

2nd August 2019

Valuation:

- We are of the view that the Stanlib Fahari REIT (I-REIT) is a “HOLD” with a target price of Kshs 9.8, representing an upside of 17.7%, from the current price of Kshs 8.54 per unit as at 2nd August 2019, and a projected FY'2019 dividend yield of 7.9% assuming the dividend payout ratio remains at the 3 year average (2016 -2018) of 96.5%,
- The I- REIT's performance in terms of projected dividend yield at 7.9% is in line with the commercial real estate market average of 8.0%, with 8.2% rental yield for retail space and 7.9% yield for office space in H1'2019. However, the expected high yield is attributable to its declining stock price closing at Kshs 8.54 per unit as at 2nd August 2019 in comparison to Kshs 11.3 as at 29th June 2018, representing a 24.4% loss of value,
- The Fahari I- REIT is currently trading at a P/B of 0.4x and P/E of 21.2x, versus an emerging markets average of 0.9x and 14.7x, respectively,

Key Highlights in H1'2019:

- Construction of the 3-screen cinema with 100 seats each at the Greenspan Mall was completed in May 2019. The launch date is scheduled for 30th August 2019 to allow for adequate time for fit-out. The cinema is meant to increase foot traffic, benefiting existing and future tenants and increase rental income for the REIT,
- The recently published Finance Bill 2019 proposes an amendment of section 20 of the Income Tax Act to exempt REIT investee companies from income tax. If successful, the amendment, which is subject to Parliament's approval, will resolve the tax leakage previously experienced at a property subsidiary level, hence increase distributable earnings.

Income Statement:

- Earnings per unit rose by 16.2% to Kshs 0.42 per unit from Kshs 0.36 per unit in H1'2018, driven by a 10.8% increase in total income coupled with a 3.7% decline in operating expenses,
- Total income rose by 10.8% to Kshs 193.5 mn from Kshs 174.6 mn in H1'2018. The performance was driven by a 26.3% growth in rental income to Kshs 170.7 mn from Kshs 135.1 mn in H1'2018, as a result of the rental income contribution following increased occupancies by its properties including the Grade A office - 67 Gitanga Place that was acquired in May 2018. However, low occupancy rates by Highway House limited rental revenue collections,
- Interest income decreased by 68.6% y/y to Kshs 13.2 mn from Kshs 41.9 mn recorded in H1'2018, attributable to the utilization of surplus cash in acquiring the 67 Gitanga Place Office in 2018, as opposed to investing in interest-earning securities,
- Rental income rose by 26.3% to Kshs 170.7 mn in H1'2019 from Kshs 135.1 mn in H1'2018 attributed to rent and service charge income from 67 Gitanga Place Office,
- Total operating expenses stood at Kshs 107.4 mn, 3.7% lower than Kshs 111.8 mn in H1'2018, out of which 54.5% was attributed to fund-operating expenses such as audit, trustee fees, and license fees, while property expenses which include maintenance of tenants and properties, filling vacancies, marketing, and public relations accounted for 45.5% of the total operating expenses,
- Net profit grew by 16.2% to Kshs 76.4 mn, from Kshs 65.8 mn in H1'2018. This is on account of the 26.3% increase in rental income and a 3.7% decline in total operating expenses.
- The REIT did not recommend an interim distribution of dividends for the period ended 30th June 2019. It was noted that a full distribution will be declared in line with the requirements of the REITs

Regulations to distribute a minimum of 80% of distributable earnings within four months after the end of the financial year.

Balance Sheet:

- Total assets increased by 1.5% y/y to Kshs 3.8 bn from Kshs 3.7 bn in H1'2018, owing to the purchase/acquisition of borehole infrastructure. Total assets comprised of investment property valued at Kshs 3.4 billion and cash reserves of Kshs 235 million,
- Total liabilities decreased by 10.6% to Kshs 113.8 mn from Kshs 127.3 mn in H1'2018, driven by a decrease in payables. The REIT incurred no financing costs in H1'2019.
- Shareholders' funds grew by 1.9% to Kshs 3.66 bn from Kshs 3.59 bn in H1'2018 and thus the REIT closed with a Net Asset Value of Kshs 20.3 per share, 1.3% higher than its listing price of Kshs 20.0.
- The REIT currently has a return on assets of 2.0% and a return on equity of 2.1%, compared to 1.8% and 1.8%, respectively, in H1'2018.

Key Take-outs:

- On the bourse, the REIT's performance has been on a decline since its listing at Kshs 20.0 in November 2015. The REIT traded at an average of Kshs 9.4 per unit in H1'2019 compared to Kshs 10.6 per unit in FY'2018, and Kshs 11.1 per unit in H1' 2018, thus losing 18.1% of its value y/y and 53.2% from its listing, an indication of the continued lack of investor appetite for the instrument,
- We expect the REITs revenues to increase driven by;
 - Revenue streams from its diverse portfolio including 67 Gitanga Road building, Greenspan Mall, Signature International Limited and Bay Holdings Limited in Industrial Area,
 - The launch of the 3-screen cinema at Greenspan Mall on 30th Aug 2019, which is intended to increase foot traffic and boost existing tenant customers,
 - Announced plans to acquire more properties from pension firms and insurers who will be compensated in the form of units in the REIT, and
 - The expected legislation to exempt REIT investee companies from income tax.

Below is a summary of the key line items in the balance sheet and income statement;

Figures in Kshs bn unless stated otherwise

Balance Sheet	FY 2017	H1'2018	FY 2018	H1'2019	Δ Y/Y (H1' 2018/ H1' 2019)
Total Assets	3.8	3.7	3.9	3.8	1.6%
Total Equity	3.7	3.6	3.7	3.7	1.7%
Total Liabilities	0.1	0.1	0.1	0.1	(15.4%)

Figures in Kshs bn unless stated otherwise

Income Statement	2017 FY	H1'2018	FY 2018	H1'2019	Δ Y/Y (H1' 2018/ H1' 2019)
Rental Income	0.28	0.14	0.31	0.17	21.4%
Income from Other Sources	0.10	0.04	0.06	0.01	(75.0%)
Operating Expenses	0.23	0.11	0.24	0.11	0.0%
Profit Before Tax	0.17	0.07	0.19	0.08	14.3%
Basic EPS	0.95	0.36	1.07	0.42	16.7%

Ratios Summary	2017 FY	H1'2018	FY 2018	H1'2019	Δ Y/Y (H1' 2018/ H1' 2019)
----------------	---------	---------	---------	---------	----------------------------



Stanlib Fahari I- REIT Earnings Update – H1' 2019

ROA	4.5%	1.8%	5.0%	2.0%		0.3%
ROE	4.7%	1.8%	5.2%	2.1%		0.3%
Debt Ratio	2.5%	3.4%	3.3%	3.0%		(0.4%)
PBT Margin	46.0%	37.7%	49.7%	39.4%		1.7%
Investment Property Rental Yield	7.0%	2.0%	5.7%	2.2%		0.3%