LETSHEGO HOLDINGS

9 September 2019

SUB-SAHARAN AFRICA FINANCIALS

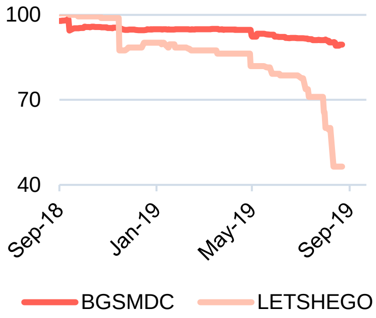
Issuer-sponsored research

Price	0.85
Target price	**2.00**
Expected share price return	135%
Expected dividend yield	10.7%
Expected total return	**146%**
Market cap (BWPmn)	1,822
Market cap (US$mn)	166
Avg. daily volume (US$mn)	1

Market performance in BWP

YTD return (%)	-46.1%
3-month return (%)	-42.9%
1-yr return (%)	-50.6%

Share price performance



Contact:

Nkemdilim Nwadialor
+2348181639134
nkemdilim.nwadialor@tellimer.com
Rahul Shah
rahul.shah@tellimer.com
Ayodeji Dawodu

Lower funding costs should support margin stability over the medium term

- **Letshego reported H1 19 net attributable profit of BWP328mn,** down 1% yoy, which is line with its trading statement forecast. Higher operating expenses, increased loan impairment charges and a higher effective tax rate (up by 2.2ppts to 39.6%) drove the decrease in profits.
- **Letshego has several key executive vacancies, including the CEO, COO, CFO and CRO roles.** During its earnings call, it announced that the recruitment process for these roles has advanced considerably and should be concluded by Q4. Dumisani Ndebele serves as Interim CEO.
- **Update on board composition.** The company also announced on the earnings call that four new Independent Non-Executive Directors (INEDs) will join the Board, subject to NBFIRA approval. The new INEDs (whose names were not revealed, due to regulatory constraints) are specialists in the fields of fintech, financial services and risk management.
- **Strategy update.** The group remains committed to strengthening its risk management, increasing cost efficiencies, improving asset quality and reducing the effective tax rate in H2. Letshego has no appetite for new acquisitions and hinted at discontinuing services that are unprofitable.
- **Changes to forecasts.** After incorporating FY 18 and H1 19 figures into our models, we have lowered our loan growth forecast (down by c5% in 2021 and 2022) due to management's emphasis on asset quality over asset growth. Falling interest rates in Botswana, Mozambique, Nigeria and Ghana necessitated a downward review of our asset yield forecasts (-3ppts in 2020 and -5ppts in 2022). We also forecast higher deposit growth (up by 10% yoy in 2020 and 2021) as Letshego attracts more retail deposits, which should support lower funding costs over the medium term.
- **Valuation.** Using a dividend discount model, we assume a 17% cost of equity and a 6% terminal growth rate; our mid-cycle ROTE estimate is 17%.

Letshego	PE	PB	ROE	DY
2019f	2.8	0.5	17.2%	10.7%
2020f	2.5	0.4	17.4%	12.2%

- **Risks to our valuation.** *Downside:* A faster-than-expected deterioration in asset quality; and/or lower-than-expected deposit growth (which could result in higher cost of funds). *Upside:* Quicker-than-expected growth in fee income from the diversification of non-funded income-generating activities.

This report has been commissioned by Letshego Holdings and independently prepared and issued by Tellimer for publication. All information used in the publication of this report has been compiled from information provided to us by Letshego and publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Tellimer at the time of publication. The sponsor has had no editorial input into the content of the note, and Tellimer's fees are not contingent on the sponsor's approval of the research.

Results commentary

- **Letshego reported H1 19 net attributable profit of BWP328mn,** down by 1% yoy but in line with its trading-statement forecast. The decrease in profits was a result of higher operating expenses and loan impairment charges, which offset the improvement in total operating income. Also, net interest income rose by 5% yoy, driven by 12% yoy growth in loans. The group's cost/income ratio increased by 1.6ppts to 41.2% in light of a 10% rise in operating expenses and the effective tax rate rose by 2.2ppts to 39%, which led to a 2% yoy dip in PAT.
- **Borrowings and accounting treatment pressure margins.** The net interest income/total assets ratio contracted due to a sharp rise in cost of funds, on the back of changes to Letshego's accounting treatment of its informal loans. Although the company does not bear the full credit risk on these loans, it is required to show the full effect interest expense of these assets. As the company shifts its focus to retail deposits going forward (30% deposits in H1 19), we expect to see a moderation in the cost of funds over the medium term.
- **Asset quality continues to deteriorate.** The group's NPL ratio inched up by 20bps to 7.3% against end-18. Management highlighted that asset quality will be a focus going forward, particularly for Ghana (c50% of its loan book is informal), which was a significant contributor to the weakness in asset quality. However, the three largest markets (Botswana, Namibia and Mozambique) which account for 65% of the loan book, have much better NPL ratios, at c5%.
- **Improved credit risk costs and provisions coverage.** The credit impairment charge rose by 8% yoy, and the cost of risk improved by 10bps yoy to 2.5%. Provisions coverage rose to 109% from 95% in H1 18.

Table 1: Cost of impairment

	FY 15	FY 16	FY 17	HY 18	HY 19
Formal	2.1%	2.3%	1.8%	2.2%	1.4%
MSE	4.3%	7.7%	10.4%	3.3%	3.2%
Informal				13.0%	20.2%
Group	2.3%	2.8%	3.1%	2.6%	2.5%

Source: Company presentation

- **Cost/income ratio came in higher, at 41.2%** (versus 39.6% in H1 18), as a 6% yoy increase in operating income was offset by a 10% increase in operating expenses (driven by a 21% increase in general and admin expenses).
- **Dividend payout ratio halved to 25%.** Management citied liquidity constraints (cash balances dropped by 47%, attributable to deposits coming off) as well prudent management of debt/equity levels. However, due to the recent share price reduction, the dividend yield came in at 8% (down from 14% in H1 18). Management, though, noted that this policy could be reviewed soon.
- **The group maintained ample capital levels, with a capital adequacy ratio of 38%** and a debt/equity ratio of 110%. The group will have to comply with new capital requirements in Mozambique (to be phased over 2018-20), Nigeria (effective April 2020) and Tanzania. Management expects the capital ratio to remain in the 30-35% range over the next few years.
- **Letshego has diversified its funding base** by introducing new funding lines and extending the tenure of existing debt instruments over the past two years. However, there is an upcoming debt instrument maturity of BWP1,440mn (30% of total borrowings) between 2020 and 2021, which could hinder Letshego's liquidity in the medium term.
- **Management has hinted at an in-depth tax review** in Botswana, Mozambique, Namibia and Tanzania. On the back of this, Letshego expects the full-year effective tax rate to trend lower to c40% (39.6% in H1 19).

- **Net loan growth supported by Ghana.** Group net loans grew by 12% yoy (16% in local currency). On a segment basis, Ghana (which accounts for 10% of loan book) had the most impressive growth – up by 54% yoy. This growth was mostly from informal loans, which rose from 26% to 50% of Ghana's loan book. Similarly, Eswatini, Uganda and Mozambique, jointly accounting for 25% of loan book, recorded loan growth within the 18-24% yoy range. These loans were driven by formal "deduction at source" loans to civil servants, which account for c90% of their joint loan book.

Table 2: Loan book analysis

				Breakdown of H1 19 loan book		
	H1 18	**FY 18**	**H1 19**	**Deduction at source**	**MSE**	**Informal**
Botswana	29%	28%	28%	99%	1%	-
Kenya	8%	8%	6%	25%	75%	-
Lesotho	5%	4%	4%	100%	-	-
Mozambique	14%	14%	15%	100%	-	-
Namibia	23%	20%	22%	100%	-	-
Nigeria	1%	1%	1%	60%	40%	-
Rwanda	0%	1%	0%	3%	97%	-
Eswatini	5%	5%	5%	100%	-	-
Tanzania	6%	6%	4%	68%	32%	-
Uganda	4%	4%	4%	64%	36%	-
Ghana	7%	11%	9%	52%	1%	47%
Total	**8,022**	**9,541**	**9,116**	**87%**	**9%**	**4%**

Source: Company presentation

- **Deposits, on the other hand, contracted by 21% yoy,** as Letshego is shifting from its traditionally large corporate deposits into retail deposits (currently, 30% of deposits). We see potential for lower funding costs as a result of this shift into retail deposits.

Table 3: Letshego H1 19 results summary

BWPmn	**H1 18**		**yoy**	**H1 19**
Income statement				
Net interest income	991	2,064	5%	1,037
Total operating income	1,156	2,362	6%	1,220
Operating expenses	458	980	10%	503
Pre-provision profit	698	1,382	3%	717
Loan impairment charge	108	361	8%	117
Net profit	370	510	-2%	364
Profit attributable to shareholders	331	439	-1%	328
Balance sheet				
Net loans	8,136	8,699	12%	9,116
Deposits	387	498	-21%	306
Total assets	9,759	10,656	7%	10,394
Ratios				
Net interest income margin	21.18%	21.04%		19.70%
Cost/income ratio	39.6%	41.5%		41.2%
Cost of credit risk	2.47%	3.79%		2.33%
NPLs/loans	7.03%	7.10%		7.30%
Provision coverage	101%	124%		126%
ROTE	17.0%	11.4%		16.9%
ROA	7.08%	4.47%		6.23%

Source: Company financials, Tellimer Research

Valuation

Key assumptions

Relative to the peer group, the shares trade at a 119% PE discount and a 147% PB discount. We believe market pricing, which recently tanked, is reflective of investors' concerns around the management changes. We think that a 17% cost of equity and a 6% terminal growth rate is appropriate given the business's geographical mix. Our mid-cycle ROTE estimate is 17%.

Table 3: Peer comparison

Company	Ticker	Country	Mkt cap (US$mn)	ADV (US$ 000s)	2019 PE	2019 PB	2019 ROE	2019 DY
Letshego Holdings	LETSHEGO BG	Botswana	166	1	2.8	0.5	17.2	11%
Tellimer frontier peers								
BRAC Bank	BRAC BD	Bangladesh	841	885	11.3	1.71	16.3%	0.0%
Credit Agricole	CIEB EY	Egypt	849	475	6.9	2.04	31.4%	9.4%
Equity Group	EQBNK KN	Kenya	1,386	866	6.2	1.22	21.2%	5.8%
Zenith Bank	ZENITH NL	Nigeria	1,501	1,761	3.0	0.61	20.9%	17.3%
Bank Alfalah	BAFL PA	Pakistan	448	361	5.1	0.80	16.6%	7.6%
Hatton National	HNB SL	Sri Lanka	440	167	7.2	0.61	8.3%	4.9%
Tellimer frontier comps median			**841**	**475**	**6.2**	**1.1**	**16.6%**	**4.9%**

Source: Tellimer Research

Risks to our valuation

We identify the following downside risks: a faster-than-expected deterioration in asset quality, which could cause the NPL ratio to increase and, possibly, higher net impairment charges, which could lower profits; and lower-than-expected deposit growth, which could result in higher borrowings and cost of funds. On the upside, we could see faster-than-expected growth in fee income. Currently, fee income is driven by credit insurance commissions, which are linked to loans; management has hinted at growing its traditionally non-funded income over the medium term.

Changes in our forecasts

- **Lower loan growth.** During the H1 19 call, management emphasised it would focus on improving asset quality in light of the deterioration in the NPL ratio. Based on this we have lowered our loan growth forecasts to 10% yoy in 2020 and 2021.
- **Reduction in borrowing costs.** Recent rate cuts in Botswana, Mozambique, Nigeria and Ghana should bring about a reduction in borrowing costs. Therefore, we have lowered our cost of funds forecast by 40bps in 2020.
- **Lower fee income.** Currently, credit insurance tied to loans accounts for c40% of fee income. In response to our lower loan growth expectations, we have also lowered our fee income forecasts.
- **Deposit growth.** We have lowered our deposit growth forecasts, although deposits should continue to increase (up by 10% yoy in 2020 and 2021) as Letshego attracts cheaper retail deposits.

Table 3: Forecast changes in summary

	2019 forecast			2020 forecast			2021 forecast		
	New	Old	Change	New	Old	Change	New	Old	Change
EPS	0.321	0.408	-21%	0.366	0.464	-21%	0.392	0.527	-26%
DPS	0.096	0.204	-53%	0.110	0.232	-53%	0.117	0.263	-55%
BPS	1.980	2.229	-11%	2.238	2.465	-9%	2.517	2.736	-8%

Source: Tellimer Research

Table 4: Updated forecasts

BWPmn	2018		2019		2020		2021		2022		2023
Income statement											
Net interest income	2,064	6%	2,196	5%	2,295	8%	2,476	6%	2,626	10%	2,896
Net fee income	31	25%	38	20%	46	20%	55	15%	64	15%	73
Other operating income	298	16%	346	13%	391	11%	434	11%	480	11%	532
Total operating income	2,362	8%	2,542	6%	2,686	8%	2,910	7%	3,106	10%	3,427
Operating expenses	980	8%	1,058	8%	1,143	8%	1,237	8%	1,338	8%	1,448
Pre-provision profit	1,382	7%	1,483	4%	1,543	9%	1,674	6%	1,769	12%	1,980
Loan loss provision	361	-42%	209	-12%	184	26%	233	7%	249	8%	269
Net operating profit	1,021	25%	1,274	7%	1,359	6%	1,441	5%	1,520	13%	1,711
Pre-tax profit	1,021	25%	1,274	7%	1,359	6%	1,441	5%	1,520	13%	1,711
Net attributable profit	439	56%	686	13%	773	6%	823	9%	900	14%	1,023
Balance sheet											
Net loans	8,699	14%	9,877	11%	10,959	10%	12,069	10%	13,322	10%	14,709
Interest-earning assets	8,752	13%	9,933	11%	11,018	10%	12,131	10%	13,387	10%	14,778
Total assets	10,656	10%	11,722	10%	12,894	9%	14,055	9%	15,319	7%	16,392
Total deposits	498	-20%	398	10%	438	10%	482	10%	530	10%	583
Total interest-bearing liabilities	5,827	-1%	5,760	5%	6,067	5%	6,393	6%	6,792	6%	7,224
Shareholders' funds	3,758	12%	4,204	12%	4,704	11%	5,239	10%	5,784	11%	6,409
Per share data											
EPS	0.20	0.57	0.32	0.14	0.37	0.07	0.39	0.11	0.43	15%	0.50
BVPS	1.75	13%	1.98	13%	2.24	12%	2.52	12%	2.81	12%	3.14
DPS	0.10	-6%	0.10	14%	0.11	7%	0.12	29%	0.15	15%	0.17
Ratios											
Revenue generation											
Net interest income margin	21.0%		19.6%		18.6%		18.4%		17.9%		18.3%
Revenues/assets	21.4%		20.0%		19.0%		18.8%		18.3%		18.7%
Gross asset yields	32.8%		31.6%		29.0%		28.0%		26.5%		26.0%
Gross funding costs	13.0%		13.1%		12.5%		12.2%		11.4%		10.9%
Operating efficiency											
Cost/income	41.5%		41.6%		42.6%		42.5%		43.1%		42.2%
Risk management											
NPLs/gross loans	7.10%		7.20%		6.20%		5.82%		5.77%		5.40%
Loan provisions/NPLs	124%		117%		123%		129%		124%		126%
Profitability											
ROA	4.47%		6.13%		6.28%		6.10%		6.13%		6.45%
ROE	11.4%		17.2%		17.4%		16.5%		16.3%		16.8%
ROTE	11.9%		17.9%		18.0%		17.1%		16.8%		17.2%
Effective tax rate	50%		40%		37%		37%		35%		35%
Dividend payout ratio	50%		30%		30%		30%		35%		35%
Liquidity and solvency											
Debt equity	142%		128%		120%		113%		108%		104%
Shareholders' equity/assets	35.3%		35.9%		36.5%		37.3%		37.8%		39.1%
CAR	33.0%		37.0%		38.0%		40.0%		38.0%		38.0%

Source: Tellimer Research

DISCLOSURES

Analyst Certification

This report is independent investment research as contemplated by COBS 12.2 of the FCA Handbook and is a research recommendation under COBS 12.4 of the FCA Handbook. Where it is not technically a research recommendation because the subject of the research is not listed on any European exchange, it has nevertheless been treated as a research recommendation to ensure consistent treatment of all Tellimer's research. This report has been produced by Nkemdilim Nwadialor who is the Analyst (the "Analyst").

Conflicts of Interest

The Analyst certifies that the views and forecasts expressed in this report accurately reflect their personal views about the subject, securities, or issuers specified herein. In addition, the Analyst certifies that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Exotix Partners LLP and its subsidiaries ("Tellimer") provide specialist investment banking services to trading professionals in the wholesale markets. Tellimer draws together liquidity and matches buyers and sellers so that deals can be executed by its customers. Tellimer may at any time, hold a trading position in the securities and financial instruments discussed in this report. Tellimer has procedures in place to identify and manage any potential conflicts of interests that arise in connection with its research. A copy of Tellimer's conflict of interest policy is available at www.tellimer.com/regulatory-information.

Tellimer does not generally produce maintenance research and as a result there is no planned frequency of research reports for securities under coverage, save that Tellimer will aim to produce updates as appropriate and as soon as practicable. Other than this, research reports are produced on an ad hoc basis.

Preparation

This report was prepared by Exotix Partners LLP, which is authorised to engage in securities activities in the United Kingdom. Exotix Partners LLP is authorised and regulated by the UK's Financial Conduct Authority under FCA register no. 586420.

This report is not an advertisement of securities. Opinions expressed herein may differ or be contrary to opinions expressed by other business areas or groups of Tellimer as a result of using different assumptions and criteria.

The information and opinions contained in this report are subject to change without notice, and Tellimer is under no obligation to update or keep current the information contained herein or in any other medium.

Distribution

This report is not intended for distribution to the public and may not be reproduced, redistributed or published, in whole or in part, for any purpose without the written permission of Tellimer. Tellimer shall accept no liability whatsoever for the actions of third parties in this respect. This report is for distribution only under such circumstances as may be permitted by applicable law.

This report may not be used to create any financial instruments or products or any indices. Neither Tellimer, nor its members, directors, representatives, or employees accept any liability for any direct or consequential loss or damage arising out of the use of all or any part of the information herein.

United Kingdom: Approved and distributed by Exotix Partners LLP only to Eligible Counterparties or Professional Clients (as defined in the FCA Handbook). The information herein does not apply to, and should not be relied upon by, Retail Clients (as defined in the FCA Handbook); neither the FCA's protection rules nor compensation scheme may be applied.

United States: This research report is provided for distribution to U.S. institutional investors in accordance with the exemption from registration provided by Rule 15a-6 under the U.S. Securities Act of 1934, as amended and all relevant guidance by the U.S. Securities and Exchange Commission ("SEC") with respect thereto.

Tellimer Markets, Inc. is the U.S. distributor of this report. Tellimer Markets, Inc. is regulated by the Securities and Exchange Commission and is a member of FINRA and SIPC. Subject to the terms set forth herein, Tellimer Markets, Inc. accepts responsibility for the contents of this report to the extent that it is delivered to a US person other than a Major U.S. Institutional Investor as defined in Rule 15a-6. Any U.S. person receiving this research report and wishing to effect transactions in any security discussed in the report or any related derivative instrument should do so through via a registered representative at Tellimer Markets, Inc. (Telephone: +1 (212) 551 3480).

UAE: Approved for distribution in the Dubai International Financial Centre by Exotix Partners LLP (Dubai) which is regulated by the Dubai Financial Services Authority ("DFSA"). Material is intended only for persons who meet the criteria for Professional Clients and/or Market Counterparties under the Rules of the DFSA and no other person should act upon it.

Nigeria: Distributed by EFCP Limited, an authorised dealing member of The Nigerian Stock Exchange, which is regulated by the Securities and Exchange Commission.

Other distribution: The distribution of this report in other jurisdictions may be restricted by law and persons into whose possession this document comes should inform themselves about, and observe, any such restriction.

Disclaimers

This report has been prepared for information purposes only. The information presented herein does not comprise a prospectus of securities for the purposes of EU Directive 2003/71/EC. Any decision to purchase securities in any proposed offering should be made solely on the basis of the information to be contained in the final prospectus published in relation to such offering. This report does not form a fiduciary relationship or constitute advice and is not and should not be construed as an offer, or a solicitation of an offer, or an invitation or inducement to engage in investment activity and cannot be relied upon as a representation that any particular transaction necessarily could have been or can be effected at the stated price.

The information and opinions contained in this report have been derived from sources believed to be reliable and in good faith or constitute Tellimer's judgment as at the date of this report but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness and any opinions are subject to change and may be superseded without notice.

Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by Tellimer with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this report relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this report may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this report. You should always exercise independent judgment in relation to the securities mentioned herein. Neither Tellimer nor any of its members, directors, or employees shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this report or lack of care in this report's preparation or publication, or any losses or damages (whether direct or indirect) which may arise from the use of this report.

Tellimer and/or its members, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Tellimer may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups of Tellimer.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States. The value of any investment or income from any securities or related financial instruments discussed in this report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Frontier and Emerging Market laws and regulations governing investments in securities markets may not be sufficiently developed or may be subject to inconsistent or arbitrary interpretation or application. Frontier and Emerging Market securities are often not issued in physical form and registration of ownership may not be subject to a centralised system. Registration of ownership of certain types of securities may not be subject to standardised procedures and may even be effected on an ad hoc basis. The value of investments in Frontier and Emerging Market securities may also be affected by fluctuations in available currency rates and exchange control regulations.

Not all of these or other risks associated with the relevant company, market or instrument which are the subject matter of the report are necessarily considered.