RioCan Real Estate Investment Trust or Hudson's Bay Co: Which Is the Better Buy?

Description

At first glance, there's nothing these two companies have in common. One owns and develops real estate; the other sells fashion. Sure, their paths cross, but other than that they play in different sandboxes competing against much different animals.

RioCan Real Estate Investment Trust (TSX:REI.UN) competes against other REITs, both those specializing in retail real estate and those diversifying into other areas such as offices, industrial and multi-family to name a few. It's the largest REIT in this country.

Hudson's Bay Co (TSX) competes against other department stores and specialty retailers in Canada, U.S., and elsewhere. It also competes against **Amazon.com, Inc.** (NASDAQ:AMZN), the champion of online retail and the fourth-largest stock traded on a U.S. exchange.

Those are its differences. But consider what makes them similar.

- They both are currently valued at 1.1 times book. That's important because Hudson's Bay is considered the weaker of the two when it comes to generating profits — HBC's P/E ratio is almost double that of RioCan — but clearly investors value them the same when it comes to the equity in each business.
- In the latest fiscal year, Hudson's Bay generated adjusted EBITDA of $781 million; RioCan generated adjusted EBITDA of $649 million in the same period. Sure, RioCan's figure was on revenues of $1.1 billion while HBC's was from $11.2 billion but they were similar.
- HBC has long-term debt of $3.3 billion which is 26% of its total assets while RioCan's long-term debt is $7.4 billion or 38% of its total assets. Their capital structures right down to the assets owned, debts owed and equity held are virtually the same.
- They're both substantial landlords. RioCan owns 46 million square feet of net leasable area; HBC owns or controls almost 50 million square feet of gross leasable area. Convert the HBC square footage to usable space and the real estate holdings are almost identical.
- They're in bed together. In February 2015, RioCan and HBC announced that they were forming a joint-venture real estate partnership to create a one-of-a-kind real estate portfolio. Eventually, RioCan will get a 20.2% interest in the partnership with Hudson's Bay owning the rest.

If you're an income investor there's question that RioCan's monthly distribution, which works out to a yield of 5.3% compared to Hudson Bay Company's 1.2% yield, is the better call.

But consider a few things before diving head first into RioCan and taking a pass on HBC.

- Portfolio managers value HBC's real estate holdings at $30 or more per share. That's almost double its share price and higher than RioCan's.
- With the introduction November 8 of HBC's brand new $60 million e-commerce warehouse in Toronto, the company's made a statement that it's serious about its global online business.

Recent acquisitions such as the $250 million deal to buy Gilt Groupe have HBC ideally positioned to grow its digital business around the world.
- HBC majority owner Richard Baker has done a wonderful job reviving the company. Five years ago it had revenues of less than $4 billion. They're now tracking near $14 billion on a 12-month basis. All you need to do is go to the Saks/HBC combo store in downtown Toronto and take in the Christmas windows to know there's a different vibe coming from the retailer the company these days.
- HBC wants to be a global retailer. It's yet to touch Asia or South America. Both are ripe for the taking. Baker's not done making acquisitions and the best part is he knows how to quickly reduce the debt used to make those buys.

Most importantly, HBC is eventually going to create the mother of all REITs, where the real estate is separately owned from the retail operations. When that happens you'll know Baker is comfortable with the retail standing on its own two feet. It will happen sooner than you think.

HBC is the better buy.

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