LETSHEGO HOLDINGS (NAMIBIA) LTD
1H19 Results Review
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Letshego Holdings (Namibia) Ltd

1H19 Results Review

Target Price (c)	***437***
Current Price (c)	332

Year End 31 December	2016	2017	2018	F2019	F2020
Net interest income (N$ million)	331	471	479	535	542
Non-interest income (N$ million)	230	207	255	261	269
Profit after tax (N$ million)	330	385	381	416	419
HEPS (c)	66	71.7	76.2	83.2	83.9
DPS (c)		19.2	23.5	25.6	25.9
DY (%)	-	4.8	6.7	7.7	7.8
P/E	5.8	5.2	4.6	4.0	3.9
P/B	1.3	1.1	0.8	0.8	0.7

Recommendation	BUY
NSX Code	LHN
Market Cap (N$m)	1,660
Shares in Issue (m)	500
Free float (%)	22
52 week high	398
52 week low	332
Expected Total Return (%)	38.9%

Source: LHN, IJG Securities

1H19 Results

Letshego Holdings (Namibia) Ltd (LHN) released interim results for the period ended 30 June 2019 (1H19). Earnings and headline earnings per share increased by 2.2% y/y from 46cps to 47cps, and profit after tax increased by 2.2% y/y to N$235.1 million. Normalising earning for the change in interest expense due to the preference share conversion, however, sees EPS increase by 2.9% to 39.6cps. As the company pays dividends annually, no interim dividend has been declared.

Total revenue for 1H19 increased by 4.0% y/y to N$447.7 million, with interest income from lending activities increasing by 2.5% to N$300.7 million. This growth is relatively low compared to the double-digit growth figures seen in recent years, but is a result of the economic environment that LHN operates in. Management notes in the results release that it expects economic conditions to remain challenging over the medium term.

Advances to customers increased by 6.5% y/y or N$16271 million, bringing the total advances to customers to N$2.66 billion. This is slightly slower than PSCE growth of 7.1% over the same period. The credit impairment charge for the period was N$9.9 million, which represents 0.7% (annualised) of gross advances. This follows an impairment charge of N$2.3 million in 1H18.

Operating expenses increased by 6.8% y/y in 1H19 as a result of a N$5.9 million (24.7%) increase in employee benefit expenses. Apart from this increase, operating expenses were well contained. LHN's cost to income ratio increased somewhat from 23.6% to 24.1%, which management notes in the results release is due to "capacity investments against compressing margins."

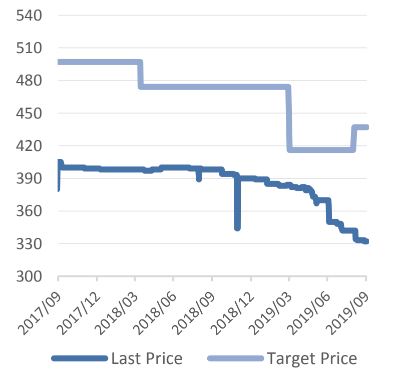
LHN reduced its cash holdings of N$750.9 million at FY18 markedly to N$213.1 million at 1H19. The cash was mainly used to grow LHN's advances portfolio and to redeem some of the preference shares. The N$330.8 million redemption of the preference shares is positive in our view, as the cost of this funding is relatively high.

Deposits due to customers decreased by a significant N$60.6 million from N$74.7 million at FY18 to N$14.2 million at 1H19. This is a result of term deposits falling during the period. LHN also used some of its cash to pay back borrowings from commercial banks, which decreased from N$341.1 million at FY18 to N$233.6 million at 1H19. Intercompany payables due to LHL decreased by N$13.4 million to N$110.0 million. LHN remains highly capitalised as Tier 1 capital increased from 68.7% in FY18 to 75.0% in 1H19, while Tier 2 fell from 26.5% in FY18 to 20.1% in 1H19, as a result of the redemption of the preference shares.

Valuation

Using a panel of standard valuation techniques, a cost of equity of 19.4% and a return long-term sustainable return on equity of 20.0%, we derive a target price of N$c437 per share. Coupled with an expected dividend of 24 cps, we expect a total return of 38.9%. As a result of the apparent discount to fair value, we maintain or **BUY** recommendation.

LHN Share Price vs Target Price (c)



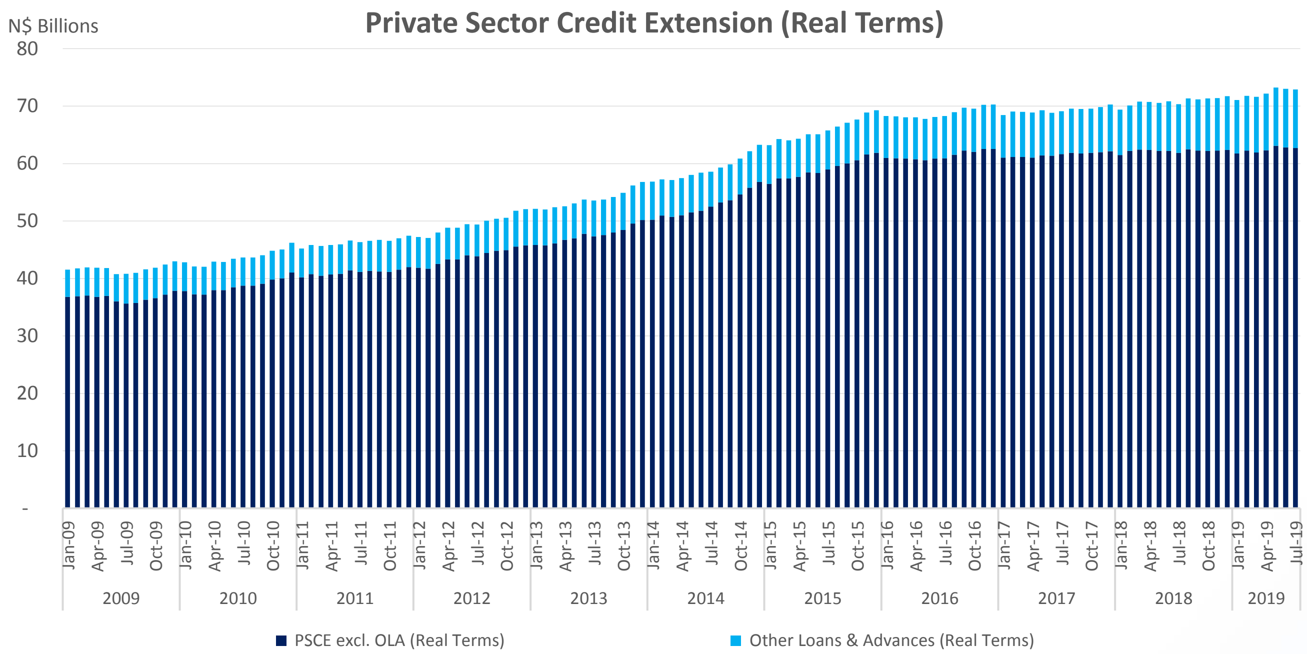
Dividends

No interim dividend has been declared.

Macro Backdrop

The Namibian economy continues on its downward trajectory as domestic economic activity remains depressed. In its July 2019 Economic Outlook, the Bank of Namibia (BoN) again revised its growth forecast downwards and now expects the Namibian economy to further contract by 1.7% in 2019 with marginal positive growth of 0.8% expected in 2020, and 1.2% in 2021.

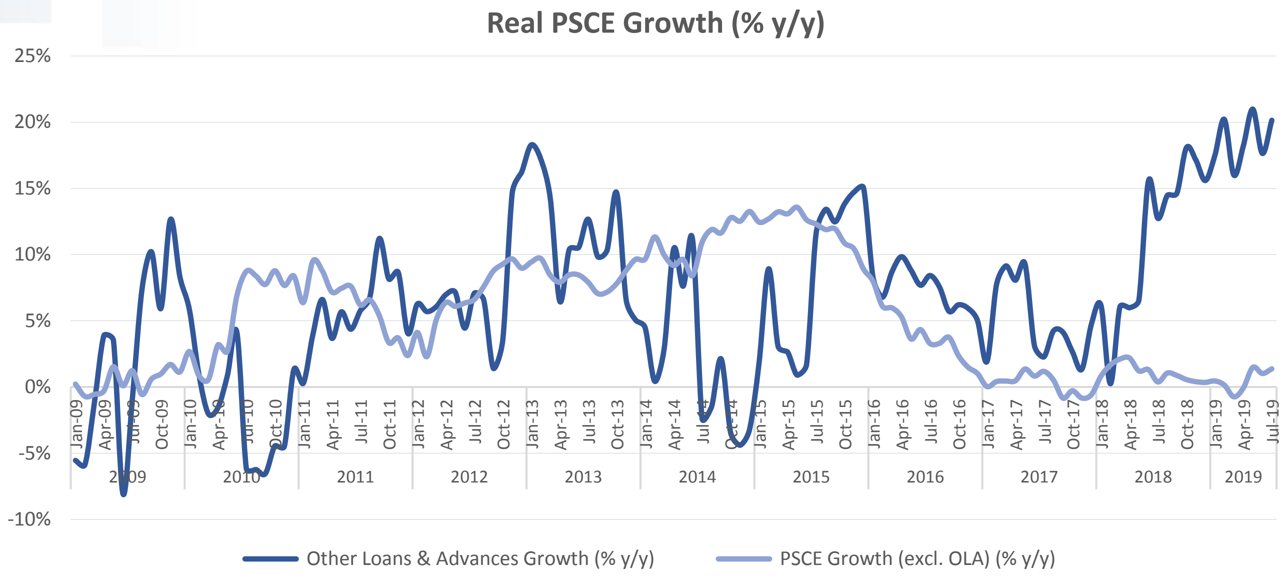
A recessionary environment puts pressure on consumers' disposable incomes and may increase their need for credit while reducing creditworthiness, transmitting this pressure onto financial institutions. The graph below shows that although the amount of credit that has been extended to the private sector has remained relatively flat in real terms since the recession started in 2016, the 'Other Loans and Advances' category of PSCE has taken up a larger share of the credit extended. This category consists of credit card debt, personal, and term loans. This is concerning as this type of debt is typically used to satisfy short-term needs and is unlikely to drive meaningful expansion of productive capacity.



Source: BoN, IJG Securities

At December 2015, 'Other Loans and Advances' (OLA) to individuals made up around 8.5% of total consumer credit. This proportion increased to 9.3% at the end of 2016 and 10.1% at the end of 2017. At the end of 2018, total OLA to individuals reached to N$6.37 billion, making up 11.2% of total individual credit. At July 2019, this proportion has increased to 14.5%.

In real terms, the 'Other Loans and Advances' category has been increasing at an average annual rate of 18.7% since the beginning of 2019. This compares to average real annual PSCE growth of 0.5% over the same period (excluding the OLA category).

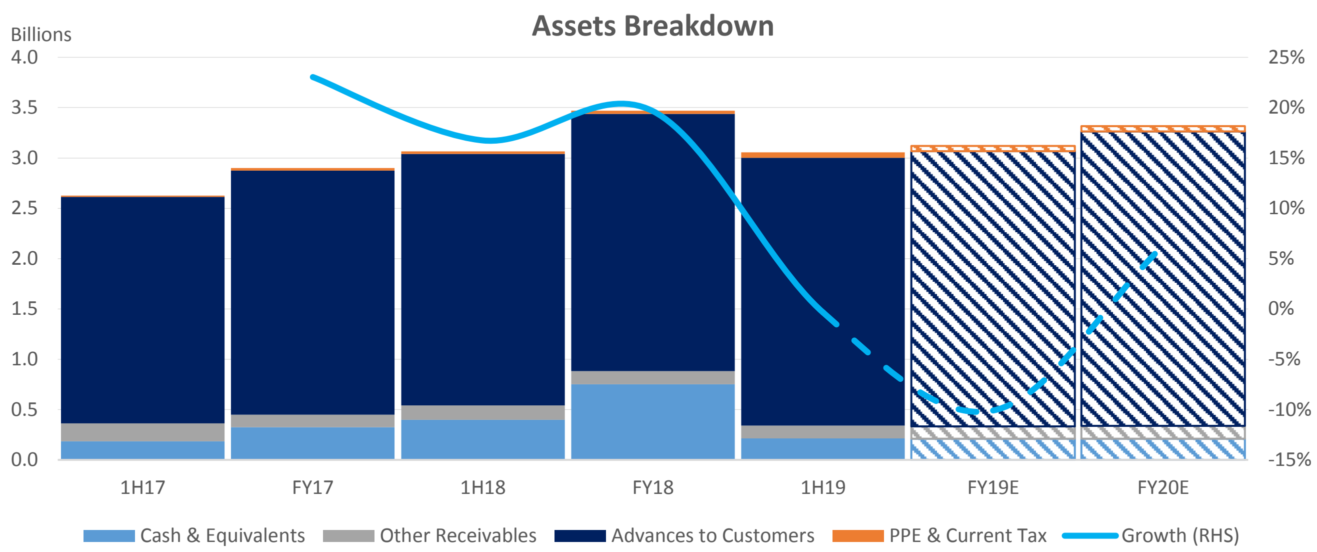


Source: BoN, IJG Securities

The high growth rate of 'Other Loans and Advances' is reflective of the dire economic situation both businesses and consumers find themselves in. This growth rate is however unsustainable in the long-run, especially when the borrowing has been used for consumptive purposes. This is concerning as not much improvement is expected in the country's economic performance in the short-term, meaning that it will become increasingly difficult for consumers to pay back these loans. Even during the best of economic times this type of credit is very risky as it is characterised with high default rates. The high growth rate in 'Other Loans and Advances' could possibly be pointing to a bubble in the short-term credit space if domestic economic conditions do not improve.

Asset Base
Growth

Letshego's total assets fell by 12.0% from FY18 to N$3.05 billion at 1H19. This is mostly due to LHN reducing its massive cash pile of N$750 million during the period. Cash and cash equivalents decreased by N$537.8 million to N$213.1 million at 1H19. The reduction in LHN's cash balance was larger than we expected. Management indicated at FY18 that the large cash balance is not a true representation of LHN's actual cash position, as a large portion of cash came in at the end of the financial period and that a large portion had been utilised just after. A significant portion of the cash was used to redeem some of the preference shares (see section on Funding), while N$117.5 million was used to pay dividends to ordinary shareholders.



Source: LHN, IJG Securities

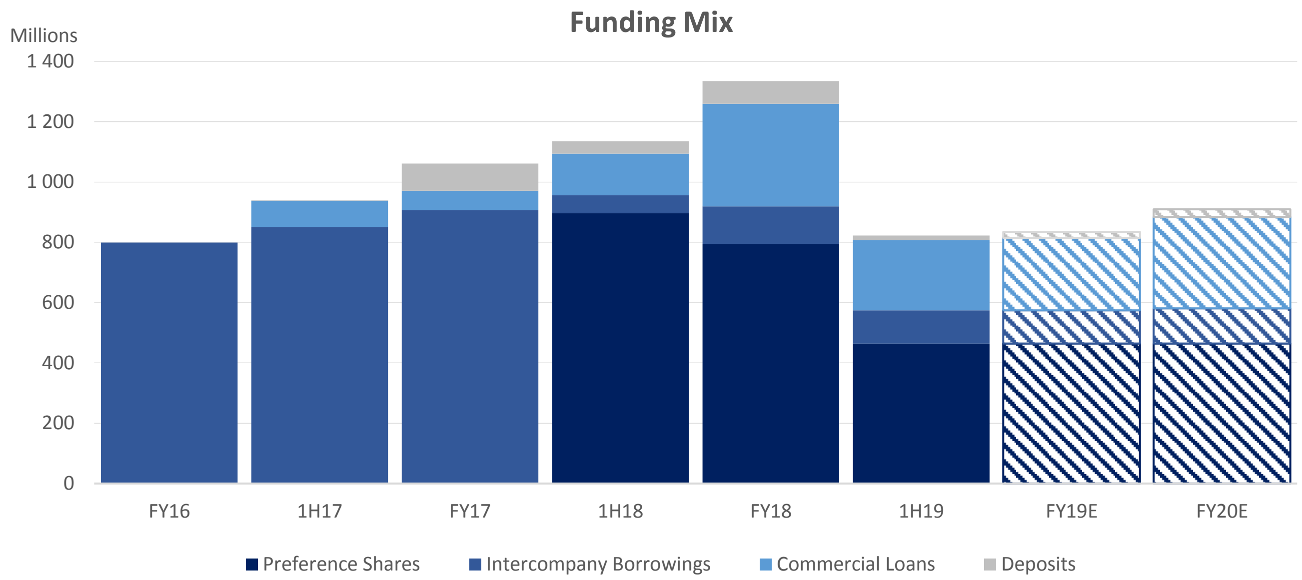
LHN's advances portfolio increased by 6.5% y/y (N$162.7 million) to N$2.66 billion in 1H19, distributed among 49,976 customers. Over the same period, PSCE grew at 7.1%, with the 'Other Loans and Advances to individuals' category, growing by 22.9%, which is the category which LHN operates in.

The fact that LHN's loan book isn't growing as quickly as the OLA category is not necessarily bad in our view if it is due to the company being more prudent in extending these relatively high-risk loans. If the fast growth that the short-term credit sector is currently experiencing does turn out to be a bubble, default rates will likely rise steeply if the economy doesn't show improvement in the medium term, resulting in losses for microlenders such as Letshego. Given the trajectory of the Namibian economy, as expected by the Bank of Namibia and IJG amongst others, slow advances growth should be viewed in a positive light if it has been a deliberate move toward prudence by LHN. The other possibility that exists is that LHN is struggling to keep up with competing microlenders, and is unable to grow its loan book as quickly, losing market share as a result.

Management points out that it is due to LHN being more conservative on growing the loan book and that a lot of focus has been placed on the quality of the book in recent months. A focus on quality and a lack of demand growth from government employees in tandem have in our view resulted in the slowed advances growth. Given the economic climate it is prudent to remain within the safety-net provided by deduction at source.

Other receivables, consisting mostly of income receivable from the cell captive arrangement with Hollard Insurance, decreased by N$4.7 million from N$131.3 million at FY18 to N$126.6 million at 1H19.

Funding



Source: LHN, IJG Securities

Following the redemption of N$100 million worth of preference shares during the second half of 2018, LHN once again redeemed preference shares in 1H19. This time N$330.8 million worth of preference shares were redeemed, which brings the amount outstanding to N$464.4 million. This is a positive development in IJG's view as this funding is relatively expensive compared to wholesale funding, and LHN was sitting with ample cash to redeem some of the preference shares. The redemption of the preference shares is at LHN's discretion according to management, giving them the flexibility to decide on when to redeem the shares.

LHN decreased its commercial bank borrowings by N$107.5 million to N$233.6 million in 1H19. At the end of 1H19, LHN had two loans from commercial banks maturing in December 2020 and June 2021. A portion of both of these loans were paid back in 1H19 as management continues to focus on balance sheet management. Intercompany payables to LHL decreased by N$13.4 million to N$110.0 million.

Deposits due to customers decreased by a substantial N$60.6 million in 1H19 to N$14.2 million, as a result of corporate client deposits that matured during the period. Management have noted that the intention is to focus on increasing retail client deposits going forward rather than on corporate client deposits as these are cheaper. Of course, it is much more difficult to raise large amounts in this fashion. But with advances growth as slow as it is, it is questionable whether Letshego actually needs funding. Term deposits continue to make up the majority of deposits, amounting to N$11.0 million at 1H19, compared to N$40.4 million at FY18. Current account deposits increased from N$411,000 at FY18 to N$3.1 million at 1H19. LHN had 4,000 banking clients at the end of 1H19, compared to 1,992 at FY18.

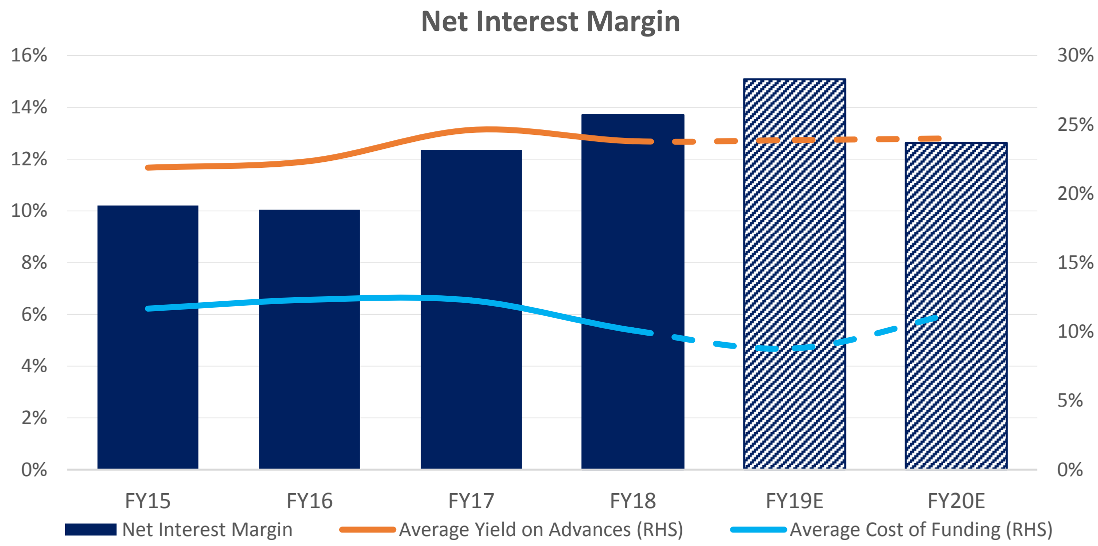
From an overall balance sheet perspective it is clear that growth in advances is slow and easily fundable through cash generated by operations. It is thus not necessary to raise funds in order to maintain the current advances growth rate. LHN is overcapitalised in our view and using the excess funds to redeem preference shares and reduce borrowings (through repayment or rolling out) is not especially good capital allocation as it will dilute ROEs. It is possible that LHN management expects demand for loans to pick up sufficiently in the near term to warrant maintaining room on the balance sheet to raise funding, but should the economic headwinds remain for the medium term we believe that returning funds to shareholders would be better capital allocation.

Interest Income and Expenses

The slower growth in advances led to a slower growth in interest income from lending activities, growing by 2.5% y/y to N$300.7 million in 1H19 (1H18: 14.3% y/y). Management does not expect the recent repo rate cut by the BoN to have a significant impact on interest income from lending activities in the current financial year, as interest on the loans are fixed. New loans that were issued after the repo rate cut will however be issued at a rate 50 basis points lower than before.

Interest income from deposits with banks increased by 88.5% y/y to N$15.7 million. We expect interest income from bank deposits to be meaningfully lower going forward, as a result of the large decrease in cash and cash equivalents during the period, assuming that no large sums of cash come in before year-end.

Interest expense (including the preference share dividends) decreased by 4.8% y/y to N$58.1 million, as a significant portion of the preference shares were redeemed since they were converted from the intercompany loan last year. The lower interest expense stemmed from the redemption and the repayment of commercial bank borrowings should allow for some expansion in the net interest margin going forward.



Source: LHN, IJG Securities

Non-Performing Loans and Impairments

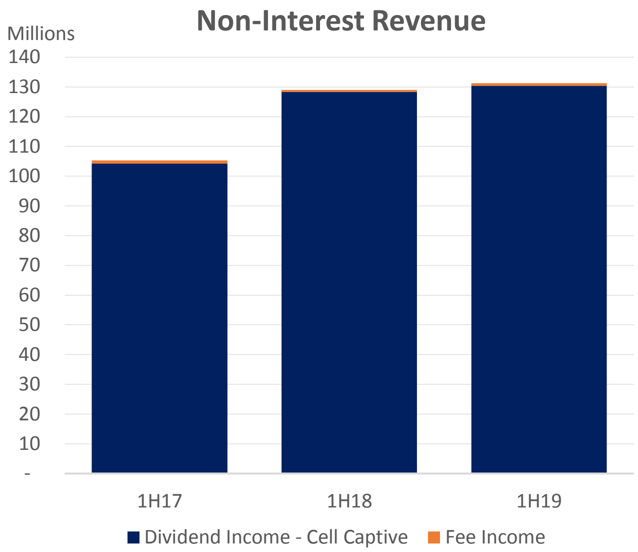
LHN's impairment charge for the period under review was N$9.87 million or 0.37% of gross advances. Non-performing loans (NPLs) stood at 5% at the end of 1H19. Management has indicated that this relatively high figure has been addressed as part of the management's efforts to focus on the quality of the loan book, and that they expect the year-end figure to be closer to 3.5%.

Non-Interest Revenue

Non-interest revenue was relatively flat, increasing by only 1.8% y/y to N$130.5 million.

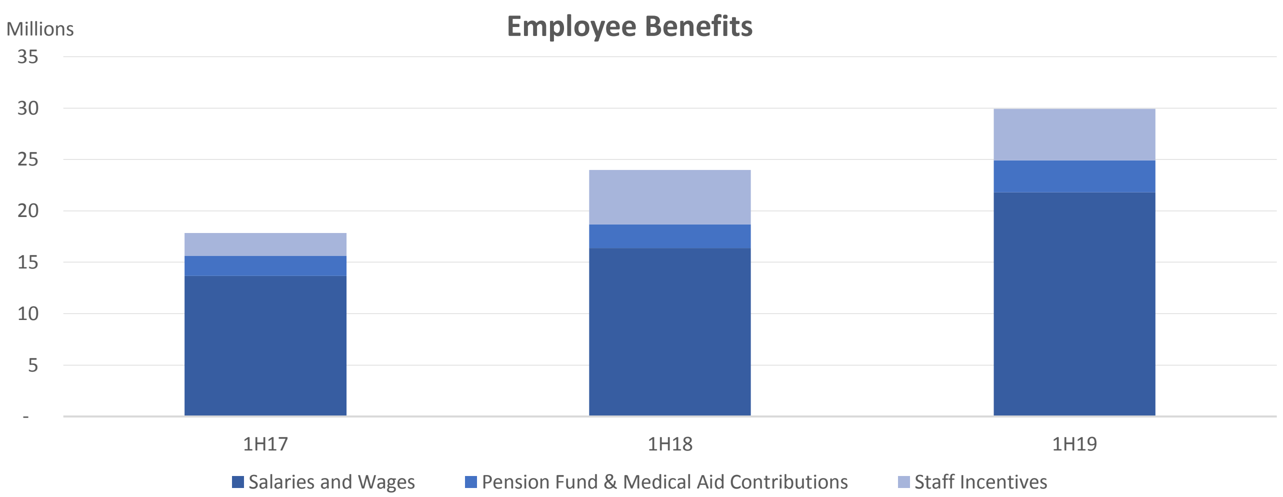
Dividends from the cell captive arrangement with Hollard Insurance increased by N$2.1 million to N$130.4 million in 1H19, compared to a N$24.1 million increase recorded in 1H18. Management states that the smaller increase is a result of the slower growth in advances. We expect growth in dividend income to remain subdued as we don't expect runaway growth in LHN's advances book soon.

Fee income rose by N$247,000 to N$850,000 in 1H19.



Operating Expenses

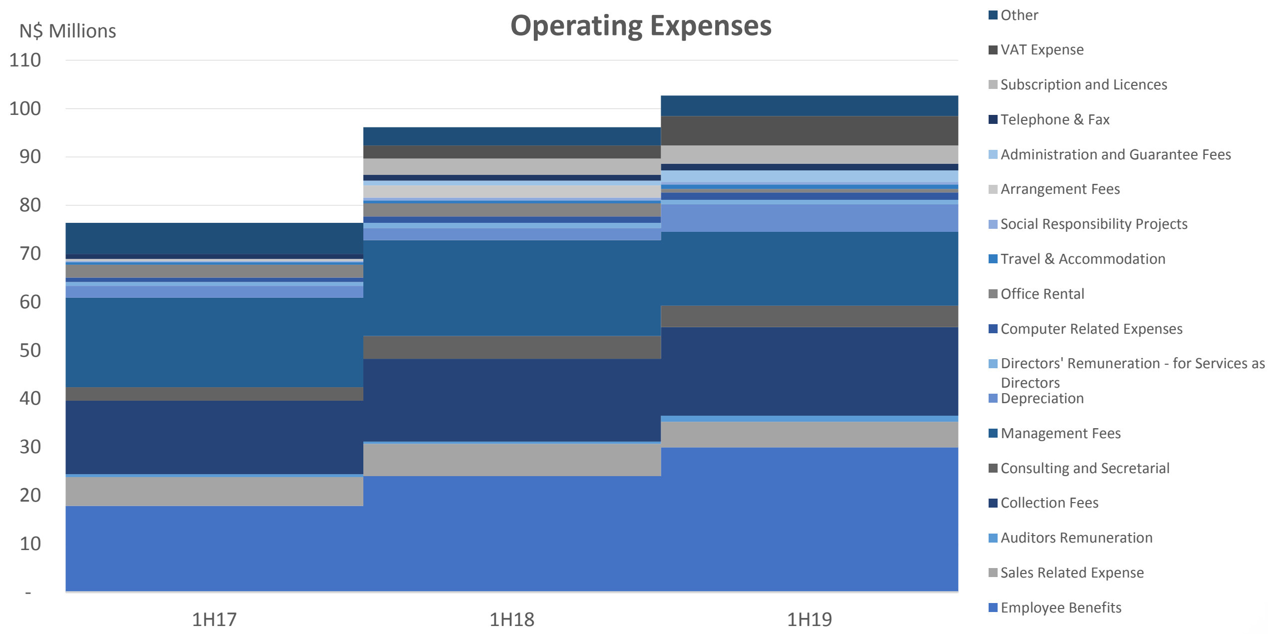
Operating expenses increased by 6.8% y/y (N$6.6 million) in 1H19. The expense category which saw the largest monetary increase was the employee benefits category which increased by N$5.9 million (24.7%) to N$29.9 million. This, according to management, is as a result of the additional staff that has been hired. As the graph below illustrates, most of this increase was driven by an increase in salaries and wages.



Source: LHN, IJG Securities

Excluding the employee benefits category from operating expenses, shows that costs were generally well contained during the period, and only grew by 0.9% y/y. Other categories that saw increases include collection fees, administration fees and VAT expense. Collection fees increased by 7.1% y/y to N$18.3 million. As these fees are micro-finance related, this increase indicates that it has either become more difficult for LHN to collect payments or that collectors are charging higher fees to LHN. VAT expense, which arises from imported services from both South Africa and Botswana, as well as internet banking and IT services, increased by N$3.5 million (130.1%) to N$6.1 million.

Expense categories which saw decreases include management fees, sales related expenses and arrangement fees. Management fees to LHL decreased by N$4.6 million to N$15.3 million. This is due to more services being localised and LHN subsequently becoming less reliant on LHL. Sales related expenses continues to decrease, dropping by 21.1% y/y to N5.3 million. Management noted earlier in the year that this is due to a decline in business and renegotiation with agents.



Source: LHN, IJG Securities

LHN's cost to income ratio increased somewhat from 23.6% to 24.1%, which management notes in the results release is due to "capacity investments against compressing margins." The ratio however remains below LHN's threshold of 28%.

Outlook

LHN remains a highly profitable business. As expected, growth in the loan book has slowed from the double-digit figures seen in recent years, as runway for growth in the public sector has become limited due to LHN already servicing a large portion of that market. Management's focus on quality over quantity will likely continue to dampen growth in the loan book, but as stated earlier in this report, is probably positive as economic conditions are expected to remain tough over the medium-term. The fact that LHN fixes the interest rates on all loans means that the recent repo rate cut and the possible cut later this year will not have any significant effect on revenue going forward.

The rollout of the company's banking business has been slow thus far. Although the number of banking clients has almost doubled since FY18, this has not yet translated into retail deposit funding. Given the profile of customers that LHN is targeting with its banking solutions, we do not expect rapid growth in deposit funding. Namibia already has a high banked population, meaning that if LHN intends on growing its banking solution it will need to convince the public to make the switch or open up a second account.

We maintain the view that the margin of safety is large given the current low LHN share price. The deduction at source model provides a safety-net which remains in place until at least 2022. The low estimated forward P/E ratio of 4.0x for FY19 in our view signals that the market continues to undervalue the company. We do not believe that the discount in the current share price is justified despite the risks posed by the microlending business model during economic downturns.

Valuation

To value the shares of Letshego Namibia, several valuation methods have been used to reduce the overreliance on a single methodology. These methods include three discounted cash flow methodologies and two justified multiple approaches. The outputs of the different methodologies were equally weighed.

Two of the main valuation input assumptions are the cost of equity and long-term sustainable growth rate. The cost of equity was calculated using the capital asset pricing model (CAPM). The resultant cost of equity amounted to 19.4%, based on a 9.38% yield on the IJG generic 10-year bond, an equity risk premium of 5.0%, an unsystematic risk premium of 2.0%, and an additional 3.0% risk premium related to LHL's influence on LHN. A long-term sustainable return on equity of 20.0% and an estimated pay-out ratio of 30.0% has been used. Seeing as the valuation is very sensitive to these inputs, a sensitivity analysis can be found in the annexures to illustrate the effect of changes in these assumptions.

The output of our valuation model is presented below:

	Value (N$'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	2,164,338	4.33	5.68	5.20	1.04	0.97	5.43%	5.93%	20%
Residual Income	1,960,628	3.92	5.15	4.71	0.94	0.88	5.99%	6.54%	20%
Dividend Discount	2,193,487	4.39	5.76	5.27	1.05	0.99	5.36%	5.85%	20%
Justified Price to Earnings	2,184,015	4.37	5.73	5.25	1.05	0.98	5.38%	5.87%	20%
Justified Price to Book	2,423,555	4.85	6.36	5.83	1.17	1.09	4.85%	5.29%	20%
Weighted Average	**2,185,205**	**4.37**	**5.74**	**5.25**	**1.05**	**0.98**	**5.40%**	**5.90%**	**100%**

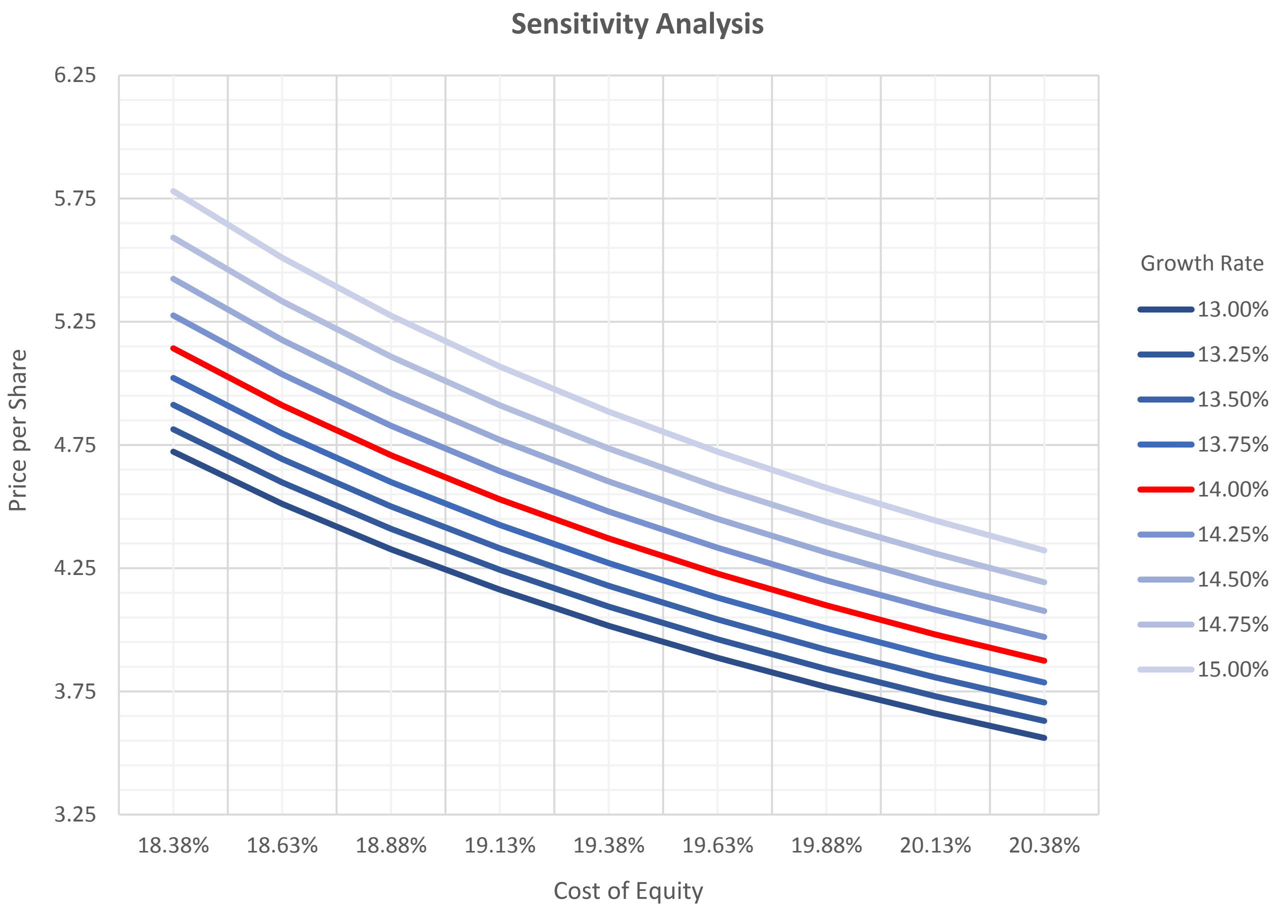
Source: *IJG Securities*

Based on the table above, we derive a **target price of N$c437** per share and coupled with an expected full year dividend of 24cps, we derive an expected **total return of 38.9%.** As a result of the apparent discount to fair value, we maintain our **BUY** recommendation.

Summary of Income Statement

	2016	2017	2018	2019E	2020E	2021E
Total Income	**685 703**	**784 585**	**874 674**	**914 857**	**969 917**	**1 027 920**
Interest Income from Lending Activities	450 025	563 375	596 693	634 177	679 254	726 801
Credit Impairment Release / (Charge)	(22 083)	9 553	(18 226)	(21 707)	(23 227)	(24 853)
Interest After Impairment	**427 942**	**572 928**	**578 467**	**612 470**	**618 595**	**624 781**
Other Interest Income	3 465	12 376	21 465	18 063	20 050	22 255
Interest Expense	(99 943)	(114 038)	(32 866)	(34 181)	(35 377)	(36 792)
Pref. Share Dividend			(87 997)	(61 164)	(61 164)	(61 164)
Net Interest Income after Impairment	**331 464**	**471 266**	**479 069**	**535 188**	**542 104**	**549 080**
Fee Income	1 943	2 229	1 176	1 700	1 870	2 057
Other Operating Income	230 269	206 606	255 340	260 916	268 743	276 806
Employee Benefits	(26 638)	(37 858)	(49 263)	(59 850)	(63 441)	(67 247)
Other Operating Expenses	(107 485)	(124 827)	(145 936)	(156 152)	(162 398)	(170 518)
Operating Profit before Taxation	**429 554**	**517 416**	**540 386**	**581 803**	**586 879**	**590 178**
Taxation	(99 602)	(132 159)	(159 510)	(165 963)	(167 411)	(168 352)
Profit for the Year	**329 952**	**385 256**	**380 876**	**415 840**	**419 468**	**421 826**
Other Comprehensive Income, Net of Tax	-	-	-	-	-	-
Total Comprehensive Income for the Period	**329 952**	**385 256**	**380 876**	**415 840**	**419 468**	**421 826**
Shares in Issue ('000)	500 000	500 000	500 000	500 000	500 000	500 000
Basic Earnings per Share (cents)	65.99	77.05	76.18	84.61	85.61	86.24
Headline Earnings per Share (cents)	65.99	71.70	76.18	84.61	85.61	86.24

Sensitivity Analysis



Source: IJG Securities

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