Dream Office Real Estate Investment Trst: The Cheapest Stock in Canada?

Description

It’s been a tough year for investors of **Dream Office Real Estate Investment Trst** (TSX.D.UN), myself included.

Shares of Canada’s largest pure-play office REIT are down more than 45% as investors exit the stock en masse based on concerns about Calgary’s office market. Vacancy in the city is soaring, and with oil’s continued weakness and new office buildings coming on the market soon, the market expects even more weakness.

According to Dream’s own estimates, the dividend is also at risk. The company pays a dividend of $2.24 annually and is only expected to earn $2.25 in adjusted funds from operations (AFFO) in 2016. That doesn’t leave much wiggle room.

While things don’t look good in the near term, I think Dream Office REIT looks to be a really good long-term hold. Here’s why I’m adding to my position today.

Incredibly cheap

As I write this, Dream is trading at $14.57 per share. According to the company’s management, the net asset value per share was $32.78. That puts shares at just 44.5% of the net asset value.

It’s easy to make an argument that Dream shares aren’t worth net asset value. The carnage being felt by the company in Calgary is very real. So let’s assume as a worst-case scenario that Dream’s real estate in the city is worth zero.

This isn’t true, of course. Some 19% of the trust’s income comes from Calgary, and that’s even after a weak 2015. Occupancy in the city is still approximately 90%. It’s far from worthless. In fact, if you look closer at the company’s portfolio, you’ll see much of it is located right downtown, close to public transit. These are good buildings in excellent locations.

Even if we assume a 19% haircut on Dream’s net asset value, the rest of the company is worth $26.55 per share. Even if we value the Calgary assets at zero, investors who buy today are still getting in at

55% of net asset value.

Let’s go one step further. Let’s assume that all of Dream’s western Canadian assets are toxic and are worth nothing. This is even more ridiculous than assuming Calgary is worth nothing, since these regions aren’t getting hit nearly as hard as Calgary.

If all of western Canada is worthless, Dream’s eastern Canadian properties still have a net asset value of $19.41 per share. Investors are getting Dream’s eastern properties at a 25% discount to net asset value and are getting everything west of the Manitoba border for free.

Even on an earnings basis, Dream trades at an incredibly cheap valuation. The company is projected to earn $2.25 in AFFO in 2016. At today’s price, shares trade at just 6.5 times AFFO. You won’t find many stocks that trade for much cheaper.

What about the dividend?

Many investors have bought into Dream shares over the last year because of the succulent dividend. Currently, shares yield 15.3%, which is the kind of yield that make income investors very excited.

I don’t think the dividend is safe. Based on projected AFFO numbers it is, but earnings could easily decline further if Calgary continues to be weak. Besides, it’s obvious that many investors don’t think Dream can maintain the payout. So management might as well bite the bullet and cut it, using the capital freed up to pay down debt or to buy back undervalued shares.

Even if Dream slices the dividend in half, investors will still be getting a yield of nearly 8%. That’s a nice premium over other fixed-income options and would likely be at a 50-60% payout ratio.

Investors shouldn’t be scared about Dream’s dividend. Rather, look at the opportunity the market is giving to buy assets on the cheap. When Calgary returns to normal and Dream’s buildings in the city look attractive again, it’s likely that shares of this beleaguered REIT will be much higher.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)

Category

1. Dividend Stocks
2. Investing

Date
2025/07/08
Date Created
2016/01/18
Author
nelsonpsmith