Under $10 This Real Estate Stock Is a Steal

Description

Tricon Capital Group (TSX:TCN) has always been one of my favourite TSX stocks.

So, when I heard April 3 that Tricon paid US$1.4 billion for 23 multi-family residential properties in the U.S. sunbelt, I thought for sure investors would push TCN stock higher on the news.

Unfortunately, that's not what happened. Instead, it dropped by almost 7%.

There are two reasons why investors might not have liked the deal.

Reason #1

In addition to assuming US$916 million in debt from the Starlight U.S. Multi-Family (No. 5) Core Fund, it will issue US$496 million in Tricon shares to pay for the acquisition.

At the end of December, Tricon had 162.1 million shares outstanding including the conversion of convertible debentures. This deal will add 50.8 million shares, an increase of 31%, diluting current shareholders in the short term.

Long term, Tricon CEO Gary Berman believes the transaction will be accretive to earnings.

"The NAV-for-NAV all-share transaction is expected to be meaningfully accretive to Tricon's EPS and book value per share, while offering the fund's unitholders an attractive premium to the prevailing unit price and the opportunity to participate in the future growth of our combined company," Berman said about the transaction.

Starlight shareholders will be able to cash out of their investment or carry on with Tricon, one of the best real estate asset managers in North America. If I owned shares in this Starlight fund, I would keep the Tricon shares over the long haul because the company is stronger today than it was before the acquisition.

Reason #2

If you know anything about Tricon, you know that its Tricon American Homes (TAH) division is one of the largest owners of single-family rental properties in North America. In fiscal 2018, TAH generated US$218.9 million of the company's US$276.1 million in revenue and investment income.

As TAH goes, so goes Tricon.

So, to add another platform for growth with this multi-family acquisition, Berman is betting that this will add even more recurring revenue to Tricon's top line, making it even more attractive to shareholders.

However, it appears that investors don't quite see it that way. They see Tricon jumping into a business that's seen a lot of growth since the recession and wondering if it didn't overpay for the 7,289 units.

I don't think US$192,000 a unit is too much to pay for recurring revenue, but I guess we'll find out.

Tricon likes the deal because it gives it another platform for growth. Not only that, but a lot of its investment clients prefer having real estate options.

"We're sticking to our residential knitting, but we want to have multi-residential products that we can sell to major pension plans and sovereign wealth funds," he said in an interview. "This is a new platform that institutions love investing in. It's very steady and very predictable income."

At the end of the day, Tricon's buying units that rent around US$1.30 a square foot compared to US$2-3 for new construction. Should a recession hit, Tricon will have an easier time keeping the units occupied and the rent rolling in.

The bottom line on Tricon stock

Over the past two years, as my Foolish colleague Kay Ng recently noted, Tricon stock's been range bound between $9 and $12. In that time, it's only traded below $10 on two occasions. At current prices, Ng believes it's neither overbought or oversold.

Tricon's made two billion-dollar transactions since going public in 2010. It probably won't be the last.

It's a frustrating stock because every time you think it's on its way to $12 and beyond, it turns back under $11.

I like the move because, ultimately, Tricon is a real estate asset manager, and if it doesn't have the product to offer institutions, it loses out on some of the action.

If TCN drops below $10, you back up the truck. Between $10 and $11, you're getting growth at a reasonable price.

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