Boardwalk REIT Is the Cheapest it Has Been in the Last 2 Years: Should You Buy?

Description

Boardwalk REIT (TSX:BEI.UN) reported a Q3 that fell way short of expectations. Continued softness in the Albertan and Saskatchewan economies led to a drop in funds from operations (FFO) and same property net operating income (NOI) growth of 22% and 15%, respectively, from Q3 2015.

Following the selloff in the wake of its report, Boardwalk is trading at the largest discount to its net asset value (NAV) within the past two years, while paying out a hefty 5.2% yield. But buyers beware: even with such a sharp decoupling between price and NAV, Boardwalk's fundamental outlook remains cloudy at best.

Huge Albertan exposure means further weakness in NOI

With 64% of its NOI coming from the province, Boardwalk is attached at the hip to Alberta. Unfortunately, as oil prices continue to languish below $50/bbl and hopes of an OPEC production freeze begin to fade, Boardwalk's vacancy woes are likely to persist into the second half of 2017.

In Q3 2016, Boardwalk reported same property vacancy loss (revenues lost from vacant properties) of $6.5 million versus $3.6 million in 2015, while incentive costs to attract tenants increased from $1.29 million to $5.6 million during the same period.

Moreover, Boardwalk reported a decline of 7.4% in year over year same property revenues for its Albertan properties, which–combined with a 6.9% in Saskatchewan revenues–led to an aggregate draw down of 15% in net operating income across all same units compared with Q3 2015.

And while the numbers were ugly, it's going to get worse before it gets better. Boardwalk has projected that Edmonton and Calgary vacancy rates have not yet peaked and will not return to their 2006-2015 averages until at least 2018.

boardwalk-vacancies

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Prolonged weakness in Alberta means vacancy losses and decreases in revenue (Source: Company Filings)

In the meantime, Boardwalk has completely revamped its stabilized (same property) NOI growth forecast for the second time this year to -12% to -10%, from the prior revision of -10% to -5% versus the original call of -2% to +2%. Furthermore, 2016 funds from operations (FFO) are expected to come in at $2.90-3.00, versus $3.40-3.60 from the original forecast.

Discount is attractive, but proceed with caution

Boardwalk currently trades at a hefty 31% discount to its net asset value (NAV) per share of $63.05. For those new to REITs, NAV is essentially a measure of a REIT’s *true* value based on the market price of its underlying investment properties.

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Author-generated based on company filings

Using data going back to Q1 2014, I compared Boardwalk’s NAV against the historical price on the day after earnings and found that its current discount factor is the largest divergence yet. That being said, I do not feel that it is significantly undervalued here, even with a 5.2% yield, for several reasons. One, Alberta weakness will persist into the near future, which will continue to pressure occupancy rates.

bei-comps

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Boardwalk vs. other oil-patch names. Author-generated based on company filings and consensus estimates

Two, Boardwalk will most likely take on debt to fund its planned acquisitions (although with a debt ratio of only 41%, it's not overly alarming; investors should be wary of future borrowings). And, finally, three, while cheap on a NAV basis, Boardwalk trades at a premium to the peer average in the Canadian residential REIT space of 17.4 times 2017 adjusted funds from operations and to other Canadian names with exposure to the oil patch.

In other words, although this valuation is forgiving, investors should be prepared to face further compression if Boardwalk misses its revised forecasts or if Alberta stumbles during its tepid recovery.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)

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