Is Melcor Developments Ltd. on the Verge of a Major Breakout?

Description

Over the past month shares of **Melcor Developments Ltd.** (TSX:MRD) have appreciated by almost 10% as the company continues to build houses in western Canada. Based in Edmonton, the company is in prime position to outperform the general market as the recession experienced by those in the province of Alberta has finally come to a close.

In the past week, the provincially owed bank Alberta Treasury Board announced the new projections for growth in the provincial economy were at astonishing 3.2% for the year as the price of oil has seesawed around the break even price of US$50 per barrel for quite some time now. Although the current lower price for oil will not lead to any large excess spending, the new normal in the economy has produced profits of $1.07 per share over the past rolling twelve months for Melcor Developments Ltd..

When breaking down the four major segments of the company, there are several pieces moving in the right direction. In the most recent quarter, almost half of revenue came from the development division (building) which is the company's most important segment. Although interest rates have increased now two times this year, the company has still rallied signalling that the supply and demand equation in the province is still not in equilibrium.

When considering the rental segments, both retail and office/industrial are picking up as the economy is projected to expand over the next year. In the industrial sector, the contracts are typically long term in nature leading to a low rate of attrition which will now shift from the basic renewing of leases to being able to increase the rates of rental per square foot as the underlying economy improves and more companies compete for fewer spaces.

The best swing for investors will still come from the rental of office buildings and retail plazas. With more slack in each of these spaces, the past few years have been much more of a renters market than a landlords market. With a growing economy, there may be more willingness to take risk on longer term contracts, mitigating the risk that space could remain empty and revenues would continue to go nowhere.

The last segment is made up of four golf courses which have experienced a few slow years. As many workers have been laid off, there is less disposable income for activities such as golf or dinners at the club which in turn has lead to revenues which have far fallen short of this segments potential. With the potential to derive a significant amount more bottom line profit from this segment, the company is in prime position to benefit from a turn in the economy which will bring about more discretionary spending.

In spite of the headwind from increasing rates, it is important for investors to realize the difference between a need and a want. In the case of housing, we need a roof over out heads – no matter the rates of interest. With what is currently a mismatch between the supply and demand, patient investors may just get the last laugh by buying and holding for years to come.

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ryangoldsman