Stockbrokers Botswana | Research

Stockbrokers Botswana Ltd.

Letshego

Financial Services Sector

Final Results

Letshego's pre-tax profit for the year ended 31 October 2006 came in at P138.7m, almost spot on the P138.9m we forecast in our last report. After-tax profit for the Group was P106.7m, P7.2m lower than the P113.9m we had forecast due to a larger tax charge than we had estimated. The difference in the tax charge came about as a result of the withholding tax on the special dividend declared in 2005 offsetting the additional company tax payable by the Company in that year. There was no special dividend to offset the additional company tax in 2006

The African expansion plan is well under way with operations in Swaziland, Tanzania, and Uganda opened in 2006. All is going according to plan with Swaziland and Tanzania performing as expected. Penetration into Uganda has been slower than had been anticipated due to the competitive nature of the market.

Due to the expansion, costs came under pressure as staff costs and other operating costs increased to P21.0m (up 46%) and P21.8m (up 91%) respectively producing a cost-to-income ratio of 23% (FY05: 18%). In all, the Group recorded bottom line growth of 12%. Letshego Guard contributed P7.8m to earnings.

Letshego changed its financial year end from 31 October to 31 January and the financials for 2007 will be for a fifteen month period. These results will be a realistic base from which to forecast earnings.

We derive DCF and DDM valuations of 1370t and 175t and target 1300t as fair value. The counter is trading on a 23% discount to our target fair value. Accordingly, we recommend the stock as a BUY to 1300t.

Key Financials

Year ended October (P)	2005	2006	2007F
Net interest income (m)	128	158	186
Growth	26%	24%	17%
Earnings per share	0.63	0.71	0.82
P/E Ratio (x)	15.0	13.4	12.9
Earnings growth	50%	12%	16%
Dividend per share	0.16	0.18	0.21
Dividend yield	1.4%	1.6%	1.7%
Net Asset Value	1.61	2.16	2.82
P / NAV (x)	5.9	4.4	3.7
Return on Equity	47%	38%	33%
Return on Assets	35%	28%	24%
Cost / income ratio	18%	23%	23%
Total Gearing	29%	30%	35%
Impairments & write offs as a % of advances	0.9%	2.3%	6.2%
Growth in advances	44%	34%	40%

Buy

P10.55 **USD 1.71**

April 13, 2006

Trading & Liquidity

Mkt cap (Pm)	1,593
Mkt cap (US$m)	258
DCI Mkt weight	5.3%
Shares in issue (m)	151
Free float	100%
Annual Liquidity	10.4%
12 month high	1055
12 month low	430

Codes

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

Results

Date of last report	March 2, 2006
	P4.15 BUY
Last results	Finals - Jan 07
Expected results	Interims - Oct 07

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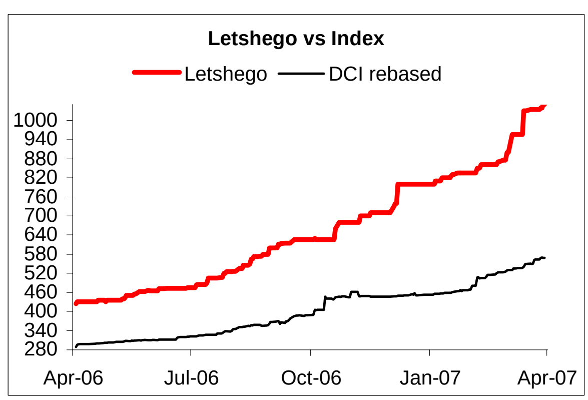


Income statement

For FY06, interest income grew 26% to P170.3m (FY05: P134.7m) driven mainly by growth in the Botswana and Swaziland loan book. The Botswana loan book growth was attributable to a combination of a lower average interest rate charged on loans, aggressive marketing, and market segmentation. Interest expense increased 70% to P12m (FY05: P7m) but the interest margin remained flat at about 94%. Net interest income was up 24% to P158.3m (FY05: P127.7m).

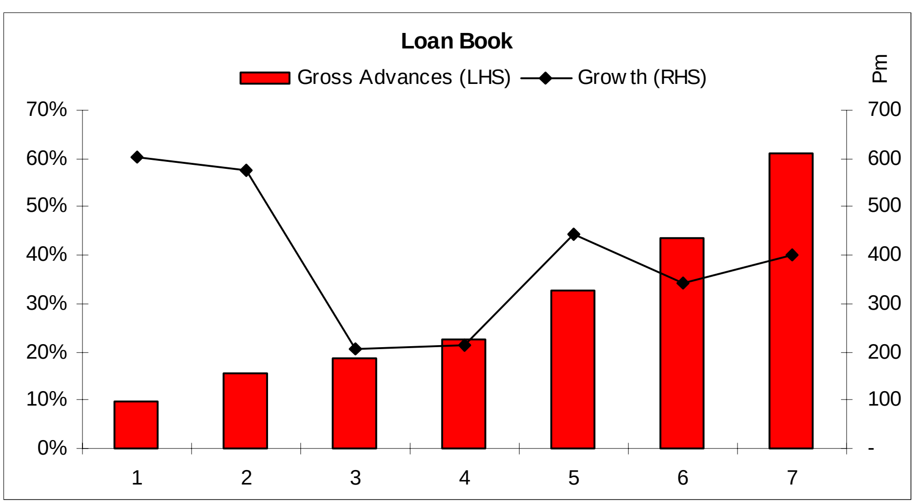
Fee and commission income recorded spectacular growth as it more than doubled to P22.7m (FY05: P11.0m). Other operating income also doubled growing to P4.3m (FY05: P2.0m). The bulk of fee and commission income reflects joining fees for the Legal Guard insurance product, arrangement fees from the executive loan product, and commission and administration fees from credit life insurance as well as service fees from the Swaziland, Tanzania and Uganda operations. Other operating income mainly comprised of profit share from Legal Guard with the underwriter Regent.

Letshego Guard division contributed earnings of P7.8m, an increase of 192% from the previous year. Relationships with attorneys and the claims process for the Legal Guard product are managed by Letshego with Regent paying them an administrative fee. Letshego also earns a commission on every premium it passes on to Regent. There are about 37000 (FY05: 31000) Letshego Legal Guard customers and the policy retention for the division is about 98%.

Staff costs escalation was 46%, an improvement on the 75% increase for the previous year, to P21.0m (FY05: P14.4m). Of the increase P1.3m came from the new operations in Swaziland, Uganda, and Tanzania while P7.8m was attributable to Botswana. The Staff costs also included P4.9m for share awards granted to key staff under the Group's long term incentive plan.

Other operating costs increased 91% to P21.8m (FY05: P11.4m) with some of the big increases being in payroll administration costs, which ballooned 727% to P2.0m (FY05: P0.2m) and other operating expenses up P6.1m to P14.4m (FY05: P8.3m) from a jump of P2.6m in the Botswana component and a P2.7m contribution from the other countries.

After tax profit was up 12% to P106.7m (FY05: P95.2m), producing an EPS of 71.0t (versus our forecast of 76.0t). Dividend cover of 4.0x was retained with a final dividend per share of 10.0t.



Tanzania

Operations in Tanzania, trading under the name Faidika, kicked off to a slow start with the country contributing a loss of P1.1m for the few months it had been in operation. Post results period demand for loans has accelerated as the marketing rollout in the country reaches consumers. About 30% of the population is Muslim and paying interest is not allowed in the religion. Tanzania is also transitioning from socialist rule and the concept of taking credit versus saving for later consumption is still fairly new.

The level of competition is low, mainly from commercial banks, co-operative lending, and two micro lending companies: Blue Financial Services and BayPort Financial Services. Only 10% of the Company's employees are based in Dar es Salaam and the rest are an active sales force spread through out Tanzania. The Group's management anticipate that the operation will become profitable in 2007. At the moment the average loan size paid out is P4k and maximum repayment period being offered is 36 months.

Uganda

Uganda has a developed and competitive market for micro lending. We noted in our last report that due to the prevailing saturation of the market expectations for the Uganda operation's performance should be moderate. Uganda contributed a loss of P1.6m to the reported earnings and management indicate that profitability in Uganda may not be achieved in 2007. On a positive note business has picked up post results with the loan payout in November 2006 being twice what it had been for the previous 3 months combined. The average loan size paid out is P4k and the maximum repayment period being offered is 24 months.

Swaziland

The Swaziland operation, performed better than expected having achieved profitability in the first year of operation. The operation managed to contribute a pre tax profit of P0.53m to earnings. Letshego is the second biggest micro lender after SMS in Swaziland. A new entrant, Real People, has also entered the market and competition between these three will only intensify. As we noted in our last report Swaziland has similar demographics to Botswana and will be most amenable to copying the Botswana model. The average loan size is P10k and the maximum repayment period being offered is 36 months.

Zambia

The Zambia operation has not commenced operation and is expected to begin till about mid 2007. Zambian banking regulations prohibit Government employees' salary deductions from exceeding 50% of net take home pay. Deduction codes are decentralised with each Ministry responsible for implementing the deduction scheme and making payment. In a fairly competitive market, the biggest player is Microfin Africa Ltd, a division of ABC Zambia with a loan book of approximately US$12m. Other key players include Pride Zambia and BayPort Financial Services. The comparably high interest rate environment in Zambia should provide the Group some scope to manoeuvre for competitive positioning.

The Company has decided to delay entering Malawi, the other country where it had planned to start operations.

Outlook

Potential to apply Botswana model to a significantly larger client base

We still hold the optimistic view on the long-term benefits of the African expansion from our last report. So far every thing has been going according to plan, and management has indicated acceleration in customer walk-ins and new advances post results release as Group operations become familiar and accepted in the new markets it has entered.

The group also continues to find new ways to generate growth in seemingly tight markets. The decision to open satellite branches throughout Botswana has been a success with daily queues that extend outside the building reported at one of the branches. There is also the opportunity for the Group to introduce add-on financial services products such as legal insurance once management develops a firmer grasp of legal systems in the new markets it has entered.

For FY07, we still maintain our forecast for accelerating growth from our last report. We expect the growth to be tempered by the set up costs for Zambia and slow penetration of the market in Uganda. The rollout of the branch network in Botswana, a 6% civil service wage increase and an expected drop in interest rates should keep revenue growth for Botswana at 2006 levels. For the Group, we forecast EPS of 82t per share (up 16%). We expect growth to accelerate in 2007 as the Group model establishes momentum in the new markets.

Valuation

Relative valuation of the counter is a difficult task given the multiple revenue streams from various countries with their own unique conditions and the lack of a bona fide listed peer on the domestic bourse. Accordingly, we have adopted a sum of the parts approach in valuing Letshego which allows us to reflect the different conditions such as growth potential in the different markets Letshego operates in. This is carried out for the markets where enough information is available to make reasonable valuations. At this stage no valuation was carried out for Zambia, which is expected to commence operation in mid 2007.

We had previously raised our risk premium to 12% as we incorporated the regional expansion projects into our forward assumptions and the inherent risks that go with it such as bad debts, political risks and competition. For the DCF and DDM we use a discount rate of 22% (10% risk free-rate) to derive 1370t and 175t respectively. We target 1300t as fair value.

Buy to 1300t.

Letshego

Financial Services Sector

Final Results

13 April 2007

Stockbrokers Botswana Ltd.

Financials

Year to October (Pm)	2005	2006	% ch	2007F	% ch
Income Statement					
Interest income	135.0	170.4	*26%*	202.4	*19%*
Financing costs	(7.3)	(12.0)	*64%*	(16.4)	*36%*
Net interest income	127.7	**158.4**	***24%***	**186.1**	***17%***
Other operating income	13.0	27.0	*107%*	28.5	*6%*
Total operating costs	(25.8)	(43.4)	*68%*	(49.0)	*13%*
EBIT before provisions	114.9	142.0	***24%***	**165.6**	***17%***
Provisions	5.2	(3.3)	*-163%*	(7.1)	*117%*
Pre-tax profit	120.0	**138.7**	***16%***	**158.5**	***14%***
Taxation	(24.8)	(32.1)	*29%*	(34.4)	*7%*
Profit after tax	95.2	106.7	***12%***	**124.1**	***16%***
Balance Sheet					
Shareholder's Funds	241.7	323.6	*34%*	426.1	*32%*
Interest Bearing Debt	69.0	97.9	*42%*	147.2	*50%*
Current Liabilities	17.4	23.5	*35%*	25.4	*8%*
Total Funds Employed	**213.9**	**328.0**	***53%***	**445.0**	*36%*
Net Advances	318.0	430.5	*35%*	581.8	*35%*
Other Assets	9.9	12.8	*30%*	15.9	*23%*
Total Assets Employed	**213.9**	**328.0**	**53%**	**445.0**	*36%*
Free Cash Flow					
Taxed EBIT after non cash adjust	95.2	106.7	*12%*	170.0	*59%*
Change in WC & funding	8.1	(7.7)	*-196%*	(19.4)	*151%*
Free Cash Flow	**103.9**	**99.4**	***-4%***	**150.6**	***51%***
Key Ratios					
Earnings per share (t)	63.5	71.1		82.1	
Dividend per share (t)	16.0	18.0		20.8	
NAV per share (t)	161.1	215.7		281.8	
Earnings growth	50.3%	12.0%		16.4%	
Gross finance margin	94.6%	93.0%		91.9%	
Earnings margin	67.7%	57.5%		57.8%	
Net Gearing	28.6%	30.3%		34.5%	
Return on ave assets	35.1%	27.6%		23.8%	
Return on ave equity	46.9%	37.7%		33.1%	
ROCE	31.7%	26.3%		22.3%	
Cost / income ratio	18.4%	23.4%		22.8%	
Provisions & write-offs as a % of advances	0.9%	2.3%		6.2%	
Growth in advances	44.4%	34.1%		40.0%	

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