How to Make Money Off This Oversold Real Estate Stock

Description

About a week ago, I happened to notice that **First Capital Realty Inc.** (TSX:FCR) was one of five stocks appearing on the *Globe and Mail's* weekly oversold list.

A stock is considered oversold when it drops below 30 on the Relative Strength Index (RSI), an indicator that technical analysts use to figure out the best time to buy.

If you're a value investor, an RSI below 30 can be a sign a stock is undervalued and worth some consideration. Of course, it could also mean the company's story has broken down, and investors are running away from its stock as fast as they can.

Which is First Capital?

In my opinion, it is undoubtedly the former rather than the latter.

First Capital Realty is one of Canada's biggest owners of retail-focused urban real estate with 161 properties across Canada and 23.6 million square feet of space for lease.

As a result of its high-quality retail real estate portfolio, strong balance sheet, and over $1 billion of real estate development planned over the next few years, First Capital's stock has delivered an annual total return of 9.3% over the past 10 years — 90 basis points higher than its S&P/TSX Capped REIT peers and 510 basis points higher than the S&P/TSX.

In the past two years, it's experienced outstanding growth in both net asset value per share and funds from operations per share — up 19.8% and 17.2%, respectively, on a cumulative basis — and yet its stock is up just 8% since the end of 2015.

I've been very positive about First Capital since April 2017 when I recommended investors buy it rather than the larger and better-known retail real estate owner, **RioCan Real Estate Investment Trust**, so it's very disappointing to see it stalling so badly.

REIT headwinds

It's been a while (April 2018) since I recommended First Capital stock or even talked about it, for that matter. I thought I'd explore how investors can use beaten-down REITs to their advantage.

First of all, REITs in general aren't doing nearly as well in 2018 as they did the two previous years thanks to jitters over rising interest rates.

While there's not much that First Capital can do about rising interest rates, Warren Buffett would tell you that some of the best investments are made when investors are fearful. I don't think REIT investors are fearful just yet, but they're certainly getting more anxious.

Recently, First Capital announced a couple of acquisitions that should help grow its income in the years ahead.

First, it's paying a total of $102 million for 2.1 acres of mixed-use development property in midtown Toronto that's a 30-second walk from my old dentist. That's going to be a gold mine. Second, it paid $44.4 million for 60% of the Hazelton Hotel in Toronto's trendy Yorkville neighbourhood. Close to some of its other retail properties in the area, it's redeveloping; adding a hotel to the mix will drive hotel guests to its nearby shopping.

If you know Toronto well, you know First Capital's properties are top of the line.

How to play its stock

Over the past five years, it's spent most of its time trading in a tight range between $18 and $20. Only once did it move out of that range — July 2016 — when it hit above $23. Otherwise, like clockwork, it's traded between $18 and $20.

First Capital pays annual dividends of $0.86 for a current yield of 4.3%. Accept the fact for the next five years that you might only make 4.3% annually until some of its development properties come on stream and the rents start rolling in.

In the meantime, build a stash of cash to buy its stock every time it drops below $19.50; it's done that four times since the beginning of 2015.

By the time 2023 rolls around, you'll have a lot of shares bought at sub-$19.50 prices, higher dividends, and I'm guessing a higher share price.

In the case of First Capital, a falling stock price is a very good thing.

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