | **555.4** | **75%** | **790.3** | **42%** |
| Provisions | 29.4 | 50.2 | 71% | 38.3 | -24% |
| **Pretax profit** | **288.7** | **505.2** | **75%** | **752.0** | **49%** |
| Taxation | 69.6 | 125.2 | 80% | 186.4 | 49% |
| **Profit after tax** | **219.1** | **380.0** | **73%** | **565.6** | **49%** |

| Balance Sheet (Pm) | 2009 | 2010 | % change | 2011 (F) | % change |
|---|---|---|---|---|---|
| Shareholders' funds | 671.5 | 1,369.3 | 104% | 1,746.4 | 28% |
| Interest bearing debt | 644.4 | 377.6 | -41% | 694.1 | 84% |
| Current liabilities | 85.2 | 168.5 | 98% | 231.8 | 38% |
| **Total funds employed** | **1,401.1** | **1,915.4** | **37%** | **2,672.3** | **40%** |
| Net advances | 1,319.3 | 1,651.6 | 25% | 2,232.7 | 35% |
| Other assets | 81.8 | 263.8 | 222% | 439.6 | 67% |
| **Total assets employed** | **1,401.1** | **1,915.4** | **37%** | **2,672.3** | **40%** |

| Key ratios | 2009 | 2010 | 2011 (F) |
|---|---|---|---|
| Earnings per share (t) | 144.6 | 20.6 | 30.7 |
| Dividend per share (t) | 36.1 | 3.0 | 10.2 |
| Dividend yield (%) | 15.4 | 1.3 | 4.4 |
| NAV per share (t) | 443.1 | 74.4 | 94.8 |
| Earnings growth (%) | 62 | 73 | 49 |
| Return on ave assets (%) | 20 | 23 | 26 |
| Return on ave equity (%) | 39 | 37 | 36 |
| ROCE (%) | 18 | 22 | 23 |
| Growth in loan book (%) | 67 | 25 | 35 |