Should You Buy RioCan REIT (TSX:REI.UN) Stock After Earnings?

Description

RioCan REIT (TSX:REI.UN) stock fell 2% ahead of its third-quarter earnings on October 29. The real estate market has been subdued since the pandemic, as the lockdown closed many non-essential retail stores. This was the first time the REIT saw an overall reduction in gross rent collection. This was also the first time the government provided a stimulus package to help small retailers pay their rent.

Why are Riocan's earnings important to investors?

The bearish tone of RioCan's stock price movement shows investors' fear that the REIT might cut dividends. It pays an annual dividend of $1.44 and has so far maintained this dividend rate. The recent plunge in its stock has inflated its dividend yield above 10%.

The biggest blow of the pandemic-induced lockdown was visible in RioCan's second-quarter earnings:

- The company's gross rent collection plunged to 73.3%.
- Its occupancy rate fell to 96.4% from 97.1% in the previous year quarter.
- It reduced the fair value of its investment properties by $451.7 million and set aside $20 million in rent abatements and bad debts, which resulted in a net loss of $350.8 million.
- None of these provisions and fair-value losses were cash losses. Hence, it had sufficient cash to pay dividends (83.2% payout ratio).

The upcoming earnings will address three major concerns of investors: rent collection, rent defaults, and occupancy rate.

What happened in the third quarter?

Things started to improve in July when the economy reopened. RioCan collected 85% of its gross rent for July. This rate improved further as reopening accelerated. The company reached out to every tenant, assessed their survival, and negotiated the rent. It deferred rent for 7.7% of its tenants and put 14.4% of its tenants through the Canada Emergency Commercial Rent Assistance (CECRA) in the second quarter.

The biggest challenge in the second quarter was the rent collection. RioCan addressed this challenge by using CERCA, security deposits, and letter of credits. The third-quarter earnings will show more than 85% gross rent collection.

The biggest challenge in the third quarter is maintaining the occupancy rate. The pandemic disrupted the non-essential retail industry. Both big and small retailers reduced their number of outlets to cut costs. But the major concern will be the occupancy rate. If it falls significantly, it will impact RioCan's future rental income until new tenants come.

However, three things work in RioCan's favour. Firstly, the company has a diversified tenant base, with no single tenant accounting for more than 5% of its revenue. And most of its tenants are big retailers with high creditworthiness, but that doesn't help much in the pandemic as it pushed names like **J.C. Penney** to bankruptcy. Secondly, over 75% of its tenants are necessity-based, service-oriented retailers that need physical stores. Thirdly, most of RioCan's retail properties are situated at prime locations.

Investors' concern around RioCan

RioCan's third-quarter earnings will shed some light on the status of the recovery and the magnitude of defaults. Will the defaults rise to the level where RioCan has to cut dividends to preserve cash? Investors' concerns are not overblown, as Dividend Aristocrats **Suncor Energy** and **H&R REIT** cut their dividend per share by 55% and 50%, respectively, in May.

Amid the worst crisis real estate has ever seen, RioCan has announced that its founder and CEO Edward Sonshine will retire next year on April 1. The president and COO Jonathan Gitlin will replace him. A management change, and of a founder, may not hold well with investors in times of crisis.

Should you buy RioCan stock?

Now, the question is, should you buy RioCan stock? If the REIT has an occupancy rate of 96% and maintains its cash flows near the second-quarter level, buy the stock. RioCan will be among the early beneficiaries of the economic recovery.

In the best-case scenario, RioCan will maintain its dividend rate, and its stock price will recover to the pre-pandemic level by five years. If you invest $5,000 in RioCan, it will give you $6,480 in investment income ($2,480 in dividend income and $4,000 in capital appreciation) in five years.

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