



Growth and Safety in a Single Stock

Description

Commercial real estate is an integral part of a truly diversified portfolio. But not all real estate is created equal. Grocery-anchored properties are necessity-based, supplying products that are essential to daily life, such as food. Necessity-based retail provides a conservative income component to your portfolio and is a pure play on inflation in the form of rising food prices.

Loblaw Companies Ltd. spun out **Choice Properties Real Est Invstmnt Trst** ([TSX:CHP.UN](#)) in 2013 in its strategy to maximize the value of the real estate holdings of its food retail operations. Bolstered by quality real estate, a strong anchor tenant in Loblaw, and strong management, Choice Properties's occupancy level remains steady at 99%, with a weighted average remaining lease term of 10 years.

On May 4 of this year, Choice Properties, which counts Loblaw as its principal tenant and largest unitholder, closed a \$3.93 billion deal to acquire Canadian REIT, or CREIT, in a strategic move to expand and diversify beyond its retail property holdings by adding more industrial, office, and residential space to its retail portfolio. The deal catapulted Choice to the position of Canada's largest REIT.

The combined entity holds 757 properties totalling 67 million square feet of gross leasable area. Combining Choice's retail properties with CREIT's retail, office, industrial, and residential portfolio provides the benefits of better diversification. CREIT's former heavy property portfolio exposure to Alberta of 38% of net operating income (NOI) drops to 21%, while Choice's exposure to Loblaw properties—88% before the deal—drops to 58%. Greater diversification yields better stability.

Almost 90% of Choice's development sites are located in Canada's six largest cities. This includes 1.5 million square feet of retail development, 1.2 million square feet of industrial development, close to one million square feet of residential development, plus a number of major mixed-use projects.

Internal property development generates higher returns than acquisitions, making it a prudent way to drive growth in net asset value (NAV). Choice Properties's development sites provide years of growth potential. This provides the means for CREIT's well-respected management team, who is now heading up Choice Properties REIT, to accelerate its non-retail business, while collecting rents from stable

tenants such as Loblaws and Shoppers Drug Mart.

Solid Q2

On July 18, Choice announced second-quarter 2018 results that were ahead of analysts' expectations. The second quarter, the first reporting period since Choice acquired CREIT, showed steady progress in the integration of the two REITs.

Funds from operations for the second quarter were \$156.6 million, or \$0.27 per diluted unit, up 4.4% from \$108.4 million, or \$0.26 per diluted unit, in the second quarter of 2017. Adjusted cash flow from operations (ACFO) was \$152.7 million, up 5.7% from \$97.5 million for Q2 2017. The ACFO payout ratio was 70.6% in the most recent quarter versus 77% a year ago.

Overall, same-store NOI grew 2%, while property developments lifted same-property NOI growth to 3.4%. With the addition of CREIT's properties portfolio, Choice is in the early stage of a very large, long-term, and accretive intensification development opportunity that will provide further opportunity for value creation well out into the future.

The program encompasses more than 3.7 million square feet of active development projects on over 60 properties in core urban markets, mostly in major hubs.

Choice units are undervalued. They trade at a 4.6% discount to NAV. The company's trailing and forward P/E ratios are both at or near their five-year lows. Based on price to sales, Choice trades at a 16% discount to its residential and commercial REIT industry group peer average.

Choice's trailing P/E of 2.70 represents a 55% discount to its industry group average, and the units are also less expensive than peers on a price-to-cash-flow basis. Choice pays a safe monthly distribution of \$0.061667 per share (\$0.74 annually), which, at today's closing price, represents a 6% yield.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CHP.UN (Choice Properties Real Estate Investment Trust)

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Category

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