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Stock to watch: Mainstreet Equity expanding in core market

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Apartment operator to book a big profit from leaving Ontario

Mainstreet Equity Corp.

Tuesday's close: $33.10, down 29 cents

52-week trading range: $21.42 - $34.26 a share

Annual dividend: none

Analysts' ratings: There were three buys, two holds and no sells, according to Bloomberg data. Target prices ranged from $34 to $36.70 a share.

Recent history: Shares of apartment operator Mainstreet Equity Corp. have been on a tear this year, gaining 38 per cent on the back of rising cash flow and asset values. Like many peers, its stock began falling in the summer amid investor concern about valuation in the Canadian real estate sector, but has rebounded lately. On Monday, Mainstreet, which buys mid-sized apartment buildings, then renovates and rents them at higher rices, reported a 20-per-cent increase in fourth-quarter cash flow from a year ago. The company, which was founded by entrepreneur Bob Dhillon, said it has also just sold 404 of its Ontario apartment units for $47-million, and is looking to shed another 260 units to expand in Western Canada, its core market.

Outook: The decision to leave Ontario will be an "additional catalyst" for Mainstreet because it is going to book a big profit, and have substantial cash after paying down debt, said Jeff Olin, president of Vision Capital Corp., which owns slightly less than 10 per cent of its stock. "They are going to redeploy it in their backyard in Edmonton, Calgary, Saskatchewan and the lower mainland in British Columbia... This company is like a mini Boardwalk REIT except that Mainstreet is creating value in their assets whereas Boardwalk is simply harvesting cash flow."

Both Boardwalk and Mainstreet are Alberta-focused apartment operators. Canada Mortgage and Housing Corp. released figures last week indicating the vacancy rate fell in October to 1.7 per cent in Edmonton from 3.3 per cent a year ago. Average rents have risen 3.8 per cent, and are forecast to rise 3.2 per cent over the next year. The Calgary vacancy rate declined to 1.3 per cent in October from 1.9 per cent a year earlier. Rents have climbed 5.9 per cent, and are forecast to rise 4.3 per cent over the next year. The CMHC one-year rent forecasts are conservative, and more likely to rise above 5 per cent, Mr. Olin suggested.

Mainstreet, meanwhile, has not indicated yet whether it plans to initiate a small dividend. "I don't want a dividend," said Mr. Olin. The company has grown from 272 apartment units in 1998 to

8,500 that are today valued at $1.1-billion, and that has been accomplished with only $10-million of net equity capital, he said. "The rest of the growth has been financed by conservative debt financing or asset sales because they were able to create value [from renovating properties]. So it is actually unique... The company can, in our opinion, increase its asset base by at least 50 per cent without diluting common shareholders by one dollar."

Mr. Olin has a 12-month target of $40 a share on Mainstreet.

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