LETSHEGO HOLDINGS NAMIBIA LTD
1H21 Results Review
October 2021

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Letshego Holdings (Namibia) Ltd

1H21 Results Review

Target Price (c)	***322***
Current Price (c)	200

Year End 31 December	2018	2019	2020	F2021	F2022
Net interest income (N$ million)	567	506	483	524	546
Non-interest income (N$ million)	255	230	168	224	225
Profit after tax (N$ million)	469	401	321	335	383
HEPS (c)	76.2	80.2	64.2	66.9	76.6
DPS (c)	23.5	22.5	22.5	26.8	30.6
DY (%)	6.7	8.3	11.3	13.4	15.3
P/E	4.6	3.4	2.3	3.0	2.6
P/B	0.8	0.6	0.4	0.4	0.3

Recommendation	BUY
NSX Code	LHN
Market Cap (N$ m)	850
Shares in Issue (m)	500
Free float (%)	22
52-week high	270
52-week low	145
Expected Total Return (%)	74.2%

Source: LHN, IJG Securities

1H21 Results Review

Letshego Holdings (Namibia) Ltd (LHN) released interim results for the period ended 30 June 2021 (1H21). Earnings and headline earnings per share increased by 26.2% y/y from 25.31cps to 31.9cps, while profit after tax increased by 26.2% y/y to N$159.6 million. Total income rose by 25.9% y/y. The higher profit stems from growth in interest income from the company's expanding advances book as well as significant growth in dividend income from the cell captive insurance agreement with Hollard.

LHN expanded its advances book by 23.2% y/y to N$3.86 billion in 1H21. Consequently, total assets increased by 25.8% y/y to N$4.43 billion. To fund the asset growth, Letshego issued a three-year floating rate note with a face value of N$231 million in May and increased borrowings from commercial banks by N$374.8 million to N$661.5 million between 1H20 and 1H21. Overall, the increase in leverage has positively impacted the company's capital structure, increasing its total leverage ratio from 160.8% in 1H20 to 182.2% 1H21.

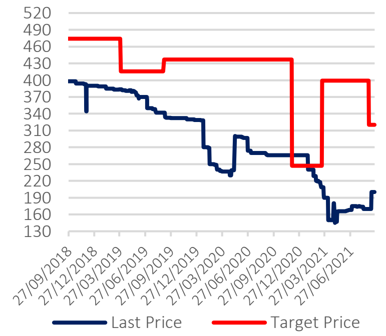
Total revenue rose by 25.9% y/y to N$435.9 million, while interest income only rose by 7.2% y/y. LHN's operating margin for 1H21 came in at 47.5%, the lowest ever for the company. The decrease was driven by a N$25.9 million increase in insurance expenses, higher guarantee fees and a N$4.2 million rise in director's remuneration.

On 11 August, it was revealed that the IFC partnered with LHN, by extending a US$50 million financing facility, aimed at providing affordable housing finance ranging between N$500,000 and N$750,000 per home. The addition of product offerings in the form of home loans will be a welcomed form of diversification of LHN's revenue streams in the future. The project is currently in testing, and the first tranche of financing is expected to be paid in November.

Valuation

LHN's earnings are in line with our forecasts, except for higher-than-expected operating expenses. Using a panel of standard valuation techniques, a cost of equity of 20.3% and a long-term sustainable return on equity of 17.0%, we derive a target price of N$322c per share. Coupled with an expected dividend of 26.8cps, we derive a potential total return of 74.2%. Despite the N$77c downward revision in our target price, we believe LHN are well-positioned to benefit from future interest rate hikes. The addition of home loans should prove to be beneficial in expanding LHN's product range. The prospects of a rate hike, coupled with a potential diversification in the form of affordable home loans increases the company's upside potential over the medium term. Overall, the current price of N$200c per share is an attractive entry point and, therefore, we maintain our **BUY** recommendation.

LHN Share Price vs Target Price (c)



Dividends

The company declared an interim dividend of N$15.96c per share.

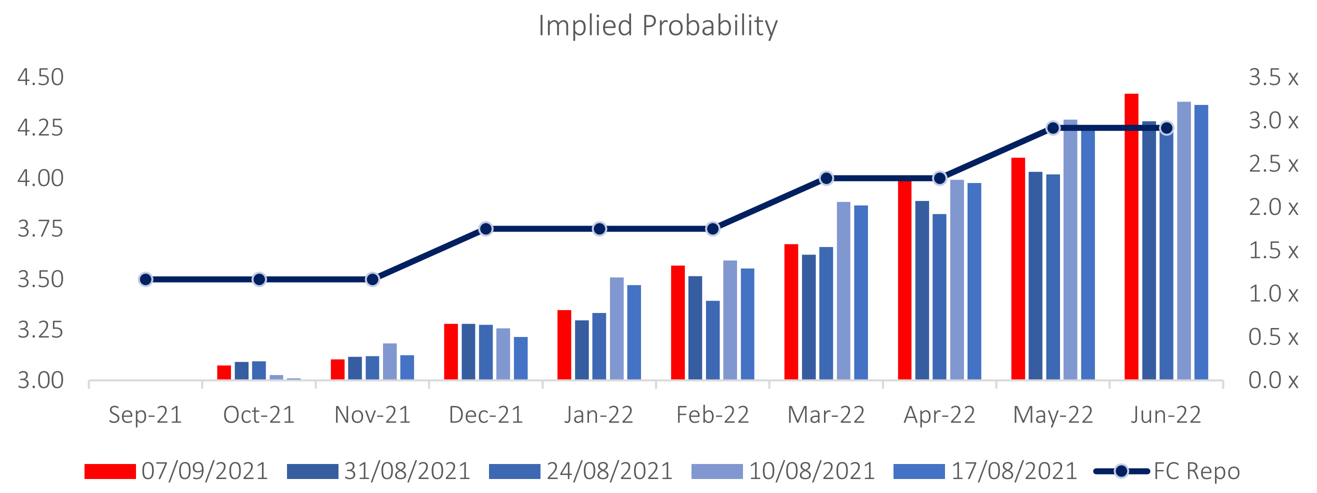
- Last day to trade: 15 Oct 2021
- Record Date: 22 Oct 2021
- Payment date: 05 Nov 2021

Macro Backdrop

According to the NSA, Namibia's Q2 GDP grew by 3.7 q/q and 1.6% y/y off a low base as the Namibian economy contracted 8.5% in 2020. As per the Bank of Namibia, the Namibian economy is estimated to record growth of 1.4% and 3.4% in 2021 and 2022 respectively. The expected expansion follows a low base after economic stagnation spanning from 2016 to 2019 was further aggravated by the pandemic in 2020 when the economy contracted by a record 8.5% y/y.

Although minor, the expected growth is welcomed, and stems from positive sentiment in the mining sector, as diamond mining is anticipated to recover with the new Debmarine vessel becoming operational and production at Elizabeth Bay resuming in 2022. The recent run in spot Uranium prices further boosts optimism and upside for medium-term prospects for the Namibian economy.

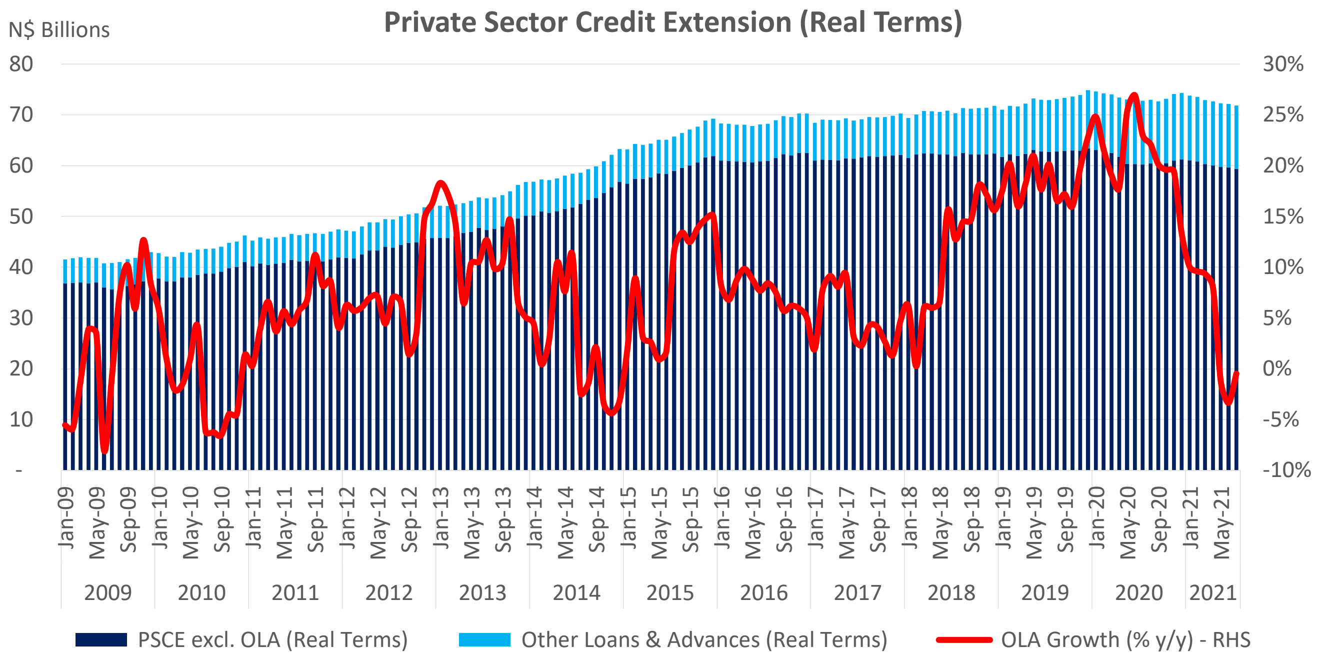
The SARB introduced five repo rate cuts in 2020 to 3.5% in July from 6.5% in December 2019. As at the time of writing the repo rate has been flat for 14 months, as monetary policy continues to accommodate constrained consumers and businesses. Despite the FRA curve pointing to a 25bps rate hike in November, the consensus maintains that a hike in 2021 is unlikely and that the SARB will likely shift from its dovish stance and introduce a rate hike in 1Q22.



Source: Bloomberg, IJG Securities

Despite historically low Namibian interest rates, demand for credit has remained muted over the last 19 months. PSCE stood at 1.85% y/y in August, slightly below the low average of 2.2% y/y for 2020. The majority of credit extension over the last year was made to individuals. Credit appetite amongst corporates remains low which is evident in the 19 consecutive months of annual contractions in instalment credit extended to corporates.

Since peaking at 26.9% y/y growth, the real growth rate "Other Loans and Advances," which consists of credit card debt, personal, and term loans has slowed considerably, and declined to negative territory for three consecutive months, from May to July. Meanwhile, mortgage loans to individuals have remained relatively stable throughout 2021, recording an aggregate of 0.27% m/m and 4.57% y/y growth.

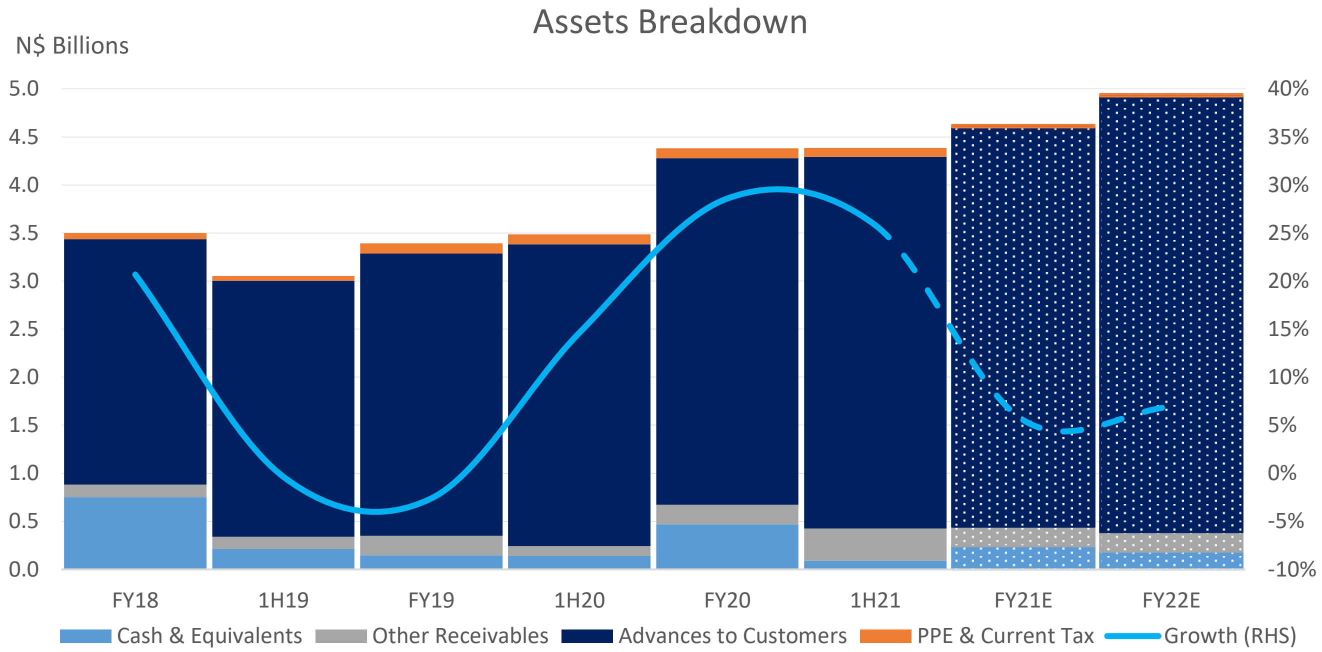


Source: BoN, IJG Securities

The global economic outlook remains gloomy, as the delta variant continues to evoke uncertainty. Namibia is no exception and faces additional issues such as high unemployment rates and low disposable income amongst individuals. Therefore, we expect PSCE growth to average within a low range of 2.5% to 4.5% over the next two years. Other loans and advances (OLA) to individuals, consisting of credit card debt, personal and term loans grew 4.4% y/y in August 2021, well below the 12.4% y/y growth in August 2020. The recent drop-in short-term credit extension stems from the increase in unemployment due to the epidemic exacerbated crisis being experienced in Namibia. We expect OLA growth to remain in single-digit territory in the medium term. The decrease in credit appetite amongst consumers will likely add pressure in the micro-lending space, which has already experienced increased competition.

Asset Base

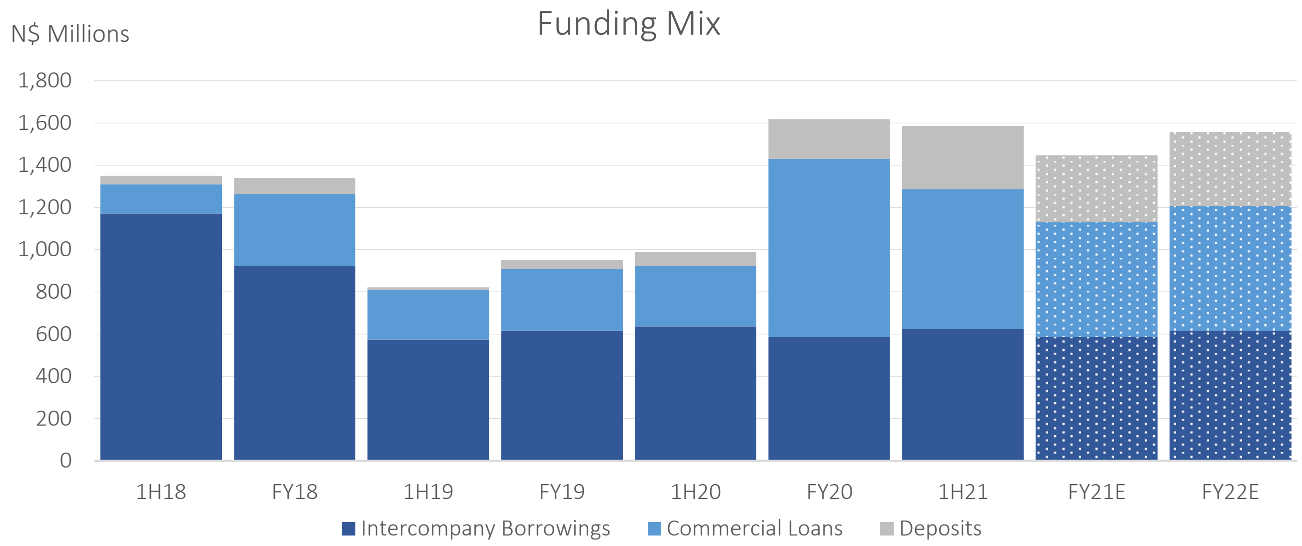
LHN's total assets grew by 25.8% y/y to N$4.43 billion at 1H21, with most of the increase originating from a 23.2% y/y expansion in advances to customers to N$3.87 billion. The growth in advances is evident in the decrease in the cash drag on its portfolio as cash and cash equivalents decreased by 35.0% y/y to N$90.6 million. The lower cash position is attributable to the increase in advances, a N$181 million repayment of borrowings and N$50.3 million in interest payments for the period.



Source: LHN, IJG Securities

Other receivables, consisting primarily of income receivable from the cell captive arrangement, rose by 153.6% y/y to N$301.5 million. Based on recent trends, the large portion of the receivable non-interest income will likely significantly increase LHN's cash position at the end of the year before being extended to customers.

Funding



Source: LHN, IJG Securities

LHN significantly altered its debt funding in 1H21. The company decreased its loans from commercial banks, from N$842.5 million in FY20 to N$430.5 million in 1H21. In May, the company issued a floating rate note with a face value of N$231 million, a cheaper source of financing than commercial bank loans. Additionally, the company has access to a US$50 million facility with the IFC, which remains undrawn. The first tranche of this facility will be utilised for testing the home loan product later in October 2021.

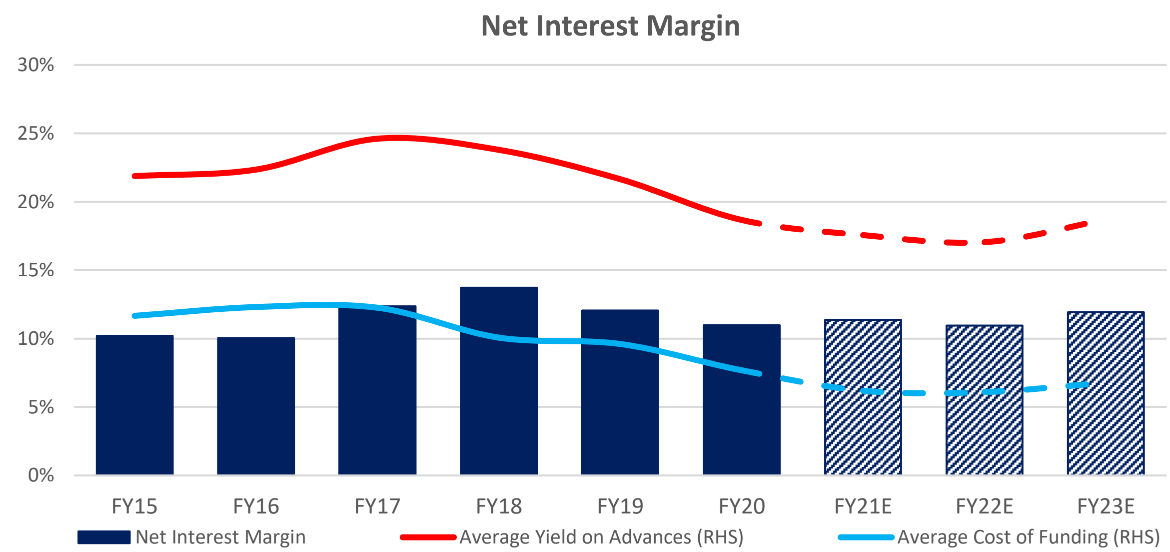
LHN recorded 354.8% y/y growth in deposits, the increase comes from a low base of N$66m and was entirely driven by term deposits, which totalled N$278.7 million. Deposits will likely be a key focus area for management in the future, as LHN aims to transition into the commercial banking scene. LHN has been slow in growing retail deposits in the past. We have witnessed the difficulty experienced by new entrants, such as e-Bank, into this space and it remains to be seen whether LHN can convert their footprint into retail deposits. The IFC facility and venture into the homeloans space may be a catalyst for individuals opening transactional accounts with the bank. We remain cautious due to the dominance of the incumbent banks and their ability to compete given their overcapitalised positions.

Interest Income and Expenses

Interest income from lending activities rose by 7.2% y/y to N$324.3 million, an acceleration from the 3.4% y/y growth in FY20. Although growth in interest income is significantly below the 23.2% y/y growth in advances, the disparity is mostly due to the prime rate being higher in 1H20, starting the year at 10.25%. Since then, the prime rate has been cut four times to 7.5%. Since LHN has to reprice new loans they were able to charge a maximum interest rate of 15.0% in 1H21, compared to 20.5% at the beginning of 1H20.

Interest income from deposits with banks fell by 75.4% y/y to N$2.0 million as LHN decreased its cash and cash equivalents by 80.7% in the last 12 months. Loans from commercial banks increased by 50.2% y/y or N$143.8 million, and an additional N$213 million floating-rate note was issued by LHN in 1H21. This brings total funding to N$1.59 billion in 1H21, 60.4% or N$597.1 million higher than in 1H20. During the same period, interest expense increased by 3.7% or N$2.0 million.

LHN's net interest margin declined from 13.7% in FY18 to 11.0% in FY20 due to recessionary pressures on the Namibian economy that resulted in the BoN increasing its accommodative stance, which was further exacerbated by the Covid-19 pandemic. However, given that LHN has significantly restructured its funding to cheaper sources, in the form of a floating-rate note, and that a rate hike by the BoN is expected in 1H22, we expect Letshego's net interest margin to make a gradual recovery in the medium term.



Source: LHN, IJG Securities

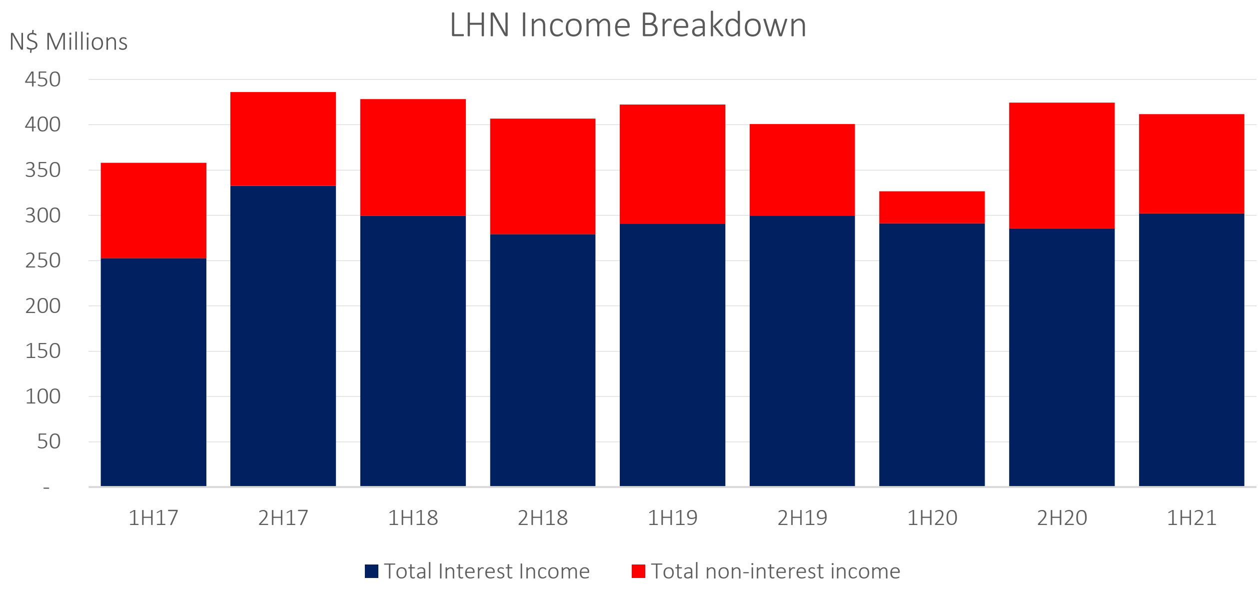
LHN's net interest margin is levered with interest expense on funding calculated as prime plus. Therefore, a rate hike results in interest income increasing by comparatively more than interest expense. Meanwhile, a rate cut has the opposite effect, decreasing interest income by comparatively more than the decrease in interest expense.

Non-Performing Loans and Impairments

LHN recorded a credit impairment charge of N$22.0 million for the period under review, compared to N$11.4 million in 1H20. Despite the increase, impairments stand at 0.6% of the advances book, significantly lower than the commercial banks. Management noted that the increase in impairment charges was due to 30% of their loan book being uninsured during the period. However, the book is now fully insured, which will have a positive impact on impairment charges going forward.

Non-Interest Revenue

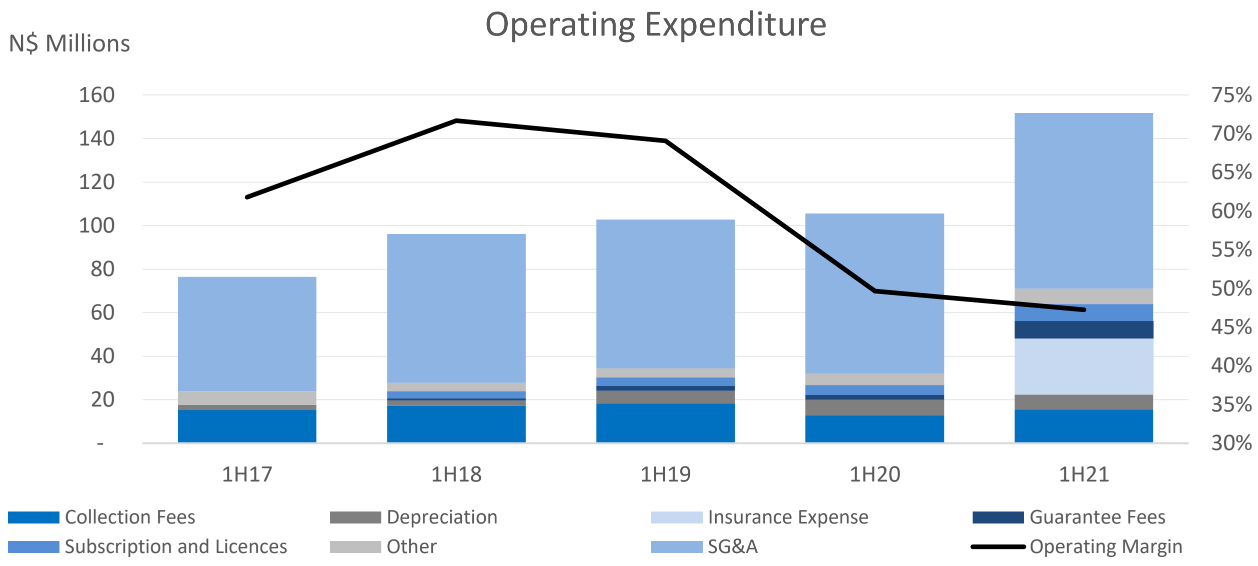
Non-interest income increased by 208.7% y/y to N$174.5 million in 1H21. 98.3% of this increase is due to a low base in cell captive income as the company was barred from charging insurance premiums for the first four months of 2020. Income from the cell captive for 1H21 totalled N$106.2 million, which represents 24.4% of total income for the period and 51.3% of operating income before tax during 1H21. This reflects the company's significant reliance on the cell captive as a source of income, therefore the expansion into the home loan space will be crucial in improving LHN's earnings quality and stability going forward. The graph below displays LHN's income split between interest and non-interest income, with 1H20 highlighting the impact on total income, should the cell captive income fall away.



IFC Partnership

Using the limited information available regarding the new product offering we have drawn conclusions that have been included in our model. Given that the product is currently in its testing phase, we expect LHN to start offering home loans to the public from July 2022. The 5-year senior loan with a two-year grace period has a face value of US$50m and will be drawn down in tranches. As mentioned above, the home loans are expected to range between N$500,000 and N$750,000 per loan. Taking an average of N$625,000 per loan, and the full face value of the IFC funding in NAD, drawn down over 7 years, we expect LHN to extend 186 mortgage loans per annum (93 in FY22.) Using LHN's existing outstanding notes, we estimate the cost of the IFC loan to be in the region of 3m JIBAR plus 3.4% or 7.1% at the time of writing this.

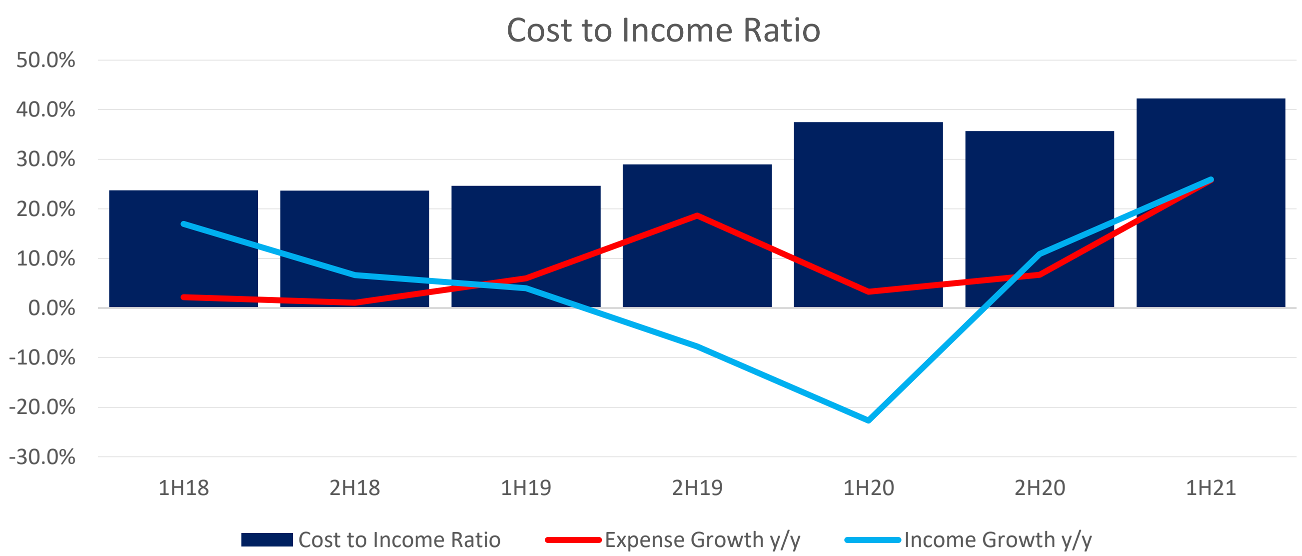
Operating Expenses



Source: LHN, IJG Securities

Prior to October 2019, LHN passed on credit default insurance expense to the client, however, this additional fee has since been classified as financing income. Given that LHN already charges the maximum interest rate of prime multiplied by two, as per the Usury Act, they were no longer able to add credit default insurance to the interest rate charged to clients. Therefore, as the company expands its advances in the future, insurance expense, and thus operating expenses will increase proportionately. However, accounting for the additional insurance expense, the micro-lending net interest margin remains above regular bank margins.

Other notable increases were observed in collection fees, which increased by 21.8% y/y to N$15.6 million. Consulting and secretarial fees also increased sharply, by 146.6% y/y to N$8.2 million in 1H21.



Source: LHN, IJG Securities

Overall, operating expenses (including employee benefits,) increased by a combined N$46.2m compared to the same period a year ago. As illustrated by the graph above, LHN's cost to income ratio has increased substantially over the past three years, from 23.7% in 1H18 to 42.5% in 1H21. This is a result of the recent acceleration in expenses, which increased at a slightly slower rate than income growth in 1H21, resulting in a jaws ratio of 0.1%.

Outlook

Overall, LHN produced respectable results in 1H21. The company achieved growth in all sources of income, which culminated in a double-digit year-on-year expansion in the group's bottom line. For the most part, Letshego's 1H21 income statement is well on track to meet IJG's forecasts for FY21, with operating expenses being a caveat, as these were heavily inflated in 1H21, resulting in a decaying operating margin. This trend has concerningly persisted since 1H19, a further downside risk for the remainder of the year.

Over the past 10 months, LHN has made positive operational and structural strides. Firstly, the restructuring of the company's funding from commercial loans towards cheaper floating rate notes has Letshego well-positioned for future rate hikes which will positively impact net income going forward, as well as widen its net interest margin.

Furthermore, the additional product offering in the form of home loans will add much-needed diversification to LHN's business model, especially given that the company has recently experienced heightened competition in the microlending space. We believe this could provide future upside as LHN widens its customer base in Namibia. We will watch closely whether LHN can capitalise on the home loans product by extending other commercial banking services to the market. Such a product may be the catalyst needed to grow the banking operations, although we will need to see tangible evidence before modelling this into our forecasts.

On the downside, LHN has been rather unsuccessful in terms of meeting a minimum of 45% Namibian shareholding. After granting Letshego its banking licence in 2016, the Bank of Namibia set 2020 as the deadline to meet the requirement. The company's local shareholders currently hold 22% and LHN have been fortunate to be granted an extension until 31 December 2023 due to Covid-19. The shareholding requirement is not a gazetted requirement and as such may be difficult to enforce, but LHN is actively working towards broadening Namibian ownership in line with the target.

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 two 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 20.3%, based on an average 10.3% yield on the IJG generic 10-year bond over the past 10 years, an equity risk premium of 6.0%, an unsystematic risk premium of 2.0%, and an additional 2.0% risk premium related to the regulatory risk that LHN is exposed to. A long-term sustainable return on equity of 17.0% and an estimated payout ratio of 40.0% has been used. The output of our valuation model is presented below:

	Value (NS'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Residual Income	2,055,764	4.11	6.41	6.14	0.79	0.73	5.47%	6.51%	25%
Dividend Discount	1,451,531	2.90	4.52	4.34	0.56	0.52	7.75%	9.22%	25%
Justified Price to Earnings	1,323,623	2.65	4.12	3.96	0.51	0.47	8.50%	10.11%	25%
Justified Price to Book	1,603,111	3.21	5.00	4.79	0.62	0.57	7.02%	8.35%	25%
Weighted Average	**1,608,507**	**3.22**	**5.01**	**4.81**	**0.62**	**0.57**	**7.18%**	**8.55%**	**100%**

Source: *IJG Securities*

Based on the table above, we derive a **target price of N$322c** per share and coupled with an expected full-year dividend of 26.8cps, we derive an expected **total return of 74.2%.** Despite the downward revision in our target price, we maintain our **BUY** recommendation.

Summary of Income Statement

	2018	2019	2020	2021E	2022E
Total Income	**874,674**	**857,300**	**794,781**	**910,370**	**940,395**
Interest Income from Lending Activities	596,693	599,896	620,240	679,915	708,821
Credit Impairment Release / (Charge)	(18,226)	(9,236)	(43,652)	(49,135)	(51,444)
Interest After Impairment	**578,467**	**590,660**	**576,588**	**630,780**	**657,378**
Other Interest Income	21,465	25,302	-98,750		
Interest Expense	(32,866)	(36,618)	72,812)	(107,251)	(111,798)
Net Interest Income after Impairment	**567,066**	**579,344**	**477,838**	**523,529**	**545,580**
Fee Income	1,176	2,103	6,797	6,797	6,797
Other Operating Income	255,340	229,999	167,744	223,659	224,777
Employee Benefits	(49,263)	(63,889)	(70,429)	(78,607)	(85,099)
Other Operating Expenses	(145,936)	(149,954)	(164,291)	(229,316)	(181,678)
Operating Profit before Taxation	**628,383**	**597,603**	**417,659**	**446,061**	**510,377**
Taxation	(159,510)	(146,497)	(102,234)	(111,515)	(127,594)
Profit for the Year	**468,873**	**451,106**	**315,425**	**334,546**	**382,783**
Other Comprehensive Income, Net of Tax	-	-	-	-	-
Total Comprehensive Income for the Period	**468,873**	**451,106**	**315,425**	**334,546**	**382,783**
Pref. Share Dividend	(87,997)	(65,932)			
Earnings attributable to Ordinary Shareholders	**380,876**	**385,174**	**315,425**	**334,546**	**382,783**
Shares in Issue ('000)	500,000	500,000	500,000	500,000	500,000
Basic Earnings per Share (cents)	76.18	77.03	63.09	66.91	76.56
Headline Earnings per Share (cents)	76.18	77.03	63.09	66.91	76.56

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