

Readers Note: I think the writer misinterpreted what Kinnaras does in this article and the general idea of what Ackman is proposing. The Firm does not specialize in real-estate buyouts but I am familiar with leveraged transactions. Aside from that, I've covered Target in a previous blog posting. The basic idea is Ackman would leverage the real estate through sale-leasebacks, a spin-off whereby the real estate is a Target REIT with Target the sole lessee, or securitize the real estate. In either case, the transaction would result in Target freeing up capital repurchase a massive amount of shares. The flip side is Target would have a heavy dose of cash interest or lease payments that would reduce earnings. What would occur over the course of a few years is that Target would deleverage, reducing interest expense and making Target's EPS grow at a fast clip. Ackman is probably expecting that the market would assess a higher EPS multiple to reflect the newer capital structure and accelerated EPS growth.

Land play proposal is looking off-Target
By Chris Serres - Minneapolis Star Tribune
February 2, 2008

Now this is a closeout sale.

Target Corp. sells all of its 200 million square feet of retail space nationwide -- equivalent to about 50 Mall of Americas -- then leases it back to keep the stores in business.

The retailer's more than 1,300 company-owned stores, 26 distribution centers and headquarters building in downtown Minneapolis could fetch about \$28 billion, according to Amit Chokshi of Kinnaras Capital in Stamford, Conn., a hedge fund active in real estate buyouts. That's enough cash, he estimated, to repurchase 530 million Target shares, or about 60 percent of the stock.

Chokshi said the buyback could more than double Target's earnings per share at a time when the retailer's sales growth has slowed. That could send earnings from the projected \$3.68 per share for the year ending in January 2009 to \$7.40 per share or more, before accounting for interest and lease expenses.

Even if investors didn't reward Target with a higher multiple than it's getting now, that would send the stock above \$109.

There's the shorthand explanation for how activist investor William Ackman, whose hedge fund has amassed a 10 percent stake in Target, came up with his December estimate that Target shares could be worth \$120 within three years.

Ackman is also pushing for the retailer to sell its \$8 billion credit-card portfolio, but much of his calculus relies on the real estate scenario.

"It's all financial engineering," Chokshi said. "If you suck out all those shares, it can mask the slowdown in Target's core business."

So why aren't investors piling into Target, which has seen its stock price fall 22 percent since Ackman disclosed his holding in July?

Call it the Lampert effect.

Hedge fund owner Eddie Lampert rolled Kmart and Sears together two years ago, exciting Wall Street not by combining two fading retailers but with the idea that his redubbed Sears Holdings was a real estate play. Sears could keep profitable locations and sell off others to retailers or developers. But as the credit markets have contracted and commercial real estate has fallen, the Sears land play hasn't come to pass as expected. Sears stock has fallen from near \$200 last spring to just more than \$100.

Lampert isn't the only cautionary tale: This month, the world's second-largest retailer, French giant Carrefour SA, cited market conditions in shelving plans to spin off its real estate.

Most analysts see the Target real estate pitch as DOA.

"For now, Ackman is out there on his own," said Howard Davidowitz of the New York-based retail consulting and investment banking firm Davidowitz & Associates.

Target owns about 85 percent of its stores -- a much higher percentage than most retailers -- because management has long believed that owning the bricks and mortar helps control fixed costs in a low-margin, cyclical business.

And while sale-leasebacks can generate large gains, they also produce a long-term drag on earnings. With Target, the annual leases and other expense payments on its 1,500 stores could total billions. Chokshi estimates that interest and lease payments could exceed \$2.5 billion a year.

Until the credit markets recover, Target also may not get fair value for its real estate, said Mark Miller, an analyst at William Blair & Co.

Investors might want to instead focus on the retailer's considerable potential without the restructuring of its real estate.

If that same \$3.68 per-share profit projected for this coming year got the 21 average multiple that Target was awarded over the past five years, the stock would be worth more than \$77. If earnings hit \$4 per share in the following year, the stock would trade at \$84 based on that multiple.

Patricia Edwards, a portfolio manager and retail analyst at Wentworth, Hauser & Violich, sees Target trading at a "depressed multiple," based on punk holiday sales. Edwards has a 12-month price target of \$62 a share; the stock is currently trading at about \$57 a share.

Target's management team could pull something bold over time; they've always been "opportunistic sellers," Miller noted, shedding Mervyn's and Marshall Field's in recent years.

"Target has a savvy management team, and they're not going to rush into a deal that isn't ideal for shareholders," he said.

Meanwhile, Ackman shows no sign of going away. He plans another meeting with management to discuss Target's real estate.