MOODY'S
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CREDIT OPINION
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Update

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Letshego Holdings Limited

Update to credit analysis following rating affirmation

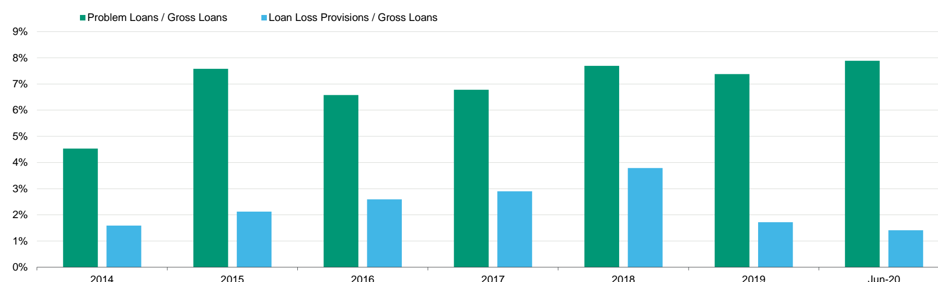
Summary

We assign a Ba2 Corporate Family Rating (CFR) and Ba3/Not Prime issuer ratings to Letshego Holdings Limited (Letshego). The outlook on Letshego is stable.

Letshego's CFR of Ba2 is driven by the company's high capital buffers and profitability, supported by its low-cost franchise and its developing diversification across products and countries, which makes the company resilient to an adverse development in any of its markets. These strengths are balanced against Letshego's high asset risk, and weak cash flow and liquidity metrics.

Letshego's Ba3 issuer ratings are based on the Ba2 CFR and the application of Moody's Loss Given Default (LGD) model for Speculative Grade Companies, resulting in a downward adjustment of the issuer ratings given the structural subordination of unsecured obligations.

Exhibit 1
Letshego's asset risk remains elevated
Problem loans and provisions over loans



Source: Moody's Investors Service

Credit strengths

» Solid capitalisation and profitability

» Focus on resilient payroll consumer lending and gradual business diversification

Credit challenges

» Asset risk will remain elevated

» Weak liquidity and cash flow metrics

Rating outlook

The stable outlook incorporates our expectations that Letshego's credit profile will weaken moderately but remain consistent with the current rating and that the company's transformation strategy will not significantly increase the company's risk profile over the next 12-18 months.

Factors that could lead to an upgrade

» The company's ratings could be upgraded if Letshego strengthens its asset quality, liquidity and cash flow.

» Letshego's issuer ratings could also be upgraded due to a reduction of the secured portion of debt, which would increase the recovery rate for senior unsecured debt classes.

Factors that could lead to a downgrade

» Letshego's ratings could be downgraded if the operating environment in the countries in which the company operates weakens further or asset quality, liquidity and cash flow deteriorate more than our expectations.

» Letshego's issuer ratings could also be downgraded following an increase of the secured portion of debt, which would lower the recovery rate for senior unsecured debt classes.

Key indicators

Exhibit 2

Letshego Holdings Limited (Consolidated Financials) [1]

	06-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Net Income / Average Managed Assets (%)	5.2	6.5	5.2	7.9	8.0	6.6[4]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	39.0	38.1	34.2	42.8	45.3	39.9[4]
Problem Loans / Gross Loans (Finance) (%)	7.9	7.4	7.7	6.8	6.6	7.3[4]
Net Charge-offs / Average Gross Loans and Leases (%)	0.3	2.6	1.7	1.8	2.4	1.7[4]
Debt Maturities Coverage (%)	21.2	51.7	82.8	26.8	42.6	45.0[4]
Secured Debt / Gross Tangible Assets (%)	16.8	17.1	21.5	23.8	23.2	20.5[4]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] IFRS [3] May include rounding differences because of the scale of reported amounts. [4] Simple average of periods for the latest accounting regime.

Sources: Moody's Investors Service and company filings

Profile

Letshego was incorporated in 1998 and is headquartered in Gaborone. It has been publicly listed on the Botswana Stock Exchange (BSE) since 2002 and is one of Botswana's largest indigenous BSE-listed companies, Letshego has an agenda focused on inclusive finance, that is aligned with government initiatives. Through an 11-country presence across Southern, East and West Africa, the Group's inclusive finance agenda is focused on anticipating and solving the needs of financially under-served customers. Letshego serves a

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

variety of financial needs of three key customer segments: Micro and Small Entrepreneurs (MSEs), public and private sector low and middle income earners and individuals in the informal market.

Detailed credit considerations

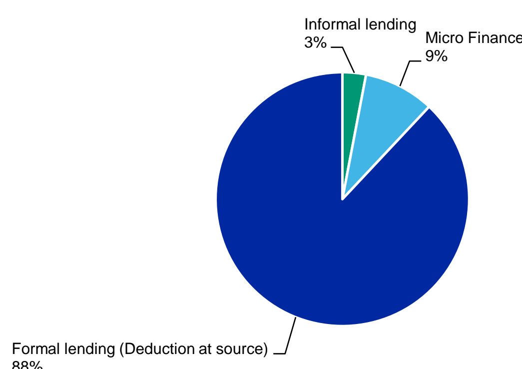
Focus on resilient payroll consumer lending and gradual business diversification

Letshego has a niche franchise specialising in loans to government and quasi-government employees under the payroll deduction at source model (around 88% of total loans). Under this model, loan repayments are taken directly from the employer prior to the distribution of monthly salaries. Letshego's business model benefits from a quick and efficient loan-approval and disbursement process, has historically led to fairly low credit costs and strong profitability and has proved resilient to the pandemic up to June 2020.

Exhibit 3

Letshego's gross advances by segment

Exposures as of June 2020



Source: Company reports

However, its concentration to payroll deduction products exposes the company to adverse developments in the regulatory and legal framework that may either (1) hamper the payroll deduction process (although not our base case scenario) and/or (2) impose or lower caps on the effective interest rate the company can charge on loans, as happened in Namibia during the first half of the year.

To counter these risks, Letshego has been increasing its geographical diversification and has a well-articulated strategy to diversify its business model by becoming a pan-African retail financial services company. As part of this strategy it has completed various acquisitions across Africa, acquired banking and deposit taking licenses in several territories including Ghana, Mozambique, Rwanda, Tanzania, Nigeria, and Namibia, and aims to convert its loan-only clients into transactional clients.

The company has various objectives as part of its transformation plan, and some of these are:

-Reduce revenue contribution from 85% Deduction at Source (DAS) lending in the low-middle income segment to 80% in 2022 and 65% in 2024, with the remainder in the more risky Micro Small Enterprises (MSE) and personal lending but also non-credit intensive deposits, payments and cards;

- Mitigate the key risk of a government changing the terms of DAS (as happened for rate caps in Namibia) by reducing the concentration from this service from 80% of profits in Botswana, Namibia and Mozambique to 55% in 2024, with the remainder spread in other seven Sub-Saharan countries;

-Increase digital contribution in loan sales from 41% (through Web and WhatsApp) to 50% in 2022 and 80% in 2024 through the launch of a new App;

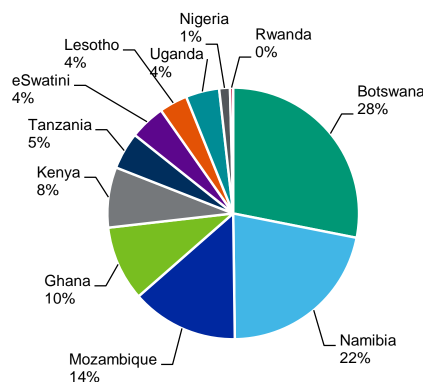
-Adopt agile way of working to improve historically weak implementation. The company experienced high rotation among top management positions over the last 18 months which may have slowed down the implementation of its strategy, but most key positions have now been filled.

Currently, the company has operations in eleven sub-Saharan African countries (Exhibit 4), with a strong niche franchise within Botswana, Namibia and Mozambique (where, it offered payroll loans to around 25%, 49% and 25% of all government employees, respectively). Letshego also has a strong presence in Ghana, but outside of these key markets exhibits a lower franchise sustainability given its weaker brand name and lower market penetration.

Exhibit 4

Letshego's loan book is becoming increasingly diversified across countries

Loan book geographical breakdown (June 2020)



Source: Company reports

Letshego's expansion will gradually reduce its overall dependence on payroll lending by broadening customer segments and products and at the same time supporting its deposit mobilisation capabilities. However, this transformation strategy is not without execution risk as the company will expand in riskier segments of the markets (micro finance loans, micro and small enterprise business loans, and low-income housing loans), where it has relatively less experience, and in countries with higher country risks than Botswana.

Asset risk will likely remain elevated

Given the challenging operating environment in many countries where it operates, the global economic disruption resulting from coronavirus outbreak and the gradual diversification into riskier non-payroll loans, non-performing loans (NPLs) and provisioning needs will likely increase, hence the assigned B2 score for asset quality, below the initial B1 score.

Letshego's NPL ratio was 7.9%, as of June 2020, up from 7.4% as of December 2019. However, Letshego's problem loans coverage (loan loss reserves to NPLs) remains robust at 103% as of June 2020. Additionally, Letshego has comprehensive credit insurance cover in markets like Namibia and Mozambique that increases the post-default recovery.

Letshego's business model has historically led to fairly low credit costs, reduced collection costs and robust collection statistics.

Credit costs declined in the first half of 2020 despite the coronavirus outbreak and the additional provisions for eSwatini operations. Letshego's overall credit costs (provisions % gross loans) were low at 1.4% in June 2020 however we expect a significant increase by year end and next. During 2019, on account of improved recoveries, there was a marked reduction in provisioning across businesses and jurisdictions, with credit costs at around 1.7% as of December 2019.

These challenges may be somewhat alleviated by the diversification benefits that the company is seeking, varying government support packages and still moderate infection rates across its markets.

In the longer term, we expect elevated asset risks to be somewhat mitigated by improvements to Letshego's risk management processes and procedures: Letshego is making ongoing investments to improve automation in credit risk management.

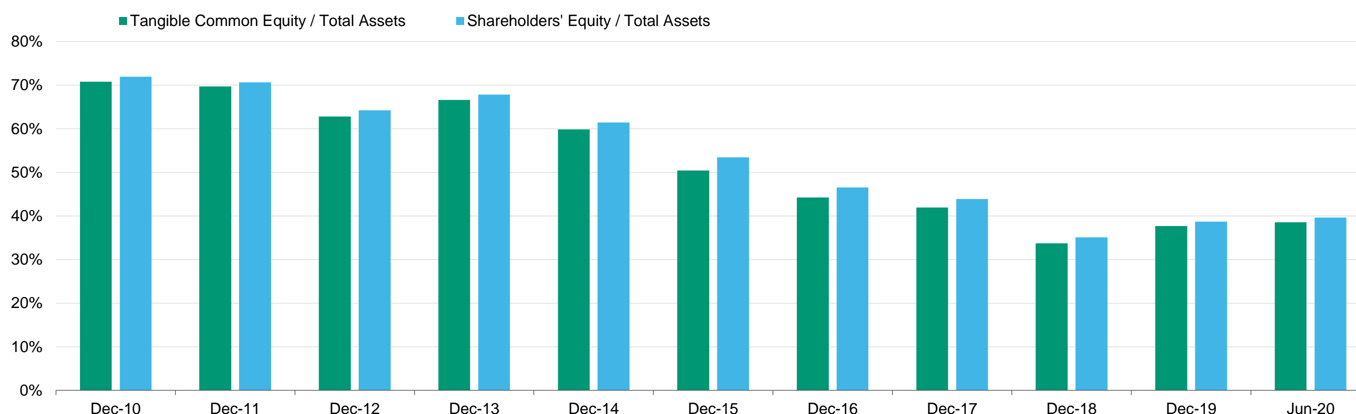
Solid capitalisation

We anticipate capital levels to drop going forward, but still expect Letshego's capitalisation level to continue to be a strength and underpin the current ratings as reflected by an assigned score of A1, below the Aa2 initial score. The company is currently well

capitalised, with shareholders' equity-to-total assets ratio of 39%, as of June 2020 (Exhibit 5), which provides a solid buffer against economic recession resulting from the coronavirus outbreak, especially on its smaller segments outside of the core payroll lending segment, as well as any adverse changes in both the competitive environment and its business model.

To maximise shareholder returns, Letshego plans to somewhat increase leverage, hence our negative adjustment to Letshego's Capital Adequacy and Leverage score. Letshego's long-term target for equity-to-total assets ratio is around 30-35%, which still represents a robust level of capitalisation.

Exhibit 5
Letshego's capital metrics remain high, although they are on a downward trend



Source: Moody's Financial Metrics, Company reports

Letshego's capitalisation provides a sound buffer against its currency risk exposure resulting from regional operations (about 71% of loans are denominated in foreign currencies). An appreciation in the Botswana Pula would result in a decrease of its net foreign-currency assets, leading to negative impact on tangible common equity. Letshego is taking steps to reduce its net foreign-currency position of about 44% of assets at end-June 2020, although we expect the progress to take time. Letshego also has a moderate exposure to interest-rate risk because a portion of its funding is floating rate, while all loans are fixed rate, although wide margins allow some room for interest-rate fluctuation.

Robust profitability

We expect interest income to reduce, on the back of falling loan yields and increased competition,while provisioning costs to increase given the fragile operating environment, hence we assign a profitability score of A2, below the Aa3 initial score. The company's diversification strategy will also put some short-term pressure on profitability through bank licensing costs and investments in fintech/information technology. In some countries, the company will look for other regulatory arrangements allowing Letshego to take deposits, which are more cost-effective than full banking licences. In the long run this will be countered by the lower cost of deposits (expected by the company to double in size in 5 years) compared to interbank funding, an increased focus on other higher-yielding unsecured lending products and gradually realising diversification benefits that will make profitability more resilient to adverse regulatory developments in any of its markets.

The pre-provision income-to-average assets ratio declined to 10.3% for first six months of 2020 (H12019: 13.8%), and the net income-to-average assets declined to a still robust 5.2% (H12019: 6.9%). The reported cost-to-income ratio remained satisfactory by global standards at 48% in first six months of 2020, supported by Letshego's low-cost business model: the company minimises the use of inefficient branches/bricks and mortar in its operations. The ratio is still above the company's target of 40%, having deteriorated from around 30% since FY2015 following (1) acquisitions in Nigeria and Tanzania and (2) the company's ongoing investment in people and systems: operating expenses increased around 4% year on year, driven by increased staff, consultancy, licensing, information technology and travel costs.

As part of its long-term strategy, Letshego plans to derive transactional-based income through customer deposit accounts and sale of other financial products, which has the potential to diversify income sources and support its profitability over time.

Weak liquidity and cash flow metrics

We consider the company's liquidity and funding structure to remain a key weakness, which we assess at Ba3, below the initial Ba1 score. This is in light of a covenant structure under its secured funding arrangements which led to a temporary reclassification of these debts as short-term, given a breach in Letshego's cash collection ratio in eSwatini. While the covenant breach has been healed in the meantime and liquidity has been restored, Letshego remains exposed to volatility in its liquidity position, in turn depending on its effective and timely debt collection capabilities, hence we assign a Caa3 score to the debt maturities coverage sub-factor, below the initial B2 score.

The debt maturities coverage ratio was 21% as of June 2020 (calculated as the level of cash and committed, unsecured bank lines available as a percentage of debt maturing within the next 12 months). The ratio has been both low and volatile over the last five years, ranging between 25% and 69%. Nevertheless, the ratio in 2019 was better than the historical average of 44%. The debt maturity profile was Botswanan Pula (BWP) 2.4 billion within 1 year, BWP 900 million between 1 and 2 years and BWP1.6 billion over 2 years. Against this, loans had longer maturity, with about BWP1.3 billion within 2 years and BWP 8 billion over 2 years. As such, loans with shorter tenor (up to 3 years) are mainly funded by borrowings and loans with longer tenor are largely funded by the ample equity of BWP4.2 billion.

The low coverage of the short-term debt with liquidity in June 2020 is mitigated by

•The fact that the company has refinanced the majority of its debt, which will increase the coverage;

•the sound margins, which would easily allow the company to sacrifice profitability and reduce new lending volumes to help repay maturing debt.

While we acknowledge that a significant source of funding is in the form of equity (which has no maturity), Letshego's remaining funding is primarily wholesale - as typical of finance companies -, which is inherently confidence-sensitive and vulnerable to investor "risk-off" sentiment, as it was the case in the Spring during the pandemic.

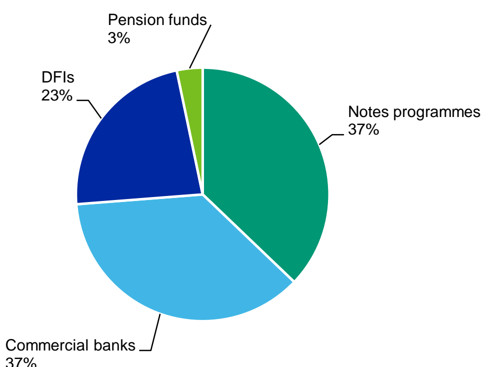
As of June 2020, bond funding accounted for 37% of total borrowings, commercial banks 37%, less confidence-sensitive Development Finance Institution (DFI) 23% and commercial paper/pensions funds 3% (Exhibit below).

The weak liquidity is somewhat compensated by a moderate percentage of secured debt over assets of 17% in June 2020 (which we score as a strength at Baa2) and a modest coverage of debt with funds from operations of 13% (which we assess at B1).

Exhibit 6

Letshego is wholesale funded, although increasingly more diversified

Breakdown of total borrowings (June 2020)



Source: Company reports

That said, over the past three years Letshego has diversified its funding structure and improved its liquidity and asset and liability maturity matching. The group has issued medium term note (MTN) under a programme which is partly listed on Johannesburg

Stock Exchange, Botswana Stock Exchange and Ghana Stock Exchange. The company plans to reduce shorter term borrowing from commercial banks and increase funding via debt capital markets, longer-term (i.e. 5-7 year) development finance institutions and more stable customer deposits, which may benefit its debt maturities coverage, funding costs as well as reduce dependency on wholesale funding.

Operating environment

We assign a Ba3 score to Letshego's operating environment, based on its industry risk score and diversification in weaker countries than Botswana. Botswana' macro level indicator does not have any weight in the scorecard since this score is higher than the industry risk score. As a result of its operating environment score, Letshego's financial profile score has been adjusted down to Ba2 from Ba1.

Macro level indicator

Letshego is domiciled in Botswana, and a significant proportion of its revenue is generated there. The A3 Macro-Level Indicator score for Botswana reflects the country's ba2 economic strength, baa1 institutional and governance strength and a susceptibility to event risk. The macro level indicator does not have any weight in the scorecard since this score is higher than the industry risk score.

Industry risk

We assign a Ba industry risk score to Letshego.

Barriers to entry in Africa's consumer lending business are moderately high as regulatory requirements and investments in loan underwriting and monitoring infrastructure form a barrier for potential new competitors. However, Letshego's business model may be negatively impacted by adverse developments in the regulatory and legal frameworks of countries in which it operates. As a result, the industry risk score also captures this regulatory/legal risk. Lastly, our assessment of Letshego's industry risk also reflects the vanilla nature of its loan products, predominantly payroll loans, which carry a low risk of obsolescence.

Support and Structural Considerations

Letshego's Ba3 issuer ratings are one notch lower than its Ba2 CFR due to the structural subordination of unsecured obligations relative to secured obligations (39% of debt or 17% of assets at end-June 2020) under our LGD model for Speculative Grade companies.

Methodology and scorecard

The principal methodology used in this rating is Finance Companies, published in November 2019.

About Moody's scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

ESG considerations

Letshego's exposure to environmental risks is low, consistent with our general assessment for finance companies. See our Environmental risk heatmap for further information.

Overall, we consider finance companies to face moderate social risks. The most relevant social risks for lenders arise from the way they interact with their customers. These risks include elevated scrutiny surrounding marketing and collections practices, product labeling and disclosure, and the handling of customer data. Social risks are particularly high in the area of data security and customer privacy. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Furthermore, the rapid and widening spread of the coronavirus outbreak is also a social consideration, given the substantial implications for public health and safety and deteriorating global economic outlook, creating a severe and extensive credit shock across many sectors, regions and markets.

We do not have any particular social risks concerns in relation to Letshego. We note the organization's CSR agenda in improving access to credit to underserved populations, improving housing conditions, education and promoting entrepreneurship among the youth.

See our Social risks heatmap for further information.

Corporate governance weaknesses can lead to a deterioration in credit quality, while governance strengths can benefit a company's credit profile. Governance risks are largely internal rather than externally driven. Letshego has experienced a lot of rotation among senior management positions in the last 12-18 months, hampering execution of its strategy, impeding continuity and raising potential governance related concerns. As such, governance remains a key credit consideration and requires ongoing monitoring.

We do not have any particular governance related concerns in relation to Letshego. After a period of rotation among senior management that took place in 2018 and 2019, all executive positions have been filled together with additional strategic hires in risk management.

Rating methodology and scorecard factors

Exhibit 7

Letshego Holdings Limited

Letshego Holdings Limited						
Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	6.49%	Aa3	A2	Expected trend	
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	38.95%	Aa2	A1	Expected trend	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.38%	Caa1	Caa2	Expected trend	
Net Charge-Offs / Average Gross Loans (%)	10%	2.56%	Baa3	Ba1	Expected trend	
Weighted Average Asset Risk Score			**B1**	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	51.65%	B2	Caa3	Expected trend	
FFO / Total Debt (%)	15%	18.37%	Ba1	B1	Expected trend	
Secured Debt / Gross Tangible Assets (%)	20%	17.06%	Baa1	Baa2	Expected trend	
Weighted Average Cash Flow and Liquidity Score			**Ba1**	**Ba3**		
Financial Profile Score	**40%**		**Baa2**	**Ba1**		
Operating Environment						
Home Country	Factor Weights	Sub-factor Score	Score			
Macro Level Indicator	0%		A3			
Economic Strength	25%	ba2				
Institutions and Governance Strength	50%	baa1				
Susceptibility to Event Risk	25%	a				
Industry Risk	100%		Ba			
Home Country Operating Environment Score			Ba2			

	Factor Weights	Score	Comment
Operating Environment Score	**60%**	**Ba3**	
ADJUSTED FINANCIAL PROFILE		Score	
Adjusted Financial Profile Score		**Ba2**	
Financial Profile Weight	40%		
Operating Environment Weight	60%		
Business Profile and Financial Policy		Adjustment	Comment
Business Diversification, Concentration and Franchise Positioning		0	
Opacity and Complexity		0	
Corporate Behavior / Risk Management		0	
Liquidity Management		0	
Total Business Profile and Financial Policy Adjustments		**Ba2**	
			Comment
Sovereign or parent constraint		**A2**	
Standalone Assessment Scorecard-indicated Range		ba1 - ba3	
Assigned Standalone Assessment		ba2	

Source: Moody's Investors Service

Ratings

Exhibit 8

Category	Moody's Rating
LETSHEGO HOLDINGS LIMITED	
Outlook	Stable
Corporate Family Rating	Ba2
Issuer Rating	Ba3
ST Issuer Rating	NP

Source: Moody's Investors Service

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