RESEARCH REPORT

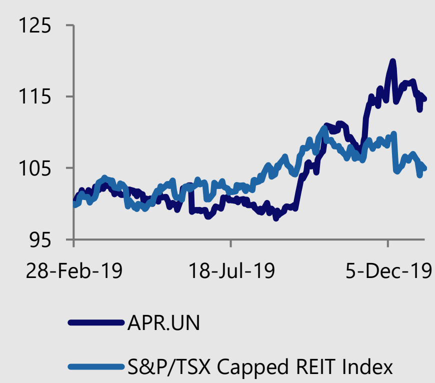
January 6, 2020

Stock Rating	BUY
Price Target	$14.28
Current Price	$12.11

Bear Case	Price Target	Bull Case
$10.83	$14.28	$15.71

Ticker	APR.UN
Market Cap (MM)	$456.5
P/FFO 2019E	13.0x
Dividend Yield	6.6%

52 Week Performance



Automotive Properties REIT

Vehicle for Success

As was mentioned earlier in the year, one aspect of the FIG team's strategy is to acquire greater exposure to cash flow driven investments instead of those based solely on share price appreciation. This same vein of thought led the FIG team to examine Automotive Properties REIT ("APR REIT", "APR", "the REIT"). APR REIT was first examined in 2017. However, QUIC never invested in the name. Due to its high yield and strong underlying market drivers, the FIG team has decided to revisit APR and determine if it is now more attractive than it once was.

To guide the analyses, the FIG team revisited the three theses posed in the original pitch:

I. Thesis I: First Mover Advantage Within Fragmented Market

II. Thesis II: Strategic Partnership With Dilawri Group

III. Thesis III: Low Risk, High Growth REIT With Attractive Yield

Finally, the valuation was considered in three ways. First, a dividend discount model was employed and yielded an implied share price of $15..14. Then, a standard NAV model was used to evaluate the underlying assets. This resulted in an implied share price of $10.83. Finally, the price to book value was graphed over time so that the valuation of the REIT relative to itself could be evaluated.

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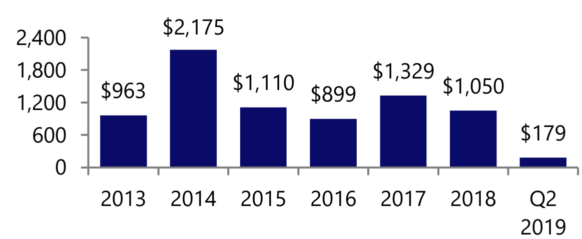
Automotive Dealership Industry Overview

Over the past two decades, the Canadian automotive industry has seen significant growth as well as changes to the competitive landscape. In 2017, ~58% of all new-vehicle sales in Canada were controlled by large auto dealership groups, compared to only 9% in 2000. These auto dealership groups own dozens of locations and sell various brands of vehicles, representing consolidation in the industry as more single-store owners exit the business. The number of ownership groups with at least five stores has increased at a CAGR of 9.2% from 27 in 2000 to 121 in 2017. There are currently ~3,600 automotive dealerships throughout Canada, typically located in close proximity to large urban centres and customer bases.

EXHIBIT I

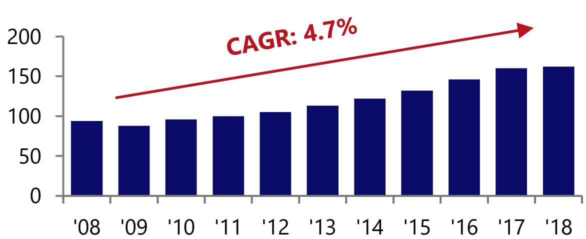
Publicly Disclosed Dealership Transactions in North America (C$MM)



Source(s): MNP Corporate Finance

EXHIBIT II

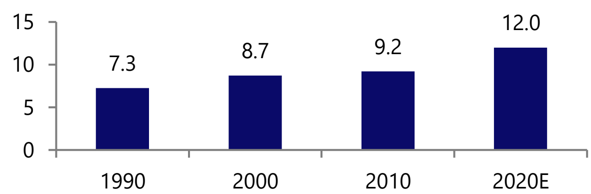
Retail Automotive Sales in Canada (C$B)



Source(s): APR Investor Presentation

EXHIBIT III

Average Age of Vehicles on Roads in Canada



Source(s): AIA Canada

According to the Canadian Auto Dealers Association (CADA), ~35.0% of all auto dealerships are located in or within close proximity to Canada's six largest markets: Vancouver, Edmonton, Calgary, Toronto, Ottawa, and Montreal (VECTOM). Changes in consumer preferences towards purchasing new cars have fueled dealership sales and location growth over the past few years, but the market remains in the early stages of consolidation. Over the past few years, changes in demographics, technology, and consumer preference have influenced the performance of various dealerships. Trends such as electric vehicle ownership, which is expected to reach 120 million vehicles globally by 2030, as well as the ability to purchase cars online or through alternative means has been creating challenges and opportunities for auto dealerships.

There are a number of structural barriers that limit entry into the Canadian auto dealership real estate market. Dealerships are typically operated under franchise agreements with original equipment manufacturers (OEMs). These manufacturers are brands such as General Motors, with high exclusivity rights creating barriers to becoming a licensed auto dealer. OEMs prefer to give franchise contracts to existing operators, as there are extensive capital requirements necessary to enter the auto space. This is the main reason why the REIT structure is suitable for this industry, as auto dealers can grow their dealership base while deploying less capital.

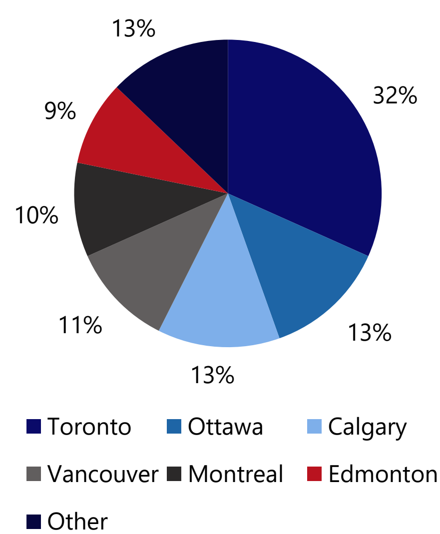
Automotive Properties REIT Overview

As was the case back when the legacy Cash Yield team pitched it back in 2017, Automotive Properties REIT (TSX:APR.UN) continues to be the only public vehicle focused solely on consolidating automotive dealership real estate in Canada. The business model that APR employs involves buying the underlying real estate from car dealerships where the owner requires liquidity either for succession planning, retirement, or expansion of the business. Because of the difficulty involved in finding a new tenant or moving a dealership to a new property, a symbiotic relationship is formed between the landlord and the tenant. This results in APR holding one of Canada's longest weighted-average lease terms of 13.5 years and leases that are structured as triple net leases, reducing costs for APR. As of Q3 of 2019, the REIT manages 2.3 million square feet of gross leasable area ("GLA") spread across 61 properties. Automotive Properties REIT has seen aggressive growth over the past five years since its IPO, increasing its number of properties by 32.

This expansion has led to not only greater geographic diversification, but also greater diversification of brand exposure.

EXHIBIT IV

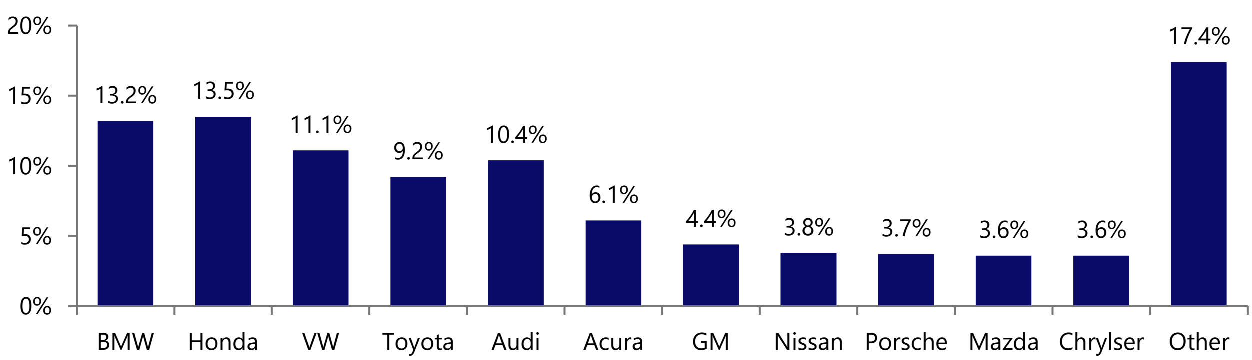
Annualized Minimum Rent By City



Source(s): RBC Equity Research

EXHIBIT V

Automotive Properties REIT Exposure by Brand Type



Source(s): Investor Presentation

Automotive Properties REIT Overview

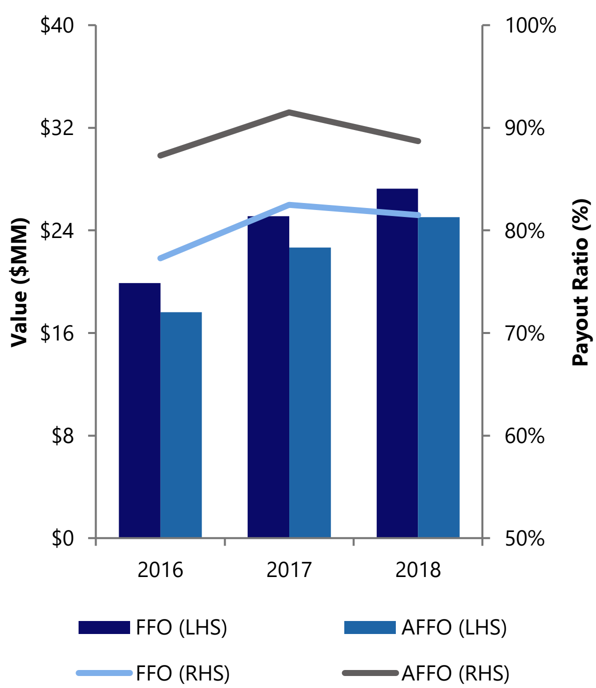
It is also important to note that this growth has not been dilutive to APR's performance. Since inception, AFFO per unit on a diluted basis has remained steady at ~$0.90.

A defining feature of Automotive Properties REIT is its close relationship with the Dilawri Group ("Dilawri", "the Group"). The Dilawri Group is Canada's largest auto dealership developer, and its relationship with Automotive Properties REIT dates back to its IPO. Because Dilawri required a strategic partner, APR REIT was created. For that reason, at its IPO, 100% of APR REIT's properties were leased by Dilawri dealerships. This relationship with Dilawri is ongoing, as Dilawri continues to hold a significant 26.2% effective interest in the REIT. What has changed in this relationship is that today, only 63% of APR's properties consist of Dilawri dealerships and only 59% of APR's cash NOI is now derived from the Dilawri group. This diversification is a strong signal, as the tenant concentration and potential conflicts of interest were key risks in QUIC's original 2017 pitch.

In summary, APR continues to be a first-mover in the Canadian auto dealership space and operates favorable leases as it steadily becomes a more diversified REIT.

EXHIBIT VI

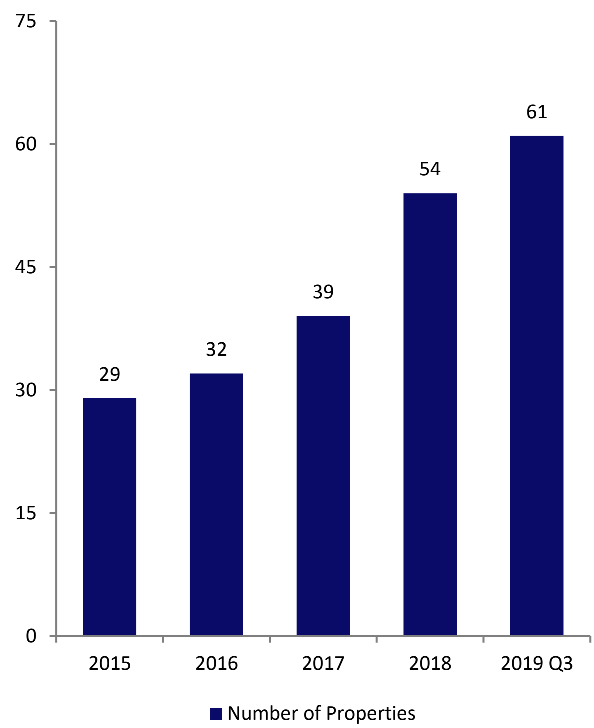
FFO, AFFO, and Payout Ratio



Source(s): APR Investor Presentation

EXHIBIT VII

Growth in Number of Properties



Source(s): APR Filings

Thesis I Revisited: First Mover Advantage Within Fragmented Market

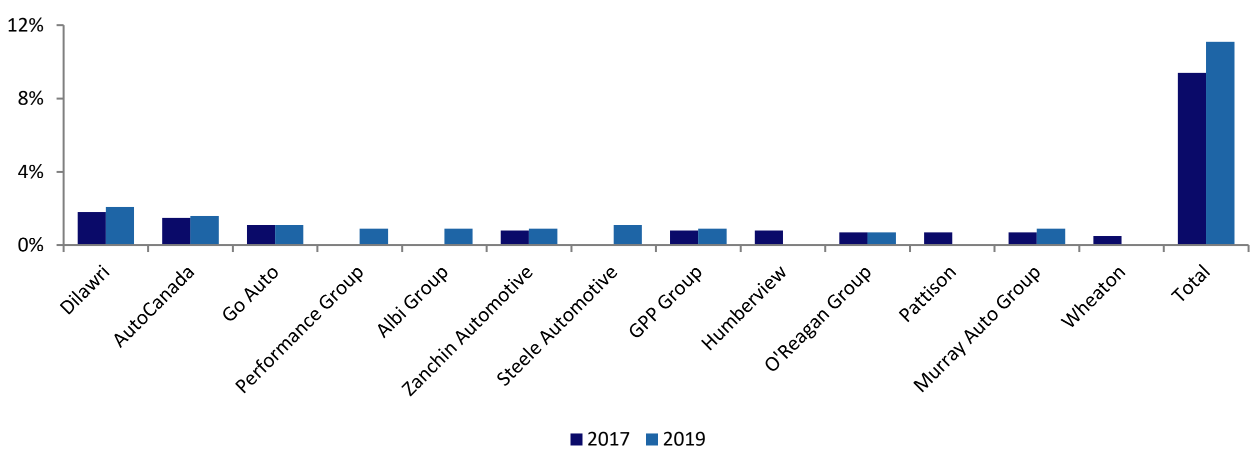
When Automotive Properties REIT was first pitched, it demonstrated an ability to consolidate the fragmented auto dealership property industry. As mentioned, APR is still the only REIT that is focused on consolidating properties in the auto industry. There has been significant consolidation in the dealership business in the last few years as smaller, family-owned businesses have sold out due to market competition or buyouts. In 2017, 58% of new vehicles were sold from franchised dealerships, up from only 9% in 2000. A major driver of this trend is that the average age of owner-operators is nearly 60 years of age and are looking to sell to a larger company rather than pass it down to their children.

Although the auto industry has seen minor consolidation from larger players like Dilawri and AutoCanada, the many smaller dealerships that are the majority of the market. 50% of companies own one dealership, 35% of companies own five or more dealerships and 15% of companies own 2-4 dealerships.

Even though consolidation has picked up since APR was first pitched, the FIG team still thinks that there is a runway for growth. As the Dilawri company grows it will serve to benefit APR. As seen in Exhibit VIII the industry is still quite fragmented, even though consolidation of the dealerships has been increasing. Considering that APR is the only REIT that focuses on buying the individual properties, it still has the first-mover advantage and will be able to capitalize going forward. Since 2017, APR has been able to grow the number of properties it owns and its GLA (sf) by over 50%. The dealership market as a whole has stayed relatively similar throughout this time as approximately 90% of the dealerships are owned by small or family businesses.

EXHIBIT VIII

Top Ten Auto Dealerships Make up Roughly 10% of Total Market (2017 vs 2019)



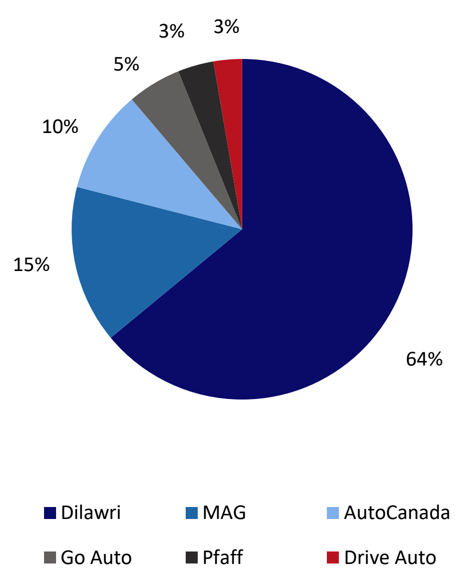
Source(s): Automotive News Canada, S&P Capital IQ, APR Reports

Thesis II Revisited: Strategic Partnership with Dilawri Group

When APR first became publicly listed in 2015, it entered into a Strategic Alliance with the Dilawri Group that would benefit both companies. APR has the right to purchase any property in Canada or the United States acquired by a member of the Dilawri Group. Additionally, the Dilawri Group has a right of first offer to purchase any property owned by APR in which the Dilawri Group is a tenant. This agreement is valid so long as the Dilawri Group has at least a 10% ownership in APR. Currently, the Dilawri Group owns approximately 30% of APR. The Dilawri group is the largest auto-dealership in Canada, owning 72 dealerships. For context, the next largest companies, AutoCanada and GoAuto own 57 and 40 respectively. By having the Strategic Alliance with Dilawri, it gives APR a growing pipeline to which they have the first right to purchase each property.

EXHIBIT IX

APR Continues to Diversify Tenants



Source(s): APR Reports

As mentioned previously, the consolidation in the industry will help both firms. The Dilawri Group has grown its share of the total market to 2.1% from 1.8% in 2017. As the Dilawri Group increases its footprint, APR is supplied with a continuous pipeline of growth for future acquisitions. This year, APR has completed three acquisitions with the Dilawri group, increasing its scale even more. While leveraging its relationship with Dilawri to have a consistent stream of potential acquisitions, the REIT has also taken proactive steps to diversify its tenant base and geographic exposure by purchasing properties from Go Auto and AutoCanada and having locations in five Canadian provinces. APR has also diversified by car type; its dealership portfolio sells 32% luxury cars, 58% mass market and 10% ultra luxury.

At the time of the previous memo, APR and the Dilawri Group were entered into an Administration Agreement whereby, Dilawri was responsible for providing a CEO, CFO and Corporate Secretary, as approved by APR. In December 2019, APR announced its intention to terminate the agreement on December 31, 2019. This means that the executives will be directly employed by the REIT instead of Dilawri, internalizing the management team and further aligning them with APR's goals. The agreement was terminated because APR felt that it had enough experience in the automotive real estate industry since its IPO to be independent from Dilawri from a management perspective.

APR will continue to benefit from any acquisitions made by Dilawri, while the internalization of the management team into the REIT is an additional catalyst. Furthermore, the REIT has not been reliant on Dilawri for growth but has tapped into markets and tenants outside of the Dilawri universe. Until APR diversifies away from Dilawri, the partnership provides stability for APR into the foreseeable future.

Thesis III Revisited: High Growth REIT with Attractive Yield

Acquisition Ability

APR completed an $84 million equity offering in June 2019, which has allowed them to re-load the balance sheet. In October of 2018, the REIT conducted another $55 million equity offering. These offerings enable the REIT to pay down debt and gain competitive interest rates. APR currently has $417 million of outstanding long- term debt at an effective interest rate of 3.79%. One of the key metrics to assess debt includes the debt to GBV value which stands at 54.7%. APR's covenants dictate that debt to GBV must be below 60%, which aligns with management's target range of 55% to 60%. APR's EBITDA to interest expense has declined year over year since 2016 to 1.5 times today. APR's ability to increase debt at competitive rates and conduct equity offerings allows for continued acquisitions.

Proven Track Record of Growth

APR has focused on acquisitions since its inception in 2014. Tangible BV has increased from $8.6 million in 2014 to $252.5 million in 2018, an annualized CAGR of 133%. The growth in tangible BV has also led to growth in debt and TOI (Exhibit X).

Lease Maturities

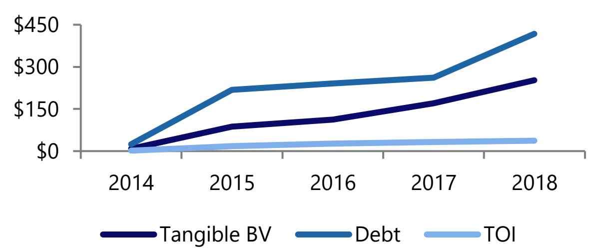
APR has a weighted average lease term of 13.4 years, which gives us confidence in the relatively new REIT. Only 2.3% cash NOI comes from leases expiring between 2020 to 2025, with the most significant expiry year being 2036, representing 14.6% of NOI.

Clear Benefit of New Acquisitions

APR's leases have basic escalators that allow rent to increase by 1.5% annually. In addition, most contracts are triple net leases, meaning the tenant is responsible for repairs, maintenance, realty taxes, property insurance, utilities, and non-structural capital improvements. Rent escalators flow directly into NOI as a result. New acquisitions will allow for additional revenue with higher margins, as scale provides for lower interest rates as well. Since 2016, the UFCF margin has increased to 61%.

EXHIBIT X

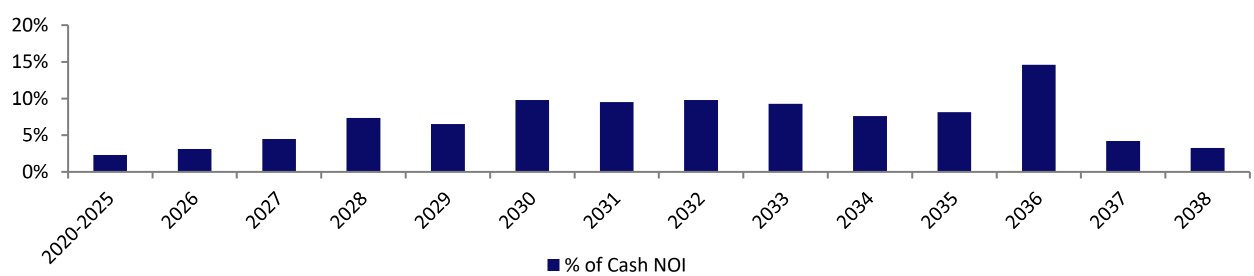
APR's Growth ($MM)



Source(s): APR Reports, Capital IQ

EXHIBIT XI

APR's Lease Maturity Profile



Source(s): APR Reports, Capital IQ

Valuation

Valuation was approached from multiple angles given the nature of the REIT. Given that the current payout ratio is under 100%, the FIG team felt comfortable with making a dividend discount model and holding the ratio consistent over the projection period. The revenue growth rate was held at 1.4% for the projection period based on APR's contractual lease increase allowances of 1.5% and a small discount for uncertainty. The terminal growth rate was 0% based on uncertainty after the 10-year projection period. The key attributes to sensitize against in the DDM includes the change in financing cost and the discount rate. A comparables analysis was conducted, but it was not included given the lack of close competitors to APR. However, most small-cap REITs trade at higher price to FFO multiples than APR, because they have an internal management team.

However, APR has stated that management will be internalized when its market capitalization reaches $500 million or by mid-2020. This measure was hard to quantify and includes uncertainty, but it could provide APR with significant multiple expansion in the coming months.

EXHIBIT XII

APR Model Assumptions and Output

BTB REIT DDM Assumptions and Output	
Terminal Year Distributions	$28,721
Expected Distributions Growth	0.00%
Discount Rate	6.00%
Terminal Value	$478,678
PV of Terminal Value	$283,329
PV of Distributions in Projection	$196,996
Equity Value	$480,324
Units Outstanding at End of Projection	31,730
Implied Share Price	**$15.14**
Current Share Price	12.12
Implied Return	24.90%

EXHIBIT XIII

APR Model Sensitivity Analysis around Discount Rate and Change in Financing Costs

Sensitivities		Discount Rate				
		5.50%	5.75%	6.00%	6.25%	6.50%
Change to Weighted Average Interest Rate	0.03%	$16.19	$15.50	$14.86	$14.28	$13.74
	0.04%	$16.35	$15.64	$15.00	$14.41	$13.86
	0.05%	$16.50	$15.79	$15.14	$14.54	$13.99
	0.06%	$16.65	$15.93	$15.28	$14.67	$14.11
	0.07%	$16.81	$16.08	$15.41	$14.80	$14.24

Valuation

The stock price to book value analysis shows that the name varies between a 20% discount to book value and a 20% premium to book value – it is currently at a 11% premium, which could suggest waiting for the name to reach a better price. However, given the FIG team's confidence in the DDM, there is belief that the stock has upside at the current price. The NAV Model aligns with the chart analysis, displaying that APR is currently trading at a 15.73% premium to NAV.

EXHIBIT XIV

APR Stock Price Versus Book Value Per Share

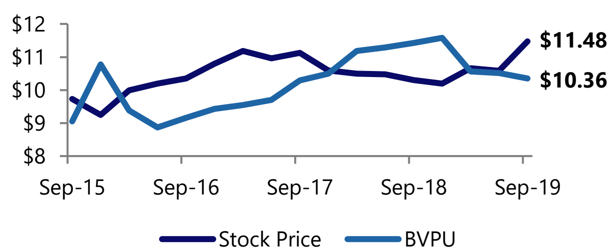


EXHIBIT XVI

APR's Premium or Discount to BV

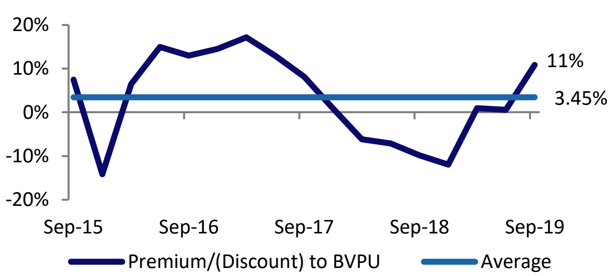


EXHIBIT XVII

Target Price Summary

Method	Weight	
DDM Implied Share Price	80%	$15.14
NAV Implied Share Price	20%	$10.83
Blended Share Price		**$14.28**
Current Share Price		$12.12
Implied Return		**17.8%**

EXHIBIT XV

APR NAV Model

NAV Model	
ASSETS	
Total Real Estate Assets	$870
Cash And Equivalents	$0
Other Current Assets	$2
Total Assets	**$872**
LIABILITIES	
Curr. Port. of LT Debt	$11
Curr. Port. of Cap. Leases	$1
Long-Term Debt	$422
Capital Leases	$7
Accounts Payable	$7
Accrued Exp.	$2
Other Current Liabilities	$3
Total Liabilities	**$453**
Total Equity	**$419**
Total Liabilities And Equity	**$872**
Shares Outstanding	39.98
Equity/Share	**$10.47**
Current Share Price	**$12.12**
Premium/Discount to NAV	**15.73%**
Average Premium to NAV	3.45%
Implied Share Price	$10.83
Implied Return	**(10.6%)**

Source(s): APR Reports, Capital IQ

Key Risk Explored: Ability of Tenants to Pay Rent

The biggest source of risk for APR is the ability of its tenants to pay risk. The Dilawri Group is APR's largest tenant, accounting for ~62% of the REIT's based rent for 2019. As of September 2019, APR's portfolio consists of 61 income-producing commercial properties. Of these 61 properties, 33 are exclusively occupied by the Dilawri Group, two are jointly occupied by the Dilawri Group and one or more third parties, and 26 are occupied by other dealership groups. When first pitched in 2015, there were two key risks related to APR's property portfolio: geographic concentration and tenant risk. The FIG team believes that APR has demonstrated its ability to manage risk. Since its IPO in 2015, Dilawri's share of base rent has decreased from 100% to 62% in Q3 2019.

Between 2018 and 2019, APR has increased its geographic base to Winnipeg and other areas in Ontario such as Ottawa/Kingston and KW/Guelph. The REIT has also increased its average rental rate from $24.70 in 2018 to $25.04 in 2019. The growth in geographies also reflects cyclical shifts for automotive brands. APR's properties are diversified among different automotive brands, with its largest tenant brand (Honda) making up 14% of the REIT's auto dealership rent. The diversification among both mass market and luxury brands contributes to the quality and stability of the REIT's cash flows as different brands experience different cycles due to economic conditions and marketed popularity.

In addition to APR's diversification in past years, the FIG team is also confident in the Dilwari Group's ability to pay rent. Dilwari's current rent coverage ratio (calculated as EBITDAR/Min. Rent Due) is at 3.4x, which has remained study for the past five years. This is on an EBITDA of $85.6 million for the year ended December 31, 2018. Finally, because a large portion of Dilwari's gross profit is due repairs, finance, and insurance, there is a degree of certainty that the group can make rental payments in the event of an economic downturn.

EXHIBIT XVIII

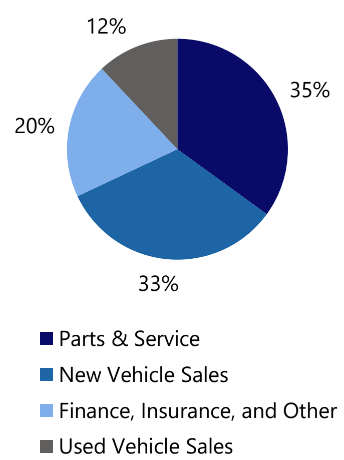
Income Producing Property Portfolio Summary

As of Sep 30, 2019	Number of Properties	GLA (sq.ft.)	Average Rental Rate (per sq.ft.)
Greater Vancouver Area (GVA)	7	176,871	$34.65
Calgary	6	271,350	$25.40
Edmonton	6	174,350	$29.79
Regina	8	183,941	$20.67
Winnipeg	2	96,135	$17.49
KW/Guelph	3	87,300	$21.47
Greater Toronto Area (GTA)	13	685,408	$27.34
Ottawa/Kingston	11	303,817	$24.00
Greater Montréal Area (GMA)	5	317,608	$18.61
Total Portfolio	**61**	**2,296,780**	**25.04**

Source(s): APR Filings

EXHIBIT XIX

The Dilawri Group Gross Profit Composition



Source(s): RBC Equity Research

References

1. AIA Canada
2. APR Filings
3. APR Investor Presentation
4. Automotive News Canada
5. Google Images
6. MNP Corporate Finance
7. RBC Equity Research
8. S&P Capital IQ