

# [Kmart, sears and esl: how a hedge fund became one of the world’s largest retailer...](https://assignbuster.com/kmart-sears-and-esl-how-a-hedge-fund-became-one-of-the-worlds-largest-retailers/)

1. Describe recent trends in the hedge fund and private equity industry and the growing overlap between the two.

- The line between some types of hedge funds and private equity LBO funds are being blurred in recent times. But most hedge fund strategies are still quite distinct from the LBO investing model.

- In the early year’s hedge funds active in the LBO arena would try to buy defaulted or near default bonds and then resell them in weeks or months later at a profit. But in recent times hedge funds have started to hang onto the distressed investments through the whole bankruptcy process, leaving them with substantial and sometimes controlling stakes in the companies. When the companies come out of bankruptcy the hedge funds claims are transformed into equity in the new entity.

2. Analyze different issues surrounding a purchase by a financial or strategic buyer and their respective strengths and weaknesses.

- A financial buyer is a buyer that purchases a business solely interested in the return they can achieve by buying a business. Financial buyers are interested in the cash flow generated by a business and the future exit opportunities from the business. On the other hand strategic buyers are interested in how a company’s fit into their own long-term business plans. Their interest in acquiring a company has to do with synergies they can extract with their current business. Other reasons could be eliminating competition, or enhancing some of its own key weaknesses.

- Strategic Buyers should theoretically be able to pay a higher price for distressed or bankrupt assets because of the synergies that would come from merging them with similar operations. The problem lies that more strategic buyers are in the same industry and experience the same business cycle, so timing of a rivals bankruptcy often found the survivors in a weak position and unable or unwilling to commit cash for an acquisition. This timing mismatch encourages financial buyers to the bankruptcy-related activities.

3. Discuss the causal events facilitating the acquisition of Sears. Could Sears have succeeded as a standalone retailer?

- Sears strategy for decades was based in malls, but after seeing the increasing sales of its competitor’s stand-alone “ big box” retail model. Soon after Sear’s management started experimenting with an “ off-mall” concept called Sears Grand. Sears experiment was successful and management wanted to roll out the off-mall Sears Grand concept nationwide at a fast pace and the same time Kmart wanted to sell fifty Kmart locations. The deal created significant values for both companies. This really got the wheels turning for both management teams for a possible merger.

- Yes, I do think Sears could have succeeded as standalone retailer, but it would have much more difficult without the merger. Sears would have expended a larger amount of cash to acquire or build new locations, thus increasing its leverage. Also By entering the stand-alone big box retail market for the first time, they would be exposing themselves to large competitors like Wal-Mart and Target, which was one main reason for the Kmart bankruptcy.

4. Evaluate Lampert’s strategy and the benefits for Sears’s shareholders.

- Lampert’s strategy was to convert some Kmart stores into Sears and bringing Sears products into Kmart stores, reduce marketing costs, lowering COGS, lowering SG&A through synergy opportunities, increasing per square foot sales for Kmart, and also monetize and nonproductive assets.

- Sears’s shareholders gain many benefits from these strategies put forward by Lampert. By merging the two companies Sears saved huge amounts of cash by not having to acquire or build new locations. While competitors opening so many new stores and Sears no have been opening stores off the mall, Sears was spending nearly $1 billion dollars a year on marketing just to stay even. Combined Kmart and Sears were spending $40 billion on COGS, Lempert and the new management team would work with its suppliers improve their business and reduce the costs for the new Sears Company. The combined SG&A for both companies was nearly $12 billion and with the merger new synergy
opportunities would reduce costs further. Also Sears’s stores in general were $80 per square foot more productive than Kmart and with 100 million square feet of real state that Kmart has, if the same productivity could be achieved at the Kmart store, that would be $8 billion dollar opportunity. All these strategies would maximize shareholder value.

5. Was ESL’s decision to take over Kmart and merge it with Sears the best option for the bankrupt retailer?

- Yes, I think the ESL decision was the best one. The real estate holdings of Kmart alone were worth several times what ESL and Lempert had paid to acquire control of the company. Lempert and ESL wanted to sell fifty Kmart locations, this fit perfect with Sears management’s desire to roll out the off-mall Sears Grand concept nationwide at a fast pace. This deal created significant value for each company, and Kmart, a struggling chain, still had 1, 400 stores left, hundreds of them in the types of locations Sears hoped to target with Sears Grand. So the idea of merger was a natural for each chain’s management teams.