Hudson’s Bay Co. to Spin Off Real Estate, Finally

Description

The stock prices of many high-profile retailers across North America have taken large hits of late. From **Lululemon Athletica Inc.** to Canada’s own **Hudson’s Bay Co.** (TSX:HBC), Q4 2016 results have been dismal. With severe competition eating into retailers’ bottom lines, traditional bricks-and-mortar retailing is struggling.

Property assets of retailers hindered by poor operations

The old ways of doing business, finding a good location, setting up a retail store, and raking in meaningful profits, seem to be a thing of the past. **Amazon.com, Inc.** and other online retailers have offered consumers newer and faster ways to shop and have been taking a toll on discount and premium retailers alike. With the bleeding unlikely to stop, retailers have gotten strategic with how they restructure their assets.

Separating the real estate portfolio of a large retail chain from the underlying retail business is one of the ways management teams of chain businesses have been able to maximize value for shareholders.

Oftentimes, large retailers with valuable portfolios of real estate find themselves in situations where the underlying value of the real estate is devalued due to the relatively poor operating results of the retail business. By separating the real estate holdings of the retailer from the retailing business, the market can provide a better (potentially higher) cumulative valuation for both the real estate portion and operations portion of the businesses.

Pundits may argue that a real estate portfolio, even if separated from the underlying retail operations, is only as good as the tenant, and therefore if the tenant fails or has poor operational performance, the REIT is likely to suffer as well. This argument holds some water; however, it is true that the majority of the real estate holdings held by HBC are unique and not likely to sit on the market for very long should HBC become distressed, making these assets prime candidates to be rolled into a REIT.

Bottom line

The decision to separate HBC’s real estate portfolio from its underlying business was well accepted by the market on Wednesday; the company's stock price appreciated nearly 8% on the news. The stock price appreciation was also fueled by the results of an operational review, which resulted in an announcement of a round of sweeping cuts to contain costs moving forward as a defensive move.

The CEO of HBC made it clear that the proposed $75 million in operational cuts along with $150 million in capital-expenditure cuts is not necessarily something the company needs to do, but it's something the retailer is doing to prepare for worst-case scenarios and potential further deterioration in the retail market.

I believe the future for HBC's new REIT to be very bright, if and when the roll out happens. In the meantime, it appears the market has priced much of the excess value of the real estate portfolio back into the business on the speculation of the proposed REIT, so I remain cautious on HBC.

Stay Foolish, my friends.

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