1 Canadian REIT to Profit From a 2021 Market Rally

Description

Canadian REITs were hammered during the March 2020 stock market crash. That saw many REITs experience large losses; investors stormed for the exits, as the severity of the coronavirus pandemic became apparent. Even after the subsequent rally, many Canadian REITs have experienced significant losses since the start of 2020.

Some, like **Artis Real Investment Trust** (TSX:AX.UN), which has lost 38% for the year to date, are trading at deep discounts to their net asset value (NAV).

This indicates that there is considerable potential upside ahead, making now the time to buy.

Strategic turnaround gaining traction

Artis owns a diversified portfolio of retail, office, and industrial real estate across the U.S. and Canada. The REIT, which has had a troubled few years, is changing the direction of its business in an effort to unlock value for investors. The success being experienced with that transformation was recognized by the market. Artis was one of the best-performing Canadian REITs during 2019 gaining 39% without including dividend over the course of the last year.

There is every indication that Artis will perform strongly once the coronavirus pandemic subsides and the economy returns to growth.

Artis is trading at less than half of its NAV of $15.52 per unit. That underscores why now is the time to buy and the considerable capital gains ahead over the long term. The REIT's NAV will grow because of its ongoing business transformation. A key element of that strategy is to boost its exposure to the larger U.S. economy, which will see net operating income (NOI) from south of the border by 10%.

Artis also intends to reduce its number of retail and office properties while increasing the industrial real estate in its portfolio. That, it anticipates, will increase NOI from industrial properties by 16%.

Changing market dynamics for REITs

The push to reduce retail real estate while boosting exposure to industrial property is a sensible move. The retail apocalypse is gaining momentum, assisted by the coronavirus. Large department store **J.C. Penny** sought bankruptcy protection earlier this month, and many U.S. retail REITs are battling to survive. The pandemic, coupled with governments shuttering non-essential businesses, has created an inflection point for internet shopping.

There has been a tremendous uptick in the volume of sales by internet retailers, particularly for groceries and fresh foods, which was previously though immune. It is unlikely that sales volumes will diminish significantly once restrictions in movement are lifted.

This is placing substantial pressure on traditional brick-and-mortar retailer and shopping mall REITs, accelerating their demise.

While demand for retail floorspace will fall, the rapid adoption of online shopping has triggered a marked uptick in demand for light industrial property.

Internet retailers require large logistical spaces to manage inventory, orders, and deliveries. Light industrial properties are ideal candidates.

Credible results for a REIT

Artis finished the first quarter 2020 with some solid numbers, despite the impact of the coronavirus.

NOI plunged 12% year over year, and it reported a $111 million net loss compared to a $25 million net profit a year earlier.

Nonetheless, A crucial performance measure for a REIT, adjusted funds from operations (AFFO) per unit, only fell 4%.

Artis is focused on strengthening its financial position. It finished the first quarter with debt to gross book value of 51% and an EBITDA to interest coverage ratio of three. Occupancy rate at the end of the quarter was 91.8%, or 0.9% lower year over year, but still indicative of strong demand for Artis's properties.

Second-quarter earnings will likely be softer, because of the impact of the pandemic and tenants asking for rent deferrals, but one the economy returns to growth Artis will experience strong growth.

Foolish takeaway

Artis is a deeply discount REIT, which possesses solid growth potential, as it reconfigures its property portfolio. While waiting for the economy to return to growth and Artis's market value to soar, you will be rewarded by its distribution yielding 7.5%. That payment appears sustainable, regardless of the impact of the coronavirus, because of an AFFO payout ratio of a low 58%. It would take a significant decline in earnings to push that ratio to an unmanageable level and force a distribution cut.

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