LETSHEGO HOLDINGS (NAMIBIA) LTD
FY18 Results Review
July 2019

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Letshego Holdings (Namibia) Ltd

FY18 Results Review

Target Price (c)	***416***
Current Price (c)	350

Year End 31 December	2016	2017	2018	F2019	F2020
Net interest income (N$ million)	331	471	479	512	524
Non-interest income (N$ million)	230	207	255	268	282
Profit after tax (N$ million)	330	385	381	423	428
HEPS (c)	66	71.7	76.2	84.6	85.6
DPS (c)		19.2	23.5	26.1	26.4
DY (%)	-	4.8	6.7	7.5	7.6
P/E	5.8	5.2	4.6	4.1	4.1
P/B	1.3	1.1	0.8	0.8	0.8

Source: LHN, IJG Securities

Recommendation	BUY
NSX Code	LHN
Market Cap (N$m)	1,750
Shares in Issue (m)	500
Free float (%)	22
52 week high	401
52 week low	344
Expected Total Return (%)	26.4%

FY18 Results

Letshego Holdings (Namibia) Ltd (LHN) released results for the full year ended 31 December 2018 (FY18). Overall, the results are robust given the abnormally prolonged economic recession. Earnings and headline earnings per share increased by 22% y/y from 77cps to 94cps, and profit after tax increased by 22% y/y to N$468.9 million. Normalising earnings for the change in interest expense due to the preference share conversion, however, sees EPS drop by 1.1% y/y to 76.2cps. A final dividend of 23.5 cents per share has been declared, an increase from the 2017 final dividend of 19.2 cents per share.

Total revenue for FY18 increased by 11.5% y/y to N$874.7 million, with interest income from lending activities increasing by 5.9% to N$596.7 million. Net interest income after impairments increased by 20.3%, mainly due to a large decrease in interest expense, which (as we reported in our 1H18 Results Review) is the result of converting the loan from the parent company into preference shares. Adjusting net interest income for the preference dividends, however, sees the net interest income growth rate drop to around 1.7%.

Advances to customers increased by N$131.4 million or 5.4% y/y, bringing the total advances to customers to N$2.56 billion. This compares to PSCE growth of 7.4% during the year. The credit impairment charge for the period was N$18.2 million, or 0.7% of gross advances. This follows an impairment release of N$9.6 million for FY17. Non-performing loans increased from 3.9% to 5.1% of gross advances during the period.

Operating expenses increased by 20.0% to N$195.2 million. The cost to income ratio, however, slightly declined from 24% in FY17 to 23% in FY18. Employee benefits increased by 30.1% from N$37.9 million in 2017 to N$49.3 million in 2018, making up the largest share of operating expenses. Most of this hike stems from increases in salaries and incentive bonuses which grew by 19.2% and 102.4% respectively. LHN's cost-to-income ratio remains well below the average of the Namibian listed commercial banks.

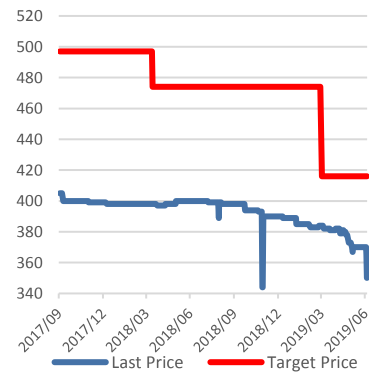
During the first half of the year, N$897.1 million of the intercompany loan from Letshego Holdings Limited was converted into 1,000 redeemable non-cumulative preference shares. N$100 million worth of these preference shares were redeemed during the second half of the year. As a result of the conversion, the company's debt to equity ratio decreased from 54% to 16%.

Loans from commercial banks increased by N$277.5 million to N$341.1 million. The financials state that the loans are partially secured and bear interest at rates between Namibia prime plus 0.3% and prime plus 2.6%. Intercompany payables due to LHL increased by N$64.4 million during the year, and currently stands at N$123.4 million. Deposits due to customers have decreased from N$90.2 million to N$74.7 million. Term deposits decreased by N$18.9 million to N$71.3 million in FY18, while current account deposits increased from N$25,000 to N$3.4 million.

Valuation

Using a panel of standard valuation techniques, a cost of equity of 19.8% and a sustainable growth rate of 14.0%, we derive a target price of N$c416 per share. Coupled with an expected dividend of 26 cps, we expect a total return of 26.4%. As a result of the apparent discount to fair value, we maintain or **BUY** recommendation.

LHN Share Price vs Target Price (c)



Dividends

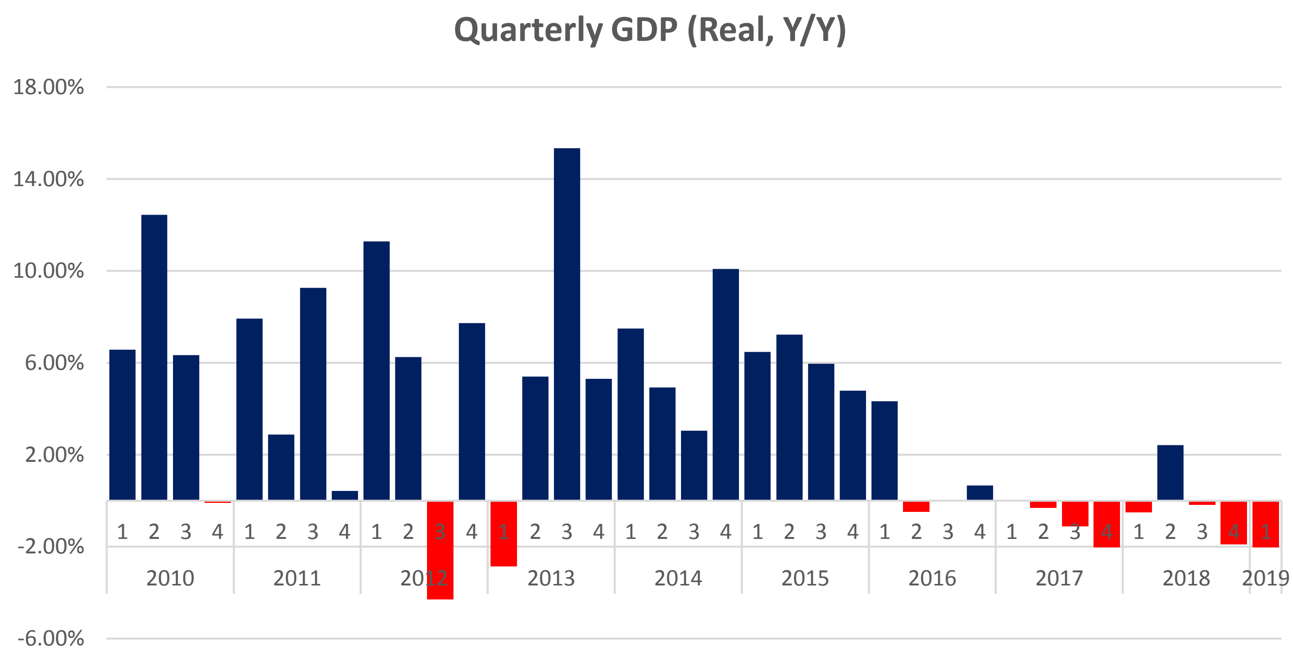
A final dividend of 23.5 cents per ordinary share was declared for the year ended 31 December 2018.

- Last day to trade: 22 March 2019
- Record date: 29 March 2019
- Payment date: 12 April 2019

Macro Backdrop

Growth Environment

The Namibian economy continues to find itself in a precarious position. Quarterly growth for the last three years has either been negative or marginally positive, meaning that the country's economy has been relatively stagnant since the beginning of 2016. The Namibia Statistics Agency's Q1 GDP data release in June shows Q1 GDP contracted by 2.0% y/y and 0.7% q/q. Data for prior periods was revised as far back as 2014, but not to the extent that material changes in growth rates was recorded as with the preliminary GDP data for 2018. The data shows that Namibia has now experienced 3 consecutive quarters of contraction on a year-on-year basis, and two consecutive quarters of contraction on a quarter-on-quarter basis. The revised data shows that eight of the last twelve quarters have posted contractions on an annual basis, separated by four quarters of very subdued growth as illustrated below.



Source: *NSA, IJG Securities*

We do not expect to see much improvement in economic performance in the remaining quarters of 2019 as the country riles from drought once again. This is likely to lead to a further increase in unemployment in an environment where GDP per capita has been declining for successive years.

Government is continuing with its pro-growth fiscal consolidation efforts, which was reiterated in this year's March budget speech. The budget revealed that fiscal controls have improved as the 2018/19 budget outturn was very close to the forecast from March 2018. This is a very positive development as improvement in fiscal controls and governance is critical to managing the fiscal position and avoiding further slippage. Government expenditure is expected to increase by 2.4% to N$66.55 billion in the 2019/20 budget year, from N$65.02 billion in 2018/19. This is an upward revision of 1.1% from the mid-term budget review last year, and the highest forecast expenditure ceiling for the year since the inclusion of 2019/20 in an MTEF period. Any slippage in the fiscal consolidation efforts will result in deteriorating debt metrics and will eventually have a negative impact on credit ratings.

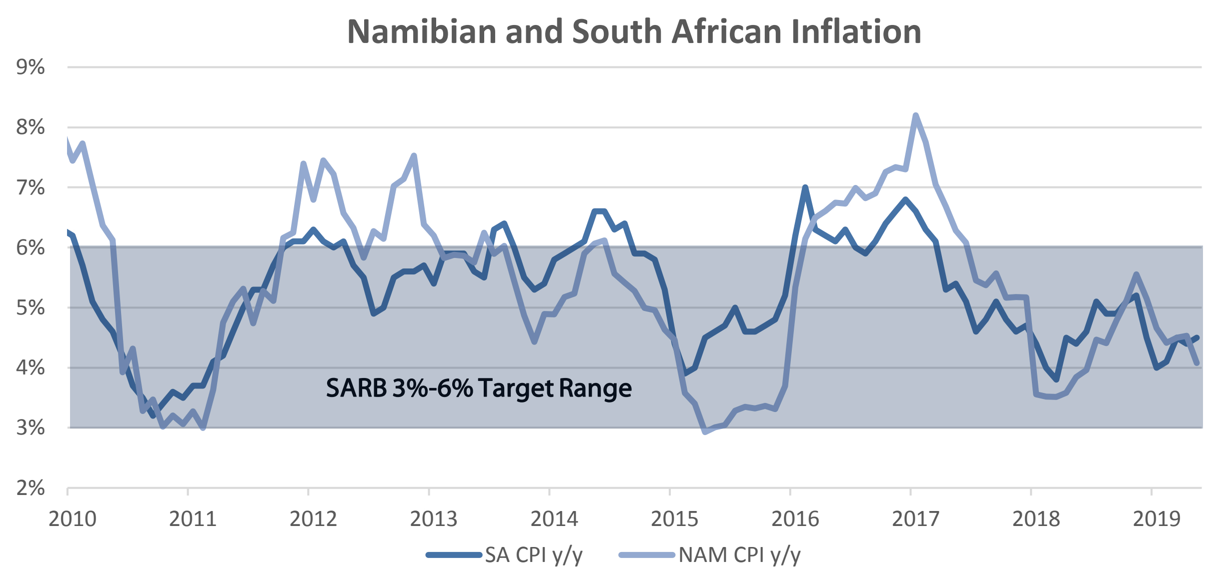
Although expected to decline over time, government continues to run large fiscal deficits, and as a result government debt continues to rise. As per the latest budget forecasts, the funding requirements are roughly N$9.2 billion, N$8.6 billion and N$7.4 billion over each of the next three financial years. Should there be overruns in expenditure or shortfalls in revenues, pressure to fund the deficits by issuing sovereign paper locally will return, which is likely to have a negative effect on banking sector liquidity and cost of funding for banks.

Additionally, business and consumer confidence remain low as the lack of clarity surrounding investor unfriendly policies such as NEEEF and the Namibian Investment Promotion Act (NIPA) remain an overhang to the investment environment, acting as disincentives for both local and foreign direct investment.

Given the current circumstances, we expect real GDP growth of 0.9% in 2019. We expect growth to be driven by a marginal rebound in tertiary sector activity as government ups operational expenditure and consumers start to find their feet. After which we expect real growth to stabilise around the 3.4% level in 2020 and 2021.

Inflation

The Namibian annual inflation rate remained firmly in the 3-6% target band in 2018, averaging 4.3%, moderating markedly from the 6.2% average in 2017. Namibian inflation remained below 4% for the first half of the year, but increased to a little over 5% during the second half following a series of fuel price increases. South African annual inflation displayed a similar trend, averaging 4.6% in 2018.

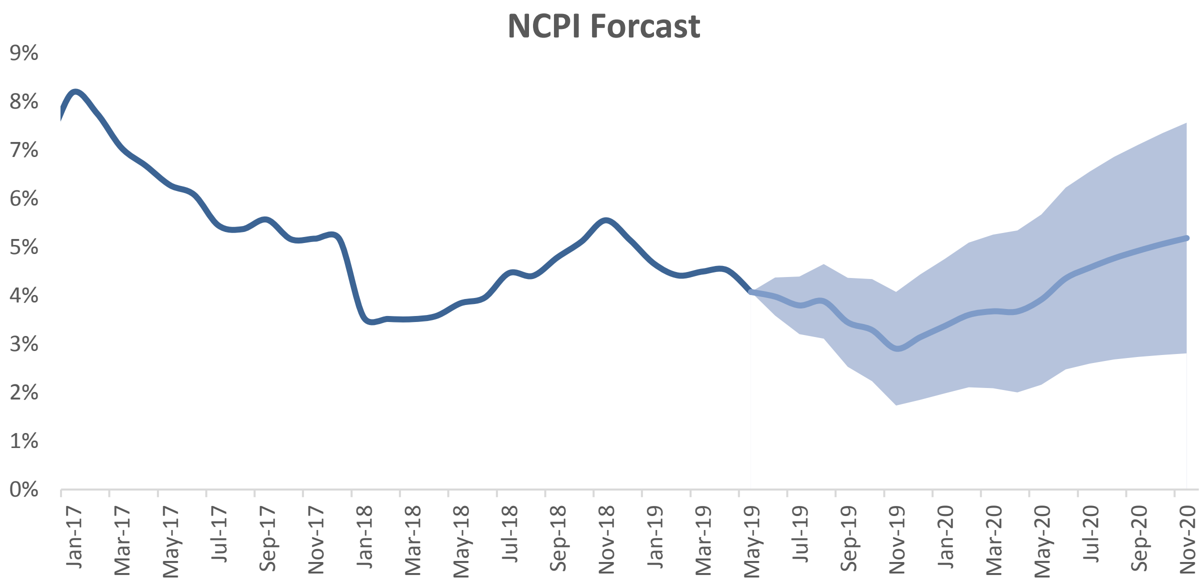


Source: *IJG, NSA, Stats SA*

Although the inflation rate has slowed somewhat in the first half of 2019, risks to the inflation outlook exist. Food inflation, which was the highest contributing basket item in the first three months of the year, could continue to rise at an accelerated pace as Namibia has experienced poor rainfall throughout the rainy season. Poor rainfall adversely affects local food production, and the resulting shortfall will make an increase in imports necessary which will lead to higher food inflation.

The price of oil has been climbing steadily since the beginning of the year, owing mostly to voluntary output cuts by OPEC and some non-OPEC producers (such as Russia), coupled with US oil sanctions on Venezuela and Iran. The Namibian government managed to finance the under-recoveries up until the end of April, but was forced to hike prices in both May and June, which will contribute to fuel price inflation.

Inflation expectations will further be driven by exchange rates, with the rand having weakened since the beginning of February. A weaker rand will further increase the cost of imports which will filter through to Namibian inflation.



Source: *IJG Securities*

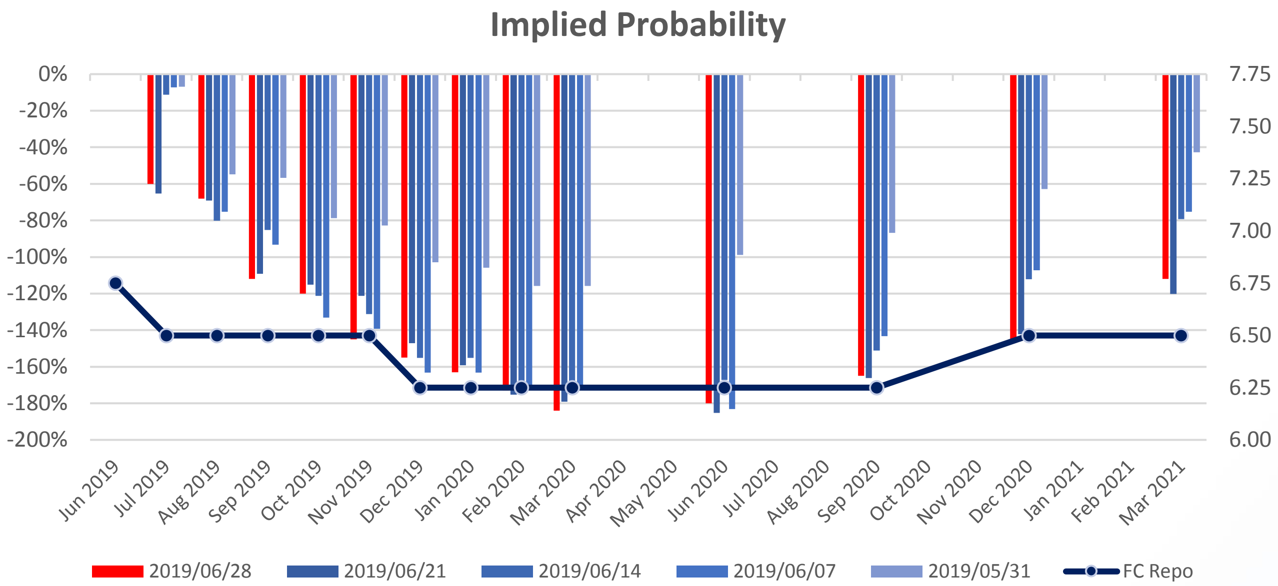
In its June Monetary Policy Committee (MPC) meeting, the BoN stated that it projects overall inflation to average 4.5% in 2019. The SARB also (through its Quarterly Projection Model) expects South African headline inflation to average 4.5% in 2019, before increasing to 5.1% in 2020. IJG's inflation model forecasts average Namibian inflation of 3.9% in 2019. However, oil price increases and subsequent transportation cost inflation poses the largest upside risk to this forecast.

Interest Rates

Interest rates remained at accommodative levels in 2018 as the Bank of Namibia's (BoN) Monetary Policy Committee (MPC) decided to maintain the Repo rate at 6.75% at all six of its 2018 meetings. The MPC stated at all its meetings that the decisions were taken to support economic growth and to safeguard the level of foreign reserves to maintain the currency peg with South Africa.

We are of the view that the BoN will remain mindful of the South African Reserve Bank's (SARB) rate path in 2019, as the BoN cannot find itself in a position where its rates are lower than that of SA for any length of time, as it would put the foreign reserve position in jeopardy. The SARB, expected to keep rates on hold for 2019 at the beginning of the year, is taking an ever more dovish tone as the year progresses. The last SARB monetary policy committee (MPC) decision was split 3:2 between members wanting to keep rates on hold and those calling for a cut, respectively.

The Forward Rate Agreement ("FRA") curve, a measure of market expectations, predicts two rate cuts of 25 basis points each in South Africa in 2019. Should the SARB cut rates we believe that the BoN will follow, bringing some relief to Namibian borrowers.

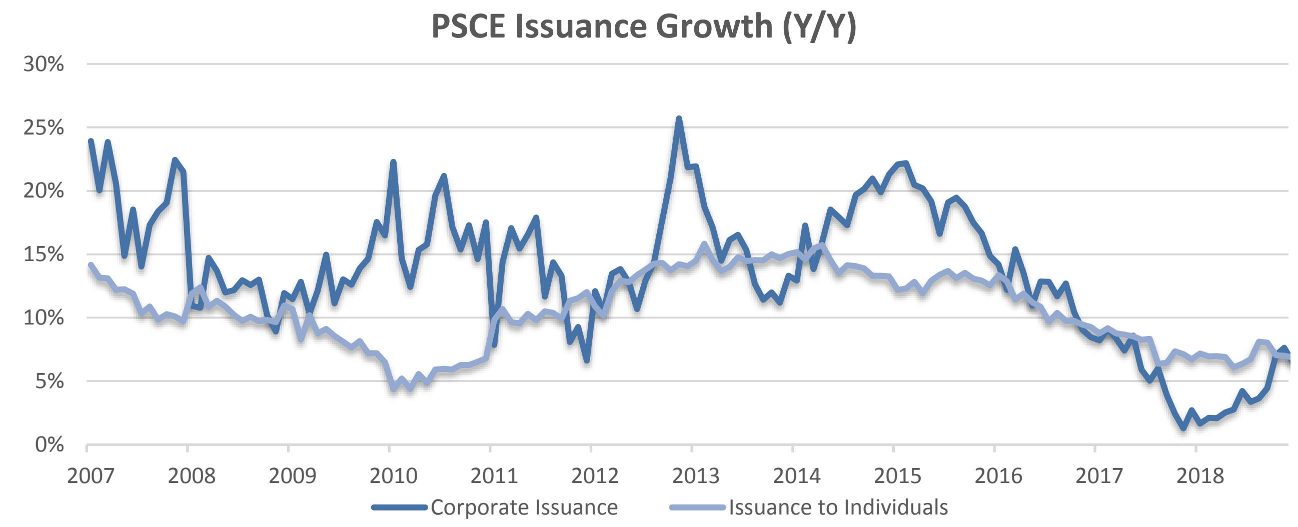


Source: *Bloomberg, IJG Securities*

It is however unlikely that a 50 basis point decrease in interest rates in Namibia will be enough to drive meaningful economic growth in the current policy environment.

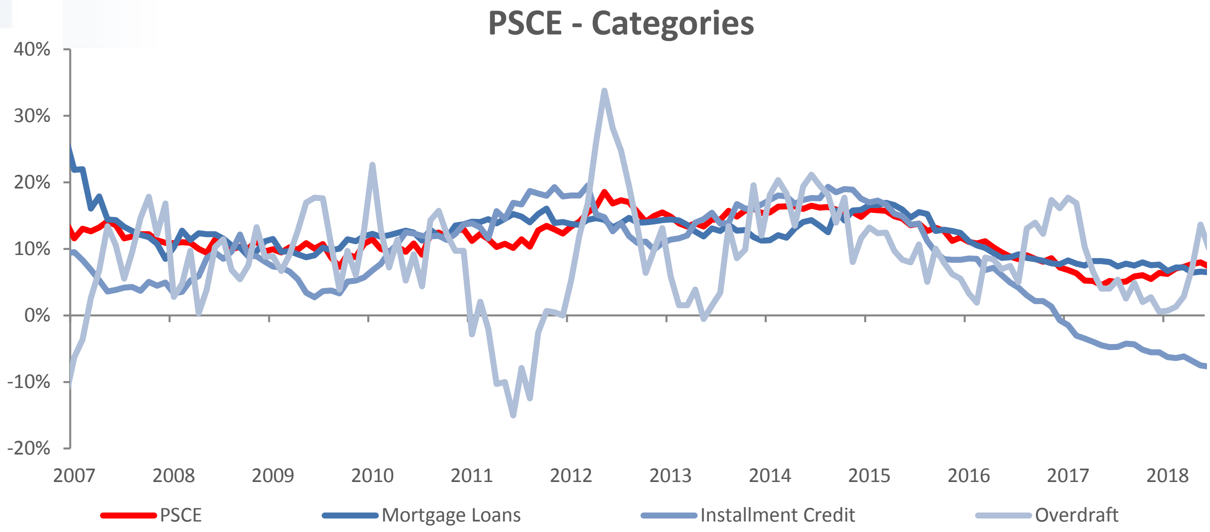
PSCE

Despite Namibian lending rates being only 1.25% above the historic lows of 2013 and 2014, there has been a noticeable slowdown in credit extension. Private sector credit extension (PSCE) rose by N$6.65 billion or 7.4% y/y in 2018, significantly slower than the double-digit growth rates of 2014 and 2015. Credit extension to individuals outpaced extension to corporates for most of the year, with corporates only borrowing more towards the end of the year. Banks have generally been more cautious to lend out funds than in the past, in an effort to contain risk, which has an impact on the availability of credit and subsequently contributed to the slowdown in economic activity.



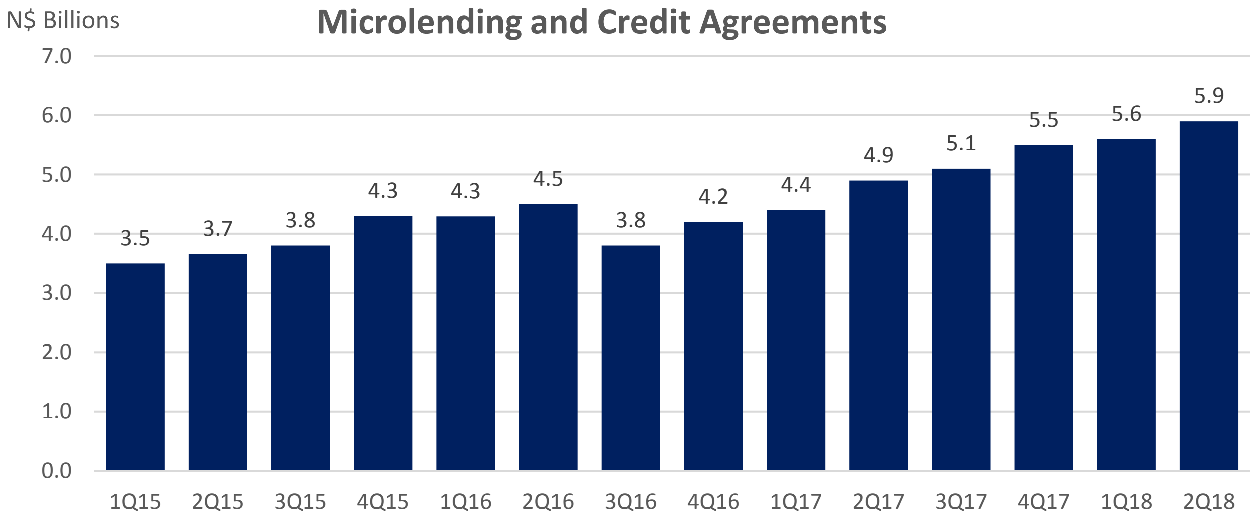
Source: *BoN, IJG Securities*

As a result of the current recessionary environment, much of the growth in private sector credit is a result of increased uptake of shorter-term loans and overdrafts by both households and corporates. Short-term borrowing satisfies short-term needs, and the subdued uptake of productive credit (mortgage financing and instalment credit) by individuals and corporations alike is a clear indication that both consumer- and business confidence remains depressed. Credit extension will be tethered to economic growth and improving disposable incomes, which is unlikely to pick up significantly in the short term in our view.



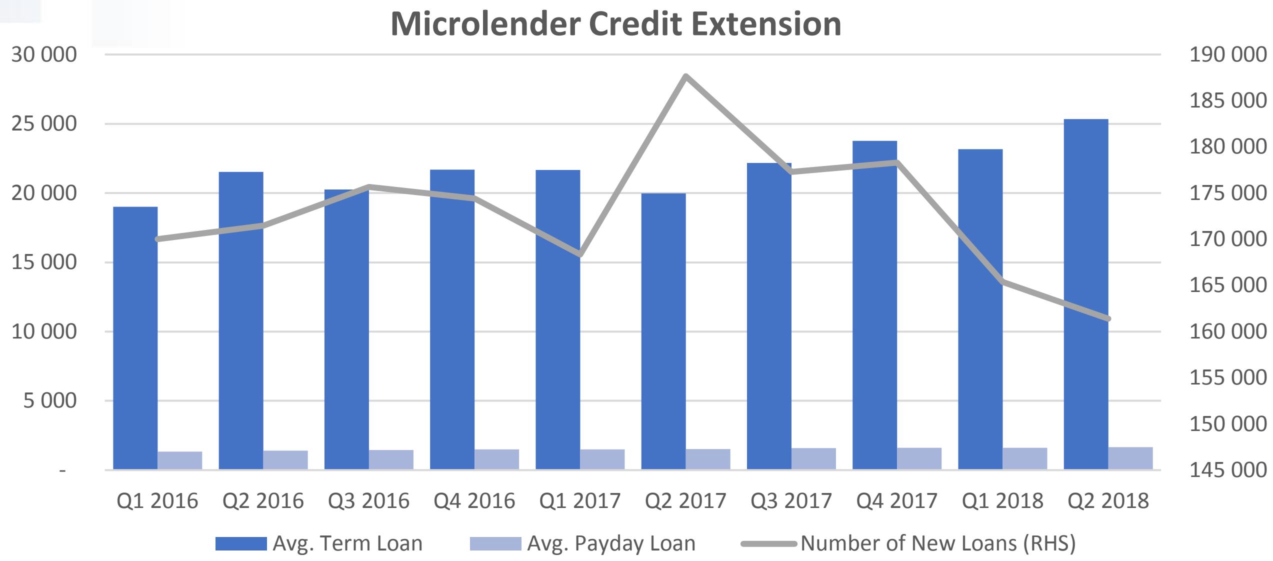
Source: *BoN, IJG Securities*

The latest available quarterly report (Q2 2018) by the Namibia Financial Institutions Supervisory Authority (NAMFISA) indicates that the value of overall microlending advances rose rapidly on both a quarterly and an annual basis. The value of advances grew by 20.9% q/q and 22.6% y/y to N$5.9 billion at the end of the second quarter of 2018. According to NAMFISA, the growth originated from the transactions of both term- and payday-loan lenders, and was driven by the higher number of household borrowers. The compound annual growth rate of the total microlending and credit agreements over the last three years was 16.1%.



Source: *NAMFISA, IJG Securities*

NAMFISA does however state that the number of new loans issued declined by 2.5% q/q and 15.3% y/y to 161,397 at the end of the second quarter. The decrease in number of new microloans meant that the average loan value increased during the second quarter. The average value of new loans extended by term lenders amounted to N$25,339, while the average value of new loans extended by payday lenders stood at N$1,657, an increase of N$2,312 and N$47, respectively, when compared to the first quarter. There were 332 microlending entities registered at the end of the second quarter of 2018.



Source: *NAMFISA, IJG Securities*

General Overview

Letshego Namibia (LHN) recorded satisfactory results for FY18, given the fact that domestic economic conditions remained challenging in 2018. The Annual Financial Statements show that earnings and headline earnings per share (EPS and HEPS) increased by 22.0% y/y from 77.1cps to 94.0cps. Normalising earnings for the change in interest expense due to the preference share conversion (see section on Funding), however, sees EPS drop by 1.1% y/y to 76.2cps. The company's total revenue increased by 11.5% from N$784.6 million in FY17 to N$874.7 million in FY18. The main drag on earnings was an increase in operating expenses of 20.0%, as well as an increase in tax of 20.7% due to the conversion of the intercompany loan to preference shares.

LHN completed the upgrade of the Swakopmund access point to a full banking branch during the period, while the upgrade of the Rundu access point is expected to be completed soon. As at 31 December 2018, LHN had 1,992 deposit customers, compared to 313 at June 2018.

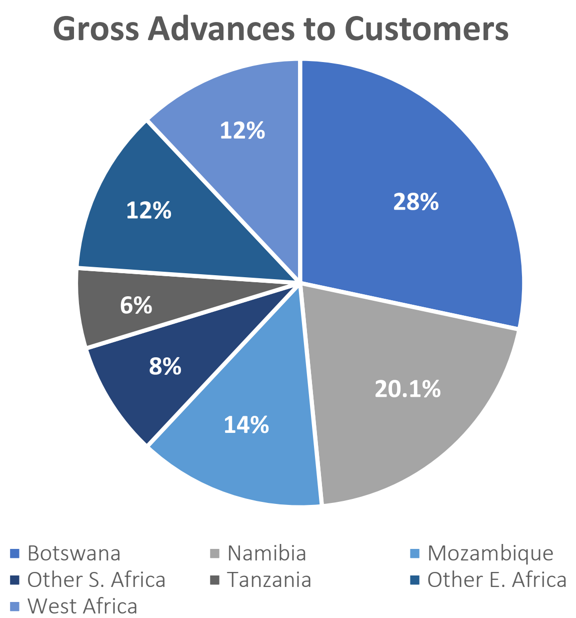
As at financial year-end, the ownership structure of LHN was as follows:

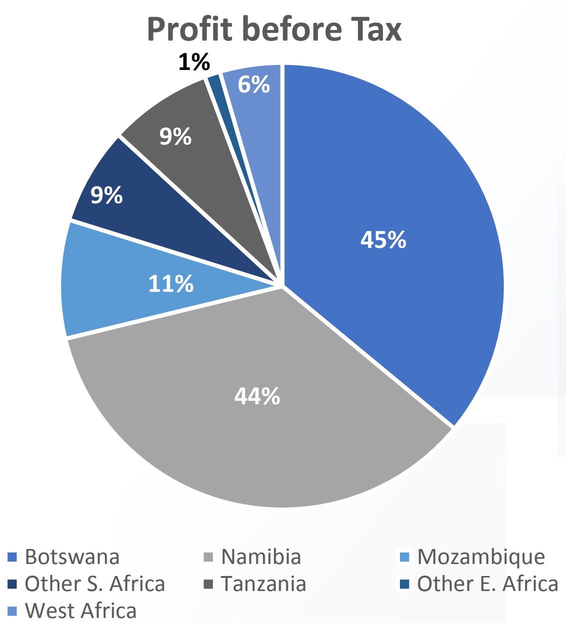
- Letshego Holdings Limited (LHL) 78.5%
- Kumwe Investment Holdings Limited 12%
- Public (retail investors) and corporate entities 9.5%

Letshego Holdings Limited

As the majority shareholder of LHN, Letshego Holdings Limited (LHL) plays a large role in LHN's operational and financial performance. LHL received roughly N$248.2 million from LHN in the form of ordinary dividends, preference dividends, interest payments and other administrative fees during 2018.

LHN is the second largest contributor to the overall Letshego Group's profit before tax, after Botswana, contributing 43.9% of the total figure of 1.02 billion Pula. LHN's gross advances to customers make up around 20.1% of the entire group's gross advances.





Source: *LHL, IJG Securities*

There have been a significant number of changes to the boards of both LHN and LHL over the last six months:

Board Changes at LHN and LHL
On 11 February, LHN announced that John Eugene Shepherd, who served as Chairman for both Letshego Holdings Namibia and Letshego Bank Namibia, had tendered his resignation effective 1 February 2019. He concluded his duties on 30 April 2019. Maryvonne Palanduz was subsequently appointed as Chairperson according to the 2018 Integrated Annual Report.
On 6 March, Letshego Holdings Limited (LHL) released an announcement on the Botswana Stock Exchange that Colm Patterson, the Group Chief Financial Officer, had resigned from the company. The announcement further stated that Josias de Kock, an Independent Non-Executive Director on the Board, would take up the role of Acting Group Chief Financial Officer, effective 6 March 2019. The announcement does not mention whether Colm Patterson had already served his notice period by the 6th of March, only that his duties shifted to Josias de Kock on that date.
On 7 March, LHN released a SENS announcement stating that Nicolaas Petrus Esterhuyse, the CEO and Executive Director of Letshego Micro Financial Services and Head of Retail Banking, had resigned. Mr Esterhuyse tendered his resignation on 15 February 2019 and concluded his duties on 22 February. This is an extremely short notice period for such an important role.
On 29 March, LHL announced that Smit Crouse, who served as Group CEO and Executive Director of the Group Board had resigned with immediate effect. Crouse was appointed as CEO at the end of September 2018. Dumisani Ndebele has been appointed as Group CEO for the interim period. The Letshego Group Board stated that it has initiated a search to identify a new Group Chief Executive, and that an announcement will be made in due course.
On 6 May, LHL released a SENS announcement on the Botswana Stock Exchange stating that Christian van Schalkwyk resigned from the Letshego Board with effect from 2 May 2019. Van Schalkwyk joined the Board on 1 April 2017 as an Independent Non-Executive Director, and was the Chairman of the Group Risk Committee, and a member of the Group Audit, Group Remuneration and Group Investment Committees.

The number of board and executive resignations at both LHN and LHL are concerning as very little information has been given surrounding the resignations. The resignation of LHL's CEO and LMFSN's CEO are particularly concerning from a shareholder perspective, as both CEOs resigned "with immediate effect". LHL's CEO was at the helm for only 6 months. The lack of guidance accompanying the spate of resignation announcements promotes speculation regarding the causes of these resignations, and is hardly a positive market signal. We would have expected clearer communication from LHL regarding the reasons behind the resignations. LHN has advised us that Mr Esterhuyse's departure resulted from the pursuit of an opportunity that opened up to him. LHN also noted that Mr Shephard's resignation stemmed from his need to reduce the demands on his time in order to better fulfil his other duties.

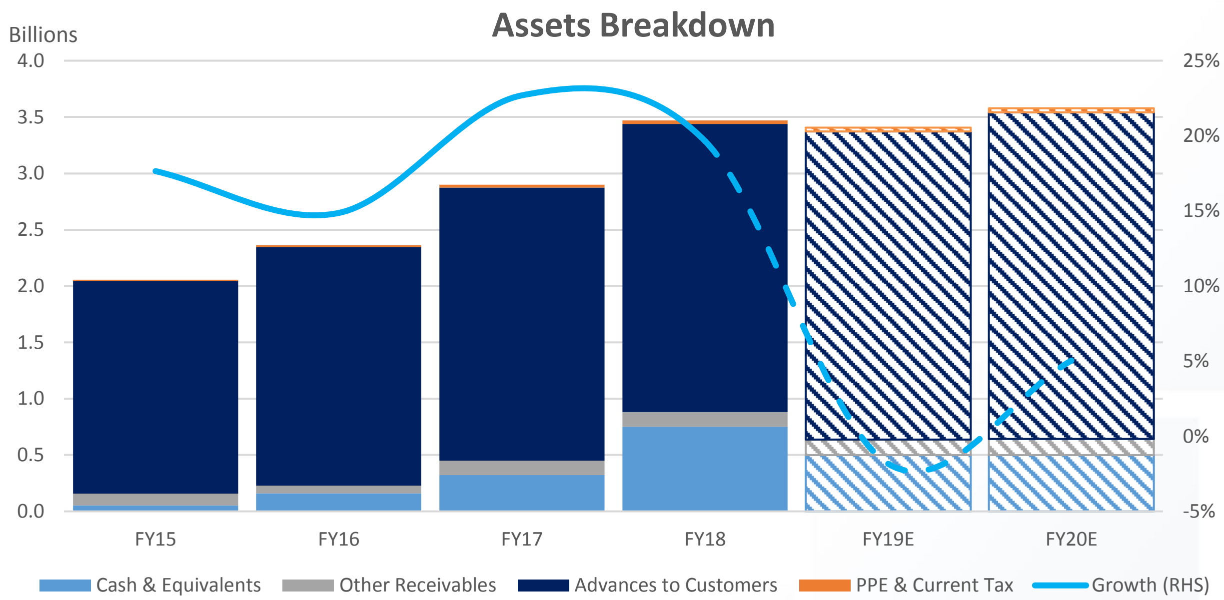
Asset Base
Growth

Letshego's total assets amounted to N$3.47 billion at the end of 2018, increasing by 19.6% y/y. Advances to customers, which continue to make up the bulk of total assets, increased by N$131.4 million (or 5.4% y/y) to N$2.56 billion. This compares to PSCE which grew at 7.4% y/y over the same period. The "Other Loans and Advances" to individuals category of PSCE, in which LHN is most active in, grew by 17.7%. Considering this it would seem LHN was extremely conservative during FY18.

LHN's advances portfolio is distributed among 51,209 clients, compared to 52,344 customers at the end of 1H18. Competition in the microlending sector has been increasing as new participants, such as Nedbank, have entered the market and existing clients have been paying off their loans, explaining the decrease in number of customers, coupled with the freeze in civil service appointments. Management stated that going forward, growth in advances will be driven by expansion into the private sector, as well as product expansion that is not deduction at source based.

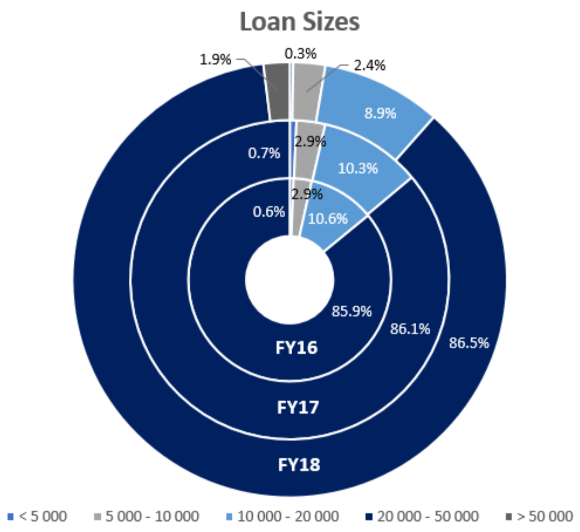
Most of the increase in total assets however stems from the N$427.2 million increase in cash and cash equivalents. LHN has increased its borrowings from commercial banks during the period and continues to have a strong ability to generate cash, resulting in an increase in the cash balance to N$750 million. Management has however noted 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 has already been utilised in expanding the loans and advances book. We are of the opinion that LHN should use a portion of the cash to repay some of its current borrowings, as the interest paid on loans and payables to LHL is relatively high.

Other receivables, consisting largely of income receivable from the cell captive arrangement with Hollard, increased by 4.3% y/y to N$131.2 million. Property and equipment meanwhile decreased by 13.1% to N$9.6 million, as depreciation charges and disposals exceeded the additions to property.



Source: *LHN, IJG Securities*

Advances Breakdown

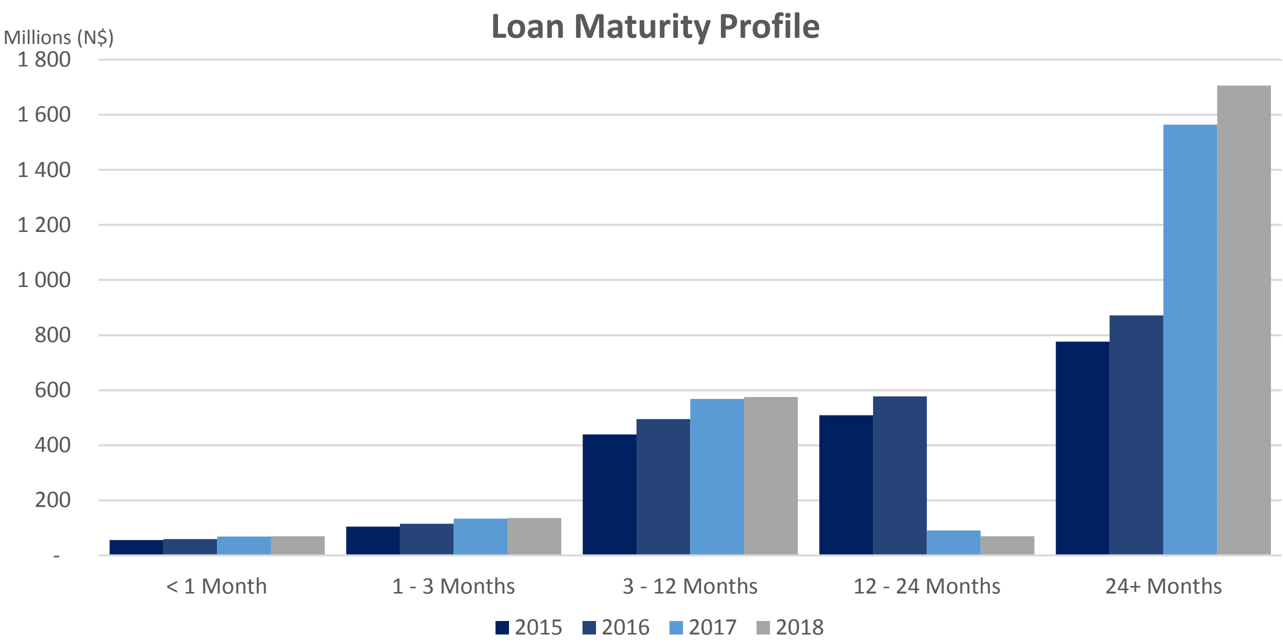


Source: *LHN, IJG Securities*

Most of the loans LHN extended are in the N$20,000 to N$50,000 bracket, which made up 86.5% of total advances at the end of FY18. The N$10,000 to N$20,000 bracket is the second largest category, making up 8.92%. The average loan size per customer amounted to N$49,906 during the period, with the average customer having about 2 loans.

Although LHN's loan book increased by N$131.4 million, the actual number of loans extended fell by 3,546 (3.2%), indicating that customers have been paying back loans, but that new loans that were extended were of higher value. LHN states that 54% of microloans are utilised for educational purposes, 22% for home improvements, 8% for business improvement, 3% for agricultural use, and the rest for other purposes.

The graph below shows the loan maturity profile of the microloans extended:



Source: *LHN, IJG Securities*

Most loan maturities are longer than two years as 66.8% of loans outstanding at the end of FY18 had a maturity of 24 months and longer. The figures suggest that there is still some loan restructuring happening to extend the duration of loans as loans with maturities between 12 and 24 months have further decreased by N$21.4 million, while loans with maturities of 24 months or more have increased by N$142.1 million. This restructuring signifies the difficult economic conditions that Namibians find themselves in, as customers resort to being indebted for longer durations in order to free up cash flows in the short term through lower monthly payments.

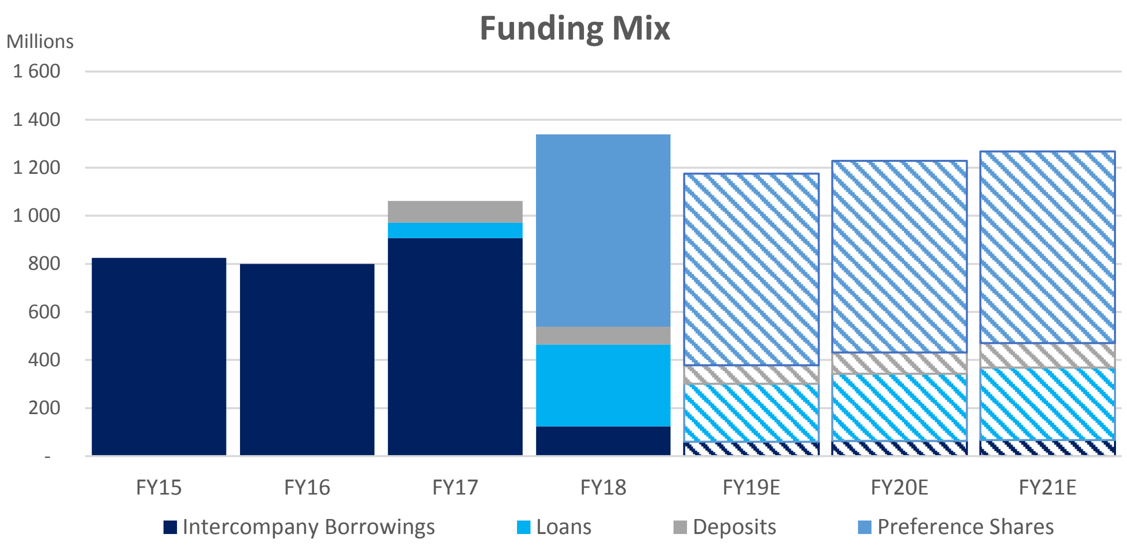
Funding

LHN made significant changes to its capital structure in the first half of the year. As we discussed in our [1H18 Results Review](), N$897.1 million of the intercompany loan from LHL was converted into 1,000 redeemable non-cumulative preference shares of N$1.00 par value each with a premium of N$897,052 each.

The conversion resulted in an increase in the balance of non-controlling interest from N$215.1 million to N$1.01 billion. The conversion further resulted in the company's debt to equity ratio decreasing from 54% to 16% by their own calculation. The preference shares pay dividends once a year, and the coupon rate remains the same as the interest rate on the intercompany loan at Namibian prime +2% p.a. N$100 million worth of preference shares were redeemed in the second half of the year.

Loans from commercial banks increased by N$277.5 million to N$341.1 million during the period. At financial year-end, LHN had three loans from commercial banks. The loans are repayable in quarterly instalments and mature in January 2019, December 2020 and June 2021. The largest of these loans are a new N$225.0 million loan from Standard Bank carrying an interest rate of 3-month JIBAR plus 4% p.a., and is guaranteed by LHL. This new loan is the main cause of the large cash balance increase on the balance sheet, as it came in towards the end of the period.

As a result of the intercompany loan conversion to preference shares in 1H18, LHN's intercompany borrowings decreased from N$907.1 million to N$59.0 million. LHN's intercompany payables however increased during the second half of the period by N$64.4 million to N$123.4 million at year end. Management noted that the increase in intercompany payables do not stem from an increase in loans from LHL, but from management fees payable to LHL. Management fees are thus capitalised. This is somewhat strange to us, as LHN has sufficient cash balances to pay the fees.



Source: *LHN, IJG Securities*

Deposits due to customers fell from N$90.2 million to N$74.7 million in 2018. A single large deposit matured in the first half of the year causing a decrease of N$49.4 million in 1H18. Deposits however increased by N$33.6 million in the second half of FY18. Term deposits decreased by N$18.9 million to N$71.3 million in FY18, while current account deposits increased from N$25,000 to N$3.4 million. We do not expect LHN's banking business to be a major threat to the major banks, as the target market's bank balances are typically small, and the country's banked population is already relatively high at 67.9% in 2017, according to the NSA.

Interest Income and Expenses

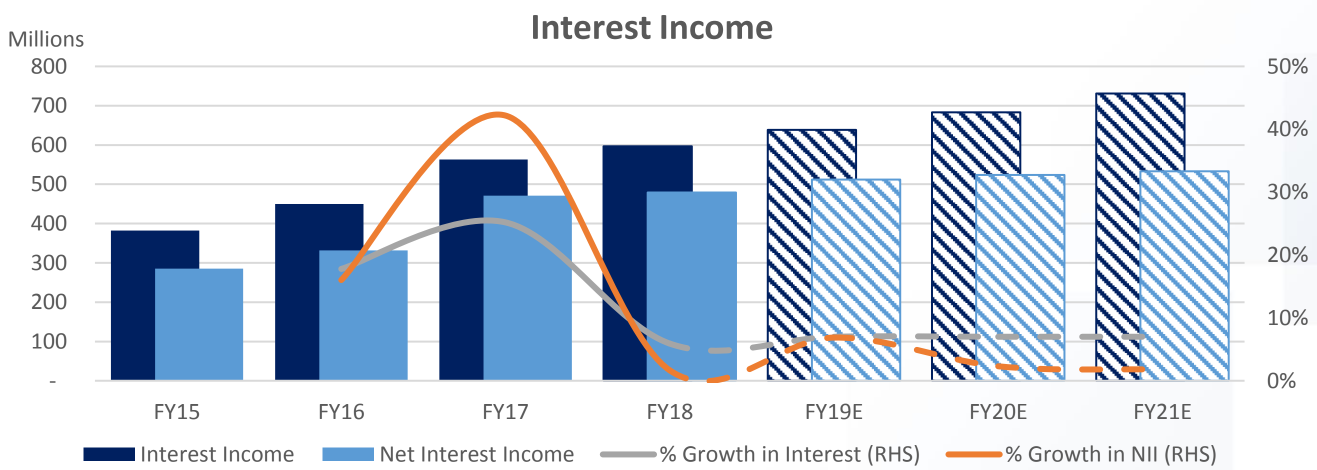
The growth in advances to customers has resulted in a 5.9% y/y increase in interest income from lending activities to N$596.7 million. Interest income from deposits with banks and money market placements rose 73.4% y/y to N$21.5 million as a result of the N$427.2 million increase in cash and equivalents during the period.

The average interest rate charged on loans amounted to 23.96% in 2018 or 2.3x the average prime interest rate, marginally down from the 24.8% charged in 2017.

Net interest income after impairments increased by N$95.8 million (or 20.3%) to N$567.1 million. This large increase is due to the intercompany loan conversion to preference shares. The preference shares are treated as equity by LHN, and as such dividend payments on the preference shares are only reflected in the Statement of Cash Flows instead of the Statement of Comprehensive Income. Adjusting net interest income for the preference dividends, however, sees the net interest income growth rate drop to 1.7% y/y.

Interest expense, consisting of interest paid for intercompany payables from LHL and term loans from commercial banks, decreased by 71.2% y/y from N$114.0 million to N$32.9 million. This enormous decrease is entirely due to the conversion of the intercompany loan to preference shares. A preference share dividend of N$88.0 million was paid during the year. For our analysis, the preference share dividend is treated as an interest expense seeing that the preference shares originated from intercompany loans. Treating the preference share dividend as interest thus sees total interest expense increase by 6.0% to N$120.9 million, and increases the effective tax rate from 25.5% to 29.5%.

Management do not expect the Bank of Namibia to deviate from the South African Reserve Bank's Monetary Policy decision regarding interest rate changes and expect interest rates to remain flat for most of the year with a possible increase towards the end of the year (at the time we engaged them in April).

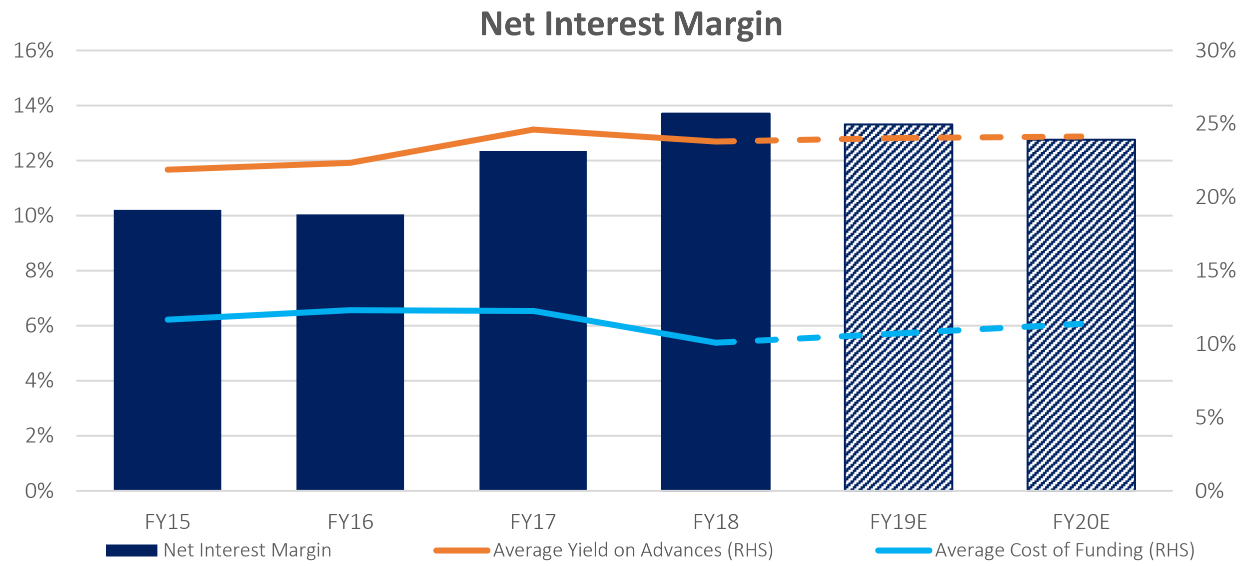


Source: *LHN, IJG Securities*

Net Interest Margin

As the micro loans that LHN issue are unsecured, LHN's net interest margin is higher than that of other commercial banks.

LHN's net interest margin widened from 12.4% to 13.7% in 2018. Most of the increase in the net interest margin was due to a decrease in the average cost of funding. The decrease in the calculated average cost of funding is due to LHN receiving the additional loan funding towards the end of the financial period, meaning that a relatively small amount of interest was paid on the additional funding, rather than actual funding costs decreasing.

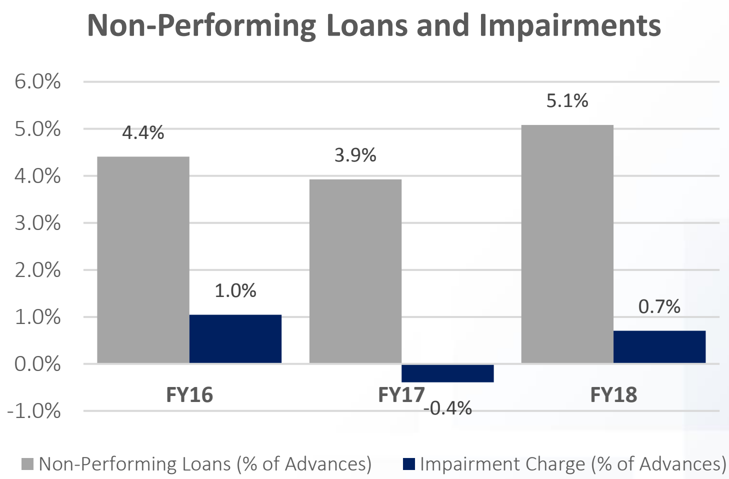


Source: *LHN, IJG Securities*

Non-Performing Loans and Impairments

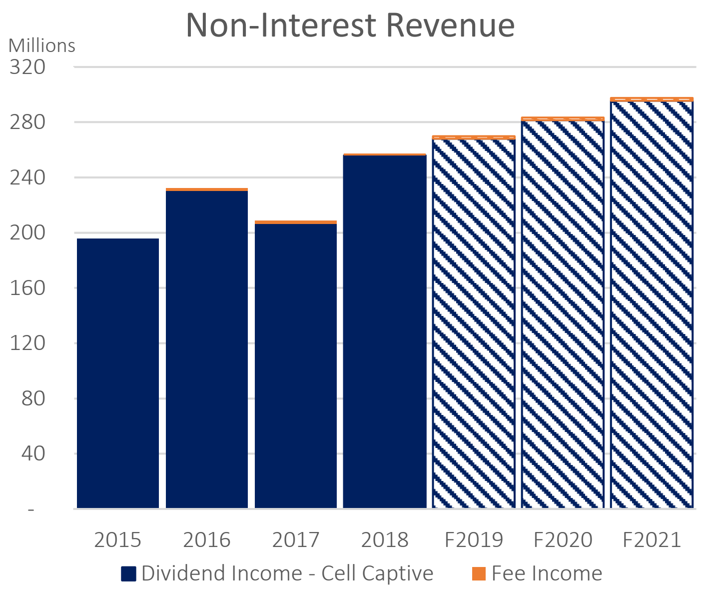
According to LHN, non-performing loans (NPLs) decreased from 3.9% to 3.6% of advances. According to our calculations, however, NPLs increased to 5.1% of advances. LHN classifies a loan as non-performing when payment is 90 days overdue.

This once again illustrates the difficult economic conditions Namibian consumers find themselves in as disposable incomes are placed under pressure.



The group recorded a credit impairment charge of N$18.2 million in FY18, compared to a credit impairment release of N$9.6 million in FY17.

Non-Interest Revenue



Source: *LHN, IJG Securities*

Non-interest revenue increased by 23.2% y/y to N$257.2 million, making up 29.4% of LHN's total income. Non-interest revenue is almost entirely made up from dividends received from the cell captive arrangement with Hollard Insurance. Dividends from the cell captive increased by N$49.4 million to N$256.0 million.

Insurance plays a large role in LHN's business model, as it not only aids in reducing credit losses, but also provides a source of non-interest revenue. Hollard Insurance administers two cell captives on behalf of LMFSN and LHN, one for long-term and one for short-term insurance.

The customer (the long-term policy holder) and Letshego (the short-term policy holder) pay premiums to the cell captives and claims are paid to the respective policyholders. The cell captive arrangement thus covers both credit and mortality risk. All claims that arise are paid out from the cell's assets, and excess reserves remaining after insurer's fees, taxes and other expenses, are paid to LHN in the form of dividends. Dividends are declared from Hollard back to LHN / LMFSN twice a year based on available reserves in the respective captives. The entire LMFSN advances portfolio is covered by the cell captive arrangement, and as such, no allowance for impairment losses is made on these advances.

The increase in non-interest revenue therefore suggests that fewer claims were made as a result of non-payment, resulting in higher profit (and dividend payments) from the cell captive.

Fee income nearly halved during the year, falling from N$2.2 million in FY17 to N$1.2 million in FY18. Fee income consists of postage fees which fell by N$1.3 million to N$922,706, and fees and commission earned from services to customers, which increased by N$249,576 to N$253,291.

Operating Expenses

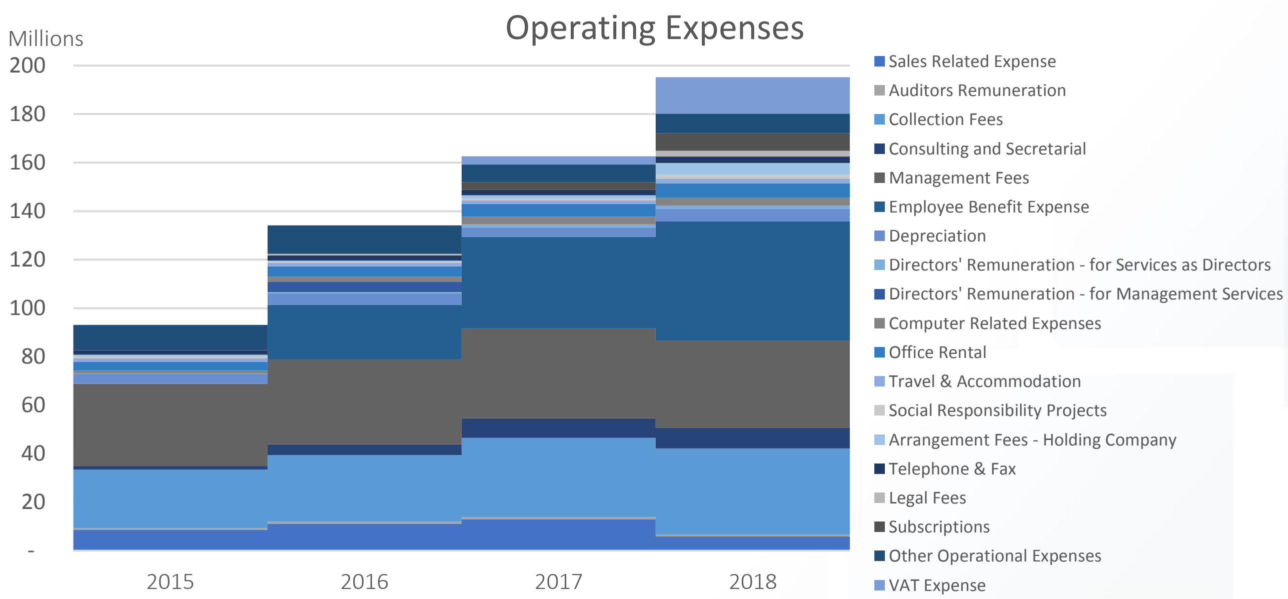
Operating expenses increased by 20.0% y/y to N$195.2 million in 2018, outpacing the growth in total income of 11.5%. This is to be expected as the company is still busy expanding its banking operations, and a lag generally exists between investments made and returns on those investments.

The main drivers of the increase in costs were VAT expense, employee benefits and subscriptions. VAT expense, which arises from imported services from both South Africa and Botswana, as well as internet banking and IT services, increased by N$11.5 million (324.0%) to N$15.0 million. Costs related to subscriptions, which are paid to Namclear and other associations, increased by N$4.1 million (or 127.8%) to N$7.3 million.

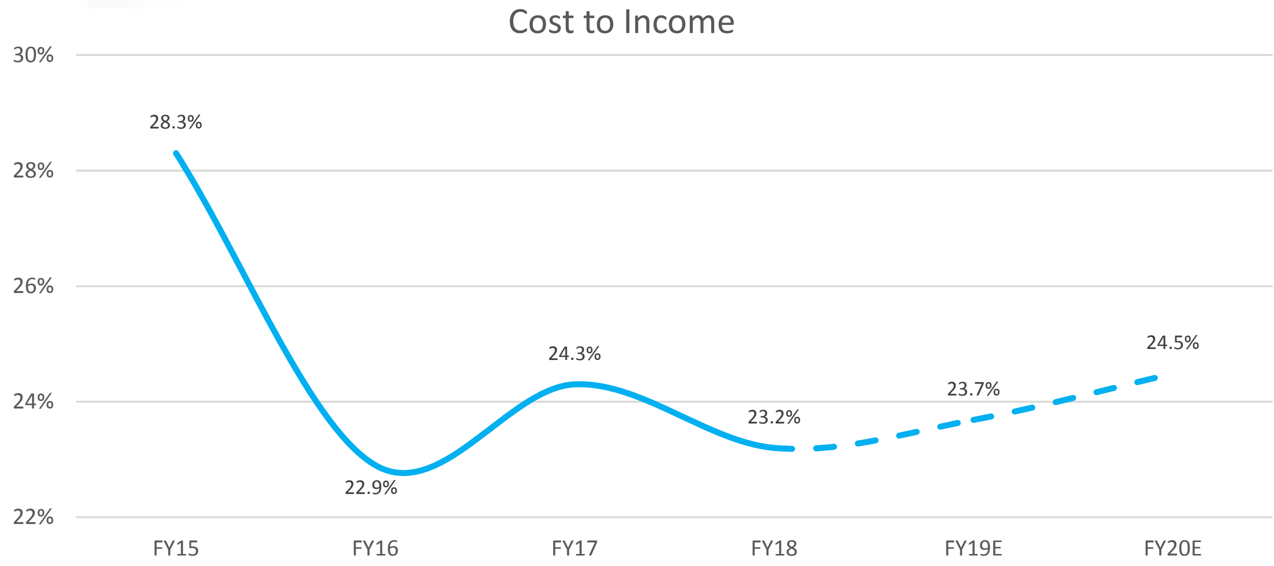
The company's number of full-time employees increased to 117 in 2018, from 98 employees in 2017. Employee benefits increased by 30.1% from N$37.9 million in 2017 to N$49.3 million in 2018, making up the largest share of operating expenses. Most of this hike stems from increases in salaries and incentive bonuses which grew by 19.2% and 102.4% respectively. No information was given in the Integrated Annual Report on why incentive bonuses more than doubled or what the performance metrics are whereby employee bonusses are decided. Given that the increase in bonuses of executive management were reasonable, it is clear that employee bonuses for the year were good.

Other operational expenses, which comprises of stationery, security, repairs and cleaning expenses, increased by 11.9% to N$8.0 million. Collection fees increased by 8.5%, which is slightly higher than the 5.4% increase in advances. Arrangement fees increased by 249% to N$5.0 million. These fees originated from the additional debt funding LHN obtained from Standard Bank and RMB.

Cost items which decreased during the period were sales related expenses, auditors' remuneration, management fees and computer related expenses. Sales related expenses decreased by N$7.1 million to N$5.8 million, which management says is due to a decline in business and renegotiation with agents. Management fees fell by N$1.2 million (3.2%) to N$35.9 million.



Source: *LHN, IJG Securities*



Source: *LHN, IJG Securities*

LHN's cost-to-income ratio decreased from 24.3% in FY17 to 23.2% in FY18. Letshego's cost-to-income ratio remains well below the average of the Namibian listed commercial banks. LHN has an internal threshold of 28%.

Outlook

Despite a difficult economic environment, LHN continued to be a highly profitable business with a strong ability to generate cash. The low estimated forward P/E ratio of 4.1x for FY19 in our view signals that the market continues to undervalue the company.

Competition in the microlending sector has been getting stronger in the last year as Nedbank has increased its maximum loanable amount to N$200,000 and the Capricorn Group has acquired Entrepo. However, thus far, it seem as if LHN is managing to hold on to its market share of credit extended to government employees, despite a slight decrease in number of customers. LHN is very dependent on the public sector where the runway for growth is fairly limited given that roughly 51,209 government employees are already customers and there is pressure on government to reverse the growth in the public service wage bill.

2019 is however an election year, and as such, government may be tempted to increase the wages of public sector workers. This would be positive for LHN as it would not only be able to extend more (or higher value) loans to government employees, but also reduce the credit risk of existing clients. Going forward, growth in advances will be driven by expansion into the private sector as well as product expansion according to management. This process has not delivered tangible results despite management noting for some time that it is the key to growth going forward.

LHL's influence on LHN raises concerns. LHN currently has intercompany payables of N$123.4 million, which consists of management fees payable to LHL. We do not see the need for capitalising these fees, as LHN has sufficient cash on hand to cover these fees. Intercompany payables carry an interest rate of Namibian prime plus 2%. LHL seem to control when these balances may be paid which raises concerns as it prevents optimal use of the balance sheet. This is especially concerning from a minority shareholder perspective.

Given the profile of customers that LHN is targeting with its banking solutions, we do not expect rapid growth in deposit funding. Namibia furthermore has a relatively high banked population (67.9% in 2017 according to the NSA) compared to neighbouring countries. As such growth from the banking division is likely to remain muted for some time going forward.

We believe that the margin of safety is relatively large given the low LHN share price at present. It is unlikely that government will significantly reduce the size of the public sector wage bill in the next year, given it being an election year. As noted above, this would be positive for LHN as it would be able to further grow its loan book. We thus do not believe that the discount in the current share price is justified by the relatively low risks of the business.

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 19.8%, based on a 9.83% 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. The sustainable growth rate was estimated to be 14.0% based on a long-term sustainable return on equity of 20.0% and an estimated pay-out ratio of 30.0%. 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 (NS'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	2,077,271	4.15	5.45	5.45	1.00	0.96	5.66%	6.28%	20%
Residual Income	2,072,019	4.14	5.44	5.44	1.00	0.95	5.67%	6.30%	20%
Dividend Discount	2,000,262	4.00	5.25	5.25	0.96	0.92	5.87%	6.52%	20%
Justified Price to Earnings	2,015,437	4.03	5.29	5.29	0.97	0.93	5.83%	6.48%	20%
Justified Price to Book	2,236,488	4.47	5.87	5.87	1.08	1.03	5.25%	5.84%	20%
Weighted Average	**2,080,295**	**4.16**	**5.46**	**5.46**	**1.00**	**0.96**	**5.66%**	**6.28%**	**100%**

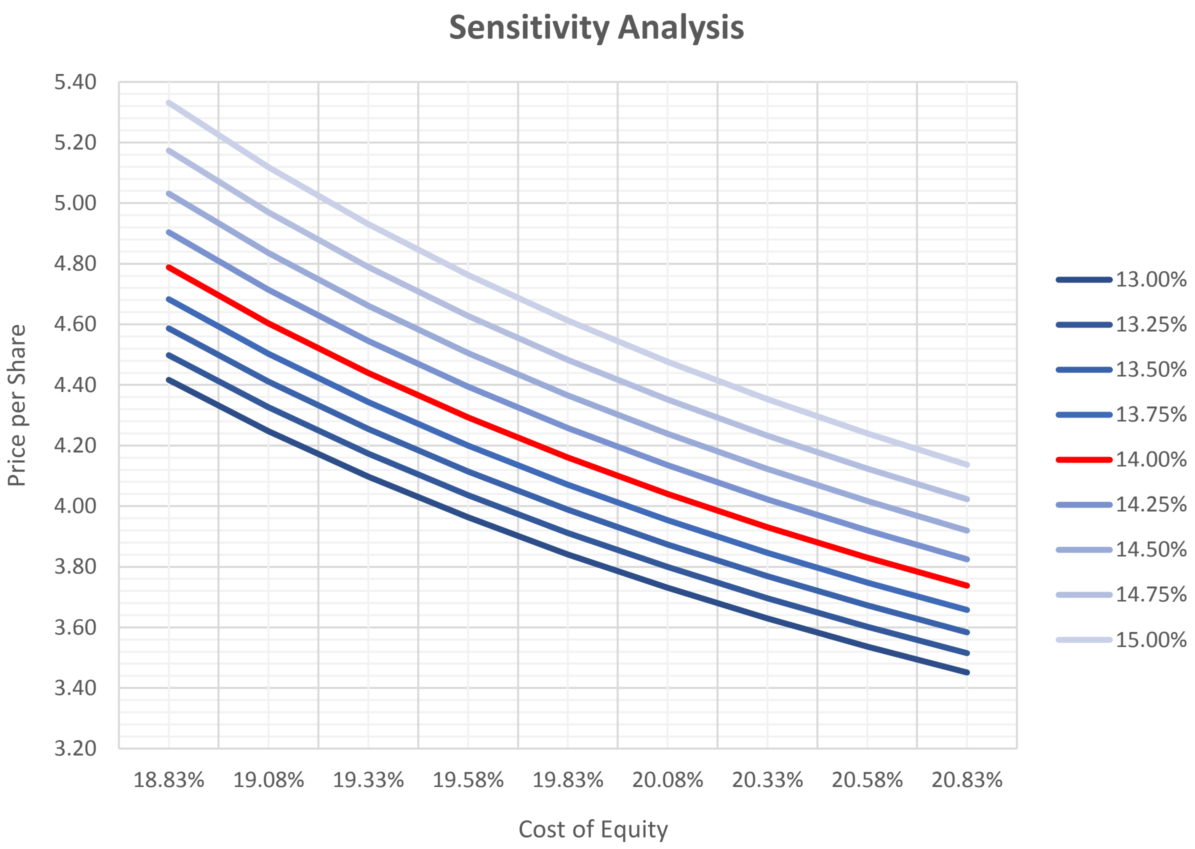
Source: *IJG Securities*

Based on the table above, we derive a **target price of N$c416** per share and coupled with an expected full year dividend of 26cps, we derive an expected **total return of 26.4%.** As a result of the apparent discount to fair value, we maintain or **BUY** recommendation.

Summary of Income Statement

	2016	2017	2018	2019E	2020E	2021E
Total Income	**685 703**	**784 585**	**874 674**	**935 826**	**1 001 724**	**1 069 009**
Interest Income from Lending Activities	450 025	563 375	596 693	638 462	683 154	730 975
Credit Impairment Release / (Charge)	(22 083)	9 553)	-18 226	(19 501)	(20 867)	(22 327)
Interest After Impairment	**427 942**	**572 928**	**578 467**	**618 960**	**625 150**	**631 401**
Other Interest Income	3 465	12 376	21 465	27 475	35 168	40 443
Interest Expense	(99 943)	(114 038)	(32 866)	(34 838)	(36 928)	(39 144)
Pref. Share Dividend				(99 632)	(99 632)	(99 632)
Net Interest Income after Impairment	**331 464**	**471 266**	**567 066**	**511 965**	**523 757**	**533 068**
Fee Income	1 943	2 229	1 176	1 783	1 890	2 003
Other Operating Income	230 269	206 606	255 340	268 107	281 513	295 588
Employee Benefits	-26 638	(37 858)	(49 263)	(57 146)	(66 289)	(75 569)
Other Operating Expenses	(107 485)	(124 827)	(145 936)	(157 611)	(167 068)	(177 092)
Operating Profit before Taxation	**429 554**	**517 416**	**628 383**	**567 098**	**573 803**	**577 998**
Taxation	(99 602)	(132 159)	(159 510)	(144 043)	(145 746)	(146 812)
Profit for the Year	**329 952**	**385 256**	**468 873**	**423 055**	**428 057**	**431 187**
Other Comprehensive Income, Net of Tax	-	-	-	-	-	-
Total Comprehensive Income for the Period	**329 952**	**385 256**	**468 873**	**423 055**	**428 057**	**431 187**
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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