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Trial of endurance

"Buy fundamentally cheap securities," John Haskell, founder and CIO of the brand-new Atla Capital Global Urbanization Listed Fund, entreats his investors in a missive dated April 13. "Avoid high debt that can permanently impair equity. Steer capital toward productive uses. Diversify."

Excluding the last imperative, Haskell's wish list would seem to be a document from another age, or, at least, another country. In America today, blue chip stocks are trading at 37.5 times their cyclically adjusted price-to-earnings ratio, a level exceeded only during the heights of the dot-com boom. At 51.9% of GDP, corporate leverage is at its highest reading outside of a recession; for comparison, corporate indebtedness amounted to 43.1% of GDP on Dec. 31, 2007, the start of the financial crisis. And today's hottest investment assets are perhaps the least productive ones—non-fungible tokens and dogecoin come to mind. Successive waves of monetary and fiscal stimulus have so flooded American markets that even defaulted commercial real estate loans change hands at 100 cents on the dollar (*Grant's*, April 2).

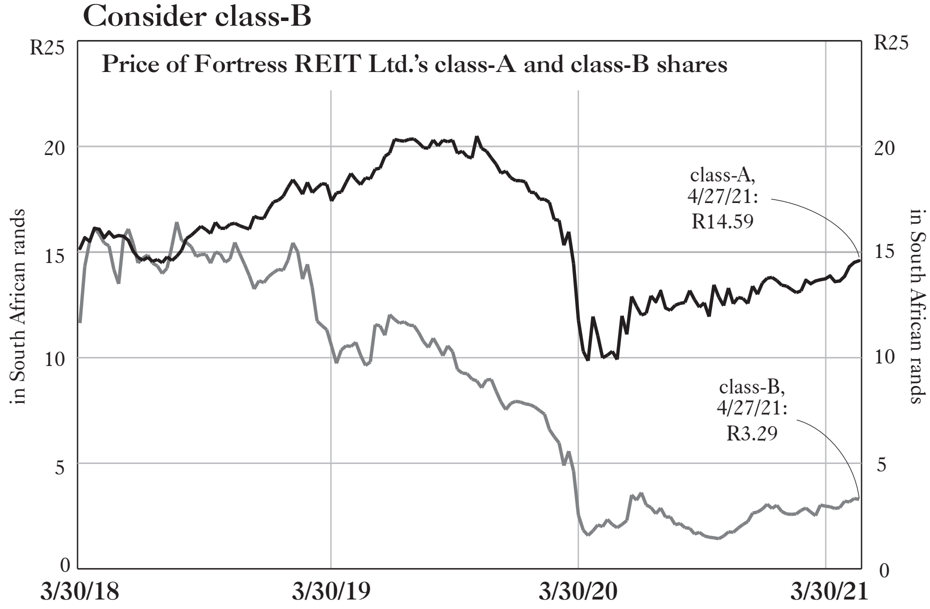
But Haskell, a former partner at Explorador Capital Management, a Latin America-focused investment partnership, is looking beyond the 50 states. Practicing what he preaches, he's combing the emerging markets for real estate-related securities that trade at commanding discounts to replacement cost.

City lights are Haskell's beacon. Let the West work from the fastness of its suburban houses. Most of the world's population growth will take place in developing cities. He quotes projections that, by 2035, Delhi (with a current metropolitan-area population of 29 million) will be the biggest metropolis, not Tokyo (now at 37.3 million). Population growth will support rising land values, denser construction and thriving property markets.

Covid-19 hit the developing world harder than it did the rich nations, but the developing world's monetary response was milder than the Fed's. In consequence, "[i]t is a buyer's market for listed real estate in emerging economies," Haskell writes, "where urbanization trends are strongest. [The fund's 15] positions have fallen 57% below three-year, dollar-measured highs on a weighted average basis. The invested portfolio trades at just 0.6x adjusted book and generates an estimated forward dividend of 7.1% on depressed current distributions. On normalized 2019 actual distributions, the invested portfolio would yield 15.6%."

Major real estate owners in the United States enjoy ready access to the capital markets, and they haven't hesitated to avail themselves of the leverage on offer. Component companies of the MSCI U.S. REIT Index showed an average debt-to-equity ratio of 100.5% at the end of 2020. In emerging markets, Haskell advises colleague Evan Lorenz, "real estate owners have less access to credit. As a result of that, in a real estate market downturn, you don't have as much distressed selling among private market participants as you might expect in developed markets. Public

Consider class-B



source: The Bloomberg

equities offer something different as they are subject to the same whims and flows of traders."

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In his April letter, Haskell detailed three investments to exploit this opportunity. First up is Fortress REIT Ltd. (FFB and FFA on Johannesburg), a diversified owner of logistics warehouses (31% of the portfolio value at year end), retail (55%), industrial (8%) and office properties (5%), both directly and through stakes in listed property securities. At 16.3 million square feet, the company's collection of warehouses is the largest in South Africa.

With a loan-to-value ratio of 38% as of Dec. 31, 2020, Fortress appears to be conservatively financed, but its capital structure is more complicated than it looks. There are two lines of common stock: class-A, which is entitled to a noncumulative, escalating dividend that grows at the lower end of the local inflation rate or 5%, and class-B, which gets any remaining income. "You have to put your arms around it," says Haskell. "In some ways, class-A is just like debt and provides a lot of leverage to B. But in other ways, class-A is like equity, and class-B isn't levered that much."

To preserve liquidity in the pandemic-induced downturn, Fortress canceled dividend payments on both kinds of stock. As the Bs don't get paid until the As have gotten their cut, this has weighed heavily on the junior tranche. The class-A shares trade, as we go to press, at a 113% premium to their net asset value, the Bs at just 35% of their NAV.

In reporting Dec. 31 results, Fortress projected a resumption of dividend payments after June 30. Assuming a 3.5% inflation rate, management estimates it will pay Zar 0.79 per share to the As and Zar 0.10 to the Bs. While this is a big decline from Zar 1.56 per class-B share payout in 2019 (a figure equivalent to 47% of the current B share price), a renewal of payouts might restore confidence in the junior share class.

Haskell finds value in the castaway B shares, and insiders at Fortress seem to agree. Over the past 12 months, executives have purchased a net $299,987 worth of the class-B shares and sold a net $216,839 worth of the class-A line. Of the four analysts who cover the B line, one says buy, another says sell and two say not much of anything.

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Next up is Atrium European Real Estate Ltd. (ATRS on Vienna), owner of retail real estate in Poland (64% of the portfolio), the Czech Republic (21%), Russia (10%) and Slovakia (5%). Showing a loan-to-value ratio of 38.6%, the company commands the humblest investment-grade debt rating, triple-B, from Fitch Ratings. The stock appears cheap at 66% of Dec. 31, 2020 net asset value and sports a 9.7% dividend yield.

Utter the words "shopping mall," and American investors see the specter of Jeff Bezos. However, while ecommerce is gaining market share from brick-and-mortar stores the world over, the United States is uniquely vulnerable to Amazon.com, Inc.-led disruption. Even now, according to a PwC report last year, there are more than 23 square feet of retail space for every American man, woman and child versus less than five square feet per resident of France, Germany and the United Kingdom.

Nevertheless, Atrium has taken steps to insulate itself from the trend toward online shopping. It has high-graded its portfolio to concentrate on prime assets in city centers, reduced the total number of its properties to 26 from 153 and altogether abandoned operations in the non-core markets of Hungary, Romania and Latvia.

"This shift to quality over quantity concentrates Atrium in the most economically vibrant and land-scarce urban markets, where convenience and experience-based retailing remains relevant," Haskell tells his LPs. "These downtown assets also offer something more: densification and diversification potential. Atrium plans to build adjacent rental residential complexes, starting with an 800-apartment development next to a key shopping complex in Warsaw, addressing demand for modern housing in the central city. The company targets 40% of total cashflows from internally developed residential projects by 2025."

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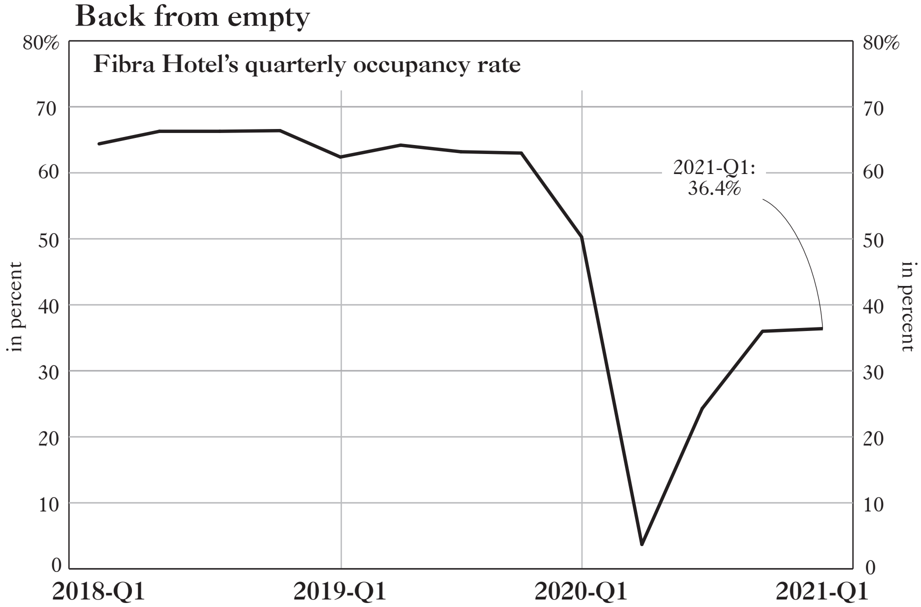
Back from empty



source: company reports

Haskell's final pick is an old and underperforming friend of this publication: Concentradora Fibra Hotelera Mexicana S.A. de C.V., a.k.a. Fibra Hotel (FIHO12 in Mexico). *Grant's* first sang its praises in the issue dated May 4, 2018, following which the REIT has returned negative 44.4% in dollar terms, including reinvested dividends.

Eighty-six Mexican hotels and resorts comprise the corporate portfolio, with a grand total of 12,558 rooms. Hotel manages properties under the Marriott, Hilton and local brands. It's the outright owner of Fiesta Americana Condesa Cancún, a resort which, unusually for Fibra, caters to international vacationers as well as domestic travelers. As of March 31, Hotel's loan-to-value ratio amounted to 30.4%.

As you can imagine, Covid-19 hasn't done the business any favors. Occupancy fell to 36.4% in the first three months of 2021, from 50.3% in the year-ago period. However, even this was a dramatic improvement from the 3.7% occupancy rate registered in the quarter ended June 30, 2020. Like Fortress, Hotel canceled its dividend last year and has indicated that it is not likely to resume it in 2021. (A new report from Grupo Financiero Banorte estimates that Hotel's payout, calculated on today's share price, will rise to 2.6% in 2022 and 15.7% in 2025 from nothing this year.)

The virus-led collapse in travel has had its familiar, salutary effect on valuation, at least. Hotel's debt and equity sum to $457 million, which capitalizes the business at $36,391 for each of its 12,558 rooms. Haskell reckons replacement cost at $93,000 per room.

"Management is substantially invested alongside minority shareholders for long-term gain," Haskell concludes his April letter. "Fibra Hotel's CEO Simon Galante holds approximately a quarter of outstanding shares and considers the REIT a tax-efficient structure to pass wealth to his children. Target returns for Fibra Hotel shares are a triple from current levels over the next five years, although COVID normalization may bring forward a substantial re-rating."

We asked Haskell, a Harvard man, why he named his fund "Atla." "It comes from the Proto-Indo-European root '*$telh_2$,' to endure, which is what any contrarian investor must do," he replied.

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