Should Investors Buy Hudson's Bay Co. on News of a Possible Macy's Inc. Deal?

Description

Hudson's Bay Co. (TSX:HBC) surged February 3 after *The Wall Street Journal* reported the beleaguered iconic Canadian retailer is in talks to acquire **Macy's Inc.** (NYSE:M).

The market appears to like the idea, but there is reason for investors to take a step back and think this one through before buying the stock.

Why?

Hudson's Bay has already made big acquisitions in the space with its purchases of Lord & Taylor in 2012 and Saks in 2013. Those deals haven't helped investors very much, as Hudson's Bay's stock is now trading near a five-year low and has fallen more than 60% since mid-2015.

It's not hard to see why there has been so much pain.

Department stores are not exactly enjoying rapid growth these days. In fact, large retailers are in full-blown retreat as more consumers do their shopping online.

In 2016, **Walmart**, **Target**, **J.C. Penney**, **Sears**, and **Kohl's** closed hundreds of locations in an effort to focus resources on their most profitable outlets.

Macy's has also struggled and announced last August that it would close 100 of its stores. The stock initially rebounded on the plan, but it has come under increased pressure in early 2017 after releasing weak holiday sales numbers that came in at the low end of previous guidance.

How bad is it?

Macy's originally expected full-year diluted 2016 earnings to be US$3.15-3.40 per share. In the January 4th statement, Macy's said the final results will come in at US$2.95-3.10.

That’s not very encouraging, and the company said 2017 is likely to see comparable sales trends similar to the 2016 November/December stats, which means a drop of more than 2%.

This stock is down more than 50% since the middle of 2015.

Is a deal good for Hudson’s Bay investors?

Macy’s is much bigger than Hudson’s Bay. At the time of writing, the American retail giant has a market capitalization of more than US$10 billion as compared to less than $2 billion for Hudson’s Bay.

The Canadian company could leverage its massive real estate portfolio to come up with the money needed to pull off a deal, but things would have to turn around quickly afterwards.

Should you buy the Bay?

Fans of Hudson’s Bay say the company’s value lies in its real estate. That might be true, but buying a company for the value of its buildings rather than the quality of its business isn’t a great long-term investment strategy.

Hudson’s Bay significantly reduced its 2016 guidance in November and again in early January, citing weak sales across the business. The company now expects to report sales of $14.4 billion for full year 2016 as compared to guidance of $14.9 billion in November and $15.9 billion in September.

The bottom line?

The department store sector is in trouble, and there is little evidence to suggest the situation is going to turn around anytime soon.

As such, I would avoid Hudson’s Bay and instead look for businesses that are leaders in a growing market.

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