Stockbrokers Botswana Ltd.

Letshego Holdings Limited

Microlending

BUY

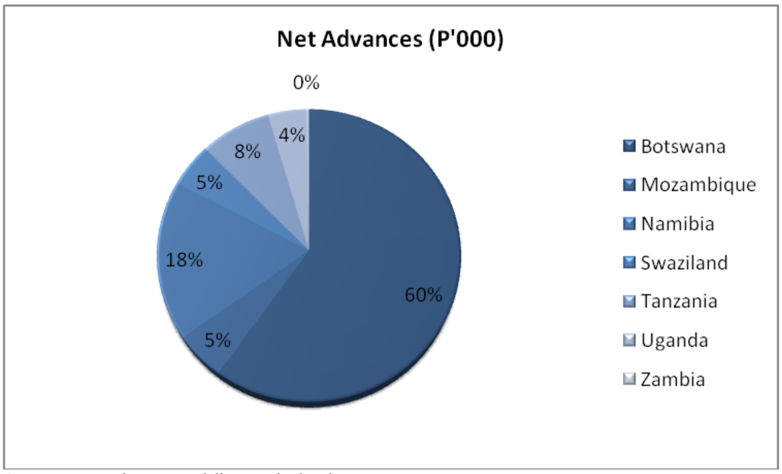
P1.93 **USD 0.25**

June 25, 2012

Financial Results Overview

Letshego Holdings Limited has released a good set of results for the year to January 31, 2012 despite the challenging operating environment. The year under review was characterised by regulatory uncertainty pertaining to the Botswana operation which is the Group's lifeline. The Government of Botswana had previously announced its intention to cease facilitating the deduction of Letshego's loan repayments from source with effect from December 2011. Worthy of note as well, is the industrial action that was undertaken by employees of the Government of Botswana which spun over two months.

Despite these complexities, the Group was able to grow its loan book to P3.0bn, a 32.0% increase from the previous year. Invariably, interest income tracked the loan book growth, registering a 24.7% increase to P900.5m. The Botswana operation continues to be the most significant market for the Group, contributing 59.9% to total net advances. Mozambique's performance surpassed our expectations, considering that it is still in start-up phase. It posted net advances of P159.1m (FY11: P 0.79m). The quality of the loan book remains healthy with an impairment charge of P44.1m (FY11: P39.0m). This represents 1.5% of the book. Low impairments, guaranteed by the effective Central Registry loan repayment system are Letshego's key competitive strength.



Source: Letshego Holdings Limited

The Mozambican start-up cost, coupled with the once-off legal and related costs associated with the establishment of Letshego's MTN programme saw operating costs rise significantly to P235.6m from P157.5m. This translates into a cost-to-income ratio of 23.8% (FY11: 19.1%). Notwithstanding the incremental expenditure during the period, the company posted a pretax profit of P711.2m, up by 13.5% from last year.

Trading & Liquidity

Mkt cap (Pm)	2,779
Mkt cap (US$m)	357
DCI Mkt weight	8.2%
Shares in issue (m)	1.997
Free float	100%
Annual Liquidity	14.9%
12 month high	184
12 month low	135

Codes

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

Results

Date of last report	February 8, 2011 P2.01 BUY
Last results	Final – Apr 12
Expected results	Interim - Oct 12

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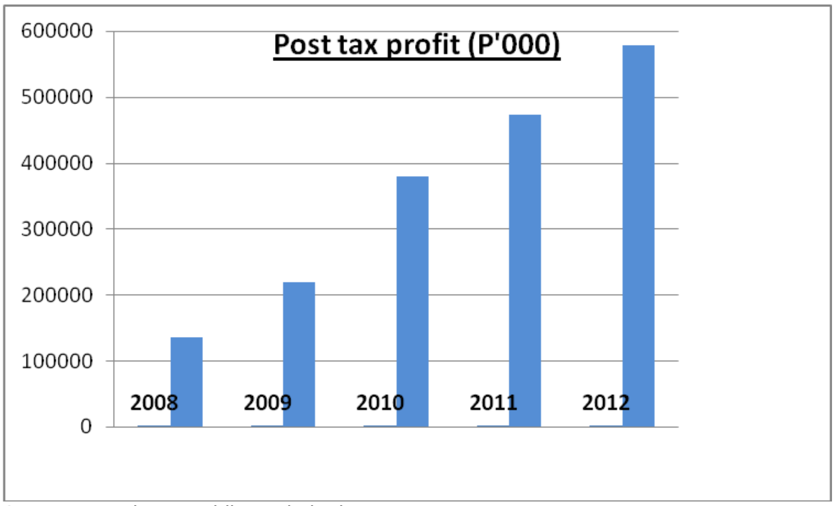
Cost-to-income ratio of 23.8% (FY11: 19.1%)

Profit after tax up by 22.1%

During the year, the company issued a scrip dividend amounting to P274m to shareholders on a basis of 7 new shares for every 100 shares held. This was done in order to optimally make use of the additional company tax reserves. The effect was a positive contribution to the bottom line due to the resultant credit to the company's tax charge. Post tax profit rose by 22.1% to P577.8m.



Sources: Letshego Holdings Limited

Debt to total asset ratio of 0.25

Letshego is well capitalized with shareholders' equity of P2.2bn. As at January 31, 2012, the Group's leverage ratio as measured by total assets to equity, was at 1.4 times compared with a weighted average for the Botswana banking sector of 9.1 times. Borrowings stood at P802.9m, producing a debt to total assets ratio of 0.25 (FY11: 0.21). Letshego funds itself through medium term loans from banks and other financial institutions. To safeguard against access to funding hampering the company's growth, management is exploring alternatives including the bond market as well as converting the company into a commercial bank that could take deposits.

Capital Raising Initiatives

Letshego to start taking deposits

Plans to transform Letshego's business model from just lending operations to being a fully fledged commercial bank are underway. An application for a banking license was submitted to the Central Bank of Namibia in December 2011. We expect that the company will do the same in its other markets. As already alluded to, this will aid in enhancing the company's capital for its future expansion plans.

MTN program listed on the JSE

Another initiative that we believe places Letshego in a good position in so far as funding is concerned has been the successful listing of a Medium Term Notes (MTN) program on the Johannesburg Stock Exchange in July 2011.

Rated Ba3 – negative by Moody's

A vital plus, is that Letshego is globally rated. Moody's Investors Services had previously assigned the company a credit rating of Ba3, with a 'stable' outlook. This was however tarnished to 'negative' following the announcement by the Government of Botswana of their intention to cease aiding in source collections. Given that the Government has since gone back on their decision, we expect an improved rating in the future.

African Expansion Plan – Acquisitions

Letshego to acquire a 62.52% interest in MAL

In line with its Pan African expansion plans, Letshego Group is in the process of acquiring a 62.52% stake in the issued share capital of Micro Africa Limited (MAL), for a consideration of $3.3 million. This is being funded from existing resources. MAL is a private company incorporated in Kenya with subsidiaries in Rwanda, South Sudan, Uganda and an associated company in Tanzania.

MAL's loan book stood at $7.2m, with net assets amounting to $3.9m as at December 31, 2011. MAL has a similar business model as that of Letshego, so integrating it will not pose a problem.

Acquisition to enhance existing product offering

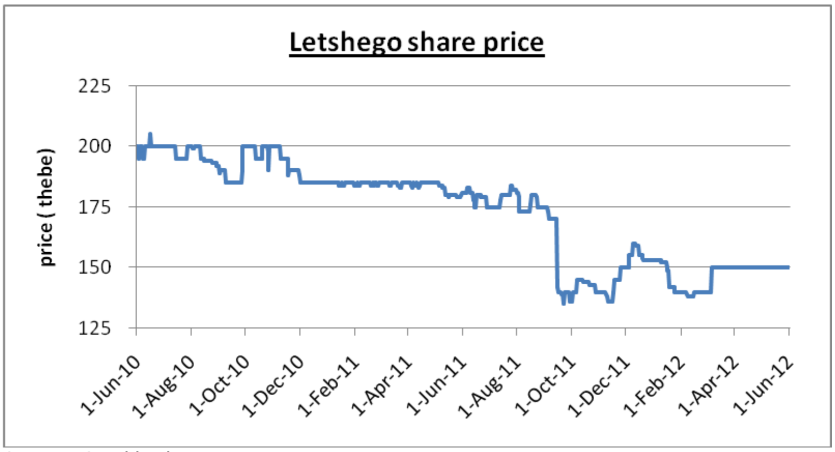
We expect the acquisition, once complete, to drive growth both in the short and long term. The acquisition will elevate Letshego's existing product offer to a new dimension because MAL will bring on board, innovative products including mobile banking technology and over the counter cash handling for loan transactions.

The group continues to evaluate new expansion opportunities into other African markets, either through further acquisitions or green fields.

Regulation

Collection methodology threatened

We reiterate that Letshego's biggest weakness with regards to its business model has been its collection methodology. This became apparent last year when the Government of Botswana announced that it would cease facilitating the deduction of loan repayments from source with effect from December 2011. The announcement created a lot of uncertainty and panic amongst investors, resulting in the share price of the company plummeting by 25% between September 1, 2011 and March 1, 2012.



Source: Stockbrokers Botswana

Alternative collection measures put in place

Without the payroll deduction model, Letshego faces the risk of loan collection and hence asset quality deterioration. Although the Group is still using the deduction at source, measures have been put in place for alternative deduction methodologies. Direct debit mandates with various banks have already been signed by all clients. As it stands, the Government of Botswana is awaiting the outcome of the ongoing court case between itself and the unions.

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The Non-Bank Financial Institution Regulatory Authority (NBFIRA), a regulatory body in Botswana, is now in full swing. This is a welcome development on Letshego's part as it will aid in levelling the playing field with regards to the Central Registry. This will ensure that all players adhere to the stipulated minimum take home amount for clients.

NBFIRA to ensure compliance

NBFIRA generates income through the levies they charge the companies they are regulating. An annual fee of 0.5% of Letshego Botswana's loan book has been effected starting February 17, 2012.

NBFIRA charges micro lenders an annual fee of 0.5% of loan book

Outlook

We are of the view that the Botswana market, which has been the Group's significant market over the years, is now reaching maturity and we expect growth to slow down going forward. This will be worsened by intensifying competition, with new entrants such as Bayport Financial Services.

Botswana operation reaching maturity

We however, still hold the optimistic view on the long term benefits of the African expansion from our last report. Management has indicated acceleration in extending the Group's footprint as well as utilizing the existing staff compliment, branch network and technology platform to drive efficiencies and new opportunities.

Growth to come from African expansion

Key Performance Indicators	2012
Return On Average Equity (RoAE)	28.7%
Return on Average Assets (RoAA)	20.5%
Cost/Income Ratio	23.8%
Dividend Yield	1.6%
PE Ratio	4.8x

Valuation and Recommendation

Given that Letshego does not have any concrete listed peers on the domestic bourse, we have conducted a relative valuation to the domestic listed commercial banks. At the current price of P1.40, the counter is trading on a historic PER of 4.8 times versus the banking sector weighted average of 10.5 times.

Low PER

Peer Stock	PER(H)
ABCH	8.5
Barclays	11.6
FNBB	12.2
Stanchart	8.5
Letshego	**4.8**
Weighted average	**10.5**
Premium (Discount) to weighted average	(54%)

For the DDM model, we have increased our discount rate to 17.5%, reflective of the looming regulatory uncertainty. We derive a DDM valuation of P1.93. This presents an upside potential of 37.9% to the current trading price of P1.40. **BUY**

Fair value of P1.93