



Sears Holdings Corp. or Sears Canada Inc.: Which Is the Better Buy?

Description

The headline is not a joke.

Analysts in the U.S. were expecting **Sears Holdings Corp.** (NASDAQ:SHLD) to report a Q4 2016 adjusted loss of \$2.85 per share; it came in at \$1.28 — much better than expected — sending SHLD stock soaring up more than 5% in early trading. North of the border, **Sears Canada Inc.** (TSX:SCC) was also up more than 5% on the news.

Should speculative investors be jumping in to the fray?

Is either stock worth owning at this point? Clearly, both have been severely beaten down in recent months. Is there enough meat on the bones at either retailer to justify placing a bet on their respective futures?

Here's how I see things.

Sears Holdings

Investors need to take the fourth-quarter earnings beat into perspective. Yes, Sears did beat analysts' \$2.85-per-share adjusted loss by 55.1%, but before you break out the bubbly, it's important to remember that this estimate is based on the data from just two analysts. By comparison, **Macy's** currently has 22 analysts providing earnings estimates. Those numbers are going to be far more reliable.

The other thing to remember is that on a GAAP basis, Sears lost US\$2.2 billion in fiscal 2016 — double its loss in 2015. On a non-GAAP basis, it lost US\$887 million, US\$166 million less than in 2015, but that's still a significant number.

On an adjusted EBITDA basis, Sears lost US\$808 million in the past 12 months on US\$22.1 billion in revenue. That's a margin of -3.7%; in the same 12 months last year, its margin was -3.3%. The dollar value might be lower, but the margin is higher. That's never a good thing.

Meanwhile, here in Canada, **Hudson's Bay Co.** (TSX:HBC) expects adjusted EBITDA in 2017 upwards of \$700 million, significantly better than Sears. Given HBC has its own issues to deal with, it should give you some indication how dire Sears's financial position is despite its Q4 earnings news.

Sears Canada

It's been more than two years since Sears Holdings sold a big chunk of its ownership in Sears Canada — in March 2014, Sears Holdings owned 51% — through a rights offering that transferred ownership of Sears Canada from the parent to Edward Lampert, the controlling shareholder of Sears Holdings.

It's a subtle difference that allowed Sears Holdings to raise US\$380 million in much-needed cash while retaining effective control through Lampert's investment firm, ESL Investments. Today, ESL Investments owns 45.3% of Sears Canada's shares and Sears Holdings owns 11.7% — enough to maintain control.

As a result of both companies' deteriorating businesses, their respective stocks have lost significant value since the rights offering. Sears Canada's market cap at the end of 2013 was \$1.3 billion; it's now \$181.4 million. Sears Holdings's market cap was US\$5.2 billion; it's now US\$859.4 million. This puts their very existence in jeopardy but provides speculators with a fantastic opportunity to play both sides of the street.

Like Sears in the U.S., Sears Canada is trying to sell everything it owns that isn't nailed down. On March 1, it announced the sale and leaseback of its National Logistics Centre for \$50 million — cash it certainly can use.

In the first nine months of fiscal 2016, Sears Canada saw revenues drop 17.2% and operating losses increase by 95.2% over the same period a year earlier. While the company continues to work on rightsizing its business, like Sears Holdings, investors have begun to wonder about its future viability given all the better options available to Canadian shoppers.

Altman Z-Score

If you've never heard of the Altman Z-Score, it's a mathematical formula used to assess a company's financial health.

Recently, I did this calculation for Sears Holdings, and it came out to 1.01; any score less than 1.80 indicates bankruptcy could be in the cards within the next 12-24 months.

So, how did Sears Canada do? It has a score of 2.62; anything between 1.8 and 3.0 suggests there could be problems ahead, but bankruptcy isn't imminent.

Bottom line

Those long on Sears Holdings argue that its real estate — though it's sold off a lot — makes it worth more than \$8 per share. Sears Canada doesn't have that to fall back on with most of its prime real estate already sold.

However, simply from a financial position, if I were to speculate on one of these stocks, which I wouldn't, I'd have to go with Sears Canada. Financially, it's in a much better way.

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