Hudson's Bay Co. Stock Is Worth $31

Description

He's a bit of an outlier, but **Bank of Montreal** (TSX:BMO)(NYSE:BMO) analyst Wayne Hood has a 12-month target price of $31 and an "outperform" rating on **Hudson's Bay Co.** (TSX:HBC) stock. That's considerably higher than the $14.35 consensus among the 12 analysts making a forecast on the company's share price.

Before you dismiss the target out of hand, it's important to note that Hood has a good reputation as a retail analyst. He's often quoted in national publications in both Canada and the U.S and was the top-ranked sell-side analyst [Multiline Retail category] for stock picking in the 2014 **Thomson Reuters** Analyst Awards. He won the same prize three years earlier.

So, he knows a thing or two about retail.

But forget Hood's pedigree for a moment and just consider the idea of HBC stock trading at $31. What does it have to do to get there in the next 12 months, or ever, for that matter?

Here are three things Hudson's Bay needs to do to if it wants to reach $31.

Retail REIT

The idea of Hudson's Bay doing a REIT has been on the table ever since it entered two real estate joint ventures valued at $4.2 billion with **Simon Property Group Inc.** (NYSE:SPG) and **RioCan Real Estate Investment Trust** (TSX:REI.UN) in February 2015.

Baker himself instigated the idea.

"I am very pleased to announce that we have partnered with Simon and RioCan to create joint ventures with mandates to grow our real estate presence and strengthen our retail banners," said Baker back in 2015. "By partnering with industry leaders, we have created two tremendous real estate vehicles for growth. Importantly, we have retained the flexibility to create REITs at a future date of our choosing."

Canadian Tire Corporation Limited and **Loblaw Companies Ltd.** have both benefited from spinning their real estate assets into publicly traded REITs — July 2013 for Loblaw and October 2013 for Canadian Tire — and investors have been after Hudson’s Bay to do so ever since.

The company estimates its real estate to be at $35.24 per share. A deal by fall would likely add several dollars to its share price. It’s got to happen before the end of 2017. If it doesn’t, you can forget $31 by next summer.

Fix off-price woes

Hudson’s Bay bought flash sales site Gilt Groupe for US$250 million in early 2016. Once valued at more than $1 billion, it announced a non-cash goodwill impairment charge of $116 million in the fourth quarter, suggesting the company severely overpaid for Gilt.

The company’s off-price business, which includes Gilt Groupe and Saks Off 5th, had terrible holiday results with comparable-store sales down 5.9%. Consolidating the e-commerce sites of both online businesses will certainly help drive revenue numbers, but it’s doubtful the company can deliver enough growth to justify the price it paid for the flash sales site.

At the very least, it needs to get Saks Off 5th at or near positive comparable store sales in both the U.S. and Canada. To that end, it’s currently revising the discount store’s product mix to reflect higher average prices and should be completed by the end of October.

We’ll know by then if it’s been successful.

Make money

More than anything, making money would drive its share price higher. Much higher!

However, if you take out gains from real estate transactions related to its joint ventures, etc., Hudson’s Bay hasn’t had an annual operating profit since fiscal 2014.

It is planning to cut $75 million in annual expenses in fiscal 2017 and will reduce its capital expenditures this year by $150 million. Both of these will certainly help, but it’s got to do more regarding controlling expenses and generating higher-margin revenue in 2017.

Otherwise, it’s got no hope of testing $20, let alone $31.

Bottom line

The rollout of a REIT in fiscal 2017 should be enough to move Hudson’s Bay’s stock price into the mid-teens, perhaps even higher. Unless Hudson’s Bay lays a significant egg this year concerning losses, I don’t see a huge risk in owning its stock right now.

That’s because any downside on the income statement should be balanced out by delivering on the REIT promises.

Will it hit $31 in the 12 months? There's about a 5% chance, maybe less. Now, if we're talking about $20, that's a whole different ball game.

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Date
2025/08/25
Date Created
2017/05/08
Author
washworth