



## Hudson's Bay Co Shares Surge 20%: Why There's Still More Upside Potential

### Description

After months of teasing from **Hudson's Bay Co.** (TSX:HBC) senior management, the company finally took the first step to unlocking the value from its massive real estate holdings.

Essentially, the deal works like this. The company entered into two separate joint ventures: a Canadian one with **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)) and a U.S. one with **Simon Property Group Inc** ([NYSE:SPG](#)). HBC is pledging a total of 10 of its Canadian properties—including flagship stores in Vancouver, Calgary, Ottawa, and Montreal—to the Canadian joint venture, which will be worth \$1.7 billion. The U.S. joint venture will be worth \$2.1 billion, which includes a total of 42 properties, including Saks' flagship store in Beverly Hills. Together, the two joint ventures are worth \$3.8 billion, and Hudson Bay will retain an 80% interest in both.

Keep in mind that the U.S. joint venture doesn't include two of the company's more prestigious pieces of real estate, the Saks Building in New York City—which is possibly the finest piece of retail real estate in the world—and The Lord and Taylor building just a few blocks away. Together, the company values those two buildings at \$5.4 billion.

After today's transactions, here's a summary of HBC's new position in regards to its real estate portfolio:

- 80% interest in two joint ventures worth \$3.8 billion
- 100% interest in two buildings in New York, worth \$5.4 billion
- Cash generated from the two joint ventures worth \$1.1 billion

To summarize, HBC exchanged \$1.1 billion for approximately 10% of its real estate. The current total value of the company's real estate is above \$9 billion, aided by the decline in the Canadian dollar compared to the U.S. greenback.

### What's next?

Ultimately, the goal of these two joint ventures is to create two separate REITs, one catered to Canadian investors, while the other would trade in both Canada and the U.S.

But first, the two joint ventures will look to make a few strategic acquisitions to “fatten up” the portfolio of each, according to Richard Baker, Hudson’s Bay executive chairman. They’ll use the equity in the current buildings as a way to leverage up and buy more, utilizing the expertise of the REIT partners to manage the whole operation.

The downside to this plan is that it could take a while. An analyst interviewed on BNN estimated the REIT process could take as long as three to five years to play out. These two new REITs are big enough that they could spend billions collectively on acquisitions, which doesn’t happen overnight.

Hudson’s Bay plans to use the majority of the proceeds from the transaction to pay down its debt, which currently stands at \$2.4 billion. This creates financial flexibility the company can either use to expand operations aggressively, or to make another acquisition.

### **What should you do?**

Although shares of the company surged 20% upon the news, I still think they’re undervalued. This is only the first step in the value-creation process.

After the \$1.1 billion is applied to debt, the company’s enterprise value will be approximately \$6.2 billion, and it’s projected to earn \$600 million in EBITDA in 2014. As it stands right now, that’s a reasonable valuation for a retailer.

But it still values the real estate at practically nothing. Remember, HBC still owns approximately \$8 billion worth of real estate. The real estate is still worth more than the company’s entire retail operations, even after a 20% surge in the value of the stock.

Unfortunately, the next step is going to take a little while longer. It’ll take years before the rest of the value is unlocked and the two joint ventures are ready for IPOs. Thus, I see the stock being flat for months, barring any positive news on the joint-venture front.

I think the next three to five years will prove to be profitable for long-term shareholders, which is why I’ll continue to hold my shares. For investors who are more short-term focused, I understand the desire to take profits, especially if the name Hudson Bay Co. remains dead money for the next few months.

### **CATEGORY**

1. Investing

### **POST TAG**

1. Editor's Choice

### **TICKERS GLOBAL**

1. NYSE:SPG (Simon Property Group, Inc.)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)

**Category**

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