



Should You Buy CT Real Estate Investment Trust Instead of Canadian Tire Corporation Limited?

Description

In 2013 **Canadian Tire Corporation Limited** ([TSX:CTC.A](#)) spun off the majority of its real estate assets to create **CT Real Estate Investment Trust** ([TSX:CRT.UN](#)). In doing so, Canadian Tire provides investors with two very different ways to gain exposure to its top tier real estate portfolio.

After the transaction, CT REIT currently controls an extremely large, geographically diversified portfolio of 256 properties spanned across Canada. These properties are 99.9% occupied, with an average lease term of 14 years, which is the longest in the entire Canadian REIT sector. In addition, CT REIT's largest tenant by far is Canadian Tire, which is one of Canada's most stable and well-known brands.

CT REIT also has good growth opportunities. With solid growth and stable earnings, does this mean it is a better buy than Canadian Tire?

The REIT transaction

It is important to understand the transaction between Canadian Tire and CT REIT in order to choose one to purchase. In October 2013 Canadian Tire decided to create CT REIT and sell \$3.5 billion worth of its properties to the REIT.

This transaction represented 256 Canadian Tire properties being sold, and Canadian Tire retained ownership in 109 stores, of which, 80 may be eligible to be sold to the REIT in the future.

What was the purpose of this transaction? Quite simply, Canadian Tire has a highly valuable portfolio of real estate, and the value of these assets was not being fully represented within the Canadian Tire structure. Since REIT investors value stable cash flows and high payout ratios, these assets would be worth more outside of Canadian Tire.

Canadian Tire investors who may be looking for growth would not value these assets as highly. The end result is that by selling the real estate, Canadian Tire can realize much more value for its assets than they were worth within the parent company. In turn, Canadian Tire can use the proceeds of the sale to fund further growth in its retail and financial services businesses, which would result in

Canadian Tire shares jumping higher on a stronger growth outlook.

The interesting part of this transaction, however, is the fact that Canadian Tire retained an 85% ownership in the REIT after the sale. This is because upon selling the \$3.5 billion in assets, Canadian Tire only took only \$241 million of the proceeds in cash.

The remainder of the proceeds came in the form of equity units in the REIT (about \$1.49 billion) and special Class C units that the REIT must pay distributions on to Canadian Tire every month, and which Canadian Tire can redeem for cash over time.

The end result is that Canadian Tire receives the benefits of selling the REIT, while also receiving plenty of income from the units it still owns.

Canadian Tire is a more attractive buy if you are looking for overall returns

Because Canadian Tire owns 85% of the REIT, while still having extensive growth opportunities from its retail and financial services business, it will likely provide better overall returns than CT REIT will. This means Canadian Tire offers the best of both worlds.

CT REIT does offer a higher yield than Canadian Tire (3.96% vs. 1.7%), which means it is likely more appropriate for investors purely seeking income. Investors seeking a higher total return (dividends plus growth in share price) will likely come out ahead by purchasing Canadian Tire.

Not only will Canadian Tire see earnings growth from future potential acquisitions (which it has plenty of capital for) and expansion in its current businesses, but Canadian Tire also has plenty of room to trade at a higher multiple of its earnings.

Canadian Tire currently trades at a large discount to its home improvement and general merchandise stores peer group. If Canadian Tire sells some of its remaining real estate to the REIT, it should increase its multiple even more as the full value of its real estate is realized.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CTC.A (Canadian Tire Corporation, Limited)

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