LETSHEGO HOLDINGS

24 August 2018

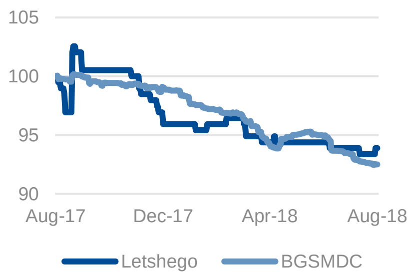
SUB-SAHARAN CONSUMER FINANCE

Price (BWP)	1.83
Current valuation metrics	
2017 PE	5.2x
2017 PB	1.1x
2017 Dividend yield	10.9%
Market cap (BWPmn)	3,945
Market cap (US$mn)	366

Market performance in BWP

YTD return (%)	-2.1
3-month return (%)	-0.5
1-yr return (%)	-6.1

Share price performance



Focus on Namibia: Near-term pain

- In this report, we focus on 78%-owned Letshego (Namibia) Limited (LHN), which accounts for 25% of Letshego Holdings Limited's loans and 37% of its profits (2017 data). Since the September 2017 listing, investors have been able to gain direct access to this business.
- **Macro challenges could dampen near-term credit demand.** We expect credit demand in the dominant government segment (99% of loans as of December 2017) to be adversely affected by the government's intention to reduce the proportion of GDP spent on the wage bill. Sluggish economic growth could also hamper near-term volumes as Namibia slowly transitions out of a recession.
- **However, traction from the IPO could help drive deposit and fee income growth.** Increased visibility and brand awareness following the 2017 IPO have helped support a product and branch network expansion, as well as cross-selling opportunities. Benefits from new product lines and additional access points are likely to translate into rapid deposit gathering and higher fee income (albeit off a low base). Management expects c120% yoy deposit growth in 2018, driven primarily by larger-ticket deposits from corporates and, to a lesser extent, the conversion of current borrowers into depositors.
- **Boost to deposits and non-interest income will come at a cost.** We expect to see a deterioration in LHN's efficiency ratio from the c24% reported in 2017 on a combination of: 1) ongoing marketing campaigns, 2) modest loan growth expectations and 3) and some margin pressure.
- **IFRS9 implementation should translate to higher credit risk costs.** Credit risk costs/gross loans could rise above LHN's 1% internal target (but would likely remain below 2%, having been 0.0% in 2017) on IFRS9 implementation. We would expect the subsidiary's NPL ratio to remain below 5.0% (3.9% in 2017), given sustained strength in the quality of collections.
- **Internal targets of 14% ROA, 25% efficiency ratio imply near-term pressure in Namibia** versus last year's 15% ROA and 24% cost/income ratio. We believe upside to these targets could potentially come from a more favorable macro environment, efficiency improvements, diversification of the loan book into higher margin businesses and normalised risk costs.
- **Group strategy is unchanged following the resignation of Letshego Holdings' CEO, Chris Low**. The board remains committed to the current operating strategy and is at an advanced stage of hiring a replacement for the role. Management has stated a new CEO could be hired as early as September 2018, pending regulatory approval. In the interim, a team including the Group's Chief Financial Officer, Head of Consumer Solutions and Head of Risk will be responsible for management-level decisions at the organisation.
- **Our group-level forecasts are unchanged.** Our estimates incorporate expectations for lower Namibia loan growth, minimal near-term efficiency gains and higher credit risk costs. Shares of Letshego trade at 5.2x 2017 earnings and 1.1x book value.
- **Interim results will be released on 3 September,** with a follow-up earnings call on 4 September.

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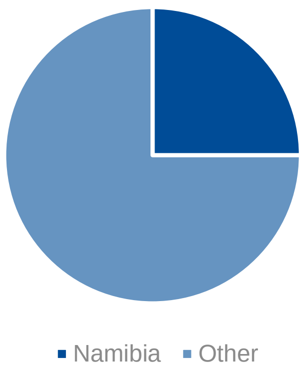
Letshego Holdings (Namibia) Limited

We focus on 78% owned Letshego Namibia Limited (LHN), which accounts for 25% of Letshego Holdings Limited's loans, and 37% of pre-tax profits (2017 data). The subsidiary was acquired by Letshego Holdings Limited in 2008, and publicly listed on the Namibian Stock Exchange in September 2017. The Initial Public Offering of c22% of Letshego Namibia shares was done to partially satisfy the Bank of Namibia's licensing conditions for granting a banking license. The group intends to fulfil the 45% local ownership target by 2020.

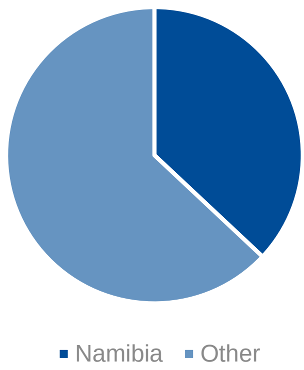
LHN's operations are largely driven by the government segment (which constituted 99% of the total loan book as of December 2017).

Figure 1: Loan mix (group level)



Source: Company filings

Figure 2: PBT mix (group level)



Source: Company filings

Key focus areas for the subsidiary's management team include:

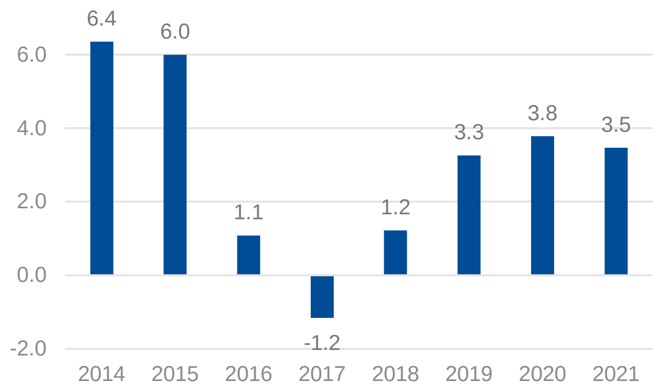
- Embracing financial inclusion, evident in strategic efforts to expand product lines and access points.
- Growing the franchise by offering a broad range of services across the value chain covering savings, borrowings, payments and micro-level investments. These services will be partially funded through an expansion of deposit-taking capabilities; the subsidiary received a deposit-taking license in 2016.
- Enhancing customer experience via a customer-centric model, which facilitates financial inclusion across Namibia.
- Embedding a future capability model, which relies on technological advancement that supports reliable and scalable systems to enhance the customer experience and access, while enabling efficient management of operational risks.

Investment Case

Macro challenges could dampen credit demand. Recent efforts by the Namibian government to curtail growth in the wage bill have led to hiring freezes in the public sector, which will likely drag on credit demand within LHN's government segment (99% of the current loan book). We that the finance minister has stated that measures will be instituted to reduce the wage bill from c16% of GDP, to c12% by 2022.

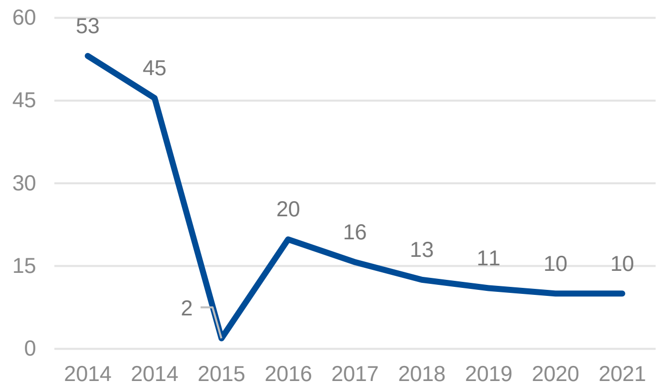
In addition, the slower-than-expected recovery of the Namibian economy is likely to dampen credit appetite. The Bank of Namibia forecasts 0.6% GDP growth in 2018 (IMF: 1.2%), driven in part by tighter fiscal policy and depressed consumer spending. Although, diversification efforts should help partially offset the decline in the government segment, we believe the days of high double-digit credit growth are now in the past and expect a gradual decline in Namibia's loan growth to c10% (in pula terms) by 2022.

Figure 3: GDP growth (2014-21f, %)



Source: IMF

Figure 4: Net loan growth (2014-21f, % pula)



Source: Company filings, Exotix forecasts. Note: in 2014, the group changed its financial year end from Jan. to Dec.

To cushion these declines, management targets: 1) higher disbursements to private sector employees, particularly in the mining and fishing segments, and 2) growth in non-government contributions to 5% in 2018 and 10% by 2020 (from 1%). We believe these targets are feasible, supported by some of the newly launched mobile loan offerings.

Traction from the IPO could help drive deposit and fee income growth. Increased visibility and brand awareness from the 2017 IPO were catalysts for Letshego Namibia's 24% PBT growth during the period. Since then, management has made a concerted effort to build on last year's progress through several campaigns and product launches with a view to boost deposit gathering and transaction income. The LetsGo All-in-1 solution is one such products: an omni-channel, location-agnostic platform that enables customers to pay and be paid. The solution enables transfers using cell phones/USSD, internet banking, Wi-code, cards, over the counter, POS, accounts and ATM.

LHN has leveraged branch-network expansions as a means of facilitating deposit gathering, opening two new deposit-taking branches YTD. These have received strong traction and enabled the opening of 400 LetsGo accounts by end-July (ie after just seven months, an increase of c670% from 60 pilot accounts at end-17). Management expects deposits to grow by N$100mn-120mn, a c120% yoy increase, driven primarily by larger-ticket deposits from corporates and, to a lesser extent, the conversion of current borrowers to depositors. Strong deposit growth within Namibia supports our view that funding costs could fall from the 8-9% currently.

Finally, increased access points through membership in the Namibia Clearing House also gives LHN access to 1,000 ATMs, helping support the agency banking model.

Near-term operating efficiency could deteriorate. Several ongoing marketing campaigns and brand awareness programs could cause expense growth to accelerate in 2018 (7% in 2017). Management expects marketing costs could rise from 5% of total operating expenditure towards 6%, which will likely negatively impact the cost/income ratio (24% reported in 2017), given the modest loan growth expectations.

Comparison of Letshego Namibia vs. the Group

Relative to the group, the Namibia subsidiary (25% of group loans) has tighter cost controls, reporting a 24% efficiency ratio in 2017 (on 7% operating expense growth), versus the 40% efficiency ratio of the group. The group's efficiency disadvantage is the result of sustained acquisitions and the resultant integration costs.

LHN has also historically had negligible risk costs, due to 1) stronger collection policies, 2) limited exposure to the riskier non-government segment (1% of LHN's loans versus 22% exposure for the group) and 3) the absence of one-time steep write-offs due to sudden policy changes experienced in subsidiaries like Tanzania in the past. In 2017, LHN's credit risk costs/gross loans ratio was c0.0%, versus 3.1% at the group level.

Finally, less attractive margins at the Namibia subsidiary versus the group are the result of 1) a higher proportion of lower-yielding government sector loans at LHN, and stiffer industry competition in Namibia.

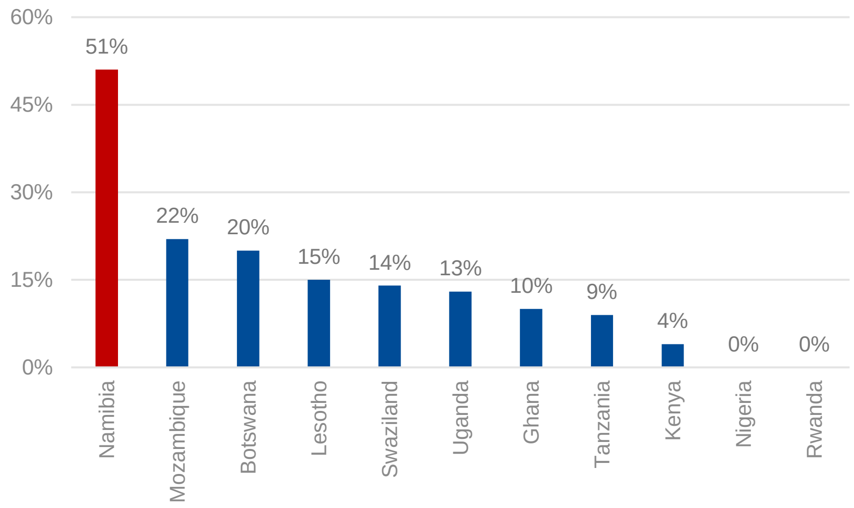
Table 2: Key operating metrics (FY 17)

Company	LHN	Group
Net interest margin	17.5%	21.2%
Efficiency ratio (reported)	24%	40%
Cost of credit	0.0%	3.1%

Source: Company filings, Exotix Research

Namibia has historically had higher penetration rates than other subsidiaries, with reported penetration rising from 33% in 2010 to 56% in 2015 (51% at end-17). We believe the market-share advantage in Namibia is likely due to competitive pricing offered at LHN versus other subsidiaries, as well as its efficient disbursement process.

Figure 5: Market penetration rates



Source: Company filings

Update on Letshego Holdings Limited (Group)

Group strategy is unchanged following the resignation of Letshego Holdings' CEO, Chris Low. On 2 August, the group announced Chris Low, Group Managing Director, would step down. Low had served the group as CEO since he was appointed in 2013. During his tenure, total assets doubled from BWP4,279mn in 2013, to BWP8,961mn as of December 2017, while earnings were roughly flat.

A team including the Group Chief Financial Officer, Head of Consumer Solutions and Head of Risk will take over Low's responsibilities until a replacement is hired. The board remains committed to the current operating strategy and is at an advanced stage of hiring a replacement for the role. Management has stated a new CEO could be hired as early as September, pending regulatory approvals. Low remains available in an advisory capacity until end-August.

Summary Financials (Letshego Holdings Group)

Our group-level forecasts are unchanged as we expect softness in the Namibia subsidiary to be offset by stronger contributions from East and West Africa in 2018.

A strong fee income growth outlook (c34% pa through 2022) is partly premised on product launches and cross-selling in Namibia. Decelerating loan growth assumes modest contributions from Namibia and Botswana (55% of the loan book). Asset quality should stay healthy, reflecting the strength of the quality of collections across the group.

Table 3: Letshego summary financials

BWPmn	2017		2018f		2019f		2020f		2021f		2022f
Income statement											
Net interest income	1,782	14%	2,039	13%	2,312	15%	2,649	14%	3,012	12%	3,375
Other operating income	273	17%	320	16%	372	16%	431	15%	494	14%	563
Total operating income	2,055	15%	2,359	14%	2,684	15%	3,080	14%	3,506	12%	3,938
Operating expenses	814	13%	922	12%	1,037	12%	1,158	11%	1,285	11%	1,426
Pre-provision profit	1,241	16%	1,437	15%	1,648	17%	1,922	16%	2,221	13%	2,512
Loan loss provisions	237	23%	293	17%	342	34%	457	27%	580	16%	671
Net operating profit	1,004	14%	1,144	14%	1,306	12%	1,464	12%	1,641	12%	1,841
Pre-tax profit	1,004	14%	1,144	14%	1,306	12%	1,464	12%	1,641	12%	1,841
Net attributable income	638	18%	753	14%	862	13%	970	12%	1,091	13%	1,228
Balance sheet											
Net loans	7,769	15%	8,920	13%	10,119	13%	11,386	11%	12,604	10%	13,889
Interest-earning assets	7,822	15%	8,977	13%	10,178	12%	11,448	11%	12,669	10%	13,958
Total assets	8,961	14%	10,215	14%	11,594	13%	13,102	12%	14,674	12%	16,435
Total deposits	228	100%	457	75%	800	75%	1,399	50%	2,099	50%	3,148
Total interest-bearing liabilities	4,240	19%	5,037	18%	5,937	16%	6,910	16%	8,015	17%	9,349
Shareholders' funds	3,957	8%	4,293	9%	4,683	10%	5,128	10%	5,635	10%	6,211
Per share data											
EPS	0.292	20%	0.349	17%	0.408	14%	0.464	14%	0.527	14%	0.599
BVPS	1.807	12%	2.022	10%	2.229	11%	2.465	11%	2.736	11%	3.046
DPS	0.175	1%	0.176	16%	0.204	14%	0.232	14%	0.263	14%	0.300
Ratios											
Revenue generation											
Net interest margin	21.24%		21.26%		21.21%		21.46%		21.69%		21.70%
Revenues/ assets	24.5%		24.6%		24.6%		24.9%		25.2%		25.3%
Gross asset yields	30.9%		31.1%		31.4%		31.7%		32.0%		32.3%
Gross funding costs	12.2%		12.5%		12.7%		12.1%		11.4%		10.8%
Operating efficiency											
Cost/ income	39.6%		39.1%		38.6%		37.6%		36.7%		36.2%
Risk management											
Cost of risk	2.90%		3.10%		3.17%		3.74%		4.27%		4.46%
NPLs/gross loans	6.78%		4.01%		4.40%		4.93%		5.09%		5.46%
Loan provisions/NPLs	142%		139%		139%		139%		141%		140%
Profitability											
ROA	7.60%		7.85%		7.90%		7.85%		7.85%		7.89%
ROE	16.7%		18.3%		19.2%		19.8%		20.3%		20.7%
Effective tax rate	32%		30%		30%		30%		30%		30%
Dividend payout ratio	59%		50%		50%		50%		50%		50%
Effective payout (incl. buybacks)	65%		55%		55%		54%		54%		53%
Liquidity and solvency											
Debt/equity	93%		98%		100%		98%		97%		92%
Shareholders' equity/assets	44%		42%		40%		39%		38%		38%

Source: Exotix Research

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Buy	44	Sell	40	Hold	50

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