Macy's Hostile Takeover Bid: The Battle Begins

Introduction

On March 3rd, Arkhouse management and Brigade Capital management announced a bid for Macy's Inc. [NYSE: M] in a take-private deal totalling $6.6bn or $24 per share, coming at a 33% premium to the company share close on March 1st, and increasing their December 1st offer of $21 per share.

Macy's is one of the United States' most historically significant retailers and department stores, founded in 1858 and pioneering the landscape of consumerism in the country while leading the retail sector for the last century. However, like other similar department stores, they couldn't quite escape the grips of the retail apocalypse and are fending off hostile takeover offers threatening their core business retail operations. If the bid were to go through and Macy's were to become profitable as a real estate company (REIT), it would set a dangerous precedent for the rest of the sector and might become the start of the end of stores like Macy's and Bloomingdale as we know it.

About Macy's

Macy's is a department store giant engaging in the retail of apparel, accessories, cosmetics, and other consumer goods. The main brand Macy's is completed by the luxury department store Bloomingdale's, and the beauty store chain Blue Mercury.

The brand's famous head-quarter in New York, Macy's Herald Square, has once been the largest department store in the US and since 1924 the brand has its own annual Thanksgiving Day parade. The company was founded in 1858 under its original name Federated Department Stores, Inc. and rebranded in 2007 after beginning the gradual replacement of its regional store names already in 2003. In 1930, the parent company acquired Bloomingdale's and had good traction in the early 20th century. However, in 1988, then called Federated was acquired by Canadian real estate developer Campeau Corporation which had also acquired Allied, a department store chain, two years prior. The former transaction of $6.5bn, which was 97% debt financed and the latter, also debt heavy, transaction of $3.6bn were made on eager profit projections which were not met in the coming years. In 1991, this led to the second largest nonbank bankruptcy in the US at the time and ended in a multiyear restructuring process. Within months from emerging from bankruptcy, Federated (today's Macy's) completed one of the largest IPOs of 1992 where they sold a much higher quantity of shares than expected, which were used to repay its long-term debt. In 1994, Federated acquired R.H. Macy & Co which should later give the name Macy's to the brand overall. In the following years, the firm continued to acquire other businesses and tried to focus on developing its own brand. Since February 4th, 2024, Tony Spring is new Chief Executive Officer of the retail giant, the former Bloomingdale's CEO wants to strengthen the brand in an ever more competitive environment.

Today, Macy's operates over 502 stores with an additional 57 Bloomingdales and 159 Blue Mercury stores, employing about 94,500 employees in the US. A subsidiary operates 2 stores in the UAE since 2010 and one in Kuwait since 2017.

The company's business model is the one of a standard department store with each subsidiary (i.e. Macy's, Bloomingdale's, and Blue Mercury) focusing on different kinds of customers. While their largest retail brand offers articles ranging from fashion, including their own brand, and beauty to articles for home décor and beyond, the other two brands focus on having a more luxurious image. Bloomingdale's sells luxury designer products in fashion and home, while Bluemercury offers luxury beauty and spa products. The department store specifically aims at differentiating these brands and puts an even stronger focus on developing its high-end brands. The former's primary stream of revenue is women's fashion, including accessories, shoes and apparel, accounting for about 60% of sales, followed by around 20% of sales in Men's and Kid's fashion. The outstanding revenue is generated in home products and other sectors. Additionally, the retailer has a very strong asset base consisting of real estate valued at $6.6bn exceeding its current market capitalisation. (Mkt cap as of 07/03/24: $5.8bn)

The retail operator has recently endured some problems due to the harsh competitive environment in their sector. Other chains have an advantage in attracting younger customers due to location or customer frequency as well as in terms of physical appearance influenced by the age of many of Macy's stores. Net sales have decreased by 5.5% YoY to $23.1bn with a 7% decrease in digital and 5% drop in physical sales. These financials led to a decline in EPS from $4.19 in 2022 to $0.38 in 2024. Additionally, high costs of restructuring have pushed the company to a net loss of $71m in Q4 2023, compared to a net income of $508m in Q4 2022. About 150 out of the 500 stores (or 30%) supposedly make up for only 10% of Macy's revenues. In January, Macy's announced to cut 2,305 jobs and published additional measures taken by the new CEO.

About Arkhouse Management

Arkhouse Management Co. LP is a New York based investment firm, established in 2016 and rebranded in 2022, that invests in public markets with a private equity approach with a focus on real estate transactions. The partners involved have completed about $25bn worth of real estate transactions and demonstrate a track record of up to 18 years of experience using a clear activist approach to their investments. The boutique firm, consisting of eight members, invests in undervalued opportunities in North America with ideal targets demonstrating the possibility of valuation improvement by implementing changes in governance, shareholder ownership, or management.

In 2021, Arkhouse has submitted a $2.2bn takeover bid for Columbia Property Trust, which they eventually lost to PIMCO's real estate arm, not before contributing to drive up the premium paid upon the share price at the time. Their only other public position was in Preferred Apartment Communities which was sold to Blackstone [NYSE: BLK] in a $5.8bn deal in 2022. Arkhouse managing partners Gavriel Kahane and Jon Blackwell have mentioned a very large pipeline of possible deals that are held back by serious due diligence in ensuring optimal results for shareholders and the fund's investors.

Takeover Bid

Macy's was one of the early adopters in the retail sector of an e-commerce platform, integrating the service in 1997, and also led the industry in loyalty and rewards card programs. By 2007 the retailers' national dominance was front and center, with stores moving away from the Federated umbrella & changing their name to Macy's.

However, their command over the space didn't spare the department store from the retail apocalypse, where multiple brick-and-mortar stores closed due to shifts in consumer spending. In February 2020, Macy's had already announced a massive restructuring that would close 125 stores and cut 2,000 jobs, after having posted an 22.84% decrease in revenue in their earnings report. These effects were exacerbated by the pandemic and resulted in a series of executive shakeups. In February 2023, Macy's CEO Jeff Gennette, 61, retired after working at the company for 40 years, and was replaced by Tony Spring. Who assumed the position of CEO of Bloomingdale's in March 2023 and was very recently announced CEO of Macy's in February 2024.

On December 1st, Arkhouse Management and partner Brigade Capital Management announced an $5.8bn take private bid offer for $21 per share for all stock they don't already own. Macy's declined the bid, stating Arkhouse didn't have a viable financing plan in place and mentioned the deal was lacking compelling value. Macy's would expect a bidder to show enough committed financing and have a track record of pulling off buyouts in the retail sector. Arkhouse later replied that any notion the plan they proposed privately to Macy's on December 1st was not actionable was untrue. Arkhouse and Brigade remained open to increasing their bid further if they were able to complete due diligence with the documents, they were requesting from Macy's but not being provided with. Shares of Macy's rose 3.4% in premarket trading after the deal was announced.

To counteract the bid Macy's announced its "Bold New Plan" that involved drastic cuts, shuttering of 150 stores, and reinvestment in better-performing locations and assets like Bloomingdale.

After the release of Macy's 4th quarter earnings report Arkhouse & Brigade decided they had enough information and, on March 3 upped their offer with a 14.3% increase on the original bid to a total of $6.6bn – $24 per share, similar take-private deal for the retailer's shareholders. This offer came at a 33% premium to the company's shares close on March 1st. The bidder mentioned Macy's restructuring plan was not only not bold or new but uninspiring, and that with new management (their recently elected nine new board members) they could have confidence in the long-term success of a private Macy's company, away from the public scrutiny.

Arkhouse Management has launched a proxy fight for Macy's after the retailer rejected the activist investor's initial offer to buy the company. Brigade and Arkhouse have extensive, combined, retail and real estate holdings and experiences and believe that accepting the deal would be proceeding in good faith for the benefit of all stakeholders in the company.

With Arkhouse Management experience in the real estate sector, the recent fortune being made from Sears holding to a real estate investment trust (REIT), and Starboard's 2015 suggestion that Macy's spin out its real estate holdings or even do a sale-leaseback transaction for its flagship store, one could start to wonder how long the annual Macy's Thanksgiving parade or Firework show on the 4th of July stick around.

Macy's owns hundreds of stores over the U.S. and in recent years has been no stranger to profiting from its real estate value: they sold their San Francisco men's store for $250m, the Minneapolis flagship for $59m, and parts of their Chicago and Pittsburgh flagships for a combined $43m. Analysts think their property portfolio could be worth anywhere from $6bn to $12bn compared to Macy's current Mkt cap as of 07/03/2024: $5.8bn. However, one could argue classic retailers could be due for a comeback today; we haven't quite seen the shift to e-commerce analysts were predicting post-pandemic, demands increased for thrifting and regulators have concerns about fast-fashion brands like Shein's recent struggle.

Despite this, Arkhouse has not revealed its plans for Macy's, they openly state they want to keep driving the retail business, saying that the real estate and retail business have a certain synergy and a reliance on each other, one doesn't have value without the other. But we cannot know for certain if Arkhouse doesn't just want to sell real estate and lease it back, a move that would provide immediate liquidity and value for the new owners. Furthermore, Arkhouse is an investment firm that typically focuses on the real estate industry. While Brigade has a history of investing in the retail sectors - they don't have the best history with keeping and running their assets. Brigade took a position in Barneys in August of 2019 by buying their debt, they shortly proceeded to exit their position as quickly as October 2019.

As mentioned before, this is not the first time Macy's is involved in a hostile takeover attempt pinned by their underlying real estate business. In April of 1988, Federated (The company that would go on to be today's Macy's) agreed to the largest non-oil sector merger at the time. Two years after this move Federated became heavily indebted due to the high cost of the takeover and filed for Chapter 11 just 8 quarters after the move. Their biggest competitors at the time benefited by acquiring some of Federated's assets at a discount from Campeau. This 1988 takeover highlights the dangers of prioritizing asset value over core business operations and could draw a close parallel with Macy's in 2024 if Arkhouse and Brigade do fundamentally plan on running the company as a spinoff real estate corporation, like what has happened Sears.

Current Situation

Following the unsolicited take-private offer and the ongoing proxy fight, new CEO Tony Spring launched a new strategic plan called "A Bold New Chapter", a name that closely resembles "North Star" and "Polaris", two failed past strategic plans the company had. This new plan is mainly centered on increasing the company's efforts to undergo some of the reforms that had already been decided on the past. Some of the main elements of the plan include the closure of underperforming stores, monetizing the prime real estate assets of the stores the company will close, re-investing in the more productive locations and on brands as Bloomingdale's, decrease costs and improve productivity through job cuts and automation, as well as invest in the growth of their beauty premium segment with their own brand, Blue Mercury.

Nonetheless, analyst have expressed their concerns about the efficacy of the proposed changes as the same ideas have been brought up in the past and the company didn't go through any significant transformations. The company called 2024 a "transition year" meaning the changes won't come into effect immediately, but rather it will be a slow and progressive transition. When asked in the most recent earnings call about the difference between the current strategic plan and the two preceding ones, Spring stated that the main difference comes from the quality of the execution of the strategy, in other words, of the managerial capacities the company currently has. However, some changes have already been announced/executed, such as the announcement of a reduction of the company's corporate workforce by reducing it by around 13% by eliminating middle layers of management and consolidating positions, as well as increasing automatization at several of the facilities. Moreover, Macy's announce that they intent to close around 150 locations (30% of their locations) by 2027, which currently only generate 10% of the revenue but account for 25% of the gross square footage, as well as add 30 new more Blue Mercury stores and 15 Bloomingdale's, increasing their participation in the luxury store sector by 20%.

However, this plan may not be fruitful because while it may be focusing on the cost and supply part, it completely disregards the demand side. Macy's central problem remains the same, with or without the "Bold New Chapter", as the product and services they sell is not necessarily compatible with the current consumption environment, primarily fuelled by young consumers. On one hand, the company is in the very middle of a very competitive market, being squeezed by luxury retailers as Saks Fifth Avenue, Neiman Marcus and Nordstrom on one side, and then by TJ Maxx, 21st Century, Marshalls on the other. Moreover, brick and mortar stores are not as productive as they used to be, primarily because of the appearance and growth of ecommerce. Furthermore, there has been a renaissance in thrifting, as well as fast-fashion brands have gained significant market share. Hence, Macy's must ramp up its ecommerce strategy and set itself apart from its competitors in order to remain competitive and improve its financial results.

On February 20, 2024, Macy's announced that Arkhouse launched a proxy fight by submitting a list nominating nine directors for the upcoming May 2024 board elections in the annual meeting. The list is mostly composed by former CEO's, restructuring and real estate experts. This came despite the initial rejection of the $21 a share offer made on December 1st, but before the latest offer from March 3rd of $24 a share. In response to the nomination, Macy's showed their support for their current 14-member board by expressing a vote of confidence in them and showed signs of the strong relationship of the board with the current management.

Conclusion

Macy's board will meet in the following days to analyse the offer that was made on March 3 for $24 a share. However, the current, or any possible higher offer in the future, may still not be what's in the company's best interests. Over the past decades, private equities have been very active buying struggling or underperforming retailers with the goal of improving their operations and financials and then selling them for a profit. However, in the process of doing so, the investor group tends to sell of the real estate and even spin-off some of the business areas to make short-term profits. Moreover, these profits may not end being reinvested in the core retail business, but rather be used to pay down outstanding debt, or extraordinary dividends to the new owners. Furthermore, while sale and leaseback of the properties may give the company a cash relieve, it will end up decreasing the companies value over the long term as their stores are one of the main drivers of its valuation. Hence, Macy's can end in the worst of all scenarios. Past similar situations have led to bankruptcies of many established companies as Toys R Us, Payless, Sears, among others.

Moreover, while the new CEO deserves the benefit of the doubt, the market is still not convinced that the new strategic plan will solve the company's problems. More than cutting costs, the company must fight to retain, and even recover, part of the market share they have lost to e-commerce and off-price retailers.

TAGS: MACY'S, RETAIL, REAL ESTATE, ARKHOUSE MANAGEMENT, TAKEOVER

