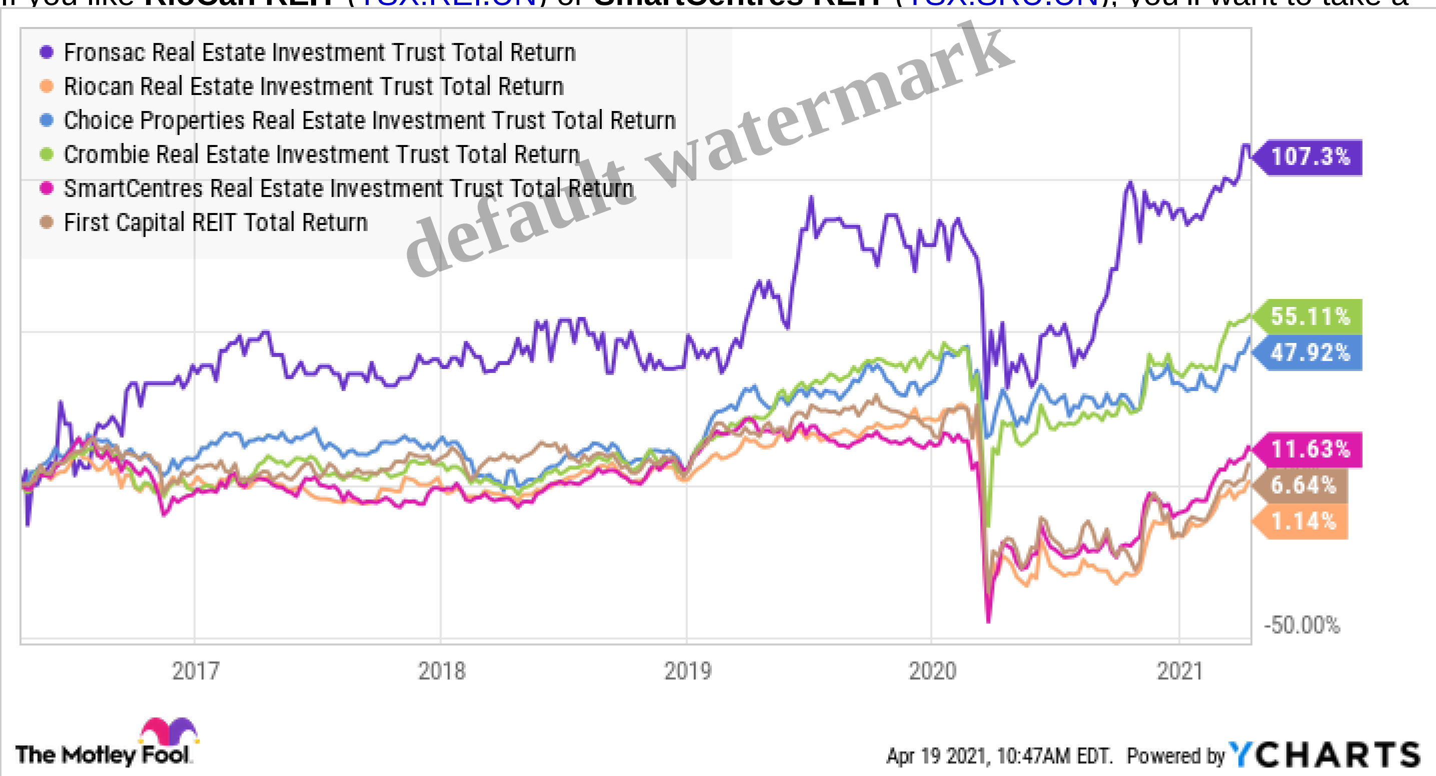
1 TSX Stock Has Been Beating Its Bigger Peers!

Description

If you like **RioCan REIT** (TSX:REI.UN) or **SmartCentres REIT** (TSX:SRU.UN), you'll want to take a



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Total Return Level data by YCharts.

While RioCan has been reinventing itself by developing mixed-use properties and turning around its funds from operations (FFO), Fronsac has continued to grow its FFO.

Specifically, RioCan's FFO per unit fell 14% to $1.60 last year. It could take a couple of years before that starts turning around. No wonder it had to cut its cash distribution by a third this year. Its new payout ratio will be roughly 62% this year. Its cash distribution should therefore be safe going forward. Right now, RioCan yields just over 4.7%.

Although Fronsac only yields about 4%, it could be a better option for income and total returns in the REIT space. The small-cap stock is a Canadian Dividend Aristocrat that has increased its cash distribution for nine consecutive years, beating SmartCentres's seven-year streak. Specifically, Fronsac's five-year dividend growth rate is 10.8% versus SRU.UN's 2.8%.

Despite the larger scale of RioCan and SmartCentres's real estate empires, Fronsac has delivered higher-quality earnings. In the past five years, Fronsac more than doubled its FFO per unit, beating RioCan's drop of 8% and SmartCentres's growth of 1%.

The outperforming growing cash flow is what has been driving the extraordinary performance in Fronsac.

Here's an overview of the small-cap stock's business.

The business

Fronsac owns a high-quality triple-net and management-free commercial real estate portfolio consisting of about 74 properties in eastern Canada.

Triple-net leases imply that tenants are responsible for variable costs such as insurance and maintenance. Management-free leases imply that tenants are responsible for the management of the property, including maintenance and minor renovations. These types of leases work in Fronsac's favour in creating a more stable and predictable cash flow.

Fronsac's occupancy rate is about 99%. Approximately 51% of its 2020 net operating income came from grocery stores (35%), **Suncor** (9%), and Tim Hortons (7%).

Beware of the low trading volume

Investors should note that Fronsac has low trading volume, which makes the stock illiquid, making it more difficult to buy or sell the stock at any time. However, it's not necessarily a deal breaker. Interested buyers or sellers can always look at the current bid or ask prices to ensure they can make a purchase or sale.

One reason for the low trading volume is that insiders own a big stake of about 15% in the REIT. This is a good thing because of the aligned interests with unitholders.

The Foolish takeaway

From 2017 to 2020, Fronsac tripled its assets to $210 million, while the stock delivered annualized returns of close to 14% in the period. Currently, the REIT trades at a discount of about 20% from the 2017 levels thanks to its growing FFO on a per-unit basis by 15% per year in the past three years.

It's estimated that Fronsac can continue growing its FFO by at least 10% per year over the next few years. Importantly, its payout ratio will be about 56%, which provides a great buffer to protect its cash distribution.

In summary, Fronsac's quality business model makes it a good consideration for income of about 4% and outsized total returns. Moreover, as it grows in scale, there's a possibility that it could be acquired.

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