It's Time to Invest Alongside These 2 Stocks

Description

What do you do when you're a company with a significant shareholder that wants to sell?

Well, if you're **First Capital** (TSX:FCR) or **Aritzia** (TSX:ATZ), you buy back your stock at a reasonable price.

Aritzia's long-time partner exits

In the case of Aritzia, it recently bought back $107 million of its stock (average price of $16.90) from Berkshire Partners, its private equity sponsor, who first invested in the women's retail chain back in 2005. An additional $330 million in stock ($16.90 a share) was sold to a consortium of Canadian banks with Berkshire Partners and director Aldo Bensadoun sold approximately 19.5 million shares.

When the buybacks were first announced, Aritzia's share price fell on the news. However, once investors realized that Berkshire's exit eliminated the uncertainty hovering over Berkshire's sale — 14 years is a much more extended investment period than a typical private equity transaction — its stock has gone on a 15% run.

Last July, I said that Aritzia stock could hit $20 by the end of the year. It came within $0.21 in early November before falling back into the mid-teens. With the Berkshire exit behind it and a business that's operating at a very high level, I would be shocked if ATZ wasn't trading above $20 by the end of the summer, let alone the end of the year.

By utilizing some of its free cash flow to buy back its stock, Aritzia CEO and controlling shareholder, Brian Hill is killing two birds with one stone. Not only is he providing a long-time partner with a profitable exit strategy, but he's also doing so in an accretive manner.

That's smart capital allocation — the key to any successful business.

What about First Capital?

I've been a fan of First Capital's real estate business for some time. I first recommended its stock in April 2017, suggesting that it was a better real estate investment than **RioCan**, a real estate investment trust (REIT) specializing in retail properties. Of course, since then, both companies have focused on their urban properties.

However, in the case of First Capital, two things held back its stock price.

The first headwind was the company's corporate structure. It wasn't a REIT, which excluded it from REIT indices, funds, etc. In February, First Capital CEO Adam Paul announced that it would convert to a REIT.

"Becoming a REIT will provide us with a number of advantages … We believe this will initially represent several million shares of additional demand at the time or near the time we convert," Paul said at the time. "Second, the conversion to a REIT will enhance comparability to our peers, virtually all of which are REITs. And finally we will be able to deliver the benefits of our business to our investors in a more efficient manner."

In the two months since the announcement, FCR stock has gone sideways. Long term, the removal of this headwind will be positive for the company's shareholders.

The second headwind is one I discussed this past December.

First Capital was 31.3% owned by Israeli real estate company **Gazit-Globe**, which only trades on the Tel Aviv Stock Exchange after delisting from the TSX and NYSE in March.

Investors were cautious to buy into First Capital knowing that it was operating under the thumb of its largest shareholder. Gazit-Globe was moving toward direct real estate ownership rather than through minority investments like First Capital, making FCR stock a bit of a lame duck in the eyes of institutional investors.

Enter the share buyback.

First Capital bought back $742 million of Gazit-Globe's stake and sold the remaining $453 million stake to the public at a 4% discount to First Capital's share price when the deal was announced.

Although Gazit-Globe retained a 9.9% interest in the company, First Capital no longer has the ownership uncertainty hanging over its stock.

As First Capital continues to transform its real estate portfolio to one that is super-urban in focus — 300,000 people within five kilometres of its properties — the company's buyback will turn out to be an excellent investment in three to five years from now.

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