The Real Estate Consolidator You Want to Own

Description

First Capital Realty (TSX:FCR) is an excellent retail real estate owner, operator, and investor that's having a bad year, down 6% year to date through September 26.

Meanwhile, the **First Asset Canadian REIT Income Fund** — First Capital is the fifth-largest holding at a weighting of 4.19% — is up 8% through the same period. Several of the ETF's top 10 holdings are some of my favourite TSX stocks, First Capital included.

The company announced its second-quarter earnings August 1. First Capital's results checked all the right boxes: Funds from operations (FFO) in the quarter grew 12% year over year, its same property occupancy increased 100 basis points to 96.8%, and the same property net operating income increased by 4.2%.

Unfortunately, because the fair value of its properties didn't increase as much in Q2 2018 as they did in Q2 2017, its net income dropped by $190 million, or $0.76 a share. There's really no way to candy coat a 70% decline in earnings.

However, it's important to note these gains and losses will change dramatically from quarter to quarter based on the changes in fair values; it's equally possible that next quarter the company could see a 70% increase in earnings as a result of larger year-over-year increases in the fair value of its properties.

What's most important here in terms of financial indicators is FFO. By that metric, the business is doing just fine.

Consolidating neighbourhoods

To successfully own First Capital stock, it helps to understand its business model and strategy for growing its real estate assets.

First Capital is all about building vibrant shopping neighbourhoods by consolidating the real estate in those areas. Because many of its long-term projects are in urban areas with older properties owned by many different entities and individuals, it's not something that can be whipped together in six to 12 months.

It takes years of working with owners to persuade them that the company's vision for a shopping area is a good one. Remember, many of the people it's trying to buy from are generational investors who tend to hold real estate for decades, not years.

It takes time.

"If I look at Yorkville or Liberty Village, we put together strategic pieces of real estate which some people, when we bought them, wondered why we'd buy those things," Gareth Burton, First Capital's senior vice president of construction and real estate recently told *Retail Insider*. "Places like Yorkville Village, Liberty Village, Mount Royal West are organic neighbourhoods where we have a much bigger vision. It could be 20 years of gestation and in the end we would have something very, very special."

Keep the big picture in mind

A lot of investors who invest in publicly traded real estate companies tend to gloss over the properties in a portfolio, preferring to get a handle on whether the company's dividend payments are sustainable based on its ability to increase its funds from operations year after year — and there's nothing wrong with that — but numbers never tell the entire story.

First Capital is playing the long game with its real estate development. In my experience, it's the only way to generate outsized returns on investment. Short-term thinking, as we see CEOs do all the time in order to please shareholders, leads to mediocre returns.

One need only look to Warren Buffett and **Berkshire Hathaway** to understand this is a cardinal rule of investing.

Buy on the dip

In July, I'd suggested that investors buy FCR stock every time it drops below $19.50. As I write this, it is below that bugaboo.

First Capital's business model is a winning one. Buy on the dip.

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1. Investing

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