Owens Realty Mortgage
(NYSE: ORM)
$16 per share
3/23/16

Trading at 64% of Net Asset Value and 82% of its current book value (which is substantially understated), Owens Realty Mortgage (ORM) offers an excellent risk/reward opportunity. With its high profile Miami condo project now under contract and its irreplaceable Tahoe project on the market to be sold, ORM could trade to $25 per share in the next 18 months.

When the Miami project is sold in the second quarter, the company will be flooded with the equivalent of nearly $4 per share in cash after paying off project related debt. The company should continue to buy back shares, could announce a larger buyback and will continue to grow their existing commercial lending business.

With a very conservative balance sheet and a profitable commercial lending arm, paying out a decent 2% yield, why not get paid while you wait for the company to trade higher as its Tahoe project is sold?

From a private commercial real estate fund to a public REIT

From 1998 to 2007, Owens was private mortgage fund, providing loans to developers as they worked on entitling and constructing their projects across the country. The company dutifully paid nice dividends of 8% a year to its private investors.

Then came the financial crisis and suddenly the private fund had lots of loans that were delinquent. The fund foreclosed on the loans and had no income coming in to pay their yield loving investors. With few alternatives, the fund decided to convert into a REIT and go public in May of 2013 to provide liquidity for their investors. The goal of the conversion was to eventually sell the properties while the company slowly returned to its commercial real estate loan business.

For two years, per REIT conversion rules, they could not sell any assets, but that changed in May of 2015.

Owns substantial property holdings after the financial crisis

There have been two principal assets that dominate the underlying value of ORM. The first property is its Miami condo conversion project called Treasures on the Bay that is right on the water. There are two towers and ORM has had to renovate the second tower for the past 18 months to get it into sellable condition. In March, the company announced that it had an agreement to sell the property. The other big asset, is the company's Lake Tahoe property.

Tahoe Potential

With the recently announced agreement to sell the Miami project, the company can focus on its prime jewel Lake Tahoe project called Chateau at Lake Tahoe that is at the foot of the Heavenly ski resort in Lake, Tahoe, CA.

While the Miami sale is a nice win for the company, the Tahoe project represents even more upside for company. The company carries the three phases of the project at a carrying cost of $59 million. But its tax basis is materially higher at $70.8 million and there was an appraisal done in 2009 that indicates the entire project is worth approximately $105 million.

Tahoe, like many other areas of prime real estate in California, is extremely hard to get new entitlements. Considering zoning challenges, the lack of land and excellent location of the Tahoe project, it is hard to imagine that it is worth less than its tax value, or that this tax value hasn't gone up significantly in value in the last several years.

The demand to live in this Chateau project is high. How do we know? Check out the website for the first phase of luxury condos called Zalanta:

http://www.zalanta.com/

In December, company started taking deposits for the first 30 condos, and as of two weeks ago 25 of the luxury condos had reservations.

The company is proving out the value that this is not just a conceptual project anymore. There is a ton of value for ORM shareholders hidden inside this property.

Other Properties

Owens updates a detailed presentation of its property holdings on their website with the latest presentation posted here:

http://www.owensmortgage.com/Cache/1001208331.PDF?Y=&O=PDF&D=&FID=1001208331&T=&IID=4381096

Starting last year, the company has been on a selling spree including selling property in Greeley, Colorado, Phoenix, Arizona and Stockton, CA. While the company has been focusing on their easiest to sell properties first. It's important to note that the sales have been at big increases over book value. Just one property sale alone in Paso Robles, CA announced on January 6th increased book value $0.45 per share to $19.48 per share.

Miami Under Contract

The big recent news that provides an excellent catalyst is the company's announced agreement to sell its Miami condo project for $82 million. If you assume that there are transaction costs of 3%, and understand that ORM owns 80.74%, the company will receive $64.2 million in cash. After payment of project related debt, the company should see proceeds of approximately $41 million, or $4 per share.

Also, the company has been carrying the value of this asset on its books for $51.9 million, so the increase to its book value will be approximately $1.21 per share, bringing book value to $20.69 per share. This means the company only trades at 77% of its book value.

Growing profitable loan book

With the successful sales of the company's properties, it has been rapidly returning to its roots and growing its commercial lending book. Just in the last year, loans have increased from $68 million to almost $107 million.

Further, the company announced in March that it increased a line of credit from $30 million to $50 million, with an option to further increase it to $75 million.

With a California focus (77% of loans are in California), the company's primary areas of focus are office and apartment buildings, followed by loans in retail, hotel and storage. The company's major areas of focus are ones that should see years of demand and tailwinds to support loan growth and low delinquency.

Valuation

The valuation is compelling with little downside now that the Miami sale has been announced. Once the sale is consummated, the company will have a book value of approximately $20.70 per share. But this doesn't include the fair market value the company's Tahoe project or other properties.

If we assume that Tahoe is worth $100 million to ORM, the company's net asset value would be approximately $25 per share, meaning the company sells for 64% of its NAV.

Stock Buyback

The company has been an active buyer of its stock and its share count has decreased almost 1 million shares from 2013 to 10.2 million shares at last count. With the big sale of Miami soon to close, I expect there to be a lot of pressure from the company's two big shareholders, Freestone Capital and Nantahala Capital Management to get more aggressive with the share buyback. The most recent one announced was for $7.5 million in January. With the company selling at such a discount to book and NAV, a buyback could create significant upside to the price target as NAV per share could go up quite quickly depending on how many shares the company bought.

Summary

With a low amount of leverage, several catalysts looming and the stock selling for a significant discount to NAV and book value, ORM offers an excellent risk/reward opportunity to investors. ORM offers investors an investment with little downside and 50%+ upside, and you get paid a small dividend while you wait for the value to unfold.