Why Did This Stable REIT Stock Drop 30%?

Description

Real estate stocks are supposed to provide investors some level of stability. Property, at least compared to the stock market, historically isn't prone to huge swings in valuation from month to month.

For more than a decade, **Artis Real Estate Investment Trust Unit** (TSX:AX.UN) has symbolized this stability. Barring the financial crisis of 2009, when nearly every stock was down 50% or more, Artis stock has consistently traded between $10 and $15 per share.

In the second half of last year, shares shed more than 30% in a matter of months, bottoming at just $9 apiece. After the fall, its dividend yield is nearing 5%, close to historical highs.

Is this your chance to buy a typically stable REIT at a discounted price?

The top REIT stock for 2019

In January I named Artis my top REIT stock for 2019. While shares are up 10% since that call, they remain well below their 2018 highs. What's so special about the company?

Artis is one of the largest diversified commercial REITs in Canada. It owns properties across many Canadian provinces and U.S. states, including Alberta, British Columbia, Manitoba, Ontario, Saskatchewan, Arizona, Colorado, New York, Minnesota, Texas, and Wisconsin. Around half of its properties are zoned as offices, with the other half split between industrial and retail.

With that level of diversification, betting on Artis is almost a simple bet on the real estate sector as a whole. At the end of 2018, occupancy rates were around 94%, suggesting the company isn't having trouble filling its properties.

In total Artis isn't really that special. On nearly every metric it's just your usual diversified REIT stock. That simplicity, however, can make it easier to spot valuation discrepancies.

Shares are on sale

By investing in Artis shares, you must believe that shares have been unfairly punished, pushing the current share price well below their intrinsic value.

Artis executive Armin Martens certainly believes this. Even after the dip, he reiterated his belief that the company is a “bulletproof REIT with a great payout ratio and good positive cash flow.”

While “bulletproof” may be overly aggressive, there isn’t much to hate about the company. If there isn’t much wrong, what caused the 30% drop?

It turns out that management broke a cardinal sin in REIT investing: they cut the dividend. The move wasn’t necessarily because the company was in trouble, but because they wanted to maintain financial flexibility while consolidating the company’s portfolio.

Over the years, the company grew a bit too fast, acquiring what ended up to be non-core assets, which are defined as properties that don’t quite fit into Artis’ core competencies. After the growth spurt, $900 million worth of assets were deemed non-core.

Management wanted to trimthe fat, but not at fire sale prices. To give them the financial flexibility to wait for optimal selling prices, they cut the dividend by 50%, providing more than $80 million in cash flow relief per year. Now, the company can be more opportunistic about asset sales.

The market hated the move, sending shares downward. Still, the fundamentals of the company haven’t changed. I’d argue that management was incredibly responsible in accepting short-term pain for long-term gain. In fact, Artis recently instituted a small share buyback, proving that management is willing to bet on themselves.

This stock won’t double or triple anytime soon, but it’s a clear value following its undeserved punishment.

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