Why Did Dream Office Real Estate Investment Trst Shares Surge 13%?

Description

Friday was a good day for **Dream Office Real Estate Investment Trst** (TSX:D.UN). Shares are 13.5% higher as I type this.

On the surface, it doesn't seem like shares should be up. The big news was that the company finally bit the bullet and slashed its monthly payout from $0.1867 per share to $0.125, representing a cut of approximately 33%. The yield from the old payout was 12.1%. Going forward, the yield will be 8.1%. That's still generous, but not nearly as nice as before.

The company was essentially forced to lower its dividend. Thanks to the weak office market in western Alberta–particularly Calgary–funds from operations are projected to fall from $2.83 per unit in 2015 to somewhere between $2.20 and $2.30 in 2016. Adjusted funds from operations are expected to be approximately $2 per share this year, which necessitated the cut.

The dividend cut was really the only bad news from the earnings release. Management reported strong leasing activity across the country, including getting commitments for more than 200,000 square feet of space in Calgary. That still wasn't enough to keep occupancy stable across Dream's whole portfolio, but the decline from 91.5% to 91.3% in committed occupancy was better than many investors expected.

The value plan

Dream's management also addressed the company's persistent discount to net asset value. Essentially, before the earnings announcement Dream was so cheap that investors were valuing its western Canadian portfolio at nothing. These buildings are responsible for about 40% of Dream's operating income–a significant portion.

I've highlighted this in past articles about Dream, concluding that it was pretty clear these buildings were worth far more than the market claimed. I wasn't sure what the catalyst would be to get the market to realize this value. I was just certain something would happen. Eventually.

It turns out Dream's management decided not to wait. The company announced intentions to sell up to $1.2 billion worth of property it deems as non-core. The thinking is that if the market won't value those assets at what the company thinks is close to market value, Dream might as well sell them. There's no arguing with the market value of cash.

Debt repayment is also going to be a priority going forward. Even though Dream has a relatively strong balance sheet with a 48% debt-to-assets ratio, the company will strive to bring that lower as it sells certain buildings and frees up some cash from the dividend cut.

Additionally, management will buy back shares aggressively if the gap between the market value and net asset value doesn't narrow. The company also suspended the dividend-reinvestment program to ensure the share-repurchase plan has real teeth.

Income investors might not like Dream's dividend cut, but it's a prudent move to ensure the company's long-term health. The company can create shareholder value much more effectively by buying back shares, selling assets, and paying down debt. And the yield is still a generous 8.1%.

Perhaps most importantly, investors now know management has a plan to help the company trade closer to net asset value. Net asset value is approximately $32 per share, which means even after a 13% move higher, there's still plenty of potential upside for shares that currently trade at $18.40 each.

CATEGORY

1. Dividend Stocks
2. Investing

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