Can RioCan (TSX:REI.UN) Protect Itself From Amazon (NASDAQ:AMZN)?

Description

RioCan (TSX:REI.UN), once the largest shopping mall real estate investment trust (REIT) in the country, has seen its price plunge from over $30 two years ago to just over $24 today. That's a correction of over 20%.

RioCan is at the epicenter of a global shift in retail. All of its malls and commercial properties are now caught in the event horizon of a black hole known as **Amazon.com** (NASDAQ:AMZN).

Earlier this year, the trillion-dollar e-commerce giant announced an expansion in Canada, with accelerated hiring and investments starting in Vancouver. This expansion of e-commerce across Canada could replace bricks with clicks, which is likely to have a direct impact on RioCan's assets.

Approximately 30% of RioCan's revenue comes from retail giants like **Cineplex**, **Walmart**, and **Dollarama**. All of these companies are in the cross-hairs of Amazon. Dollarama's stock is already down 34.5% year to date. Dwindling mall traffic and retail sales will trickle down to RioCan's books eventually.

It's not like the management is asleep at the wheel. In an interview with the *Financial Post* earlier this year, RioCan founder Ed Sonshine said the team was busy divesting and trying to get smaller to face off competition. The REIT is selling off properties and trying to shift its focus to mixed-use real estate in Canada's top markets.

It's on track to sell over $2 billion (US$1.6 billion) worth of properties soon. By the end of this divestment drive, nearly one-third of RioCan's assets (100 properties) will be sold.

This releases cash flow that can be reinvested in mixed-use properties that combine the lucrative rental yields of commercial properties with the stability of residential ones. It's what the company calls "RioCan Living." The company is eyeing 10,000 residential units across Canada.

In my opinion, this journey from retail to mixed-use is unlikely to be smooth. There's plenty of demand for residential units right now, but the economy is on shaky ground, and Canadians already have a hefty mortgage burden. Couple that with the rising interest rates, and you can see why this planned move makes me uneasy.

Higher interest rates usually have a negative impact on the bottom line of rental development companies. Any sudden shock to the economy could sour this market quickly. It's also a market with long lead times, where even the biggest players could take years to gain regulatory approvals.

However, a combination of experienced management, good cash flow, reasonable valuation, and attractive dividends make this an interesting investment opportunity. RioCan currently trades at 98% of its book value and offers a 5.85% dividend yield. The price-to-funds-from-operations ratio (P/FFO) is attractive at just 12.66.

RioCan is trying to do the best it can to ward off the threat from Amazon and a decline in mall traffic over the next decade. The company is simply responding to where the demand is, but interest rates and economic volatility could close this window of opportunity soon, and the management needs to move as quickly as possible.

If you believe management can successfully pull off its shift in strategy, this may be a great time to take a closer look.

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