Hudson's Bay Co. eyes launching REIT 'some day in the future'

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Bloomberg The company owns or controls 11-million square feet of retail space in Canada.

TORONTO — Hudson's Bay Co. could eventually seek more value for its shares by creating a real estate investment trust, chief executive Richard Baker said Tuesday as the company reported a third quarter loss in its return to the public markets.

But the possibility of such a move, similar to that announced by grocer Loblaw Cos. last week and greeted enthusiastically by investors, failed to excite HBC shares, which ended the day down 4¢ at $16.77.

"We own … 11-million square feet of really spectacular real estate, and we have always believed that sometime in the future, we could have the opportunity to create similar to what Loblaw is proposing, so we are very excited by their announcement and we think it bodes well for future value," Mr. Baker, a Connecticut real estate investor who controls the company, told analysts in HBC's first conference call as a renewed public company.

HBC had noted the value of its real estate in its IPO documents: The company owns or controls 11-million square feet of retail space in Canada and also has 11.7 million of leased retail space, with controls in excess of 45 years at 88% of that leased retail space. The retailer raised $365-million from a public offering which closed Nov. 26.

"It is nice to be invested in a retailer that owns a lot of real estate, and the type of real estate we own would fit very nicely into a REIT," Mr. Baker said. "We are not presently working on this plan, but it is something that we often talk about and foresee getting more involved in some day in the future."

One real estate industry analyst, who did not want to be named, suggested a key issue between the two retailers is that they operate in distinctly different types of business, one more cyclical than the other. "Loblaws is very much about the covenant," he said, referring to the strength of the company and its credit worthiness. "They are also very different retailers, one is selling staple products."

Mr. Baker said that for now, HBC is focused on improving sales and earnings performance in its core businesses: The Bay department store, Home Outfitters and the U.S. chain Lord & Taylor.

Investors are keen to see the company continue a turnaround under the stewardship of Bonnie Brooks, whose vision for The Bay chain helped spur net earnings in 2011 of $1.45-billion, up from profit of $88-million in 2010 and a loss of $18-million in 2009.

One thing is clear — unlike most other retailers who are scrambling to prepare for the arrival of Target in March and April, when it begins opening 125 stores across the country, Mr. Baker does not view the Walmart rival as a big threat.

"Other than the first two weeks when Target opens, I think we will see zero impact from Target," he said in an interview, adding that selling off most of Zellers' leases to Target for $1.8-billion helped him assess what kind of a threat it may be to The Bay.

"The [merchandise] overlap between a U.S. Target and a Hudson Bay store was less than 5% — very little. We might share a similar customer, but that customer is buying different things at their store from ours."

HBC, which includes Lord & Taylor's 48 stores and Home Outfitters' 69 stores, said its loss from continuing operations in the period ended Oct. 27 was $8.5-million, or 8¢ per share, compared with a loss from continuing operations of $7.5-million (7¢) a year ago. Revenue rose to $930.4-million from $896.7-million in the 2011 period.

Consolidated same-store sales, an important retail benchmark, increased 3.5% in the third quarter, with an increase of 4.5% at Hudson's Bay and 5.2% on a U.S. dollar basis at Lord & Taylor.

But time will tell whether the company's core retail results will improve enough to hit its targets, which include boosting HBC's sales per square foot to $170 to $180 per square foot in three to five years' time from $133 in 2011, and Lord & Taylor to $240 to $250 per square foot from $210 in 2011.

The company's net loss, which included a $6.5-million gain from discontinued operations, was $2-million, or 2¢ per share. That compared with net income of almost $1.24-billion or $11.83 per share a year ago, when the company enjoyed an unusual gain of almost $1.25-billion from discontinued operations.

As for this year's numbers, "for us, it is all about the fourth quarter," said Michael Culhane, HBC's chief financial officer, noting the business is more cyclical than a retailer like Loblaw, with much of the benefits seen from pre-holiday shoppers. "Half the earnings are going to come in this quarter, so I think the numbers will dramatically change the next time you look at the page."

That said, Hurricane Sandy will affect the fourth quarter's results — more than 80% of Lord & Taylor stores were closed for up to seven days and fourth-quarter sales will see a negative impact of by US$20-million, Mr. Culhane said. Consolidated same-store sales for the month were flat in November, while they were up 9% at Hudson's Bay and declined 12% Lord and Taylor that month.

Since buying the business from the family of U.S. investor Jerry Zucker in 2008, Mr. Baker has replaced 90 out of 100 of the former company's retail executives and refreshed the flagging 90-store Bay chain, shedding unpopular brands and adding new ones, as well as adding more fashionable and exclusive items and brands with higher price points.

Some analysts, however, are waiting for further proof that the strategy will work. "We question the Bay's strategy to turn its stores into a higher-end chain," analyst ***Kathleen Wong*** of ***Veritas Investment Research*** wrote in a recent report initiating coverage on the stock.

She noted the company had achieved impressive results from the partnership it struck with the popular U.K. retailer Topshop, which it has exclusive franchise rights for in Canada. The Bay will have Ten Topshop and Topman outlets in its Canadian stores by March 2014.

But ***Ms. Wong*** estimated HBC's projections for increased sales per square foot depend on non-Topshop square footage generating "an aggressive 4% to 5% same store sales growth annually" in order to meet management's objectives, which could be a challenge given the intensifying competitive landcape in Canada. In addition to Target, U.S. department store Nordstrom will opens its first Canadian locations in 2014.

The company said its sales benefited from promotional events such as “Bay Days” at the Bay and “Friends and Family” at Lord & Taylor. Foreign exchange rate movements related to Lord & Taylor and lower sales at Home Outfitters negatively impacted consolidated same store sales results.

The chains had an 8% same-store sales increase in October at both banners, the company said, but November results were hurt by the impact of Hurricane Sandy.

The company also introduced an initial quarterly dividend of 9.375¢ per share.