The Best Buy of the Year — but Only for Investors Seeking a 10% Yield and Capital Appreciation

Description

Close to one year ago, shares of **Dream Office Real Estate Investment Trst** (TSX:D.UN) were trading at a substantial discount to tangible book value and paying a dividend yield that was simply not sustainable. The bad news is that investors saw a decline in the dividend (short-term pain) to obtain a sustainable yield and increase in the share price.

On a regular basis, there are companies that fall out of favour for a variety of reasons, which (in the REIT sector) leads to two clear advantages for investors. The first is a decline in the share price, which will lead to a higher yield, while the second is a discount to tangible book value. In each case, investors buying shares in one of these companies for the first time end up in prime position to be rewarded over the long term. From experience, we've learned that a solid management will be successful at re-aligning objectives and closing the gap between the share price and the value on the balance sheet.

In fact, the approach is not as complicated as many think. In the case of a REIT, there are assets that produce rents (revenues) and the value of those assets are dependent on the rents that are paid.

The stock that investors need to consider at a current price of $7.60 is none other than **Slate Office REIT** (TSX:SOT.UN), which has declined to an almost 52-week low and offers a dividend yield of 10%. As can be expected, the payout ratio (as a function of free cash flow) is slightly more than 100%, which the market feels is not sustainable. There is no need for investors to worry, though!

Close to two weeks ago, the company announced a normal course issuer bid (share buyback) that would allow for the repurchase of up to 10% of the outstanding shares. With a market capitalization in excess of $530 million, this would translate to more than $50 million in share buybacks. After announcing the sale of a property, the company now has the ability to deploy the proceeds from that sale into the share buyback and allow the savings to accrue to the company's payout ratio. With fewer shares outstanding, the company will need less capital to sustain the dividend payment.

Similar to how the company is buying back its own shares (and receiving a bargain), investors can do the same. At the current price, shares trade at a discount to book value by close to 17%, which is expected to increase as fewer shares remain outstanding. Although the company was a little aggressive when issuing shares in the past, the turning point is now upon us. After deploying the capital that was raised, the money that remains available is now being returned to shareholders under very favourable terms.

With the potential for this “no-brainer” investment to return more than 20%, investors need to ask themselves just how many shares they wish to purchase.

CATEGORY

1. Dividend Stocks
2. Investing

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Author
ryangoldsman