



Why H&R Real Estate Investment Trust's Price Refuses to Rise

Description

H&R Real Estate Investment Trust ([TSX:HR.UN](#)) is trading at \$18.70 per unit, 4% higher than its 52-week low and 22% below its 52-week high. Does that mean there's more upside to the diversified real estate investment trust (REIT) than downside?

Why H&R REIT's price refuses to go up

Since the start of 2015 H&R REIT's unit price has been in a downtrend. That's thanks (or rather, no thanks) to its exposure to Alberta. About 28% of the REIT's adjusted same-asset property operating income comes from Alberta.

H&R REIT earns 49.6% of its rental income from its top 15 tenants. Four are from the energy industry, and they generate 20.9% of the REIT's rental income.

Encana Corporation (TSX:ECA)(NYSE:ECA) is H&R REIT's top tenant, and it generates 12.6% of its adjusted same-asset property operating income and 11.3% of the its rental income.

Encana experienced its fourth consecutive quarterly loss and is cutting its workforce by 20%, slashing its dividend by 79%, and reducing its capital spending by about 55% year over year.

Including this workforce reduction, since 2013 Encana has cut its workforce by 50%, and its dividend has been slashed almost 93% from an annual payout of \$0.80 per share to \$0.06 per share. These actions are expected to add \$50 million of cash flow to the company's pot this year.

Additionally, as of February 19 Encana has hedged close to 75% of expected 2016 oil, condensate and natural gas production.

All of these actions should help Encana navigate the challenging environment. Encana rallied 23% on the news.

Since Encana has 22 years of remaining lease terms with H&R REIT, any good news for Encana's business is good news for H&R REIT.

Is H&R REIT's 7.2% yield safe?

On December 31, 2015 H&R REIT's occupancy was 95.9%, 1.8% lower than a year before. Interestingly, the decrease was mainly due to **Target Corporation** disclaiming its leases.

Since the REIT maintains a high occupancy, has remaining lease terms of about 9.5 years, and has an adjusted funds-from-operations payout ratio of about 85%, its rental income should remain pretty stable, and its yield of 7.2% is sustainable.

However, investors should be aware that even when distributions are sustainable, the board can still choose to cut them for other reasons.

Conclusion: Is there more upside than downside?

Since H&R REIT has sizeable rental income from Alberta, there's a higher risk of vacancy if commodity prices remain low. However, at least a part of that risk is priced into the stock, seeing that its unit price has declined since the start of 2015. When commodity prices improve, so will H&R's price.

Based on its normal multiple, H&R could trade at least at the \$22.50 level, implying there's some margin of safety, and there's potential upside of 20%. In the meantime, unitholders can collect a 7.2% yield.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

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1. TSX:HR.UN (H&R Real Estate Investment Trust)

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