IMARA INVESTING IN AFRICA

Securities

Letshego Holdings Ltd

Full Year Results to 31 December 2015

Marginal declines in earnings despite strong revenue generation……

Equity Research

Botswana

15 March 2016

Financial Services

Recommendation			BUY
Current Price (BWP)			2.50
Highest Price - last 12 months			3.50
Lowest Price - last 12 months			2.35
PER (x)			7.10
PBV (x)			1.31
Div. yield (%)			6.80
Earnings Yield (%)			14.06
Income Statement (BWP'm)	**FY 15**	**FY 14**	**%ch**
Net interest income	1,426.86	1,287.33	1.60%
Non-interest income	258.09	206.82	14.39%
Total income	1,684.95	1,494.15	3.37%
Impairments	-138.86	-91.48	39.15%
Operating expenses	-509.59	-432.53	8.00%
Profit before tax	1,036.49	970.13	-2.06%
Attributable earnings	767.71	721.85	-2.51%
EPS* (thebe)	35.15	33.17	-2.86%
DPS* (thebe)	17.00	16.50	3.03%
NAV/share (thebe)	191.41	188.35	1.62%
Balance sheet			
Cash on hand	526.29	320.54	64.19%
Loans and Advances	6,311.68	5,686.80	10.99%
Total Assets	6,837.97	6,007.34	13.83%
Deposits	231.86	4.00	5703.73%
Cash collateral	44.67	41.69	7.14%
Borrowings	2,768.41	1,937.84	42.86%
Liabilities & Equity	3,044.94	1,983.53	53.51%
Ratios			
Net interest margin*	23.78%	25.45%	
Cost-income	30.24%	28.95%	
non interest- total income	15.32%	13.84%	
Cost of risk	2.31%	1.81%	
RoaE*	18.55%	19.00%	
RoaA*	11.12%	12.77%	

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Against the backdrop of a tough economic climate and low interest rate environment which eroded NIMs across the banking sector, Letshego delivered a satisfactory performance during the year ended 31 December 2015 relative to its peers, reflected by a 10.99% increase in loans and advances, although registering marginal drops of 2.51% and 2.81% in attributable earnings and earnings per share, respectively. The period under review saw Letshego continue on its diversification strategy - geographically and by product offering - with deposit taking operations commencing in Tanzania and Nigeria and the launch of products such as asset financing. Letshego changed its year end from 31 January to 31 December during FY 14 therefore items on the comprehensive income statement in this scorecard were annualised to allow fair comparison and analysis year-on-year.

Our calculated NIMs shrunk by a moderate 167bps to 23.78% from 25.45% at FY 14, mainly attributable to thinner calculated net interest spreads y-o-y of 16.01% at FY 15 vs. 18.27% at FY 14 due to a 2.72pp increase in our derived average cost of funding to 13.22% during the period under review from 10.50% at FY 14, while calculated average asset yields remained relatively flat edging up by only 0.46pp to 29.23% at FY 15 (FY 14: 28.77%). Total credit extension grew by 10.99% to BWP 6.3bn from BWP 5.7bn at FY 14, benefitting from the 13.09% growth in the Group's borrowing customer base to 300,000 from 265,265 at FY 14, which consequently underpinned the 10.48% increase in interest income to BWP 1.8bn (FY 14: BWP 1.5bn). However, a 78.70% hike in interest expense to BWP 326.7m at FY 15 (FY 14: BWP 167.6m) weighed down the growth of net interest income, which translated into a modest 1.60% growth attained at FY 15. The rise in interest expense was mainly driven by a 38.81% increase in overdraft facilities and term loans, as well as an increase in foreign exchange losses (FY 15: BWP 75.7m vs FY 14: BWP 1.8m) relating to the increase in cross border borrowings from funders, and the weakening of the ZAR, NAD and MZM against the Botswana Pula.

The NIR to operating income ratio increased by 1.48pp to 15.32% y-o-y, as a result of a 14.39% rise in non-interest income to BWP 259.1m, which was underpinned by an 11.69% growth in income from insurance arrangements to BWP 163.8m (FY 14: 134.5m). The CIR increased from 28.95% at FY 14 to 30.24% at FY 15 on the back of an 8.00% increase in total operating expenses to BWP 509.6m which emanated from higher depreciation and amortisation (+49.26%); direct costs (+16.22%) and consultancy fees (+112.17%). The latter expense stemmed from costs incurred during the transition stage between the commercial terms being agreed and the regulatory approvals being obtained for the two acquisitions during the year, and external services employed to review and develop the overall micro finance operations in East Africa. Impairment charges increased by 39.15% to BWP 138.9m from BWP 99.8m at FY 14, partly due to operations in East and West Africa – as although the division contributes only 20.81% to the group's loan book, the operations consist mainly of micro lending and therefore have high impairment models.

This was mirrored by the 349.07% growth in the sector's impairment provisions to BWP 118.7m from BWP 26.4m at FY 14, subsequently accounting for 47.18% of the group's total impairment provisions at FY 15. The escalation in impairments subsequently translated into a 45bps increase in cost of risk to 2.31% from 1.81% attained at FY 14, still in alignment with the Group's appetite of between 1% and 3%. The effective tax rate rose by 2.54pp y-o-y from 23.39% to 25.93% at FY 15 and consequently the Group's bottom line decreased by 2.51% to BWP 767.7m compared to BWP 787.5m at FY 14. RoaE and RoaA declined to 18.55% and 11.12%, from 19.00% and 12.77% at FY 14, respectively. A final dividend of 8 thebe per share was declared, implying a dividend yield of 6.80% (FY 14: 6.90%) and a dividend cover of 2.07x (FY 14: 2.01x).

Total assets grew by 17.55% to BWP 7.5bn from BWP 6.3bn at FY 14 anchored by the aforementioned 10.99% y-o-y increase in customer advances to BWP 6.3bn and a 64.19% increase in cash and cash equivalents to BWP 526.3m from BWP 320.5m at FY 14.

Acquisitions of *Advans Bank Tanzania Limited* and *FBN Microfinance Bank Limited* (Nigeria) underpinned a 209.26% rise in goodwill to BWP 170.9m (FY 14: BWP 55.3m). During the period under review *Moodys* reaffirmed Letshego's Ba3 credit rating which further enabled the Group to increase gearing in its capital structure. The Company refinanced ZAR 475.0m of maturing bonds and raised an additional ZAR 180.0m, attaining a total ZAR bond issuance of ZAR 980.0m, consequently leading to a 42.80% increase in note programmes (FY 15: BWP 1.3bn vs FY 14: BWP 934.4m). This, alongside a 25.29% increase in interbank borrowings (FY 15: BWP 1.0bn vs FY 14: BWP 836.0m) drove the 42.86% rise in total borrowings to BWP 2.8bn, which subsequently underpinned the 45.57% growth in total liabilities to BWP 3.3bn from BWP 2.3bn attained in the comparative period. The result of this was an increase in the debt to equity ratio to 66.20% at FY 15, compared to 47.33% at FY 14.

As at 31 December, the Group's principal sources of debt financing were as follows: Medium Term (48%), Commercial Bank (38%), Development Funding (10%) and Commercial Paper (4%), and of the BWP 2.7bn borrowings - short term borrowings increased to BWP 1.2bn vs. BWP 632.0m at FY 14; while long term borrowing rose to BWP 1.5bn vs BWP 1.3bn in the corresponding period. Total deposits stood at BWP 231.9m (7.06% of total liabilities) vs. BWP 4.0m at FY 14 (0.17% of total liabilities). The largest contributors to customer deposit growth to BWP 154.5m (FY 14: BWP 4.0m) were from the Mozambique and Rwanda divisions. The consolidation of FBN Microfinance Bank Limited saw it contribute the totality of the Group's short term deposits from banks of BWP 77.4m, or 2.36% of total liabilities.

Table 1.0: Regional Loan Book Portfolio

Country	% loan book as at FY 14	% loan book as at FY 15
Botswana	35%	34%
Kenya	4%	6%
Mozambique	20%	17%
Namibia	24%	22%
Tanzania	5%	6%
Uganda	4%	5%
Swaziland	3%	2%
Rwanda	2%	3%
Lesotho	3%	4%
Nigeria	-	7%

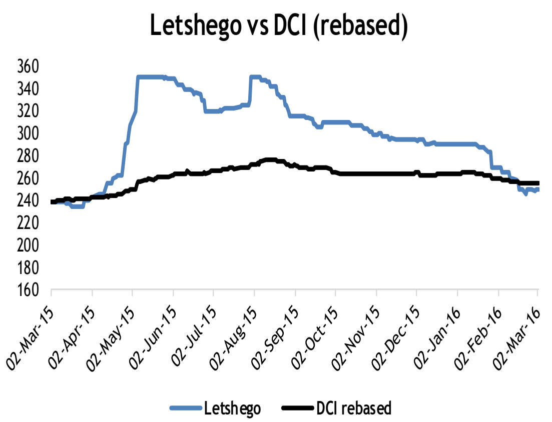
Source: Letshego Results Presentation

The NPL ratio increased by 3.47pp to 9.65% at FY 15 vs. 6.18% on the back of a 73.44% increase in the Group's total non-performing loans to BWP 609.1m within the domain of general economic pressures which weighed down consumer disposable incomes. According to the IMF World Economic Outlook (January 2016), the Sub-Saharan region registered a 150 bps drop in economic growth to 3.5% at FY 15 from 5.0% at FY 14, while Nigeria also recorded a decline from 6.3% at FY 14 to 3.5% at FY 15. The Southern Africa division accounted for 74.59% of the Group's NPLs (FY 14: 76.77%); while the East and West Africa division contributed 25.41% (FY 14: 23.23%). Accordingly, the Group's NPL coverage ratio increased from 0.22x at FY 14 to 0.41x at FY 15. The East and West Africa division has a riskier model compared to the Southern Africa division – as at FY 15, 100% of the customer base in the sector were payroll customers while 100% of customers in Nigeria and Rwanda were non-payroll customers. A further 70% and 40% of Kenya and Uganda's customer base were also non payroll customers, respectively. It was in this regard that at FY 15 the East and West Africa's NPL coverage was 0.77x vs Southern Africa division's coverage of 0.29x.

The Group continued to diversify its loan book portfolio as demonstrated in Table 1.0. Most geographic operations recorded solid loan book growth y-o-y with Kenya's smaller and more diversified portfolio growing the most (+110%) to BWP 400.0m, followed by Rwanda (+62%), Lesotho (+32%) Tanzania and Uganda (both +14%); excluding Swaziland (-5%), Mozambique (-4%) and Namibia (-2%). Due to strong competition, the Botswana segment increased loans and advances by a modest 7%, 4pp less than the corresponding period's 11%.

Letshego currently trades at a PER and PBV of 7.10x and 1.31x respectively, which is generally lower than its deposit taking peers in Botswana, expectedly. It continues to drive its financial inclusion strategy by delivering financial services to sections of disadvantaged and low/middle income segments of society and now has 4 deposit taking licenses, which facilitate services such as money transfer, bill payment and remittance services. Being an unsecured micro lender, the Group's key strength lies in maintaining a quality book, mainly through the deduction at source payroll model. Generally, we buy the company's growth and diversification story. Letshego continues to expand its income streams by pursuing geographic, customer and product mix diversification. Despite disposing of the South Sudan division in March 2015, diversifying outside of Botswana is on track with operations in 9 countries outside Letshego's mainstay operation in Botswana.

We expect the Group's RoE to improve next year through both organic growth but also due to the fact that while the acquisitions in Tanzania (November 2015) and Nigeria (December 2015) only consolidated revenues for a short period, they consolidated the full balance sheet, hence having a disproportionate impact on RoE, while next year revenue from the two acquisitions will be consolidated for a full 12 months. Products that were launched during FY 15 include agriculture supply chain financing, asset financing and micro insurance, and management has reiterated the Company's intention to pursue customer diversification through non-government payroll customers. Moreover, the acquisition of deposit taking businesses to expand deposit capabilities will, in the long term, lower the Group's overall cost of funding. Although the counter's price has been subdued partly as a result of a share overhang, and possibly consequential to the Group not acting on the announced share buyback since 27 April 2015 - we believe that the counter has a progressive trajectory. Our valuation yields a target price of BWP 3.13, representing an upside of 25.28%, accordingly, we maintain our **BUY** call.



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