Canadian REIT Is up 16%: What Should Shareholders Do?

Description

Canadian REIT (TSX:REF.UN) surprised the market by appreciating nearly 16% higher on Thursday. Aren't REITs supposed to be slow growth?

What's the deal?

Choice Properties Real Est Invstmnt Trst (TSX:CHP.UN) agreed to buy Canadian REIT in a cash and stock deal — specifically, $22.50 in cash and 2.4904 Choice Properties units per Canadian REIT unit. Using Choice Properties's Thursday closing price of $12.04 per unit, that's an implied Canadian REIT price of roughly $52.48 per unit.

The deal still requires the approval of Canadian REIT unitholders. At least two-thirds of the votes need to support the merger for it to go through. As well, there are some other closing conditions. If all goes well, the transaction will close in Q2 2018.

Overview of Canadian REIT

Canadian REIT is a quality diversified REIT with retail, industrial, and office properties spanning 22.5 million square feet.

At the end of 2017, Canadian REIT had a portfolio occupancy of 94.7%, which aligned with 2016's occupancy, and its funds from operations payout ratio was 55.4%.

Canadian REIT's largest and second-largest tenants are **Canadian Tire** and **Loblaw**, which contribute about 6.2% and 2.8%, respectively, of its gross rental revenue.

Canadian REIT has increased its distribution per unit for 16 consecutive years. Its three-year distribution growth rate is 2.2%.

Overview of Choice Properties

Choice Properties is largely a retail REIT with 546 properties spanning roughly 44.1 million square feet. Its portfolio focuses on shopping centres anchored by supermarkets and drug stores as well as standalone supermarkets and drugstores.

At the end of 2017, Choice Properties had 525 retail properties, 14 industrial properties, one office complex, and six undeveloped parcels of land. Choice Properties's principal tenant is Loblaw, Canada's largest retailer. At the end of 2017, Loblaw owned 82.4% interest in Choice Properties.

At the end of 2017, Choice Properties maintained a high occupancy 98.9%, which was the same as the end of 2016, its average base rent for the year increased 2.27% from the previous year, and its remaining weighted average lease term was 10 years. Its funds from operations payout ratio was 68.1% in 2017.

Since 2013, Choice Properties has increased its distribution per unit by 3.3% per year on average.

What should shareholders of each REIT do?

The combined company will generate 78% of its net operating income from its retail assets, 14% from its industrial properties, and 8% from its office assets. So, shareholders will largely be exposed to a retail portfolio, albeit a stable one.

Canadian REIT unitholders will own roughly 27% of the combined company. Canadian REIT unitholders who'd bought the REIT for its stable distribution might stick with the combined REIT for the same reason. However, for the cash portion of the deal, they should consider investing in other value, dividend ideas.

Canadian REIT unitholders who'd bought the depressed stock for price appreciation should consider taking profits and going elsewhere, as the stock is fully valued after the run-up.

Choice Properties unitholders might consider holding on to the stock as it has been depressed. After all, the REIT's distribution remains safe, and it offers a juicy yield of +6%. Moreover, the merger will increase the scale of the REIT and diversify its portfolio.

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