Is Cominar REIT a Buy After its Recent Strategy Announcement?

Description

Just after being shaken by a credit-rating downgrade by DBRS early August, **Cominar REIT** (TSX:CUF.UN) has decided to refocus its asset portfolio by selling several non-core properties to concentrate on Quebec, Montreal, and Ottawa, where management believes Cominar has competitive moats.

Cominar announced on August 22 that it expects to realize more than $1.2 billion from asset disposals in non-core markets, including western Canada and the Atlantic provinces, and it will use $200 million of the proceeds for future developments in its core market.

The REIT will carry out a normal course issuer bid (NCIB) to repurchase up to 9,000,000 outstanding units for cancellation, spending from a $125 million budget, and pay down $875 million of outstanding debt for a target 48% debt ratio, which is much better than the 52.7% leverage exit Q2 2017.

The market was evidently quite receptive of the news, as evidenced by an immediate ~7% share price rebound.

However, will management successfully eliminate the deep discount to net asset value that Cominar's units trade at in the market today, with a current price-to-book-value ratio of 0.64?

Much will depend on the REIT's execution of the new strategy going forward, but there are already some potential positives to this move.

Stronger core portfolio

Cominar has decided to concentrate in those markets where it has a dominant position and can enjoy some synergies with its internal leasing and operating processes.

During a conference call on August 25, management revealed that of the 3.2% sequential decline in net operating income (NOI) in the combined portfolio last quarter, the core portfolio only declined 2.91% in Q2 2017.

The core portfolio has recently been performing a lot better than the combined portfolio, and management guided for same property NOI growth of between 0.2% and 1.2% in the core portfolio, which is +1.2% better than the -1% to 0% NOI growth for the combined portfolio for the year 2017.

Most noteworthy, the REIT's exposure to Quebec could pay better in the coming quotas as the province's economic growth is expected to outperform that of the broader economy.

Add this to Cominar's new developments, like the one near a new IKEA store, among others, which even DBRS acknowledged to be of good income potential in its credit-rating downgrade report last month, and the REIT could really out perform in the coming quarters.

Current consensus analyst forecast, as polled by **Reuters,** is for Cominar to outperform its peers in the short to medium term.

The risks

Cominar intends to implement its new strategy over the next 24 months. This could be too a long time, and a lot could change during this period. However, the timeline could be necessary to realize good sales value on the real estate.

Moreover, Cominar will increase its leverage right away to carry out the NCIB. This could be troublesome if the asset sales take a slow pace during the current rising interest rate environment.

Furthermore, Cominar is removing geographical diversification from its income portfolio while maintaining a core portfolio with a 37% exposure to retail, 67% of which is in closed mall space — a high-risk area considering the growing weakness in the brick-and-mortar retail business line.

There could be increased volatility in Cominar's unit price as the REIT implements the new plan, and investors may be surprised by a further dividend cut if the REIT fails to balance new leverage, cash flows, and new development expenditure — a fear DBRS expressed when explaining its credit-rating downgrade last month.

Most noteworthy, Cominar will repay credit lines first before making any new acquisition and development plans. If asset sales progress is slow, the REIT will maintain current portfolio composition for longer than what investors may like, and the market price of units will continue heavily depressed.

Investor takeaway

Cominar is going back to its Quebec roots, where it has competitive advantages. Management has given up on a DBRS credit-rating upgrade, but their new plan may improve Cominar's market valuation.

Investors could enjoy long-term capital appreciation, while pocketing a nice 8.5% payout yield if the strategy works out, but the fear of another dividend cut could grow if new leasing and rent increases in Quebec fail to cover the gap created by deleveraging and a loss of income after asset disposals.

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