

CREDIT OPINION

15 February 2019

Update

✓ Rate this Research

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Letshego Holdings Limited

Update following publication of Rating Methodology for Finance Companies

Summary

We recently affirmed [Letshego Holdings Limited](#) (Letshego) Ba3/Not Prime issuer ratings and assigned Ba2 Corporate Family Ratings. The rating action followed the publication of our new [Finance Companies](#) rating methodology on 10 December 2018.

The ratings assigned to Letshego capture the company's solid capitalisation and profitability, supported by its niche, low-cost, franchise. They also capture Letshego's growing diversification across regional countries, which makes the company more resilient to an adverse change in any one of its operating markets.

The rating balances these strengths against Letshego's (1) narrow, albeit gradually diversifying, business model, with a high reliance on payroll deductions for loan repayment collections, (2) high exposure to foreign exchange risk, (3) elevated asset quality risks, and (4) dependence on market-sensitive wholesale funding; although actions are being taken to address this weakness.

No external support has been imputed in Letshego's rating given its (1) limited importance to [Botswana's \(A2, Stable\)](#) payment system and (2) its immaterial holdings of customer deposits.

Credit strengths

- » Letshego is gradually diversifying its business model across products and countries
- » Solid capitalisation buffers
- » Strong profitability supported by high margins

Credit challenges

- » The credit profile of Letshego is sensitive to changes in regulatory and legal frameworks
- » Capital is sensitive to Letshego's large foreign currency exposures
- » Asset quality risks will remain elevated
- » High reliance on wholesale market funding and weak liquidity metrics

Outlook

The company's ratings carry a stable outlook. The stable outlook reflects our expectation that the company's financial fundamentals will remain relatively stable over the next 12 to 18 months, despite elevated credit risks from its regional and lending expansion.

Factors that could lead to an upgrade

- » An upgrade of the company's rating would depend on Letshego successfully developing broader African financial services operations, while maintaining strong profitability and capitalisation, and strengthening its liquidity profile.
- » Letshego's issuer ratings could be upgraded due to a positive change to its debt capital structure that would increase the recovery rate for senior unsecured debt classes.

Factors that could lead to a downgrade

- » Negative rating pressure could be exerted on Letshego's rating if regional authorities in the company's main operating markets change the terms of, or impose restrictions on, the deduction (at source) of loan repayments from the wages of public-sector employees, leading to a sharp rise in bad debts and impairment costs. In addition, negative pressure could be exerted on the rating if (1) Letshego's expansion in other sub-Saharan markets, client segments and products, results in a material weakening of asset quality and profitability metrics; or (2) Letshego's capitalisation metrics were to materially weaken.
- » Letshego's issuer ratings could be downgraded due to adverse changes to its debt capital structure that would lower the recovery rate for senior unsecured debt classes.

Key indicators

Exhibit 1

Letshego Holdings Limited

	H1 2018	2017	2016	2015	2014	2013
Total managed assets (BWP Million)	9,815	9,017	7,932	7,540	6,412	5,024
Total managed assets (USD Million)	944	917	742	670	674	550
Net Income / Average Managed Assets	7.9%	7.9%	7.9%	10.7%	12.7%	14.0%
Debt Maturities Coverage	--	20.5%	32.5%	28.8%	21.4%	--
Secured Debt / Gross Tangible Assets	0.6%	23.8%	23.2%	18.6%	19.8%	13.0%
Tangible Common Equity / Tangible Managed Assets [1]	38.1%	42.8%	45.3%	52.0%	60.8%	67.4%
Problem Loans / Gross Loans	--	1.3%	1.3%	10.6%	4.5%	0.3%
Net Charge-offs / Average Gross Loans & Leases	--	1.8%	2.4%	0.2%	0.9%	1.4%

[1] Tangible managed assets are assets including loan loss reserves, less intangible assets.

Source: Moody's Investors Service

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.moody's.com for the most updated credit rating action information and rating history.

Profile

Letshego was incorporated in 1998, is headquartered in Gaborone, has been publicly listed on the Botswana Stock Exchange (BSE) since 2002 and is one of Botswana's largest indigenous BSE-listed companies, with a market capitalisation of 3.9 billion Pula (BWP) and an agenda focused on inclusive finance, that is aligned with supporting 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 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

Operating environment

We assign a Ba3 score to Letshego's operating environment, based wholly on its industry risk score (the macro level indicator does not have any weight in the scorecard since this score is higher, see scorecard below).

As a result of its operating environment score, Letshego's financial profile score has been adjusted down to Ba2 from Baa3 (see scorecard below).

Industry risk

We assign a Ba industry risk score to Letshego. Barriers to entry in Africa's consumer lending business are moderately high. Regulatory requirements and investments in loan underwriting and monitoring infrastructure act as a barrier to entry 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.

Letshego is gradually diversifying its (narrow) business model across products and countries

Letshego has a niche franchise specialising in unsecured loans to government and quasi-government employees under the payroll deduction model (around 68% 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 and has historically led to fairly low credit costs and strong profitability.

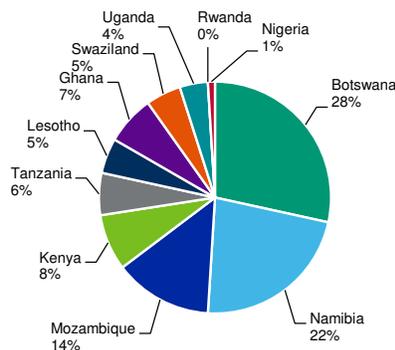
However, as mentioned above, its concentration to the aforementioned product exposes the company to adverse developments in the regulatory and legal framework that may either (1) hamper the payroll deduction process (although not our base case scenario) and/or (2) impose or lower caps on the effective interest rate the company can charge on loans.

To counter these risks, Letshego has been increasing its geographical diversification and has a strategy to diversify its business model, by becoming a pan-African financial services company. As part of this strategy it has completed various acquisitions across Africa, has acquired banking and deposit taking licenses in several territories (it has a deposit-taking license in Ghana, Mozambique, Rwanda, Tanzania, Nigeria, and Namibia) and aims to convert its loan-only clients into transactional clients. The company currently has operations in eleven sub-Saharan African countries (Exhibit 2), with a strong niche franchise within Botswana (where it offers payroll loans to around 20% of all government employees as of June 2018), Namibia (51% of government employees), and Mozambique (22% of government employees). Outside these three markets, Letshego currently exhibits a lower franchise sustainability given its weaker brand name and lower market penetration.

Exhibit 2

Letshego's loan book is becoming increasingly diversified across countries

Loan book geographical breakdown (June 2018)



Source: Letshego

Letshego's expansion will gradually reduce its overall dependence on payroll lending (by broadening customer segments and products) and support its deposit mobilisation capabilities. However, going forward, the company will need to manage potentially elevated credit losses from (1) riskier non-payroll related loans (micro finance group loans, micro and small enterprise business loans, and low-income housing loans), albeit compensated by higher margins; (2) higher sub-Saharan Africa country risks; and (3) its relative inexperience in these newer markets and product offerings.

Asset quality risks will likely remain elevated

We assign a weighted average Asset Risk score of B1 to Letshego, one notch below its initial score. Letshego's business model has historically led to fairly low credit costs, reduced collection costs and improved collection statistics. As a consequence, Letshego's overall credit costs (provisions % gross loans) remained fairly low at 2.5% as at June-end 2018 (year-end 2017: 2.9%). However, with Letshego gradually diversifying into riskier non-payroll loans, non-performing loans (NPLs) will likely increase, although this is countered by the diversification benefits obtained. In addition, the subdued economic environment in many countries where Letshego operates, and the higher provisioning needs under new IFRS 9 guidelines (an issue faced by financial institutions globally), imply further pressure on NPLs and provisioning needs.

Letshego disclosed an NPL ratio of 7.6% as at June-end 2018, higher than the 6.8% reported in December 2017. Increasing NPLs are primarily due to (1) challenging operating conditions in some of Letshego's regional operations, such as Tanzania, Rwanda and Uganda, and (2) an increased portion of non-payroll related loans to total loans.

Reported loan loss provisions to pre-provision income were 15.5% as of June-end 2018 (19.1% for 2017), with the problem loans coverage (loan loss reserves to NPLs) improving to 95% of NPLs from 73% in December 2017. Additionally, Letshego has comprehensive credit insurance cover in markets like Namibia and Mozambique that increases the post-default recovery.

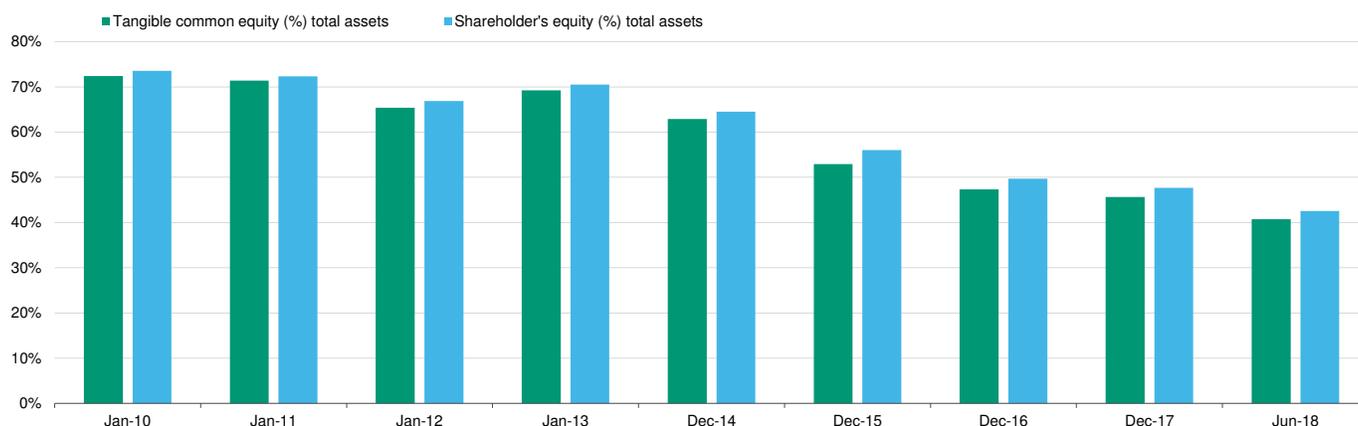
Going forward, we expect elevated asset risks to be moderated by improvements to Letshego's risk management processes. Letshego is making ongoing investments to improve automation in credit risk management.

Solid capitalisation buffers, although high foreign exchange exposure poses risks

We assign a Capital Adequacy and Leverage score of A1 to Letshego, two notches below its initial score. While we currently anticipate capital levels to drop further, Letshego's capitalisation level is expected to continue to underpin the current ratings. The company is currently well capitalised, with a reported shareholders' equity-to-total assets ratio of 42.6% as at June 2018 (Exhibit 3), which provides a solid buffer against any adverse changes to both the competitive environment and to its current business model.

Any material drop in capitalization, more than what we currently anticipate, could weigh on its current rating. To maximise shareholder returns, Letshego plans to increase leverage by acquiring more debt and/or reducing equity levels through share buybacks, hence our negative adjustment to Letshego's Capital Adequacy and Leverage score. Letshego's long-term target equity-to-total assets ratio is 30%, which still represents a robust level of capitalisation.

Exhibit 3

Letshego's capital metrics remain high, although they are on a downwards trend

Sources: Moody's Financial Metrics, Company's Financial Statements

Letshego's substantial currency risk exposure (as a result of its regional operations, 72% of loans are denominated in foreign/non-pula currencies) poses a downside risk to its capital levels. An appreciation in the Botswana pula would result in a decrease of its net foreign-currency assets, leading to negative implications for tangible common equity. However, Letshego is taking steps to reduce its net foreign-currency position, although we expect the progress to be slow. Letshego also has a moderate exposure to interest-rate risk because a portion of funding is floating rate, whereas all loans are fixed rate, although the large margins allow some room for interest-rate fluctuation.

Strong profitability supported by high margins

We assign a Profitability score of Aa1 to Letshego, in line with its initial score. We expect that profitability will remain sound despite declining loan yields. Loan yields have fallen on account of lower interest rates and increasing competition. While the company's diversification strategy will put some short-term pressure on profitability (through bank licensing costs and investments in fintech/information technology), this will be countered by a successful execution of its strategy that will lead to diversification benefits and will make profitability more resilient to a downturn in any one market.

The pre-provision income-to-average assets ratio remains relatively stable at 14.9% as at June-end 2018 (FY2017: 14.5%), as does the net income-to-average assets ratio at 7.9% (FY2017: 7.9%), following a 15% increase in operating income year-on-year. The cost-to-income ratio remains strong by global standards at a reported 40% as of June-end 2018, supported by Letshego's low-cost business model (the company minimises the use of inefficient branches/bricks and mortar in its operations). However, the ratio is above the company's internal target of 37%, having deteriorated from around 30% during FY2015 following (1) acquisitions in Nigeria and Tanzania (not included in 2015 figures) and (2) the company's ongoing investment spending in people, capabilities, and systems (operating expenses increased around 10% year on year, driven by increased staff, consultancy, licensing, information technology and travel costs).

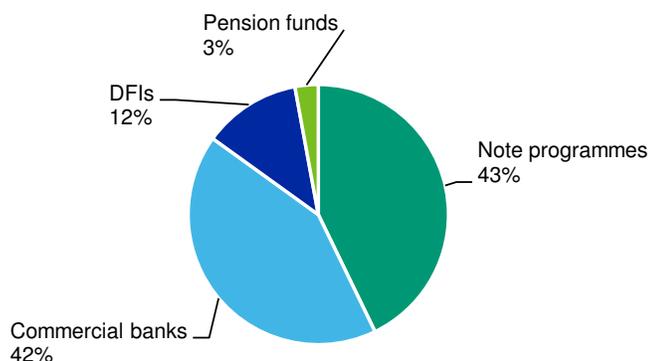
It is important to note, as part of its long-term strategy, Letshego plans to derive transactional based income through customer deposit accounts, which has the potential to diversify income sources and support its profitability over time.

Reliance on wholesale market funding and weak liquidity metrics

We assign a weighted average Cash Flow and Liquidity score of Ba2 to Letshego, one notch below its initial score. While we acknowledge that a significant source of funding is in the form of equity (which is permanent and of indefinite maturity), Letshego's remaining funding is primarily wholesale, which is inherently confidence-sensitive and vulnerable to disruption. As of June 2018, bond funding accounted for 43% of total borrowings, commercial bank funding for 42%, Development Finance Institution (DFI) funding for 12% and commercial paper/pensions funds for 3% (Exhibit 4). Letshego's liquidity metrics also remain low with its 24 month coverage ratio around 23% as of June 2018 (the above ratio is calculated as the level of cash and committed, unsecured bank lines available as a percentage of debt maturing within the next 24 months).

Exhibit 4

Letshego remains wholesale funded, although increasingly more diversified
 Breakdown of total borrowings (June 2018)



Source: Letshego

That said, over the past three years Letshego has diversified its funding structure, and improved its liquidity and asset and liability maturity profile through a Johannesburg Stock Exchange listed senior secured bond, senior unsecured bonds listed on the Botswana Stock Exchange (BWP300 million out of BWP2 billion had maturities of at least 10 years), and a medium term note (MTN) programme in both Ghana and Mozambique. The company plans to reduce borrowing from commercial banks and increase funding via debt capital markets, development finance institutions and customer deposits.

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to system-wide trends and market shares from the central bank. Bank/Company-specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document [Financial Statement Adjustments in the Analysis of Financial Institutions](#), published on 09 August 2018.

Rating methodology

The principal methodology used in this rating was [Finance Companies](#) rating methodology published in December 2018.

Rating methodology and scorecard factors

Exhibit 5

Letshego Holdings Limited: Finance Companies methodology scorecard

Financial Profile	Historical		Assigned			
	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	7.87%	Aa1	Aa1		
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	38.10%	Aa2	A1	Expected trend	Other adjustments
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.60%	Caa1	Caa1		
Net Charge-Offs / Average Gross Loans (%)	10%	0.02x	Baa2	Baa3	Expected trend	
Weighted Average Asset Risk Score			Ba3	B1		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	20.49%	Caa2	Caa3	Expected trend	
FFO / Total Debt (%)	15%	22.43%	Baa3	Ba1	Expected trend	
Secured Debt / Gross Tangible Assets (%)	20%	23.76%	Baa2	Baa2		
Weighted Average Cash Flow and Liquidity Score			Ba1	Ba2		
Financial Profile Score	0.4		Baa2	Baa3		
Operating Environment						
Home Country						
	Factor Weights	Qualitative Scale	Score			
Macro Level Indicator	0%		A3			
Economic Strength	25%	Moderate -				
Institutional Strength	50%	High				
Susceptibility to Event Risk	25%	Low				
Industry Risk	100%		Ba			
Home Country Operating Environment Score			Ba2			
	Factor Weights			Score	Comment	
Operating Environment Score	0.6			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	Susceptible to regulatory action that may affect payment at source eligibility	
Opacity and Complexity				0		
Corporate Behavior / Risk Management				0		
Liquidity Management				0		
Total Business Profile and Financial Policy Adjustments				Ba2		
Sovereign or parent constraint				A2		Comment
Standalone Assessment Range				ba1 - ba3		
Assigned Standalone Assessment				ba2		

Note: Scorecard extracts figures from annual reports and latest publicly available semi-annual financial statements.

Source: Moody's Investors Service

Ratings

Exhibit 6

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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