

**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 8.9% from the current price of Kshs 9.0 as at 1<sup>st</sup> May 2020, and an FY'2019 dividend yield of 8.3%, assuming the dividend payout ratio remains at the 3-year average (2016 -2019) of 95.5%,
- The I-REIT's performance in terms of dividend yield at 8.3% is above the commercial real estate market average of 7.7%, with 7.5% rental yield for retail space and 7.8% yield for office space in Q1'2020. However, the yield is attributable to its declining stock price closing at Kshs 9.0 per unit as at 1<sup>st</sup> May 2020, a 57.5% drop from its initial price of Kshs 20.8 as at November 2015 and 12.5%, lower than Kshs 9.6 recorded at the beginning of the year,
- The Fahari I-REIT is currently trading at a P/B of 0.4x and P/E of 9.3x, versus an emerging markets average of 0.9x and 12.5x, respectively,

**Key Highlights in FY'2019:**

- In November 2019, STANLIB Kenya Limited (SKL) together with The Co-operative Bank of Kenya Limited in their respective capacity of REIT Manager and REIT Trustee announcement that SKL had entered into a sale of business agreement with ICEA LION Asset Management Limited (ILAM), dated 6<sup>th</sup> November 2019. As per the Agreement, the assets acquired by ILAM include SKL's investment management mandates and all rights, obligations and benefits of SKL in terms of or in connection with SKL's role as Promoter and REIT Manager in relation to the REIT,
- At the Greenspan Mall, construction of a 3-screen cinema was completed in May 2019 and the cinema formally launched in October. The cinema is operated by Motion Cinema who have signed a 10-year lease agreement. Other capital projects completed at Greenspan Mall include sinking of a new borehole and installation of a steel tank in order to reduce water expenses and improve reliability of supply,
- The REIT realized a net profit of Kshs 175.2 mn and declared a first and final distribution of Kshs 135.8 mn, which amounts to a 94.2% pay-out ratio will thus be paid by no later than 31 May 2020. Investors will realize 8.3% dividend yield at the market price of Kshs 9.0 as at 1<sup>st</sup> May 2020.

**Income Statement:**

- The earning per unit recorded a 9.4% decline to 0.97 from 1.07, attributed to a 9.0% decline in net profits,
- Rental income grew by 11.0% in line with lease escalations and as a result of income from the new cinema at Greenspan Mall as well as full year income contribution from the 67 Gitanga Place office building acquired at the end of May 2018,
- Property expenses grew by 5.0% mainly due to recognition of expenses from 67 Gitanga Place for the full year whilst only seven months were included in FY'2018. In addition, the tax leakage from the provision for irrecoverable withholding tax by tenants grew by 22.0% to Kshs 16.5 mn from Kshs 13.5 mn in 2018,
- Distributable earnings grew by 13.0% to Kshs 144.0 mn compared to Kshs 127.9 mn in the comparative period as a result of the significant decrease in fund operating expenses caused by the recovery of VAT input which had previously been capitalised to fund expenses,
- The REIT Manager recommended and the REIT Trustee approved maintaining the distribution at the same level as prior year, and a first and final distribution of Kshs 135.8 mn, which amounts to a 94.2%

pay-out ratio, and will be paid by no later than 31<sup>st</sup> May 2020. This is In light of the significant capital projects recently undertaken at Greenspan Mall and the likely negative impact of the coronavirus pandemic on cashflows,

- Net profits decreased by 9.0% to Kshs 175.2 mn from Kshs 193.5 mn mainly due to the reduction in fair value gain on revaluation of investment property compared to prior year on the back of a sluggish real estate sector with continued downward pressure on rental income especially in the retail sector.

#### **Balance Sheet:**

- Total assets increased by 0.7% y/y to Kshs 3.88 bn from Kshs 3.85 bn in FY'2018, attributable to a 2.7% increase in investment property to Kshs 3.5 bn from Kshs 3.4 bn in FY'2018, with the construction of a 3-screen cinema completed in May 2019 and the cinema formally launched in October,
- Total liabilities decreased by 10.6% to Kshs 115.0 mn from Kshs 128.7 mn in FY'2018, driven by a decrease in payables, as the REIT incurred no financing costs in FY'2019,
- Shareholders' funds grew by 1.1% to Kshs 3.8 bn in FY'2019 from Kshs 3.7 bn in FY'2018 and thus the REIT closed the year with a Net Asset Value of Kshs 20.8 per share, 4.0% higher than its listing price of Kshs 20.0,
- The REIT currently has a return on assets of 4.5% and a return on equity of 4.7%, compared to 5.0% and 5.2%, respectively, in FY'2018.

#### **Key Take-outs:**

- On the bourse, the REIT's performance has been on a decline since its listing at Kshs 20.75 in November 2015. The REIT traded at an average of Kshs 8.9 per unit in FY'2019, compared to Kshs 10.6 in FY'2018, thus losing 16.0% of its value y/y and 57.1% from its listing, an indication of the continued lack of investor appetite for the instrument,
- We expect the REITs rental revenues to increase driven by; (i) increased diversification of the portfolio, with the operation of the 3-screen cinema with 100 seats each, at Greenspan Mall, which is intended to increase foot traffic and boost existing tenant customers, and (iii) the November 2019 legislation amendment exempting the income of REITs investee companies from income tax. Previously, only the income of REITs was exempt from corporation tax. However, we expect the REIT as with the entire economy to be impacted by the COVID- 19 pandemic which has resulted in a slowdown in the economy globally.

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

*Values in Kshs bn unless stated otherwise*

<b>Balance Sheet</b>	<b>FY'2017</b>	<b>FY'2018</b>	<b>FY'2019</b>	<b>Δ Y/Y (FY'18/ FY'19)</b>
Total Assets	3.8	3.9	3.9	0.7%
Total Equity	3.7	3.7	3.8	1.1%
Total Liabilities	0.1	0.1	0.1	(10.6%)

*Values in Kshs bn unless stated otherwise*

<b>Income Statement</b>	<b>FY'2017</b>	<b>FY'2018</b>	<b>FY'2019</b>	<b>Δ Y/Y (FY'18/ FY'19)</b>
Rental Income	0.28	0.31	0.34	11.2%
Income from Other Sources	0.10	0.06	0.03	(55.7%)
Operating Expenses	0.23	0.24	0.23	(5.6%)
Profit Before Tax	0.17	0.19	0.18	(9.4%)
Basic EPS	0.95	1.07	0.97	(9.4%)

Ratios Summary	FY'2017	FY'2018	FY'2019	Δ Y/Y (FY'18/ FY'19)
ROA	4.5%	5.0%	4.5%	(0.5%)
ROE	4.7%	5.2%	4.7%	(0.5%)
Debt Ratio	2.5%	3.3%	3.0%	(0.4%)
PBT Margin	46.0%	49.7%	46.2%	(3.5%)
Rental Yield	7.0%	5.7%	5.1%	(0.7%)