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Hudson's Bay presses forward in face of retail landscape 'headwinds'

By MARINA STRAUSS

Market conditions have led to lower corporate forecasts, but retail giant is still pursuing both online and bricks-and-mortar expansion

Can Richard Baker keep the magic going at Hudson's Bay Co.?

The HBC governor and executive chairman has transformed the Toronto-based retailer since acquiring the ailing business in 2008 by investing in upgrades while overseeing an array of takeovers and real estate deals.

The U.S. real estate magnate also had a hand in reshaping the Canadian retail landscape by paving the way for Target Corp. to enter Canada in 2013. When Target Canada collapsed this year, its closing benefited HBC and other domestic rivals by easing overall retail pressures.

Yet despite his game-changing initiatives, Mr. Baker today faces uncertain times that threaten to change the retail game.

Saks Fifth Avenue, his crown jewel that HBC acquired in late 2013, is suffering as tourist visits to the United States have dropped dramatically in response to the strong U.S. dollar. And HBC's newly acquired German-based Galeria Kaufhof has been pinched by the terrorism scare in Europe.

HBC's stock, which soared by more than a third last year fuelled by revelations of the high value of the retailer's real estate, has been sliding sharply this year and is almost back to its $17 initial-public-offering price of late 2012.

Still, Mr. Baker is undaunted. "I feel good about the initiatives and the direction in which we're heading," he said in a recent interview. "If you compare us to our peers both in Canada and the United States, you'll find that our stock is in line. It took a hit, similar to the other retailers in our category. Frankly, I think our stock is a great opportunity."

Investors got spooked in December when HBC lowered its 2015 and 2016 forecasts. It cited an overall weaker retail space; unseasonably warm fall weather, which dampens sales of coats and cold-weather items; a rash of discounting in the holiday season, which squeezes margins; and the ripple effects of the Paris terror attacks on Kaufhof.

Jerry Storch, the experienced U.S. merchant who became HBC's chief executive officer about a year ago, insists the "headwinds" are "temporary and transient."

Even so, some industry observers point to more fundamental cracks in the retail landscape, especially for department stores.

Steven Dennis, president of retail specialist SageBerry Consulting in Dallas, predicts a tough slog over the long term for luxury retailers such as Saks in North America.

The former executive of posh U.S. retailer Neiman Marcus said most luxury spenders, referred to as "HENRYs" – high earners not rich yet – pull back when the economy wanes. Luxury department stores will struggle to replace the customers they lose, Mr. Dennis said. Most existing-store sales growth has come from price increases rather than rising customer transactions, he added. "Prices just don't rise forever without affecting demand."

What is more, affluent consumers' spending is shifting to experiences and services, such as travel and eating out, from buying fashions, he said. And as Saks and other retailers invest"mightily" in tying together their physical and digital stores, more shopper spending is moving to the Web while suppliers increasingly become key rivals by running their own e-commerce and stores, he said.

Others say HBC has become a complex company that is difficult to compare with other retailers.

"Their problem is that investors have seen few animals with these stripes," said Perry Caicco, a retail analyst at CIBC World Markets.

Still, Mr. Caicco said HBC has done a series of "excellent" deals in "selling assets high; buying assets low; paying for assets with assets' own money" and "turning around moribund department stores."

But ***Kathleen Wong***, an analyst at ***Veritas Investment Research***, argues that HBC is simply a real estate play masking weak retail operations.

And a frail performance among U.S. retail peers this fall "signals challenges ahead," she warned.

HBC had been trading at about its $17 IPO price until it carried out two "creative" transactions to unlock the value of its owned real estate, including spinning off dozens of properties into two joint ventures, she said. Now the shares are hovering around $18. She recommends selling them.

Mr. Baker isn't slowing down. His team is bidding about $250-million (U.S.) for online flash-sale site Gilt Groupe, a deal that could close in January, a source said.

By February, HBC will launch its first two Saks Fifth Avenue stores in Canada, while also rolling out its sister discount chain, Saks Off 5th.

Mr. Baker says he's focused on achieving economies of scale and improving retail operations while continuing to look for more acquisitions and real estate transactions to gain financial flexibility.

Saks Fifth Avenue's flagship property in New York alone has been appraised at $3.7-billion (U.S.), more than the $2.9-billion HBC paid for the entire chain.

And the company is investing heavily in its e-commerce and fixing digital snags that result in missed or late customer orders.

"Our systems will get better and better," he said.

"While we are having an increased number of situations where customers have bad experiences, we have a lot more business going on."