Cytonn INVESTMENTS

Stanlib Fahari i-REIT Earnings Update – H1'2017

7th August, 2017

Valuation

- We are of the view that the Fahari REIT is a "Buy" with a target price of Kshs 14.6, representing an upside of 25.0%, from the current price of Kshs 12.25, as at 11th August, inclusive of a dividend yield of 5.9%, assuming a 92% pay-out ratio from distributable earnings, similar to the 2016 dividend pay-out
- Fahari REIT is currently trading at a P/B of 0.6x and a P/E of 28.3x, vs an emerging markets average of 0.9x and 14.9x, respectively

Highlights:

- The REIT registered a 220.8% growth in earnings per unit to Kshs 0.43 per unit from Kshs 0.13 per unit in H1'2016 attributed to a significant reduction in fund-management costs and increased rental income
- Out of a total asset value of Kshs 3.7 bn, 66.0% is invested in properties worth Kshs 2.4 bn, with 34.0% in cash and cash equivalents. The REIT, that has been in operation for 20 months now, is allowed to invest no more than 25% of its total asset value in cash and cash equivalents after the first 24 months
- The REIT realised a net profit of Kshs 78.3 mn but did not recommend a dividend distribution. We project a 5.9% dividend yield, which is low compared to the market average of 10.0% rental yield for retail space and 9.3% yield for office space

Income Statement

- Earnings per unit rose by 220.8% to Kshs 0.43 per from Kshs 0.13 per unit in H1'2016 mainly due to a 30.0% decline in operating expenses to Kshs 112.5 mn from Kshs 160.8 mn in H1'2016. The decline in expenses is because of the one-off set up and listing costs such as promotional and marketing expenses incurred in H1'2016 equal to Kshs 118.3 mn and the fact that the REIT currently has no debt, thus no financing costs compared to the previous period, which had Kshs 23.0 mn. Excluding the one off expenses, the operating cost decreased by 1.2% to Kshs 42.0 mn from kshs 42.6 mn, rental income grew by 14.2% to Kshs 138.0 mn from Kshs 120.9 mn in H1'2016. The growth of in rental income is as a result of rental income generated by two of the properties that were acquired towards the end of June 2016, which have contributed Kshs 15.9 mn to this income line,
- Operating expenses stood at Kshs 112.5 mn from Kshs 160.8 mn in the previous period last year, of which 62.7% was attributed to fund-operating expenses such as audit, trustee fees and license fees, with property expenses accounting for 37.3% (Kshs 42.6 mn versus Kshs 42.1 mn the previous year) including maintenance of tenants and properties, filling vacancies, marketing and public relations. This shows that approximately 60% of the revenues are going to professional fees, hence the low returns to the investor. This is likely to continue, but the REIT may bank on economies of scale to increase profits with acquisition of additional properties,
- Net Profit grew by 220.8% to Kshs 78.3 mn, from Kshs 24.4 mn in H1'2016. This is on account of the, 14.2% rental income, the 30.0% decline in expenses. We project a 5.9% dividend yield on 2017 returns assuming 92% distribution,

Balance Sheet

- Total assets increased by only 0.45% to Kshs 3.69 bn from Kshs 3.68 bn in H1'2016 driven by a 0.3% increase in investment property from revaluation and a 29% decrease in receivables, to Kshs 102.4 mn from Kshs 143.8 mn. No new properties were acquired during the period from H1'2016 to H1'2017,
- Total liabilities declined by 25.3% to Kshs 121.1 mn from Kshs 162.2 mn in H1'2016, driven by a 26% decrease in payables to Kshs 157.2 mn from Kshs 116.1 mn in H1'2016 as the REIT incurred no financing costs in H1'2017
- Shareholders' funds grew by 1.6% to Kshs 3.6 bn from Kshs 3.5 bn in H1'2016,
- The REIT currently has a return on assets of 2.1% and a return on equity of 2.2%, compared to 0.7% and 0.7%, respectively, in H1'2016.

Ratios Summary	H'1 2016	H'1 2017	y/y change in percentage points
ROA	0.7%	2.1%	**1.5%**
ROE	0.7%	2.2%	**1.5%**
Debt Ratio	4.4%	3.3%	**(1.1%)**
PBT Margin	8.2%	41.6%	**33.4%**

Performance

- On the bourse, the REIT’s performance has been on a decline since its listing at Kshs 20.0 per unit. In 2016, the REIT traded at an average of Kshs 17.4 per unit, while in 2017 it has been trading at an average of Kshs 11.4 per unit, losing 37.5% of its value as at 4th August 2017
- The above is so because, in principle the REIT is not capitalising on the key advantages of REITS which includes:
    i. High Yields – The projected dividend yield on the REIT is 5.9%, which is lower than government securities and market average yields for retail space in Nairobi at 10.0% while that of office space is 9.3% on average
    ii. Diversification – The Fahari REIT is not well diversified in property and also location as 2 of its properties are in the lower performing zones of Nairobi. That is Mombasa Road and Industrial area.

  The REIT is also suffering due to poor investor sentiments on the returns of listed property in Kenya.

Going forward, the REIT is expected to increase revenues as they intend to acquire additional properties by September 2017 that will not only diversify sectoral exposure, but also improve economies of scale. The REIT manager plans to raise Kshs 9.0 bn in a cash call to buy the properties later this year. There is however need for the REIT to align its interests with those of investors to ensure higher earnings, thus boost investor appetite for the product.

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

Figures in Kshs bn unless otherwise stated

Balance Sheet	H1'2016	H1'2017	y/y change
Total Assets	3.68	3.69	**0.4%**
Total Equity	3.52	3.57	**1.6%**
Total Liabilities	0.16	0.12	**(25.3%)**

Income Statement	H1'2016	H1'2017	y/y change
Rental Income	0.12	0.14	**14.2%**
Income from Other Sources	0.09	0.05	**(39.5%)**
Operating Expenses	0.16	0.11	**(30.0%)**
Profit Before Tax	0.02	0.08	**220.8%**
Basic EPS	0.13	0.43	**220.8%**