Kmart and sears essay essay sample

Finance

Kmart, Sears and ESL: How a Hedge Fund Became one of the World's Largest Retailers 1. Describe recent trends in the hedge fund and private equity industry and the growing overlap between the two. A: Hedge funds, historically, were more interested in the buying and short selling of defaulted or near-default bonds within a few weeks or months. This strategy was more of a short-term, exit-focused strategy. Now, however, some hedge funds are becoming more interested in the restructuring and long-term controlling of attractive assets. Hedge funds' stakes in these companies are then transformed into equity from the arising new entity. Private equity is split up into Venture Capital and Leveraged Buyout funds, with a little made up of mezzanine funds. LBO companies buy publicly traded companies that are experiencing inefficiencies from costly regulation of being publicly traded and the incentives of managers and shareholders. The growing overlap is correlated between the LBO side of private equity and the more recent trend in hedge funds of acquiring large stakes in mature, failing companies in order to have a longer-term return. 2. Analyze different issues surrounding a purchase by a financial or strategic buyer and their respective strengths and weaknesses.

A: Financial buyers, like Warren Buffett for example, have the cash readily available in the instance of a company's bankruptcy. Because the funds are readily available early on, usually financial buyers found themselves able to acquire distressed assets and/or companies at the most attractive prices. A drawback or weakness associated with financial buyers is the lack of expertise or even flexibility, as is the case for mutual fund managers or pension plans. Strategic buyers, on the other hand, are able to create synergies through buying out distressed assets or companies if they have the cash readily available. This is usually not the case, and what ends up happening is that financial buyers get the bid first and steal the prize. 3. Provide a brief historical background of the problems facing Kmart and the characteristics of the distressed debt market, including factors that influence an investment in a distressed company. A: Kmart was, in the late 1970s, much larger than the famous superstore giant called " Wal-mart" with sales 20x that of Wal-mart's and roughly 850 more stores nationwide. However, Kmart's sales stayed consistently stagnant, while Wal-mart became the giant it is now. A poor supply chain, unfriendly store layout, among other things, created a huge disadvantage versus other big box retailers.

In 2001, Kmart made a tragic decision to cut costs close to Wal-mart's famous " everyday low price", but by doing so, took on huge losses and sold items well below cost. This resulted in a lack of liquidity and the ending result of filing for chapter 11 bankruptcy. Hedge funds started studying the value of Kmart's distressed assets, but none had the capital nor the confidence to amass a controlling stake in the defaulted bonds. The bonds wouldn't be sold at par value, but they would be sold for either cash through the sale of assets or bondholders would receive equity in the new company emerging from bankruptcy. Bankruptcy was considered an opportunistic time to acquire businesses that had strong synergies with existing, healthy companies of the same industry. However, when one sector is struggling to stay afloat, other companies aren't usually able or willing to commit the cash to acquiring the failed company and thus financial buyers step in. 3. Discuss the causal events facilitating the acquisition of Sears. Could Sears have succeeded as a standalone retailer?

A: ESL was the controlling owner of Kmart, with Lampert as CEO. He wanted to start making changes to Kmart and provide it with additional stability through the selling of 50 store locations. ESL, as a 10% owner of Sears, made the connection that Sears and Kmart could mutually benefit from the selling and buying of these 50 more rural store locations. Sears needed the locations in order to attract the loyalty of customers moving out to such locations, while Kmart needed to find a buyer. With over 1400 stores nationwide, Kmart could sell even more locations to Sears and create value for both companies. Vornado was rumored to financially buyout Sears as a real estate investment. Lampert had to make a move to reduce the cost structure and attain economies of scale. It's very unlikely that Sears could have competed and succeeded as a standalone retailer: 1) Sears' loyal customer base had begun moving out to more rural areas, away from Sears' locations and into Walmart and Target store locations; 2) without the necessary capital and resources, Sears would have had to take the immense risk of leveraging more and building stores in more removed locations; and 3) Sears's business revolved around mall shopping, an old and archaic way of shopping.

Evaluate Lampert's strategy and the benefits for Sears's shareholders. A: Lampert saw synergistic opportunities with the M&A of Sears and Kmart. By so doing, Sears would reach its target audience, while Kmart would be expanding their business through Sears and attain a more favorable cost structure. Lampert also had an interest in the real estate and saw the price of the real estate going up over time, while improving profits of both Sears and Kmart. Through the M&A, shareholders benefited from an increase in EPS, which drove the stock price higher and provided value to shareholders. 5. Was ESL’s decision to take over Kmart and merge it with Sears the best option for the bankrupt retailer? A: According to the financial statements, Kmart’s sales had essentially remained flat over the years leading to the eventual Chapter 11 bankruptcy. With no growth in sales and increased liabilities, there was a consistent decrease in net income and retained earnings. After the merger, liabilities were decreased dramatically while assets remained higher, resulting in slight growth and a deemed ‘ healthy’ signal to shareholders’ future in Kmart. The synergistic value created through the merger was the only thing that saved Kmart; without it, there wouldn’t be a Kmart.