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News

Mainstreet Equity on upswing

Barry Critchley, Financial Post · Tuesday, Feb. 15, 2011

M ainstreet Equity Corp., one of the handful of real estate companies that are not a real estate investment trust, released its first quarter financial statements Monday -- and they were judged good enough for investors to push the shares to a six-month high.

Calgary-based Mainstreet, which owns mid-market apartment buildings and which operates largely in Western Canada, posted gains in all areas, including rental revenue, funds from operations, net operating income and operating margin. Unlike REITs, the company does not pay a dividend, preferring to plow that cash back into its operations. And it continues to make acquisitions--adding 510 units in its most recent quarter--while continuing to buy back its own shares.

"We had a good quarter," said Bob Dhillon, Mainstreet's larger-than-life chief executive, who asks the question: "How do you bet in the Western Canadian commodity market with limited risk?" His answer, "You buy Mainstreet. We have cash, cash flow, we have equity appreciation, we have operations in the part of country that is growing the fastest, and we have low-cost CMHC financing."

He added that after the quarter ended, the company arranged an additional $29-million financing with CMHC and other financial institutions and plans to seek an extra $6.1-million in the second quarter.

"We are a mid-market add-value consolidator in Western Canada which trades below replacement cost, which is the number one driver of value," Dhillon said, adding that the company has clear title to properties with an appraised value of $44-million against which it can finance.

"He has a different model to what the REITs do," said one analyst who requested anonymity. "It's more entrepreneurial and doesn't dilute itself when it acquires rental properties. That's why he has gone from owning 272 apartments to almost 7,000 on issuing net equity of just $10-million."

The $10-million net equity arises because Mainstreet bought back most of the $33-million from the sale of a convertible debenture it issued a few years ago. Mainstreet also did a substantial issuer bid, affecting about 30% of its float, a few years ago.

Dhillon said Mainstreet doesn't issue equity because "we have a self-generating cash-flow engine which is a testament to our business model. And we don't pay dividends because we believe in the Warren Buffett statement. 'We have a better use for the cash.' "

Even so, Mainstreet said much remains to be done given that economic conditions in the markets where it operates still aren't that positive -- all of which translates into continued high vacancy rates. For the quarter, the vacancy rate was 11.2% (compared with 11.3% in the previous quarter and 18.9%one year previous).

In its release, the company listed the challenges as being the need to offer incentives and concessions to retain existing tenants and attract new ones; the general inability to raise rental rates; the continued high rates of tenant turnover and bad debts.

According to Bloomberg, four analysts who cover Mainstreet have termed it a "buy" with the average one-year target being $19.31 a share. One analyst, Jeff Roberts of Desjardins Securities, calls Mainstreet his top pick with a $22.50 target, which he moved up from $16.50 last December. At that time, the target was still 10% below the fund's net asset value of $25 a share.

Mainstreet (MEQ/TSX) closed yesterday at $16.71. The stock has gained more than 50% over the past six months. The record high is $19.60, reached on Feb. 22, 2007.