Prem Watsa Continues to Double Down on Retail

Description

He came. He saw. He conquered.

I'm talking about **Fairfax Financial Holdings Ltd.** (TSX:FFH) CEO Prem Watsa's $300 million bid for Toys "R" Us Canada — a move that keeps the 82 Canadian toy stores permanently open for business.

While the U.S. business is a mess and faces liquidation, the Canadian operation is profitable, holds 29% market share for toy sales in Canada, second only to **Wal-Mart**, and generates 14% of its annual revenue through its online website.

So, why was Fairfax the only bidder? Well, technically it wasn't.

Los Angeles-based billionaire Isaac Larian, the founder of Bratz dolls, bid US$215 million for the Canadian stores, but has decided to focus his efforts on the U.S. stores, satisfied with Fairfax's plan to grow Toys "R" Us Canada.

That's great news for employees, Canadian toy buyers, and, most importantly, Fairfax shareholders. Here's why.

Fairfax doubles down on retail

While the media continue to focus on the death of retail and run out of the fire, Fairfax continues to run into the fire, picking up good assets at cheap prices.

Fairfax is paying $300 million for Toys "R" Us Canada. The business owns 22 of its 82 stores, which are valued at $220 million. So, that puts the risk at about $80 million. However, Fairfax also has $70 million in net working capital, which means it's really only risking $10 million plus the capital required to improve the customer experience in-store.

"There's so much more that can be done if Melanie [Teed-Murch], the CEO, is given the earnings generated in the business to spend on bringing the business into the modern retail era," said Paul Rivett, president of Fairfax. "From a bricks-and-mortar perspective, think about young families with young kids and being able to make it more of a destination where the kids can be playing with Thomas the train, and the parents can be grabbing a coffee."

He's right.

Who gets excited about taking their kids to Wal-Mart to buy toys? Not many. Yet, it has greater market share in Canada than Toys "R" Us. That makes absolutely no sense. In the absence of good customer experiences, shoppers will opt for the best price, but give parents the opportunity to build memories with their young children, and price becomes secondary.

Fairfax's other retail investments

If you live in Toronto and shop at Yorkdale Mall, you can't help but marvel at the relatively new two-floor Sporting Life that's open in the section of the mall once occupied by Sears Canada. It's a showpiece that will generate huge revenue for Fairfax, as it continues to grow the sporting goods chain across the country.

Recently, I'd discussed the impact French sporting goods giant **Decathlon** will have on **Canadian Tire Corporation Limited** (TSX:CTC.A). What I failed to mention in my article was the inroads Sporting Life is making to chip away at Sport Chek's dominance in sporting goods retail. Together, Decathlon and Sporting Life are going to make life difficult for Canadian Tire.

Sporting Life is one of several retail businesses Fairfax owns. Others include William Ashley (china), Praktiker (home improvement) and Golf Town (golf retail).

Fairfax's non-insurance businesses (I haven't mentioned all of them by any means) generated $3.3 billion and $212.1 million in revenue and operating income in 2017. In 2012, its non-insurance businesses generated $864.2 million and $35.6 million in revenue and operating income, respectively.

Fairfax acquired 75% of Sporting Life in December 2011 for $31.5 million. At the time, it had approximately $100 million in revenue. In 2017, Sporting Life had revenue of $160 million, a compound annual growth rate of 8.2%.

I'd guess Fairfax's $32 million investment in Sporting Life is worth close to $100 million today — not bad for one of its first forays into retail.

Bottom line on Toys "R" Us acquisition

Fairfax has learned a lot in the past six years, which will help as it moves to reshape Toys "R" Us in Canada.

If you're a Fairfax shareholder, you ought to be very happy with Prem Watsa's latest move. It's a winner.

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