

Real Estate

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Industry Comment

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Real Estate

Real Estate: Target Buying Zellers Leases Likely Biggest Boon for Primaris

- ◆ This morning Target announced an agreement to purchase from HBC its Zellers leasehold interests in up to 220 of the 279 sites currently operated by Zellers. Zellers will sublease these sites from Target and continue to operate them under the Zellers banner for a period of time. Target expects to open 100 – 150 Target stores throughout Canada in 2013 and 2014 and will unload many of the other outlets to other chains (including Wal-Mart). Potential other interested parties that have expressed an interest into expanding into Canada but have found it difficult to find attractive retail space include Kohls, Marshall’s (owned by TJX which also owns labels such as Winners and Homesense), Dick’s Sporting Goods, and J Crew.
- ◆ While the Target transaction is not likely to impact cashflows on Zellers leased space acquired by Target for landlords directly (given that the weighted average lease terms for HBC where disclosed are north of 7 years and often include renewal options) the replacement of Zellers by a stronger tenant could significantly improve traffic to the shopping centres, ultimately resulting in more favourable rents from CRUs for landlords and increasing real estate values.
- ◆ The news is difficult to quantify based on current public information for retail landlords in our coverage universe as 20% of the Zellers leases will not be acquired by Target. While we believe the news is likely positive for those shopping centres where the Zellers leases will be acquired and likely replaced by a stronger tenant, for those shopping centres left behind this could ultimately result in store closures and given that Zellers is an anchor for many shopping centres this could mean decreased traffic for the less fortunate stores. Zellers leases carry obscenely low rental terms ranging from \$1/SF to \$7/SF so ultimately there does remain the possibility that in such a case landlords of the shopping centres left behind will have the opportunity to replace Zellers with tenants paying higher rent.
- ◆ Amongst our coverage universe the REITs with highest exposure and that we expect to benefit most from the news are Primaris, First Capital, and RioCan. We estimate the aforementioned REIT’s revenue exposure to Zellers at 3.1%, 3.2%, and 2.7% respectively (see Exhibit 1). However, we estimate the news to have a disproportionately large beneficial impact on Primaris who possesses the largest exposure of shopping centres as a percentage of their portfolio to Zellers as an anchor tenant (anchoring 31% of properties), presenting the largest impact on the overall portfolio from potential increased traffic a stronger anchor might draw. Assessing the downside – is there really? Management teams have often reiterated their belief that if they had the opportunity to take back Zellers leases that they believe that they could redevelop the space and re-lease the space at much higher rents and all 3 landlords certainly do have a successful track record on that front. Crombie is next in line with an estimated 1.8% revenue exposure to Zellers. Calloway, CREIT, and Cominar have nominal exposure. Exhibit 1 herein summarizes the estimated individual exposure of the aforementioned REITs to Zellers.

Company	Ticker Primary	Ticker Secondary	Current Price	Rating	Target Price (6-12 months)	Total Return To Target
<b>Retail</b>						
Calloway REIT	CWT.UN-TSX		C\$24.10	2	C\$25.00	18%
Crombie REIT	CRR.UN-TSX		C\$12.72	3	C\$12.50	8%
First Capital Realty	FCR-TSX		C\$15.05	2	C\$16.50	13%
Primaris Retail REIT	PMZ.UN-TSX		C\$19.40	2	C\$21.00	15%
RioCan REIT	REI.UN-TSX		C\$22.01	3	C\$23.00	7%
<b>Office/Diversified</b>						
Cominar REIT	CUF.UN-TSX		C\$21.06	3	C\$21.75	13%
CREIT	REF.UN-TSX		C\$31.80	2	C\$34.00	9%

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**Exhibit 1: REIT Exposure to Zellers Inc. as of 3Q10**

	HBC % of Revenues	# of HBC Stores	# of Zellers Banner	% of HBC Stores under Zellers Banner	Zellers % of Revenues***	% of Properties with a Zellers Tenant	Wtd. Avg. Lease Term
REI.UN	3.3%	40	33	83%	2.7%	11.1%	9.1**
PMZ.UN	6.9%	20	9	45%	3.1%	31.0%	7.6**
CRR.UN	2% *	8	7	88%	1.8%	5.3%	7.2**
FCR	3.8% ^	20	17	85%	3.4%	9.6%	7.4**
CWT.UN	3.0%	17	4	24%	0.7%	3.1%	9.1**
REF.UN	N/A	6	2	33%	N/A	1.3%	N/A
CUF.UN	1.2%	3	1	33%	0.4%	0.4%	N/A

## Legend:

N/A = Not available

\* All Zellers

^ Zellers/Home Outfitters

\*\* May include lease renewal options beyond lease term

\*\*\* Assumes similar rents paid across all HBC banners

Source: Company Reports, The Globe and Mail "Target, J Crew Among U.S. Retailers Interested in Canada" Jan-13-11

## Company Citations

Company Name	Ticker	Exchange	Currency	Closing Price	RJ Rating	RJ Entity
Dick's Sporting Goods Inc.	DKS	NYSE	US\$	35.42	3	RJ & Associates
J. Crew Group, Inc.	JCG	NYSE	US\$	44.05	3	RJ & Associates
Kohls Corp.	KSS				NC	
Target Corporation	TGT				NC	
TJX Companies Inc.	TJX				NC	
Wal-Mart Stores Inc.	WMT	NYSE	US\$	54.85	1	RJ & Associates

Notes: Prices are as of the most recent close on the indicated exchange and may not be in US\$. See Disclosure section for rating definitions. Stocks that do not trade on a U.S. national exchange may not be approved for sale in all U.S. states. NC=not covered.

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<b>Strong Buy and Outperform (Buy)</b>	72%	53%	49%	22%
<b>Market Perform (Hold)</b>	25%	40%	39%	12%
<b>Underperform (Sell)</b>	3%	7%	0%	17%

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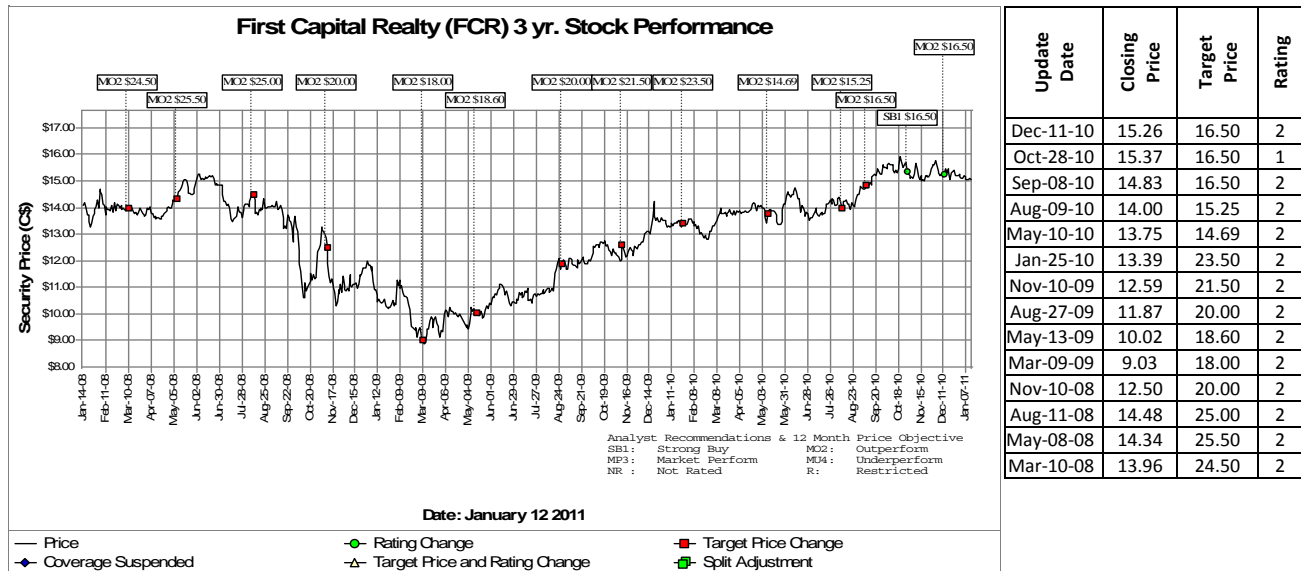
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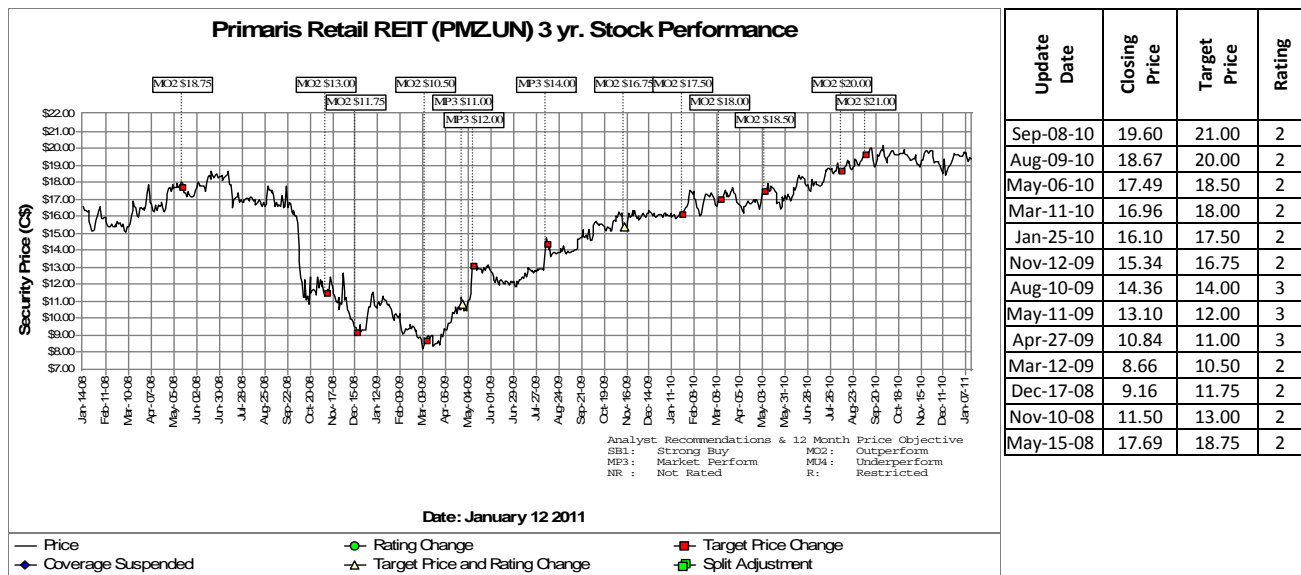
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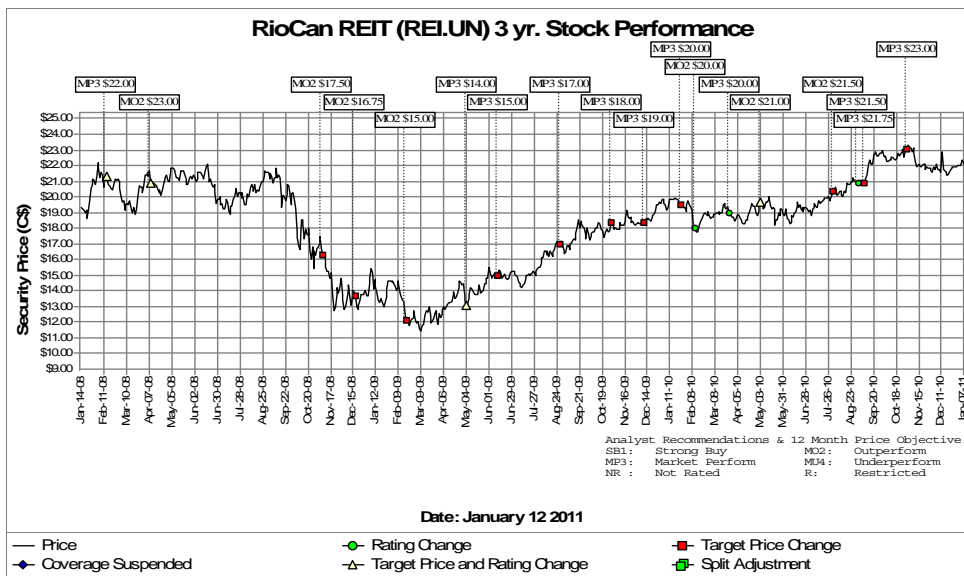
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**Valuation Methodology:** Our valuation methodology for Primaris considers a peer group multiple comparison and the stock's valuation as it compares to our estimate of net asset value (NAV).



Update Date	Closing Price	Target Price	Rating
Oct-29-10	23.05	23.00	3
Sep-08-10	20.85	21.75	3
Aug-31-10	20.88	21.50	3
Jul-30-10	20.40	21.50	2
May-03-10	19.70	21.00	2
Mar-24-10	18.99	20.00	3
Feb-10-10	18.03	20.00	2
Jan-25-10	19.48	20.00	3
Dec-09-09	18.36	19.00	3
Oct-29-09	18.34	18.00	3
Aug-27-09	17.00	17.00	3
Jun-11-09	14.96	15.00	3
May-04-09	13.11	14.00	3
Feb-18-09	12.15	15.00	2
Dec-17-08	13.72	16.75	2
Nov-06-08	16.25	17.50	2
Apr-08-08	20.90	23.00	2
Feb-13-08	21.29	22.00	3

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