The New Way to Make Money in Retail … Allegedly

Description

The news that shareholder activist Jonathan Litt of Land & Buildings has taken a position in Canadian retailer **Hudson's Bay Co.** (TSX:HBC) has come to light. The new investor, similar to others in his position (south of the border), is making a demand: unlock value through the real estate holdings.

While this approach may not seem consistent with the way things were done in the past, it is important to note that while the traditional business of the retailer has declined, the real estate owned and occupied by these big-box retailers can be monetized for shareholders. **Sears Holdings Corp.** (NASDAQ:SHLD) led by Eddie Lampert has taken this very approach.

For those wanting to take this approach, the real estate assets must be separated from the activities of the day-to-day business.

In the case of Sears Holdings Corp., the assets were spun into a separate company called **Seritage Growth Properties,** which is owned by the same shareholders as the retailer. From then on, the retail company becomes a tenant and pays rent to the landlord.

Although this may not seem to unlock any value, it must be noted that separating the two companies will make it easier to redevelop the square footage not being used.

Seritage Growth Properties has been far more successful in taking the big-box retail square footage and slicing it up into smaller pieces, thereby increasing the revenues per square foot quite substantially.

In Canada, we could compare this to split shares, essentially allowing those who want to invest in the retail business the ability to do so without the real estate holdings. This allows investors like Jonathan Litt to enjoy the real estate value. Those not wanting to go along for the ride, of course, have the ability to sell the shares of either business.

In the case of Hudson's Bay Co, it is important to consider the cash flow statement, which will show the breakdown of the daily retail operation in addition to the funds used in long-term capital expenditures, which essentially puts a roof over the retail operation (quite literally).

For fiscal 2016, the total cash flow from operations (CFO) at Hudson’s Bay was $312 million. Capital expenditures were in excess of one billion, while depreciation was just shy of $700 million. Clearly, more money is going into the real estate than is coming from the day-to-day operations of the company.

Although most retail investors do not always appreciate the involvement of an activist, it is important to at least consider any plan put forth for a struggling operation.

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Date
2025/08/20
Date Created
2017/07/17
Author
ryangoldsman