

Action Note

Equity Research

June 23, 2020

Real Estate

Mainstreet Equity Corp.

(MEQ-T) C\$69.00

Q2 Results Miss; Well Positioned to Capitalize on Opportunities

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Event

Q2/20 results (period ended March 31, 2020).

Impact: SLIGHTLY NEGATIVE

Q2/20 FFO/share (f.d.) was \$0.97, +6% versus Q2/19 but below our \$1.14 estimate. Consensus was \$1.15. AFFO/share f.d. (our calculation) of \$0.68 was also below our \$0.87 estimate. The negative variance versus our estimate was due to lower-than-expected NOI (\$0.10/share) and higher G&A (\$0.06/share) and interest (\$0.02/share).

Collections and Leasing. As of June 19, Mainstreet had collected 95% of June rents (May collections were 97%). Management noted that it expects June collections to reach May levels, which would be largely in line with historical trends. Currently ~2% of tenants are on deferral programs.

Liquidity. Since January 1, Mainstreet has generated \$111 million of additional mortgage proceeds. **We note that the latest 10-year CMHC-insured mortgage was locked in at 1.66%, a record low for Mainstreet.** Management expects to put mortgage financing on its entire pool of unencumbered assets valued at \$177 million over the course of 2020, which is expected to generate ~\$100 million of proceeds, in order to take advantage of the low-interest rate environment and execute on acquisition opportunities. The company is currently budgeting \$10 million of capital expenditures through the remainder of 2020. **We believe Mainstreet has ample liquidity to execute on its growth plans through the pandemic.**

Forecast. We have lowered our 2020 AFFO/share estimates by ~9% to account for the Q2 miss, the impact of COVID-19 and higher operating expenses. 2021 is largely unchanged. We are also introducing our 2022 forecast. We have increased our NAV/share estimate to \$74.30, owing to a small modelling error in our previous forecast.

TD Investment Conclusion

Mainstreet's Q2/20 results were impacted by an increase in several non-controllable expenses (property taxes, insurance), and to a lesser extent COVID-19. We expect these headwinds to persist through 2020, however, we believe the company is well-positioned to ride out the pandemic and capitalize on both the low interest rate environment and acquisition opportunities. **We are increasing our target price to \$82.00 from \$59.00 on a higher multiple. However, with a 19% return and in consideration of its limited trading liquidity, we are maintaining our HOLD rating.**

Recommendation:	HOLD
Risk:	MEDIUM
12-Month Target Price:	C\$82.00↑ Prior: C\$58.00
12-Month Dividend (Est.):	C\$0.00
12-Month Total Return:	18.8%

Market Data (C\$)

Current Price	C\$69.00
52-Week Range	\$40.59 - \$96.25
Mkt Cap (f.d.) (\$mm)	\$648.6
Mkt Cap (basic) (\$mm)	\$648.6
Float Cap (\$mm)	\$303.6
EV (\$mm)	\$1,766.8
Current Dividend	\$0.00
Dividend Yield	0.0%

Financial Data (C\$)

Fiscal Y-E	September
Shares O/S (f.d.) (mm)	9.4
Shares O/S (basic) (mm)	9.4
Float Shares (mm)	4.4
Net Debt/Total Cap	58.1%
NAVPS	\$74.30
Net Debt/EBITDA	14.3x

Estimates (C\$)

Year	2019A	2020E	2021E	2022E
EBITDA (\$mm)	74.0	79.0	88.0	97.0
FFO/Shr	4.17	4.58	5.52	6.14
FFO/Shr (old)	—	4.88	5.44	—
AFFO/Shr	3.18	3.45	4.36	4.96
AFFO/Shr (old)	—	3.78	4.32	—

FFO/Shr Quarterly Estimates (C\$)

Year	2019A	2020E	2021E	2022E
Q1	1.00	1.20	1.36	1.47
Q2	0.92	0.97	1.26	1.40
Q3	0.99	1.06	1.34	1.54
Q4	1.29	1.34	1.55	1.73

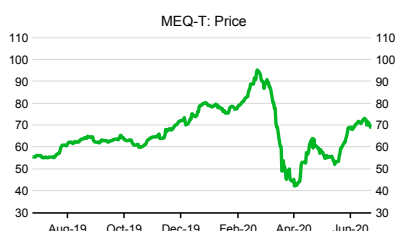
Valuations

Year	2019A	2020E	2021E	2022E
EV/EBITDA	23.9x	22.4x	20.1x	18.2x
P/FFO	16.5x	15.1x	12.5x	11.2x
P/AFFO	21.7x	20.0x	15.8x	13.9x

Supplemental Data

Year	2019A	2020E	2021E	2022E
D/GBV	52.6%	52.8%	52.7%	52.8%

All figures in C\$, unless otherwise specified



Company Profile

Mainstreet Equity Corp. is a Calgary-based real estate corporation focused on the acquisition, redevelopment, repositioning, and asset and property management of mid-market apartment buildings. The corporation currently owns and operates residential rental units, including apartments and townhouses, in B.C., Alberta, and Saskatchewan.

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Details — Q2/20 Highlights (Exhibits 1, 2 & 3)

Same-property NOI was +1.2%

Same-property vacancy increased 40bps y/y to 6.6%, while AMR was +2.9% to \$951. Average monthly operating expenses increased 6%, which resulted in the NOI margin declining 100bps to 58.9%. NOI margins were down across the portfolio owing largely to higher property taxes (including +20% in Calgary) a 35% increase in insurance, as well as additional costs related to COVID-19 (cleaning, sanitizing, PPE). Alberta SPNOI was +1.2%, B.C. was +4.9% and Saskatchewan was -5.5%.

Acquisitions (Exhibit 4)

During the quarter, the company acquired 279 units for \$40.6 million (~\$145,700). Post-Q2, Mainstreet acquired another 61 suites for \$5.4 million (\$88,500/suite) in Calgary and Edmonton, bringing the 2020 YTD total to 474 suites for \$57.3 million (\$120,900/suite). Management is planning to accelerate its counter-cyclical acquisition activity to capitalize on the current lack of buyers and any panic-driven selling.

Balance Sheet/Liquidity (Exhibit 5)

Q2 leverage (D/GBV) was +10bps q/q at ~54%. During the quarter, the company financed five maturing mortgages for \$66.3 million and 18 clear-title properties for \$50.1 million at a 10-year rate of 2.32%, generating \$75.8 million in total additional funds. As at Q2/20, Mainstreet had 31 clear-title assets with a fair value of ~\$177 million (Q1/20: \$252 million). Post-Q2, the company financed nine maturing mortgages for \$65.8 million, including \$35.2 million of up-financing at a 10-year rate of 1.76%. Mainstreet has ~\$113 million of mortgages maturing in 2020/21 at an average rate of ~4%. Given the current 10-year CMHC rate, we see opportunity for interest expenses savings on 2020 and 2021 renewals, including the impact of up-financings. We do not expect the CMHC's recent announcement regarding equity take-out loans to impact Mainstreet's up-financing activities.

Outlook

COVID-19

Given that Mainstreet's portfolio tends to target lower-middle market renters (average rents between \$900-\$1,000/month), it could experience a more pronounced affect from the decline in immigration and international students. The company's tenants may also be disproportionately impacted by the economic shutdown, which could further impact collection rates, particularly once the CERB benefits end in September. That said, we are encouraged by the re-opening of economies across Canada, which should hopefully benefit leasing momentum as we head into peak leasing season. The portfolio's lower rents may also attract renters who have elected to seek out less expensive accommodations as a result of COVID-19. Management will also be accelerating its stabilization program as it looks to take advantage of the current low interest rate environment. Longer-term we remain confident in Mainstreet's strategy and portfolio. **With solid liquidity, we believe the company is well-positioned to execute on acquisitions and its stabilization program through the remainder of 2020.**

Forecast

We have included ~\$100 million of unannounced acquisitions in H2/20 and \$100 million in both 2021 and 2022.

Valuation

Mainstreet is currently trading at a 13% discount to our revised NAV estimate of \$74.30/share (previously \$59.00/share), which is well above its historic average of a 17% discount. This compares with a 15% discount for its Canadian peers and an 18% discount for the U.S. multi-residential peers. On a P/AFFO multiple basis, Mainstreet is trading at 20.0x 2020E AFFO/share versus its Canadian peer group at 22.8x.

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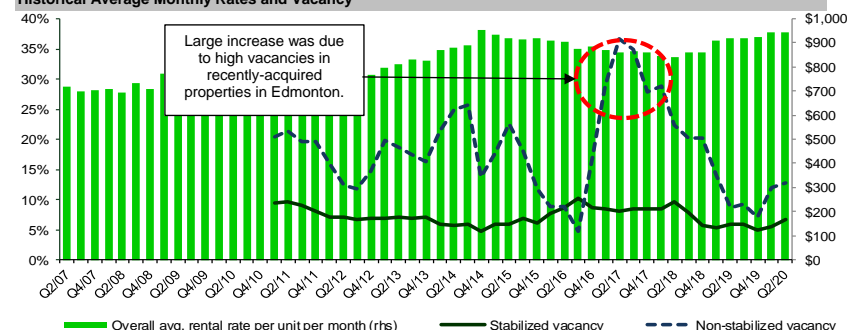
June 23, 2020

Exhibit 1. Financial Summary and Portfolio Performance

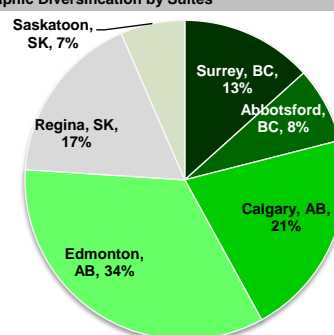
Financial Overview						
(\$mm except shares and \$/share)	Q2/19	Q2/20	Y/Y %	TD Est	Act/Est	Comment
Portfolio Statistics						
Total Portfolio	12,333	13,314	8.0%			
Stabilized Suites	10,353	11,878	14.7%			
Non-stabilized Suites	1,980	1,436	-27.5%			
Average Vacancy During the Quarter	6.5%	7.4%	90bps			
Average Monthly Rent/Unit during the Period	\$920	\$942	2.4%			
Stabilized NOI						
Revenue	28.899	33.797	16.9%	32.959	2.5%	
Operating Costs	11.415	13.887	21.7%	13.019	6.7%	
NOI	17.484	19.910	13.9%	19.940	-0.2%	
NOI Margin	60.5%	58.9%	-159bps	60.5%	-159 bps	➔ Margins declined y/y largely owing to higher property taxes and insurance, and to a lesser extent, COVID-19.
Non-Stabilized NOI						
Revenue	4.838	3.435	-29.0%	4.832	-28.9%	
Operating Costs	2.166	1.641	-24.2%	2.174	-24.5%	
NOI	2.672	1.794	-32.9%	2.658	-32.5%	
NOI Margin	55.2%	52.2%	-300bps	55.0%	-277 bps	
Total NOI	20.156	21.704	7.7%	22.598	-4.0%	➔ NOI difference versus our estimates had a negative impact of \$0.10/share
NOI Margin	59.7%	58.3%	-145bps	59.8%	150 bps	
General and Administration	3.334	3.381	1.4%	2.844	18.9%	➔ Difference versus our estimate was \$0.06/share
Interest Income	-0.043	-0.034	nmf	-0.001	nmf	
Losses/(Gains)	-0.025	0.000	nmf	0.000	nmf	
EBITDA	16.865	18.357	8.8%	19.755	-7.1%	
Net Interest Expense	8.555	9.213	7.7%	9.021	2.1%	➔ Difference versus our estimate was \$0.02/share
Current income tax	0.000	0.000	nmf	0.000	nmf	
Other	0.038	0.053	nmf	0.000	nmf	
FFO	8.272	9.091	9.9%	10.733	-15.3%	
AFFO	5.943	6.418	8.0%	8.160	-21.3%	
FD FFO/share	\$0.92	\$0.97	5.7%	\$1.14	-15.3%	Consensus was \$1.15
FD AFFO/share	\$0.66	\$0.68	3.9%	\$0.87	-21.3%	
FD average shares outstanding	9.022	9.382	4.0%	9.382	0.0%	

Portfolio Summary

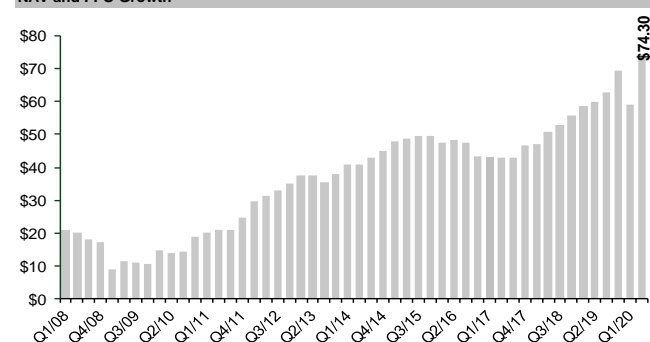
Historical Average Monthly Rates and Vacancy



Geographic Diversification by Suites



NAV and FFO Growth



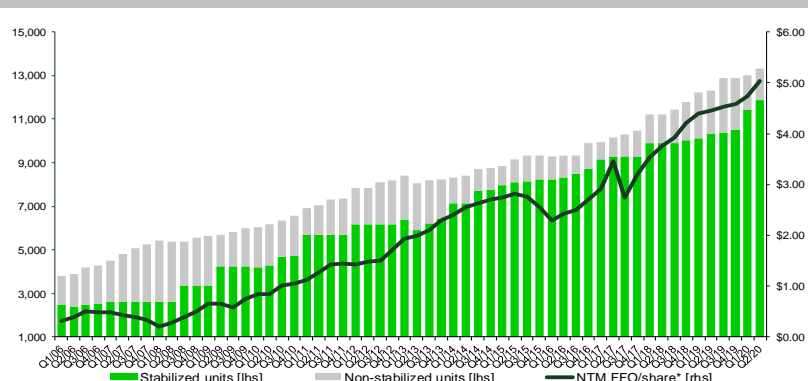
NAV Summary

(\$mm except shares and \$/share)	Estimated Cap Rate		
	5.15%	5.40%	5.65%

Estimated NAV Per Share (FD)	\$83.70	\$74.30	\$65.60
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Implied Cap Rate 5.50%

Source: TD Securities, company reports



* NTM FFO = Next twelve months FFO; TD Securities' estimates are included in the NTM FFO for the last four quarters shown in the chart.

Same-Property NOI Forecast

2019A	2020F	2021F	2022F
9.4%	1.2%	2.8%	3.6%

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Exhibit 2. Summary of Q2/20 Operating Metrics

	Portfolio			Same-Property			British Columbia			Alberta			Saskatchewan		
	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change
NOI	21,704	20,156	7.7%	19,804	19,576	1.2%	6,178	5,766	7.1%	11,893	10,751	10.6%	3,633	3,639	-0.2%
Avg Vacancy Rate	7.4%	6.5%	90 bps	6.6%	6.2%	40 bps	0.6%	0.5%	10 bps	7.7%	7.5%	20 bps	12.5%	10.2%	230 bps
Avg Rental Rate/Month	942	920	2.4%	951	924	2.9%	1,082	1016	6.5%	959	931	3.0%	778	797	-2.4%
Avg Operating Expense/Month	393	370	6.2%	391	370	5.7%	346	317	9.1%	409	397	3.0%	397	357	11.2%
Operating Margin	58%	60%	-140 bps	59%	60%	-100 bps	68%	69%	-100 bps	57%	57%	0 bps	49%	55%	-600 bps
W-A Units	13,179	12,227	7.8%	11,789	11,784	0.0%	2,799	2,751	1.7%	7,205	6,720	7.2%	3,175	2,756	15.2%

Source: Company reports, TD Securities Inc.

Exhibit 3. Q2/20 Same-Property NOI Growth by Province

	Alberta			British Columbia			Saskatchewan			Portfolio		
	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change	Q2/20	Q2/19	% Change
Revenue	18,601	18,233	2.0%	8,932	8,386	6.5%	6,092	6,039	0.9%	33,625	32,658	3.0%
Operating Costs	8,020	7,781	3.1%	2,881	2,618	10.0%	2,920	2,683	8.8%	13,821	13,082	5.6%
NOI	10,581	10,452	1.2%	6,051	5,768	4.9%	3,172	3,356	-5.5%	19,804	19,576	1.2%
NOI Margin	56.9%	57.3%	-44bps	67.7%	68.8%	-104bps	52.1%	55.6%	-350bps	58.9%	59.9%	-105bps

Source: Company reports, TD Securities Inc.

Exhibit 4. Acquisition Activity

City	Period	Suites	Cost (mm)	Cost/Suite
Calgary	Q1/20	8		
Edmonton	Q1/20	23	\$11.3	\$84,328
Saskatoon	Q1/20	55		
Kamloops	Q1/20	48		
Calgary	Q2/20	34		
Edmonton	Q2/20	220	\$40.6	\$145,677
Regina	Q2/20	25		
Edmonton/Calgary	Q3/20	61	\$5.4	\$88,525
2020 Total/Average		474	\$57.3	\$120,979

Source: TD Securities, company reports

Exhibit 5. Liquidity

Liquidity Analysis (\$mm)				Mortgage Refinancing Profile (\$mm)			
	Size	Used	Available	Maturing in next 4-yrs	Balance Maturing	% of total	Term to *WAIR Maturity
Cash	\$10.1	n/a	\$10.1	2020	32.6	3%	4.08%
Credit Facility	85.0	21.0	64.0	2021	80.7	7%	3.94%
Clear-title assets (55% LTV)	97.4	0.0	97.4	2022	77.5	7%	3.05%
Total liquidity	\$192.5	\$21.0	\$171.5	2023	98.3	9%	3.37%
Total liquidity as % of:				Total outstanding	\$1,132.2	100%	2.89%
Total mortgage debt	\$1,132.2		175%	Less: Deferred Financing Costs	-\$24.9		6.6 yrs
Debt maturing 2020 & 2021	\$113.3			Credit Facilities Drawn	\$21.0		
Fixed Rate Debt			100%	Total Debt	\$1,128.3		
Unencumbered Assets			\$177.0				

*WAIR = weighted average interest rate (effective rate)

Source: TD Securities, company reports

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Exhibit 6. Forecast Revisions

	Q3/20E			2020E			2021E			2022E
	Previous	Revised	% change	Previous	Revised	% change	Previous	Revised	% change	
\$mm										
Revenue	\$37.8	\$38.2	1.16%	\$150.1	\$151.4	0.88%	\$159.5	\$164.7	3.29%	\$178.1
NOI	22.8	22.2	-2.43%	93.4	92.0	-1.50%	100.7	102.1	1.41%	111.7
Margin	60.2%	58.1%	-210bps	62.2%	60.8%	-140bps	63.2%	62.0%	-120bps	62.7%
G&A	(2.9)	(3.4)	18.88%	(11.4)	(13.1)	14.23%	(11.9)	(14.1)	18.88%	(14.7)
Interest expense	(9.1)	(8.8)	-2.72%	(36.2)	(35.9)	-0.65%	(37.8)	(36.2)	-4.19%	(39.4)
FFO	\$10.8	\$10.0	-7.84%	\$45.8	\$42.9	-6.15%	\$51.0	\$51.8	1.49%	\$57.6
FFO/share	\$1.16	\$1.06	-7.84%	\$4.88	\$4.58	-6.15%	\$5.44	\$5.52	1.49%	\$6.14
AFFO	\$8.3	\$7.3	-11.47%	\$35.5	\$32.4	-8.77%	\$40.6	\$40.9	0.91%	\$46.5
AFFO/share	\$0.88	\$0.78	-11.47%	\$3.78	\$3.45	-8.77%	\$4.32	\$4.36	0.91%	\$4.96

Source: TD Securities Inc.

Exhibit 7. Trading Comparables

	Symbol	Current Price	Mkt Cap (mm)	Yield	Payout on '20E AFFO	EV	P / AFFO '19A	P / AFFO '20E	P / AFFO '21E	AFFO CAGR ²	NAV	P / NAV	NAV Cap Rate	Implied Cap Rate	Net Debt/ EBITDA ¹	Net Debt incl. conv. / Gross AV
Canadian Multi-Residential REITs and Corp.																
CAPREIT	CAR-UN	\$50.20	8,584	2.8%	71%	13,756	27.3x	25.1x	23.2x	8%	\$55.50	90%	3.8%	4.1%	8.7x	35%
Boardwalk REIT	BEI-UN	\$28.60	1,459	3.5%	51%	4,182	14.7x	14.5x	13.9x	3%	\$43.00	67%	5.3%	6.1%	12.2x	56%
Northview Apartment REIT	NVU-UN	\$34.60					Restricted									
Killam Apartment REIT	KMP-UN	\$17.61	1,800	3.9%	85%	3,298	21.7x	22.0x	20.5x	3%	\$20.20	87%	4.7%	5.1%	10.5x	42%
InterRent REIT	IIP-UN	\$14.54	2,049	2.1%	72%	2,533	33.8x	33.8x	30.3x	6%	\$14.60	100%	3.9%	3.9%	9.0x	21%
Minto Apartment REIT	MI-UN	\$20.60	1,215	2.1%	58%	1,917	28.2x	27.1x	24.2x	8%	\$24.00	86%	3.6%	4.0%	11.2x	33%
Morguard NA Residential REIT	MRG-UN	\$14.91	838	4.7%	75%	2,174	14.9x	16.0x	13.9x	3%	\$22.20	67%	5.2%	6.5%	11.7x	53%
Mainstreet Equity Corp.	MEQ	\$69.00	649	n/a	nmf	1,767	21.7x	20.0x	15.8x	17%	\$74.30	93%	5.4%	5.5%	14.3x	62%
European Residential REIT	ERE-UN	\$4.33	998	3.7%	75%	1,936	24.1x	23.5x	20.2x	9%	\$4.80	90%	4.1%	4.5%	20.3x	46%
Canadian Total / Avg			17,592	3.3%	59%	31,563	23.3x	22.8x	20.3x	7%		85%	4.5%	4.9%	12.2x	43%
US Total / Avg			101,396	3.8%	74%		19.3x	19.3x	18.9x	1%		82%				25%

Notes

¹ Net Debt/EBITDA calculated as 2020 average Net Debt / 2020 EBITDA² Compound annual growth rate (CAGR) over a two-year period ('19E to '21E)

Source: TD Securities, ThomsonOne, SNL Financial (for non-covered companies)

Justification of Target Price

Our \$82.00 target price (previously \$58.00) represents a 10% premium to our revised \$74.30 NAV/share estimate. Given the 20%+ NAV CAGR achieved over the last 10 years, we believe a premium to NAV is appropriate. On an earnings basis, our target price equates to an 18.5x-19.0x multiple to our 2021E AFFO/share (previously 13.25x-13.75x). The increased multiple reflects the re-opening of the Canadian economy and stabilization of oil prices.

Key Risks to Target Price

Key risks to our target price include a prolonged impact of COVID-19, weakness in the oil markets, slowing rent growth or higher vacancies; local real estate markets; interest rates; adverse rental legislation; significant increase in utility costs; operating cost pressures; competition from other landlords; and the ability to source acquisitions on an accretive basis.

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TD Securities Equity Research Disclosures

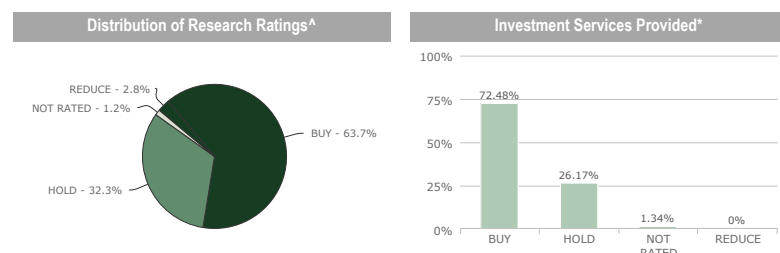
Company	Ticker	Disclosures
Mainstreet Equity Corp.	MEQ-T	9

1. TD Securities Inc., TD Securities (USA) LLC or an affiliated company has managed or co-managed a public offering of securities within the last 12 months with respect to the subject company.
2. TD Securities Inc., TD Securities (USA) LLC or an affiliated company has received compensation for investment banking services within the last 12 months with respect to the subject company.
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Additional Important Disclosures

Price Graphs

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Current as of: June 23, 2020

[^] Percentage of subject companies under each rating category: BUY (covering ACTION LIST BUY, BUY and SPECULATIVE BUY ratings), HOLD, and REDUCE (covering TENDER and REDUCE ratings) and NOT RATED (covering UNDER REVIEW, SUSPENDED, and NOT RATED).

^{*} Percentage of subject companies within each of the four categories (BUY, HOLD, REDUCE, and NOT RATED) for which TD Securities Inc. has provided investment banking services within the last 12 months.

Definition of Research Ratings

ACTION LIST BUY: The stock's total return is expected to exceed a minimum of 15% (with higher thresholds for less liquid, more risky securities) over the next 12 months and it is a top pick in the Analyst's sector.

BUY: The stock's total return is expected to exceed a minimum of 10% (with higher thresholds for less liquid, more risky securities) over the next 12 months.

SPECULATIVE BUY: The stock's total return is expected to exceed a minimum of 30% over the next 12 months (with higher thresholds for less liquid securities); however, there is material event risk associated with the investment that could result in a significant loss.

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HOLD: The stock's total return is expected to be between 0% and 10%, (with higher thresholds for less liquid, more risky securities) over the next 12 months.

TENDER: Investors are advised to tender their shares to a specific offer for the company's securities or to support a proposed combination reflecting our view that a superior offer is not forthcoming.

REDUCE: The stock's total return is expected to be negative over the next 12 months.

SUSPENDED: Due to evolving circumstances, we can no longer generate what we consider a defensible target price and rating at the current time.

UNDER REVIEW: Our rating is under review pending additional information and/or analysis. The prior rating should not be relied on.

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Action Note

Equity Research

June 23, 2020

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