TFSA Investors: Is This TSX REIT Still a Buy After its 109% Gain?

Description

The hotel industry in the United States is enjoying a swift recovery in 2021, as domestic travel resumes after a severe pandemic slump in 2020. In a June 24th report from marketplace insights firm STR, overall occupancy levels in U.S. hotels during the week ending June 19 improved to 68%, or just under 10% of 2019 levels — the highest level in 85 weeks.

According to STR's latest data, one market has already reported numbers better than pre-pandemic readings. "Among the top 25 markets, Tampa saw the only occupancy increase over 2019 (+1.2% to 77.5%)," the report noted. This is great news for hotel REIT investors. A strong recovery is already underway before international travel kicks in.

I love real estate investment trusts (REITs) for their long-term high yields and tax-free income potential in a Tax-Free Savings Account (TFSA). A buy-the-dip recommendation to play this sector's recovery, **American Hotel Income Properties REIT** (TSX:HOT.UN) has since gained 109% since a March call last year. The gains look good so far, but could there be more upside?

Being greedy in a fearful market paid for contrarian AHIP investors

American Hotel Income Properties REIT (AHIP) owns a portfolio of 78 premium-branded hotel properties in the United States. The trust had just made significant property acquisitions. It was carrying out a significant property renovation and branding exercise when the coronavirus pandemic forced property closures, with a catastrophic hit to cash flows. Liquidity levels were already low after concluding new property acquisitions deals just before the pandemic.

AHIP's management fully suspended distributions when hotel traffic levels plummeted during lockdowns. It reduced staffing levels and implemented several painful cost-cutting measures to survive the pandemic onslaught. Senior executives accepted salary payments in restricted HOT.UN stock units to help the trust conserve cash during a survival crisis. The strategies paid off.

In a contrarian buy-the-dip call, I first recommended buying beaten-down AHIP units in March 2020, before recovery prospects were priced in. It was the best time to buy low on a business that was in severe distress. This was the best time to buy heavily discounted premium real estate properties. And units have more than doubled since then, with a 109% gain.

Is American Hotel Income Properties REIT stock still a buy?

Fast forward to April 2021, the picture on AHIP's business has significantly improved from March 2020 settings.

Domestic travel and tourism are fast recovering in America. AHIP's hotel occupancy rates improved sequentially from 51.2% in January 2021 to over 68% by April. It won't be surprising if AHIP's second-quarter funds from operations (FFO) turn positive after a breakeven was reported during the first quarter (prior to non-recurring items).

Management has always stressed that the trust has been far ahead of peers in occupancy levels and adjusted operating earnings per hotel. AHIP could post much better results than the 68% occupancy reported for the broader industry. The trust has two hotel properties in Tampa totaling 181 guestrooms, and it could be enjoying the Tampa outperformance, too.

The business has undoubtedly recovered. However, given the emerging scares from rising inflation rates, which exacerbate the threat of rising interest rates in North America, investor focus should turn to the REIT's balance sheet and how it can quickly reinstate distributions.

Wall Street analysts expect American Hotel Income Properties REIT to report a 116% year-over-year growth in revenue for the June 2021 quarter. Funds from operations (FFO) per unit could recover to \$0.08 — the first positive reading in five consecutive quarters. However, the trust needs more time before its earnings and cash flows can sustain a regular distribution.

Investor takeaway

My focus has shifted from a deep long-term value discount on HOT.UN units to how management will execute after the pandemic. Rising interest rates could delay the liquidity recovery process. However, I am optimistic that domestic tourism will boost AHIP's earnings and cash flows during the second half of 2021. That said, it doesn't seem like the trust could reinstate its suspended distribution by 2022.

Although AHIP units remain under \$5 each, they no longer seem heavily discounted after a fine 34% run so far this year. However, the initial goal for buying the distressed REIT was for potentially juicy income payouts after the pandemic. Holding AHIP units in a TFSA remains a noble idea.

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Date
2025/06/27
Date Created
2021/06/30
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