



Is RioCan Real Estate Investment Trust Too Overvalued to Buy Today?

Description

There is no disputing the quality of **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)). It's widely known as the finest REIT in Canada, and for good reason.

It starts with the company's collection of property. With more than 320 different shopping destinations across Canada and the United States, RioCan has successfully diversified itself across North America. Its holdings aren't tiny strip malls either; chances are you've shopped at one of its large outdoor retail facilities.

Additionally, RioCan has done a nice job diversifying itself against tenant risk. The recent announcement of **Target's** Canadian division shutting its doors is a great example. Not only did Target only represent 2% of RioCan's total square footage, but the company has already gotten commitments to fill up some of Target's soon to be vacated space, with companies like **Wal-Mart** seizing the opportunity to expand.

Additionally, RioCan has another wildcard working in its favour. The company has recently started a project where it builds condos on its existing property. It finds a little extra space, and instead of building out, it builds up. This allows it to build condos considerably cheaper than traditional builders, since the fixed cost of the land, utilities, and road paving are already in place. These condos are also proving popular places to live because of proximity to retail stores and public transit.

But while I'm a fan of RioCan, there's one thing I'm not a fan of, and that's the company's valuation.

How much should you pay for quality?

As Warren Buffett has famously said, we should all be looking for wonderful companies trading at fair prices, rather than fair companies trading at wonderful prices.

But thanks to the **Royal Bank of Canada's** recent interest-rate increase, the value of most REITs have popped to a new high, as investors are willing to settle for less yield. Does this mean investors are paying a higher valuation as well?

Upon closer inspection, it turns out that RioCan is trading at about a five-year average, at least from a price-to-funds from operations (FFO) metric.

Year	Trailing FFO	Price Range	Average P/FFO
2015	\$1.65	\$26.72-\$30.08	17.2
2014	\$1.56	\$24.51-\$27.90	16.8
2013	\$1.47	\$23.55-\$29.19	17.9
2012	\$1.43	\$25.75-\$28.80	19.1
2011	\$1.33	\$22.33-\$26.90	18.5

RioCan is currently at 18x its FFO, which is a little on the expensive side compared to its recent history, but only slightly. There were buying opportunities in the past couple years that do appear to be more attractive than today's price, but overall I'd say RioCan is fairly valued.

But what about on a yield basis? That's when it gets a little more tricky.

Year	High Yield	Low Yield	Average
2015	5.3%	4.7%	5.0%
2014	5.8%	5.1%	5.5%
2013	6.0%	4.8%	5.4%
2012	5.4%	4.8%	5.1%
2011	6.2%	5.1%	5.7%

This is where RioCan starts to look a little more overvalued. The company's dividend is currently 4.75%, which is about as low as it's been in the last five years. Investors looking to get a 5.5% yield on RioCan would have been able to do so as recently as December, and the yield went even higher back in September.

There's one caveat when it comes to looking at the dividend—RioCan can always increase it. The company's payout ratio is currently 85% of FFO, which is the lowest it's been for years.

Should long-term holders care?

If you're looking to buy RioCan today and hold for a couple of decades, does all this stuff really matter? RioCan is the cream of the crop after all.

That's true, but it's also really easy to find better value in a competitor. Take **Calloway Real Estate Investment Trust** (TSX:CWT.UN) as an example. The company has a current yield of 5.2%, and trades at a 15.7x its FFO, compared to RioCan's 18x valuation and yield of 4.75%. Calloway's main

tenant is Wal-Mart, which is actually a plus, since it brings in plenty of foot traffic to filter over to other retailers.

If rates stay low and RioCan can continue to grow its funds from operations, look for the stock to slowly move higher. But it's unlikely that the stock will ever trade at much higher valuations. Thus, investors should prepare themselves for solid returns from this company, but nothing spectacular.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:REI.UN (RioCan Real Estate Investment Trust)
2. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)

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