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CREDIT OPINION
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Update

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Letshego Holdings Limited

Semiannual update

Summary

The Ba3/Not Prime issuer ratings assigned to Letshego Holdings Limited (Letshego) capture the company's solid capitalisation and profitability, supported by its niche, low-cost, franchise. It also captures growing diversification across regional countries, which makes the company more resilient to an adverse change in any one of its operating markets.

The ratings balance these strengths against Letshego's (1) narrow, albeit gradually diversifying, business model, with a still 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.

The Ba3 issuer rating assigned to Letshego reflects its stand-alone credit profile. No external support has been imputed in Letshego's ratings given its limited importance to Botswana's payment system resulting from its small scale, and given that it does not have any material 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

» Narrow business model

» High foreign exchange risks

» Asset quality risks will likely remain elevated

» Reliance on wholesale market funding and weak liquidity metrics

Rating 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 potentially elevated credit risks from its regional and lending expansion.

Factors that could lead to an upgrade

» An upgrade of the company's ratings would depend on Letshego successfully developing broader African financial services operations, while maintaining strong profitability and capitalisation, and strengthening its liquidity profile.

Factors that could lead to a downgrade

» Negative rating pressure could be exerted on Letshego's ratings if regional authorities in the company's main operating markets impose restrictions on the deduction (at source) of loans and other 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 ratings if (1) Letshego's expansion in other sub-Saharan markets, client segments and products, results in any material weakening of asset quality and profitability metrics; or (2) Letshego's current sound capitalisation metrics were to materially weaken.

Key indicators

Exhibit 1
Letshego Holdings Limited

	H1 2017	2016	2015	2014 [1]	2013 [2]	2012
Total Managed Assets (BWP Million)	8,808	7,992	7,540	6,412	5,024	4,320
Total Managed Assets (USD Million)	858	748	670	674	550	540
Pretax Preprovision profits / Average Managed Assets	14.7%	14.8%	17.1%	36.8%	37.2%	23.3%
Net Income/ Average Managed Assets	8.7%	8.7%	11.0%	25.0%	26.1%	17.5%
ROE (NPATBUI / Avg. Equity) [3]	17.7%	16.4%	18.8%	18.5%	19.4%	25.5%
Tangible Common Equity / Tangible Managed Assets % [4]	44.7%	46.5%	52.0%	60.8%	67.4%	63.7%
Problem Loans/Gross Loans	--	9.3%	7.6%	4.5%	0.3%	0.8%
Problem Loans/(Shareholder Equity+ Loan Loss Reserve)	--	15.8%	11.6%	6.5%	0.4%	0.9%
Net Charge-offs / Average Gross Loans & Leases	--	2.4%	0.2%	1.7%	2.5%	1.0%

[1] For the fiscal year ending 31 December 2014 (11 months)
[2] For the fiscal year ending 31 January 2014
[3] NPATBUI refers to net profit (loss) after-tax before unusual items
[4] Tangible managed assets are assets including loan loss reserves, less intangible assets

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.

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 4.2 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 to 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

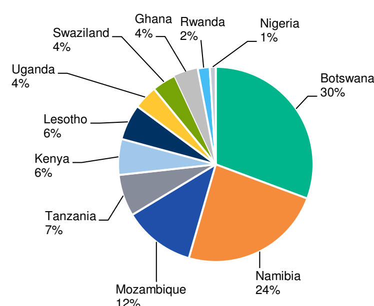
Letshego is gradually diversifying its (narrow) business model across products and countries

Letshego has a niche franchise specialising in unsecured loans to government and quasi-government employees under the payroll deduction model (around 88% of total loans). Under this model, loan repayments are taken directly from the employer prior to the monthly salary being distributed. 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, at the same time, its concentration to one single product exposes the company to potential volatility in financial metrics or any adverse developments in the regulatory and legal framework that may either (1) hamper the payroll deduction process (although not our base case scenario)[1], 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 broader-based 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 2017), Namibia (51% of government employees), and Mozambique (22% of government employees). In the rest of the markets Letshego generally exhibits a lower franchise sustainability given weaker brand name and market recognition compared to its more established markets.

Exhibit 2
Letshego's loan book is becoming increasingly diversified across countries
June 2017



Source: Letshego

This expansion will gradually reduce its overall dependence on payroll lending (by broadening customer segments and products) and support its deposit mobilisation capabilities. In the short-term, however, the company needs to manage potentially elevated credit losses from (1) higher credit costs in non-payroll related loans (micro finance group loans, micro and small enterprise business loans, and low-income housing loans) of around 4%-8% (albeit compensated by higher margins); (2) higher country risks; and (3) its relative inexperience in these newer markets and product offerings.

Asset quality risks will likely remain elevated

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 3% for the first six months of 2017, albeit

higher than the 2.6% reported in 2016. With Letshego gradually diversifying into non-payroll loans, non-performing loans (NPLs) and provisioning costs will likely increase, although this is countered by the higher margins available in non-payroll related lending and the diversification benefits obtained. In addition, the subdued economic environment in many countries where Letshego operates in, and the higher provisioning needs under new IFRS 9 guidelines (an issue faced by financial institutions globally) also imply further pressure on provisioning needs.

NPLs for December 2016 were at 9.3% (as per our policies NPLs include all impaired loans and loans past due by 90 days), significantly higher than the 7.6% in December 2015. Higher NPLs over the past three years are primarily due to (1) a change in the company's NPL classification policy, whereby all loans delinquent by more than 90 days are now classified, (2) challenging operating conditions in some of Letshego's regional operations, such as Mozambique, Rwanda and Kenya more recently, and (3) an increased portion of non-payroll related loans.

Reported loan loss provisions to pre-provision income increased to 19.2% during the first half of 2017, from 16% in December 2016 (end-2015: 11.8%), with the problem loans coverage (loan loss reserves to NPLs) deteriorating to 42% for December 2016 from 51% in December 2015, albeit higher than the 29% in December 2014. Letshego also has comprehensive credit insurance cover in markets like Namibia and Mozambique that increases the post-default recovery.

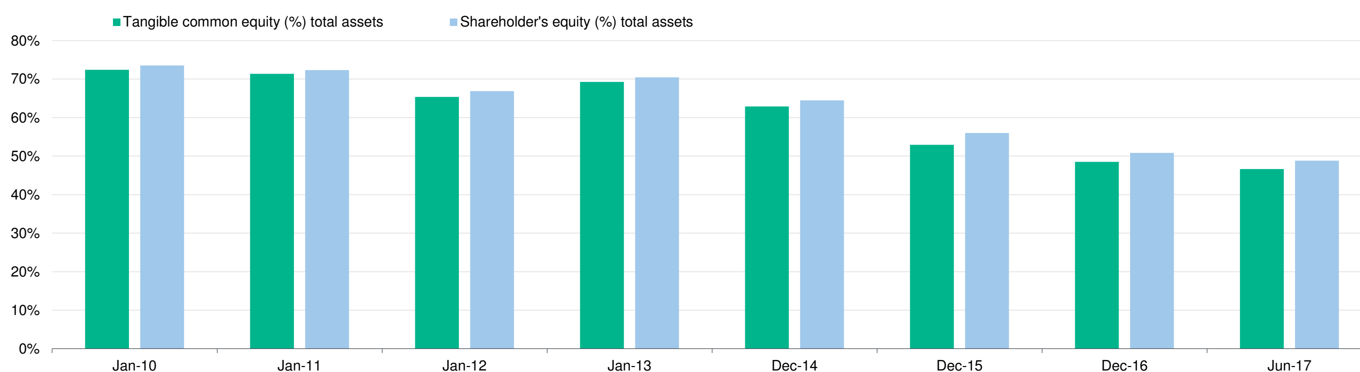
Solid capitalisation buffers, although high foreign exchange exposure poses risks

While we currently anticipate capital levels to further drop slightly, 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 48.8% at June 2017, despite a drop (Exhibit 3), which provides a solid buffer for the company to face any adverse changes both to 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 ratings. As part of its strategy, Letshego plans to acquire more debt and/or reduce equity levels through further share buybacks to optimize its capital structure. We understand, however, that management will not cancel any additional shares bought back which should maintain strong capital levels.

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) poses a downside risk to the currently solid capital levels. We estimate that a severe stress scenario of a 40% appreciation in the Botswana Pula would result in a decrease of its net foreign-currency assets, leading to a loss equivalent to over 30% of tangible common equity. Positively 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 expect that profitability will remain sound despite declining, albeit still strong, loan yields, owing to lower interest rates and increasing competition, and a higher cost base as a consequence of the company's broader financial services offering in certain markets.

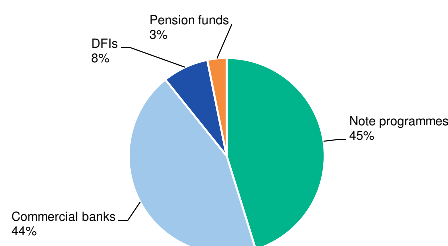
While the company's diversification strategy will put some pressure on profitability, this will be countered by a successful execution of its strategy that will lead to diversification benefits and will make profitability more resilient to a downturn in any one market.

The reported pre-provision income-to-average assets ratio remains relatively stable at 14.9% for the first six months of 2017 (FY2016: 15%, FY2015: 17.4%), as does the net income-to-average assets ratio at 8.8% (FY2016: 8.9%, FYE2015: 11.4%), following a 10% increase in operating income year-on-year. The cost-to-income ratio remains strong by global standards at a reported 40% during the first six months of 2017, supported by Letshego's low-cost business model and strategy. However, the ratio is above the company's internal target of 35%, having deteriorated from 29% during FY2015 following (1) recent 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 20% during H1 2017 year-on-year, driven by increased staff, consultancy, and travel costs).

Reliance on wholesale market funding and weak liquidity metrics

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 2017, bond funding accounted for 45% of total borrowings, commercial bank funding for 44%, Development Finance Institution funding for 8% and commercial paper for 3% (Exhibit 4). Letshego's liquidity metrics also remain low with its 24 month coverage ratio around 19% as of December 2016. 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
June 2017



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 the BWP2 billion had maturities of at least 10 years), and a medium term note (MTN) programme in both Ghana and Mozambique. The company continues to broaden its funding profile by tapping an increasing number of local institutional investors and financial institutions, as well as development finance institutions, while the company also aims to gradually tap 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 13 June 2017.

Rating methodology

The principal methodologies used in this rating were “Finance Company Global Rating Methodology”, published in October 2015. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies. Letshego's assigned rating is in line with the outcome of the Finance Company scorecard - as per the aforementioned methodology.

Rating methodology and scorecard factors

Exhibit 5

Letshego Holdings Limited

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View	Forward View
Non-Financial Factors						Ba	Ba
Factor: Franchise Positioning						**B**	**B**
- Market Position and Sustainability			x				
- Operational Diversification				x			
Factor: Risk Positioning						**Ba**	**Ba**
- Potential Volatility of Assets/Cashflows			x				
- Governance and Management Quality	x						
- Risk Management			x				
- Key Relationship Concentrations	x						
- Liquidity Management				x			
Factor: Operating Environment						**Ba**	**Ba**
- Economic Strength				x			
- Institutional Strength			x				
- Susceptibility to Event Risk			x				
Financial Factors						Ba	B
Factor: Profitability						**Aa/A**	**Aa/A**
- PPI / AMA	16.54%						
- Net Income / AMA	11.14%						
- Pre-tax Income Coefficient of Variation		34.88%					
Factor: Liquidity						**B**	**B**
- 24 Month Coverage Ratio					23.04%		
- Secured Debt / Gross Tangible Assets		18.62%					
Factor: Capital Adequacy						**Aa/A**	**Aa/A**
Capital Bucket: Traditional Finance Company							
- TCE / TMA	52.43%						
Factor: Asset Quality						**Ba**	**B**
- Problem Loans / Gross Loans				4.14%			
- Problem Loans / (Shareholders Equity + LLR)	6.17%						
Scorecard estimated stand-alone credit assessment:						**Ba3**	**Ba3**
Assigned Rating:						**Ba3**	

Ratings

Exhibit 6

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

Source: Moody's Investors Service

Endnotes

1 Under a scenario where authorities cease to facilitate the payroll deduction process, Letshego will be faced with an onerous change in its operating model, a sudden and substantial rise in bad debts and impairment costs (to over 10% of gross loans) and materially higher operating expenses.

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