Forget REITs: Here's How to Own Real Estate on the Cheap

Description

Everyone wants to own real estate: commercial, residential, you name it; people keep talking about it.

Things have gotten so ahead of themselves in the residential market the federal government is cracking the whip, introducing new rules to ensure that people who have insured mortgages of any kind can actually afford them should interest rates rise.

These are crazy times indeed.

On the commercial front, real estate investment trusts have seen good times in recent years with the **iShares S&P/TSX Capped REIT Index Fund** beating the TSX in seven out of the 11 past years with some of the top REITs in the XRE trading near 20 times earnings.

While I wouldn't say things are out of control like the prices for Vancouver and Toronto single-family dwellings, investors concerned about getting value in their investments might want to consider this alternative.

Buy **Hudson's Bay Co.** (TSX:HBC) stock.

That's right. Canada's oldest company and largest operator of department stores. It's the same company that, in early September, reported a second-quarter loss of $142 million. With retail in bad shape both in Canada and the U.S., I'll grant you it's a contrarian move, but it's one worth making. Here's why.

Veteran portfolio manager John Zechner appeared on *Business News Network* this summer. His top pick: HBC, whose department store brands include the iconic Hudson's Bay, Saks Fifth Avenue, Lord & Taylor, and Galeria Kaufhof.

Ever since Executive Chairman Richard Baker convinced **Target** to pay $1.8 billion for 220 Zellers leases in 2011, I was a fan. It worked out badly for Target and its Canadian employees, and that's never a good thing, but you can't help admire his business acumen. Zellers was broken and he knew it, yet he managed to extract real value for shareholders.

Let's fast forward to today.

HBC's net income on an IFRS basis shows a second-quarter loss. However, when you take out interest, taxes, depreciation, and amortization as well as rent, you get adjusted EBITDAR of $263 million, or 8.1% of retail sales–210 basis points higher than in Q2 2015. For fiscal 2016, HBC expects adjusted EBITDAR to be $1.6 billion, or 10.7% of its $14.9 billion in annual sales. That's about the same percentage as a year earlier.

So, that tells investors that store profitability isn't deteriorating despite the challenging retail conditions.

That's important why?

Zechner estimates that HBC's real estate assets are worth $30 per share–almost double its current stock price. That means investors are valuing its actual retail operations at negative $13 per share. That might be reasonable if its adjusted EBITDAR was negligible, but it's closing in on $2 billion.

Sure, it's spending a lot of money opening and remodeling stores in a very competitive retail environment, but when was the last time you can remember a Canadian company opening retail stores in mainland Europe? How about never?

These are exciting times for HBC, and while many of its moves have yet to hit pay dirt, I believe they eventually will. In the meantime, a 1.1% yield isn't half bad, considering the potential upside from its real estate holdings.

Bottom line

You can buy **RioCan Real Estate Investment Trust** (TSX:REI.UN) and get a 5.5% yield on your investment. This is from a stock that's currently within 14% of its all-time high and has never traded over $31 in its 20-year history as a public company.

Or you can get the same amount of real estate exposure on a per-share basis through HBC with an equity kicker through the upside potential of its operating retail business.

Unlike **Sears Holdings Corp.**, HBC's real estate is not the key to its survival–but it sure helps.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

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