2 Value Stocks I’m Buying With an Extra $5,000

Description

I’ve recently begun experimenting with adding a distressed real estate portion to my portfolio.

The logic goes something like this. Often a real estate investment trust (REIT) will get absolutely hammered if investors start to speculate a dividend cut is coming. The stock might go down 25 or 50% as income investors hit the *sell* button now and ask questions later.

Most of the time this is a gross overreaction. Sure, a dividend cut hurts, but once investors look past the yield, they usually see a stock that trades at a low price-to-funds from operations ratio, and often at a nice discount to book value too.

Management then takes a couple of years, fixes the business, and shares rebound nicely. Combine that with even a reduced dividend and we have a nice total return combo.

I did just that with **Dream Office REIT** a few years ago. The trust dipped down to $15 per share on concerns about its Alberta portfolio and the sustainability of its dividend. I loaded up on cheap shares and was able to sell for a 50% gain just over a year later.

Two REITs currently fit the same profile today, so I purchased shares. Let’s take a closer look at both of these names.

Slate Office REIT

After at least a year of speculation, **Slate Office REIT** (TSX:SOT.UN) made it official last month and slashed its distribution nearly 50%. The new payout is $0.40 per share on an annual basis, good enough for a 6.7% yield.

Slate was previously one of the highest-yielding stocks on the TSX, and it was obvious that many investors were just there for the yield. Shares are down more than 10% in the six weeks since the dividend cut was announced.

But there are plenty of positives here. Slate's fourth-quarter numbers were pretty solid. Funds from operations checked in at $0.76 per share in 2018, giving shares an incredibly cheap valuation of just 7.7 times funds from operations. You won't find many REITs cheaper than that.

The company's U.S. expansion is going well too, with the acquisition of two office towers in Chicago. Expanding stateside makes all sorts of sense; there are plenty of investment opportunities that offer the company a chance to buy quality assets at below replacement cost.

Finally, investors are buying all this for a significant discount to net asset value. At the end of 2018, Slate Office REIT had a net asset value of $8.55 per share. Shares are $6 each at writing.

American Hotel Properties

American Hotel Properties REIT (TSX:HOT.UN) has quietly grown into a decent-sized hotel owner, with 112 hotels spread across 89 U.S. cities. The problem is the acquisition of these hotels has left the company with more debt than investors normally like to see.

This debt, along with lackluster results of late, has investors speculating that a dividend cut is coming soon. Shares yield more than 12% today. Fears of a recession hitting the hotel sector hard don't help matters, either.

But it isn't all bad news. Management is confident results will improve now that several prominent locations have been renovated. Shares trade at a price-to-funds from operations ratio that's even cheaper than Slate Office REIT's, checking in at 6.5 times earnings. And HOT.UN shares trade at a significant discount to their stated book value.

Remember, the stock traded for more than $11 per share about two years ago, which means that today's $7 per share price could be 50% higher in the future. And even if the company does slash the dividend by 50%, you'll still get paid more than 6% to wait.

The bottom line

I've recently taken positions in both of these companies with the intention of selling once investors really start getting bullish on both names again. I have total return targets of approximately 20% annually for each, which I think both accomplish in two to three years. Both these stocks are just too cheap today.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:HOT.UN (American Hotel Income Properties REIT LP)
2. TSX:RPR.UN (Ravelin Properties REIT)

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