



ILAM Fahari I-REIT Earning's Note– H1'2020

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02nd August 2020

Valuation:

- We are of the view that the ILAM Fahari I-REIT is a “BUY” with a target price of Kshs 11.78, representing an upside of 102.4%, from the current price of Kshs 5.82 as at 29th July 2020, and a projected FY'2020 dividend yield of 12.7% assuming the dividend payout ratio remains similar to the 4-year average of 96.0% (2016-2019),
- The I-REIT's performance in terms of projected dividend yield at 12.7% is significantly higher compared to the average rental yields recorded in commercial office and retail sectors in H1'2020 with 7.3% and 7.4%, respectively. However, the expected high dividend yield is largely attributable to the low trading price of the I-REIT, at Kshs 5.9 as at 30th June 2020 compared to Kshs 9.2 as at 29th June 2019. Additionally, dividends are likely to remain weak due to the current unfavorable economic environment,
- The Fahari I-REIT is currently trading at a P/B of 0.3x and P/E of 12.2x, versus an emerging markets average of 0.9x and 16.0x, respectively.

Key Highlights in H1'2020:

- In May 2020, ICEA Lion Asset Management (ILAM), a local fund manager, announced that it had completed a transaction with Stanlib Kenya Limited (SKL) that would see it acquire the latter's role of managing the property fund, Stanlib Fahari I-REIT, from South Africa-based Liberty Holdings Ltd. ILAM acquired all rights, obligations, and benefits of SKL in connection with SKL's role as promoter and REIT manager,
- In June 2020, the Cabinet Secretary for the National Treasury and Planning, Ukur Yatani, drafted rules under the Income Tax (Real Estate Investment Trusts) Rules, 2020 that will require Real Estate Investment Trusts (REITs) to apply for tax exemptions from Kenya Revenue Authority (KRA) during registration. The proposed rules seek to assure investors of the tax exemptions and seal any possible loopholes in tax collection.

Income Statement:

- Earnings per unit increased by 14.3% to Kshs 0.48 in H1'2020 from Kshs 0.42 in H1'2019 driven by a 2.4% increase in rental income coupled by a 5.1% decline in operating expenses,
- Rental income grew by 2.4% to Kshs 174.7 mn from Kshs 170.7 mn in H1'2019. However, the growth was slower than the 26.3% increase recorded in H1'2019, attributable to the COVID-19 impact on the retail and commercial office sectors which has led to rent rebates for struggling tenants thus, suppressing rental income growth,
- Interest income decreased marginally by 0.6% to Kshs 13.1 mn from Kshs 13.2 mn in H1'2019 due to the downward readjustment on interest rates being experienced in the market due to the

cumulative 1.5% downward revision in the Central Bank Rate (CBR) to the current 7.0% coupled with the bias by banks towards government securities as opposed to lending due to increased credit risks,

- Total operating expenses stood at Kshs 101.9 mn in H1'2020, 5.1% lower than Kshs 107.4 mn in H1'2019 attributable to the 8.8% decline in Fund operating expenses to Kshs 53.4 mn from Kshs 58.6 mn in H1'19, which according to the manager was due to reduced expenses in the form of Annual General Meeting and investor briefing activities, which have been deferred to August due to the COVID-19 pandemic, coupled with the 0.7% decline in property expenses to Kshs 48.5 mn from Kshs 48.8 mn in H1'2019 due to measures taken by the REIT manager to control expenses and cushion the fund from the effects of the pandemic,

Net profit grew by 12.6% to Kshs 86.0 mn in the period under review from Kshs 76.4 mn in H1'2019, on account of increase in fair value of investment property to Kshs 7.8 mn in H1'2020, from a loss of Kshs 10.3 mn in H1'2019, as well as reduced operating expenses by the manager in a bid to cushion the REIT from the adverse impact of the ongoing pandemic, and,

- The REIT did not recommend an interim distribution of dividends for the period ended 30th June 2020. 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 declared within four months after the end of the financial year.

Balance Sheet:

- Total assets increased by 1.0% y/y to Kshs 3.82 bn in H1'2020 from Kshs 3.77 bn in H1'2019. Total assets under management stood at Kshs 3.7 bn including the four investment properties (a shopping center, an office building and two semi-office/ light industrial buildings) which are valued at Kshs 3.5 bn and cash reserves of Kshs 241 mn,
- Total liabilities decreased by 9.5% to Kshs 102.9 mn from Kshs 113.8 mn in H1'2019 attributable to the 9.5% decline in trade and other payables to Kshs 102.9 mn from Kshs 113.8 mn in H1'2019. The REIT remained without debt as at H1'2020,
- Shareholders' funds grew by 1.3% to Kshs 3.71 bn in the period under review from Kshs 3.66 bn in H1'2019 and thus, the REIT closed with a Net Asset Value of Kshs 20.52 per share, 2.6% higher than its listing price of Kshs 20.0,
- The REIT currently has a return on assets and return on equity of 2.3% compared to 2.0% and 2.1%, respectively in H1'2019.

Ratios Summary	H'1 2017	FY'2017	H'1 2018	FY'2018	H1'2019	FY'2019	H1'2020	Y/Y Change (% Points)
ROA	2.1%	4.5%	1.8%	5.0%	2.0%	4.5%	2.3%	0.2%
ROE	2.2%	4.7%	1.8%	5.2%	2.1%	4.7%	2.3%	0.2%
Debt Ratio	3.3%	2.5%	3.4%	3.3%	3.0%	3.0%	2.7%	(0.3%)
PBT Margin	41.6%	46.0%	37.7%	49.7%	39.4%	46.2%	47.8%	8.4%
Rental Yield	3.2%	7.0%	2.0%	5.7%	2.2%	5.1%	2.5%	0.2%

Performance:

- On the bourse, the REIT continued to perform poorly trading at an average of Kshs 8.0 in H1'2020 and closing the period at Kshs 5.9, 70.5% lower than its initial listing price of Kshs 20.0 and 71.2% lower than the net asset value per unit of Kshs 20.52 as at H1'2020, an indication of the continued lack of investor appetite for the instrument,
- We expect the REIT's revenue to continue declining in the near term due to COVID-19's impact on commercial office and retail sectors which is expected to continue suppressing rental income growth.

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	H1'2017	FY'2017	H'1 2018	FY'2018	H1'2019	FY'2019	H1'2020	Y/Y Change
Total Assets	3.69	3.76	3.72	3.85	3.78	3.88	3.82	1.0%
Total Equity	3.57	3.67	3.60	3.72	3.66	3.76	3.71	1.3%
Total Liabilities	0.12	0.10	0.13	0.13	0.11	0.12	0.10	(9.5%)

Figures in Kshs bn Unless Stated Otherwise

Income Statement	H1'2017	FY'2017	H'1 2018	FY'2018	H1'2019	FY'2019	H1'2020	Y/Y Change
Rental Income	0.14	0.28	0.14	0.31	0.17	0.34	0.17	2.4%
Income from Other Sources	0.05	0.10	0.04	0.06	0.01	0.03	0.01	0.3%
Operating Expenses	0.11	0.23	0.11	0.24	0.11	0.23	0.10	(5.1%)
Profit Before Tax	0.08	0.17	0.07	0.19	0.08	0.18	0.09	12.6%
Basic EPS	0.43	0.95	0.36	1.07	0.42	0.97	0.48	14.3%

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