

# MOODY'S INVESTORS SERVICE

## Credit Opinion: Letshego Holdings Limited

Global Credit Research - 03 Jun 2014

Gaborone, Botswana

### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Ba3
ST Issuer Rating	NP

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### Key Indicators

#### Letshego Holdings Limited

Total Managed Assets (BWP Million)	[1] 2013	4,970.2	2012	4,279.2	2011	3,212.7	2010	2,430.2	2009	1,915.4	2008	1,401.0
Total Managed Assets (USD Million)		540.5		538.6		404.4		305.9		241.1		176.3
Pretax Preprovision profits / Average Managed Assets		20.06%		23.40%		26.77%		30.64%		33.49%		22.71%
Net Income/ Average Managed Assets		14.13%		17.61%		20.48%		21.78%		22.92%		15.64%
ROE (NPATBUI / Avg. Equity) [2]		20.31%		26.15%		28.74%		30.57%		37.73%		32.84%
Short Term Debt / Total Debt % [3]		–		18.17%		38.60%		24.04%		31.98%		56.74%
Tangible Common Equity / Tangible Managed Assets % [4]		68.17%		64.33%		70.40%		71.67%		69.94%		46.61%
Problem Loans/Gross Loans		–		4.73%		5.28%		1.42%		3.00%		2.15%
Problem Loans/(Shareholder Equity+ Loan Loss Reserve)		–		5.70%		7.07%		1.87%		3.75%		4.25%
Net Charge-offs / Average Gross Loans & Leases		–		1.04%		1.96%		1.60%		2.77%		1.44%

	2013	2012	2011	2010	2009	2008
4,970.2	4,279.2	3,212.7	2,430.2	1,915.4	1,401.0	
540.5	538.6	404.4	305.9	241.1	176.3	
20.06%	23.40%	26.77%	30.64%	33.49%	22.71%	
14.13%	17.61%	20.48%	21.78%	22.92%	15.64%	
20.31%	26.15%	28.74%	30.57%	37.73%	32.84%	
–	18.17%	38.60%	24.04%	31.98%	56.74%	
68.17%	64.33%	70.40%	71.67%	69.94%	46.61%	
–	4.73%	5.28%	1.42%	3.00%	2.15%	
–	5.70%	7.07%	1.87%	3.75%	4.25%	
–	1.04%	1.96%	1.60%	2.77%	1.44%	

[1] For the fiscal year ending January 31, 2014 [2] NPATBUI refers to net profit (loss) after-tax before unusual items [3] Short term debt refers to short term borrowings as reported by the company [4] Tangible managed assets are assets including loan loss reserves, less intangible assets

### Opinion

#### Rating Rationale

The Ba3/Not Prime issuer ratings assigned to Letshego Holdings Limited (Letshego) remain constrained by the company's narrow business model, with a high reliance on payroll deductions for loan repayment collections that expose the company to potential regulatory and legal changes in Botswana and elsewhere, and high exposure to foreign exchange risk. In addition, while the company has diversified and broadened its funding profile over the past few years, it remains dependent on market-sensitive wholesale funding.

More positively the rating benefits from strong, albeit declining, profitability (the net income-to-average assets ratio stood at 14.1% during the fiscal year ending January 2014, FYE2014) and solid capitalisation (the tangible common equity-to-tangible managed assets ratio was 68%), which provide the company with a solid buffer to

absorb the negative effect of any adverse changes either in the competitive environment or in its current business model.

While we acknowledge that the company's strategy to diversify its business model is long-term credit positive, the company will need to adequately manage new and increasing risks in the short term. The company aims to gradually increase its geographical footprint and reduce its overall dependence on payroll lending, by broadening its customer segments and products, and build broader financial services operations with deposit mobilisation capabilities.

The Ba3 issuer rating assigned to Letshego reflects its standalone 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 the fact that it does not have any customer deposits.

### **Rating Drivers**

- Established niche, but narrow franchise
- Regulatory and legal framework remains vulnerable to changes in Botswana and elsewhere, with potentially higher credit and operating costs
- Reliance on wholesale market funding; although it has diversified and broadened its funding profile
- Good profitability and solid capitalisation that provide a good buffer for the company to meet any adverse changes to its current business model
- High exposure to foreign exchange risk

### **Rating Outlook**

The company's ratings carry a stable outlook. The outlook has been changed to stable from negative in December 2013, reflecting our assessment of the reduced risk of authorities in Botswana imposing restrictions on Letshego's payroll deduction business model.

### **What Could Change the Rating - Up**

An upgrade on the company's ratings would depend on Letshego successfully developing broader African financial services operations, while maintaining strong financial performance (profitability, asset quality and capitalisation). We expect these operations to help (1) diversify its funding profile; (2) strengthen its overall franchise; and (3) enhance the regulatory and supervisory framework.

### **What Could Change the Rating - Down**

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 sudden rise in bad debts and impairment costs. In addition, negative rating pressure could be exerted on the ratings if Letshego's expansion in other sub-Saharan markets, client segments and products, results in any material weakening of asset quality, profitability and capitalisation metrics.

## **DETAILED RATING CONSIDERATIONS**

### **ESTABLISHED NICHE, BUT NARROW FRANCHISE**

Letshego is a successful niche consumer finance company operating successfully in 10 sub-Saharan African countries (including Botswana, Namibia, Mozambique, Tanzania), primarily offering unsecured loans to government and quasi-government employees. However, Letshego remains highly reliant on its limited payroll lending product offering and payroll deduction model, and there are fairly low barriers to entry in its main operating markets. While we acknowledge that the company's strategy to diversify its business model is long-term credit positive, the company will need to adequately manage new and increasing risks in the short term.

The company has a strong niche franchise within Botswana (where it does payroll lending to around 21% of all government employees) and Namibia (where it does payroll lending to around 46% of all government employees), benefiting from a quick and efficient loan-approval and disbursement process. As of the fiscal year ended January 2014, operations in Botswana contributed 36% of revenue, Namibia 20% and Tanzania 14% (where Letshego

does payroll lending to around 10% of all government employees). Operations in Mozambique have also been growing very rapidly since their launch in 2011 and already contribute 11% of revenue (the company does payroll lending to around 10% of all government employees). None of the remaining markets contribute more than 5% of revenue.

The bank's strategy to become a pan-African broad-based financial institution, recent acquisitions and the progress made in acquiring banking licenses in several territories, will gradually reduce its overall dependence on payroll lending (by broadening customer segments and products) and support its deposit mobilisation capabilities. Given that short-term franchise growth opportunities within Botswana are diminishing and interest yields are becoming more competitive, the company is also seeking to strengthen its regional expansion. The company has recently acquired Micro Africa Limited - a financial group based in Kenya specialising in small, medium and micro enterprises and unsecured consumer lending that also has regional operations in Rwanda, South Sudan and Uganda - while it has also recently announced it is negotiating to acquire another financial institution in East Africa. In addition, Letshego has acquired a deposit-taking license in Mozambique and Rwanda, and is in the process of applying for a banking license in Namibia.

While long-term credit positive, in the short-term Letshego needs to balance the higher country risks, and Letshego's limited experience and fairly weaker brand name and market recognition, which leads to a lower franchise sustainability in most of the regional markets outside Botswana and Namibia. Letshego is also inexperienced in some of the new product offerings, all of which may lead to elevated credit losses in the short term.

#### **LETSGO REMAINS EXPOSED TO POTENTIAL ADVERSE REGULATORY AND LEGAL CHANGES THAT WOULD LEAD TO HIGHER CREDIT AND OPERATING COSTS, DESPITE ITS GRADUAL DIVERSIFICATION**

The outlook on the ratings has recently been changed to stable to reflect our assessment of a lower likelihood that the authorities in Botswana will impose restrictions on the company's payroll deduction model. In addition, Letshego's credit profile has become increasingly better positioned to absorb any negative change in the regulatory or legal framework in any of the company's main operating markets. This is a result of Letshego's increased geographical diversification and gradual progress in its strategy to acquire banking licenses in its main operating markets.

However, despite improvement, Letshego's narrow product base continues to expose the company to any potential adverse regulatory and legal changes in Botswana and elsewhere. While the company has its own affordability criteria, Letshego also adopts a payroll deduction model whereby loan repayments are taken directly from the employer (mainly the government) prior to the monthly salary being paid to customers, facilitated through a Central Registry, which combines all deductions from the government and checks that regulatory loan affordability requirements are adhered to. A Central Registry reduces collections costs and improves collection statistics, although a Central Registry is not in place in some of its important markets like Mozambique and Tanzania.

As such, while not our central scenario, governments in Letshego's main operating markets may unexpectedly decide to cease to facilitate these payroll deductions. Under such a stress scenario, 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 as Letshego would need to implement new collection mechanisms (the company maintains direct debit agreements with all customers). At the moment, the company has limited experience in developing underwriting models and standards that will allow it to manage the higher potential credit costs of alternative deduction models. Letshego is also exposed to other regulatory risks such as a potential lower cap on the effective interest rate it can charge on loans that will lead to lower earnings generation.

As a result of Letshego's payroll deduction model and the group's policy of having credit insurance on each loan, credit costs have historically been maintained at fairly low levels of 1%-3% per annum, with the loan impairment charges-to-average loan book ratio at 1.7% for the year ended 31 January 2014, which was slightly up from last year owing to a higher contribution by Micro Africa (FY2013: 1.1%; FYE2012: 1.6%; FYE2011: 1.9%). On evidence of impairment (e.g., when a debtor becomes unemployed), the company writes-off the loan, resulting in a low level of impaired loans as a proportion of total loans.

#### **RELIANCE ON WHOLESALE MARKET FUNDING, ALTHOUGH IT HAS DIVERSIFIED AND BROADENED ITS FUNDING PROFILE**

The company relies primarily on wholesale funding to support its activities, which is inherently confidence-sensitive and vulnerable to disruption. However, we acknowledge that the company has diversified and lengthened its funding structure. Over the past 18 months, the company issued a South African rand-denominated ZAR700 million (BWP647 million) senior secured bond (listed on the Johannesburg Stock Exchange), and senior unsecured bonds amounting to BWP350 million, (listed on the Botswana Stock Exchange), out of which BWP300 million had maturities of at least 10 years. The bond issue proceeds have also improved Letshego's liquidity profile, and the asset and liability maturity profile. As mentioned above, the company also aims to gradually tap customer deposits.

### STRONG PROFITABILITY AND SOLID CAPITALISATION BUFFERS

Letshego's profitability and capitalisation levels, provide the company with a solid buffer to face any adverse changes both to the competitive environment and to its current business model.

With tangible common equity-to-total assets of 67% at FYE2014 (FYE2013: 63%, FYE2012: 70%), the company is well capitalised. We expect that the company will remain well capitalised despite capitalisation potentially declining towards industry norms of around 30%-40% as the company acquires more debt in order to finance its loan growth.

We also expect that profitability will remain strong despite declining trends with lower, albeit still strong, loan yields, owing to lower interest rates and increasing competition, and a higher cost base as a consequence of the bank's broader banking offering in certain markets. The pre-provision income-to-average assets ratio was 20% during FYE2014 (FYE2013: 23.4%, FYE2012: 26.8%) and the net income-to-average assets ratio was 14.1% (FYE2013: 17.6%, FYE2012: 20.5%). The net interest margin was 25% during FYE2014 - broadly stable from FYE2013 but lower compared with 30% during FYE2012.

Certain one-off events have weighed on bottom line earnings growth for the year, compared with last year, such as higher operating charges (up 48%) as a result of the consolidation of Micro Africa for the full year (it was only included for seven months last year), and higher provisions against assets in South Sudan. As a consequence of these, but also the higher investment in human resources and infrastructure, the cost-to-income ratio increased to 33% during FYE2014, compared with 26% the previous year.

### HIGH EXPOSURE TO FOREIGN EXCHANGE RISK

Letshego has substantial currency risk exposure as a result of its regional operations and 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, with around a 90% impact on FYE2013 profitability or 21% of tangible common equity.

Letshego also has a moderate exposure to interest-rate risk, as a portion of funding is floating rate, whereas all loans are fixed rate; although the large margins allow some room for interest-rate fluctuation.

### SOURCES OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, data related to system-wide trends and market shares are sourced from the central bank and the company's regulator (the Non-Bank Financial Institutions Regulatory Authority or NBFIRA). Issuer-specific figures originate from the company's 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 documents entitled "Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies" and "Frequently Asked Questions: Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies", both published on 19 July 2012.

### RATING METHODOLOGY

The principal methodologies used in this rating were "Finance Company Global Rating Methodology", published in March 2012. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies. Letshego's assigned rating is in line with the outcome of the finance company's scorecard.

### Rating Factors

Letshego Holdings Limited

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View		Forward View
<b>Non-Financial Factors</b>						<b>B</b>		<b>B</b>
<b>Factor: Franchise Positioning</b>			x	x		<b>B</b>		<b>B</b>
- Market Position and Sustainability								
- Operational Diversification								
<b>Factor: Risk Positioning</b>			x	x		<b>B</b>		<b>B</b>
- Potential Volatility of Assets/Cashflows								
- Governance and Management Quality								
- Risk Management								
- Key Relationship Concentrations								
- Liquidity Management	x			x				
<b>Factor: Operating Environment [1]</b>			x			<b>B</b>		<b>B</b>
- Economic Strength		x						
- Institutional Strength		x						
- Susceptibility to Event Risk		x						
<b>Financial Factors</b>						<b>Baa</b>		<b>Baa</b>
<b>Factor: Profitability</b>						<b>Aa/A</b>		<b>Aa/A</b>
- PPI / AMA	26.94%							
- Net Income / AMA	19.96%							
- Pre-tax Income Coefficient of Variation		35.39%						
<b>Factor: Liquidity</b>			95.06%			<b>Baa</b>		<b>Baa</b>
- 24 Month Coverage Ratio			95.06%					
- Secured Debt / Gross Tangible Assets			18.15%					
<b>Factor: Capital Adequacy</b>						<b>Aa/A</b>		<b>Aa/A</b>
Capital Bucket: Traditional Finance Company								
- TCE / TMA	64.33%							
<b>Factor: Asset Quality</b>				3.81%		<b>Ba</b>		<b>Ba</b>
- Problem Loans / Gross Loans				3.81%				
- Problem Loans / (Shareholders Equity + LLR)	4.88%							
<b>Scorecard estimated stand-alone credit assessment:</b>						<b>Ba3</b>		<b>Ba3</b>
<b>Assigned Rating:</b>							<b>Ba3</b>	

[1] Capped at B; The operating environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.



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