Is This Top-Performing REIT Worth its High Multiple?

Description

Canadian Apartment Properties REIT (TSX:CAR.UN), or CAPREIT, has been a wonderful investment. Since 2014, the stock has delivered an annualized rate of return of about 20%. However, the run-up may be overdone, as it trades at its highest multiple in 16 years!

The business

CAPREIT is one of the best Canadian residential REITs to own. Its portfolio of apartments, townhomes, and manufactured home communities are predominantly located in and near major urban centres.

At the end of the first quarter, the REIT's diversified portfolio consisted of 50,630 units, including 44,174 residential suites and 31 manufactured home communities comprised of 6,456 land-lease sites.

CAPREIT continues to perform

CAPREIT's first-quarter results compared to the same period last year are as follows. The REIT increased its operating revenues by 8%, its net operating income by 11.8%, its same-property net operating income by 7%, its normalized funds from operations by 10.6%, and its net funds from operations per unit by 7.9%.

The REIT had an occupancy rate of 98.8% with growing average monthly rents, and its net funds from operations payout ratio was 70.4%, which implies that its distribution is safe.

Distribution

At about $43 per unit, CAPREIT offers a 3.08% yield. The REIT's quality portfolio and steady growth in a stable industry have allowed it to increase its distribution every year since 2012. In the past five years, CAPREIT increased its distribution per unit by 3.1% per year on average.

Image source: Getty Images.

Valuation

CAPREIT tends to trade at a premium multiple because of its quality. Most of the time, CAPREIT is expensive. And it's more so today. At the recent quotation, it's trading at a multiple of about 23, while the REIT increased its funds from operations per unit by about 3.3% per year on average in the past three years.

The stock was pretty fully valued a year ago when it traded at roughly $33.50 per unit at a multiple of about 18.8. Now, the stock is even more expensive. At this point, it's pretty much a matter of how much the next investor is willing to pay for the stock.

The **Bank of Nova Scotia** analyst agrees that there's essentially no upside and no margin of safety for the stock right now, as the REIT's 12-month target implies a decline of about 7%.

Investor takeaway

Given CAPREIT's quality management, excellent assets, and stable performance, the stock is worth a premium multiple. However, the stock has run up past that point and is now in overvalued territory.

It's better for investors to avoid this stock now and wait for an event that will bring down its valuation before considering a position. If you're willing to pay a premium multiple of 16-18 for CAPREIT, start nibbling the stock in the low $30s.

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kayng