Cominar Real Estate Investment Trust: Be Wary of This 9.5% Yield

Description

In today's world of low interest rates on GICs, government bonds, and other traditional sources of income, many investors have turned to the stock market in search of a more attractive return on their cash.

Real estate investment trusts (REITs) have become a popular choice for these investors. They're attracted to the steady cash flow real estate offers, as well as the ability to easily understand the business. And in exchange for the favourable tax treatment enjoyed by REITs, these companies pay out most of their earnings back to shareholders in distributions. This translates into some very enticing dividends.

Cominar Real Estate Investment Trust (TSX:CUF.UN) pays one of the highest dividends in the whole sector. Its $0.1225 per share monthly payout works out to an annual yield of 9.5%. In a world where 2% GICs are considered "high yield," it's easy to see why investors are attracted to such a payout.

But with greater reward comes increased risk. In other words, there's a reason why the market is giving Cominar such a high dividend yield. It could be in danger of being cut.

The skinny

The world of dividends is pretty simple. If a company isn't making enough to pay the distribution, one of two things needs to happen: earnings either need to increase or management will begrudgingly cut the payout.

Cominar is currently experiencing this problem. Through the first half of 2016, the company has posted adjusted funds from operations–think of that number as a REIT's distributable income–of $0.72 per share. That compares to $0.77 for the first half of 2015 and a distribution of $0.735 per share.

That gives the company a payout ratio of 102%.

Why are results worse than last year? There are a few reasons, including the company selling off some non-core assets, weakness in the company's two largest markets of Montreal and Quebec, and slightly increased capital expenditures. But mostly, the company is just struggling to keep tenants and pass through rent increases to the businesses that do stay.

Cominar has been trying to improve its payout ratio for months now. It took steps like eliminating the dividend reinvestment plan back in January, but then reinstituted it recently.

The other problem

The elevated payout ratio isn't the only problem haunting Cominar. The company is also suffering from a high debt load.

At the end of its most recent quarter, Cominar had a debt-to-assets ratio of 54.6%, which is higher than the 50% maximum investors like to see. Even after pledging to get this number down for much of the last year, it hasn't budged. It was 54.6% at the end of the second quarter in 2015, too.

The company is taking steps to pay down the debt. It recently announced a private placement of 12.78 million new shares, a deal that will raise it $200 million to put towards the debt and for other corporate purposes.

The problem with that is it further boosts the payout ratio. Cominar will be responsible for a further $18.8 million in additional dividends annually. That works out to about $0.11 per share.

Make a safer choice

There's no guarantee Cominar will cut its dividend. The payout ratio could easily be lowered by the company posting some better results in the next few months, and the company does have more than $2 billion in unencumbered property it could sell to reduce debt. It's also cash rich after raising $200 million.

But at the same time, there's a reason why shares are off more than 12% in the last two months. The market just doesn't think Cominar is a safe dividend choice. Issuing shares to help pay a dividend might work in the short term, but it's no long-term solution.

CATEGORY

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2. Investing

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Date
2025/09/11
Date Created
2016/09/28
Author
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