SEARS HOLDINGS

Sears Holdings' Second Quarter 2017
Pre-Recorded Conference Call Transcript
August 24, 2017

Operator:

Good day, ladies and gentlemen, and welcome to the Sears Holdings Corp. second quarter 2017 earnings conference call. [Operator instructions]

Chris Brathwaite:

Thank you, Operator. Ladies and gentlemen, welcome to the Sears Holdings earnings call. I am Chris Brathwaite, Vice President of Corporate Communications for Sears Holdings, and I am joined today by Rob Riecker, our Chief Financial Officer. This morning, we released our second quarter results for 2017, which are available on the investors section of our website under "Events and Presentations." You can access the accompanying slide presentation for our call today through the same section of the website.

Moving to slide 2, I would like to remind you that today's discussion will contain forward-looking statements related to future events and expectations. These statements are based on current expectations and the current economic environment or are based on potential opportunities and actual results may differ materially from those expressed or implied in the forward-looking statements. Factors that could cause the Company's actual results to differ materially from those listed in today's press release can be found in the presentation for today's call that is posted at the Investor Information section of searsholdings.com and in our most recent Annual Report on Form 10-K and other SEC filings. Finally, we assume no obligation to update the information presented on this call, except as required by law.

In addition, as noted on Slide 3, our discussion will include certain non-GAAP financial measures. Reconciliations to the most directly comparable GAAP financial measures can be found in the presentation and today's earnings release. Any reference in our discussion today to EBITDA means Adjusted EBITDA, as defined in the presentation.

I will now hand off the call to Rob.

Rob Riecker:

Thanks, Chris.

Good morning and thank you for joining our call.

I am pleased to report that in the second quarter of 2017, we achieved significant improvement in reported net loss and Adjusted EBITDA, supported by our decisive actions to improve operational performance. We also continued to take action to improve our liquidity position through several transactions, which I will cover in more detail later in the call.

First, let's turn to slide 4 to review key year-over-year financial performance measures and some of the operational highlights for the quarter.

At Sears Holdings, we remain focused on streamlining our operations, right-sizing our store footprint, reducing our operating expenses and taking incremental actions to further improve our financial performance in a challenging retail environment.

We reported total revenues of $4.4 billion in the second quarter of 2017, compared to $5.7 billion in the same quarter last year. The decrease in total revenues was largely driven by continued softness in store traffic and elevated price competition in the retail industry, as well as the closures of under-performing stores, which accounted for approximately $770 million of the revenue decrease. We closed 180 stores over the first and second quarters of 2017, and an additional 150 previously announced stores are expected to be closed by the end of the third quarter of 2017.

We reported a net loss attributable to Sears Holdings' shareholders of $251 million in the second quarter of 2017, compared to a net loss of $395 million in the prior year second quarter. We also reported a substantial improvement to our Adjusted EBITDA, which was a loss of $67 million in the second quarter of 2017, compared to a loss of $191 million in the prior year second quarter.

The significant improvement in our operating results, particularly in the months of June and July, is largely driven by the progress we've made on our restructuring program. Key actions under this program include simplification of the Company's organizational structure, streamlining of operations and the previously referenced store closures. To date, we have actioned over $1.0 billion in annualized cost savings of our $1.25 billion target for the full fiscal year.

From an operational perspective, we remain focused on maximizing the value of our assets, and finding new ways to engage and better serve our members.

In July, we announced an agreement with Amazon to launch Kenmore products on Amazon.com. This represents an exciting milestone in our Company's transformation, as we leverage technology and innovation to significantly expand the reach and unlock further value from our Kenmore brand. This strategic alliance is also expected to create new revenue opportunities for our Sears Home Services and Innovel Solutions divisions as I'll explain shortly in this call.

Earlier this summer, we also announced a strategic partnership with Time Inc. that delivers even more value for our Shop Your Way members. Over 300 magazine titles – including Sports Illustrated, Time and InStyle – will be available on Sears.com and ShopYourWay.com, where members will be able to choose an unlimited number of subscriptions and receive 100 percent of the cost back in points. We are also leveraging our data analytics capabilities to create recommendations based on our members' preferences, interests and purchase behavior throughout the entire Shop Your Way ecosystem. This unique level of personalization demonstrates our ability to find innovative ways to engage our members and deliver meaningful value to them every day.

In addition, building on the success of our first concept store in Fort Collins, Colorado, we recently opened a dedicated Sears Appliances and Mattresses store in Pharr, Texas. These smaller-format stores provide a fully-integrated retail experience, leveraging new technologies to showcase two of the Company's strongest categories. We expect to introduce additional smaller, specialized concept stores in the upcoming quarters. At the same time, we will continue to right-size our store footprint to ensure we are positioned to meet the realities of the changing retail environment.

Moving on to slide 5.

As previously mentioned, we are committed to unlocking the potential of our brands and business through innovative partnerships, such as the one between Kenmore and Amazon.

This agreement is a major milestone for our Kenmore brand, as well as our Sears Home Services and Innovel Solutions businesses.

This marks the broadest distribution to date of Kenmore home appliances outside of Sears branded stores and related online retail platforms. In addition, our Sears Home Services and Innovel Solutions divisions will provide white-glove service for delivery, installation and product protection for the full range of Kenmore home appliances sold on Amazon.com, thus expanding their reach to all customers who shop for Kenmore appliances on that platform. In this way, our partnership with Amazon is expected to open new revenue streams for three of our businesses: Kenmore, Sears Home Services and Innovel Solutions.

As Kenmore Smart appliances integrated with Amazon Alexa are available for immediate purchase and installation, this agreement also provides a convenient, integrated offering to the millions of customers who shop on Amazon.com every day. This is exactly the kind of innovative collaboration we strive for at Sears Holdings and we look forward to working with Amazon to support the successful launch of the Amazon Kenmore Store in regional markets across the U.S.

We are committed to unlocking value from our various assets, as evidenced by the creative agreements that have expanded the reach of the iconic Kenmore and Craftsman brands. We continue to evaluate new ways to create additional value from our brands and businesses through strategic partnerships, new technology and other means.

Moving to slide 6, we continue to achieve significant progress on our transformation.

We are taking the necessary steps to rationalize our cost base to offset continued revenue pressure in a difficult retail environment. We believe our restructuring program is critical to becoming a more competitive, efficient and agile retailer moving forward. We will continue to drive improvements in our organization by focusing on best members, best categories and best stores.

In the first quarter, we announced an increase in our cost savings target of $250 million, bringing the total to $1.25 billion by the end of fiscal year 2017. We have made significant progress toward this target by actioning over $1.0 billion in annualized cost savings to date, which puts us on track to achieve our goal by the end of this year.

During the second quarter, we also successfully executed numerous transactions to increase our financial flexibility to fund our operations and continued transformation.

These transactions include the amendment to our Second Lien Credit Facility to create a $500 million Line of Credit Loan facility as well as the extension of the maturity of our existing Letter of Credit Facility for a year and the elimination of the unused portion of that facility. Additionally, during the second quarter, we were able to pay down approximately $276 million of our real estate loans. Following the end of the quarter, we executed additional asset sales which generated cash proceeds of nearly $160 million, of which we expect to use approximately $25 million to further pay down our real estate loan, with the remaining proceeds to be used to pay down a portion of the balance on our revolving credit facility.

Finally, we entered into a second agreement to purchase another group annuity contract from MetLife to annuitize an additional $512 million of pension liability, which I will discuss in greater detail later in this call.

We also continued to unlock value from our assets. We have generated over $460 million in cash from real estate transactions during the second quarter. We continue to make progress on our marketing of real estate properties and evaluating offers as part of our original target of raising at least $1.0 billion in proceeds.

We have a valuable real estate portfolio, which at the end of the quarter comprised of nearly 900 leased as well as over 350 owned stores, many in prominent locations. We continue to have a high degree of flexibility across our store leases as a result of renewal options and the minimal base lease commitment. We are committed to evaluating strategic options across our real estate portfolio to unlock value from these assets, including in-store partnerships and sub-division opportunities.

These financing and real estate transactions, among others, demonstrate the Company's commitment to generating additional liquidity in order to fund our transformation while continuing to fulfill all our financial obligations.

We also continue to work toward providing a more rewarding member experience through our Shop Your Way ecosystem. As I mentioned, in the second quarter we entered into a strategic partnership with Time Inc. and Synapse Group that delivers significant value and services to our members.

We will continue to strengthen the competitiveness of our Shop Your Way platform through new collaborations and unique solutions that offer great value and convenience to our members every day.

On slide 7, I will provide more detail around the actions we have taken during the second quarter to increase our financial flexibility and de-risk our balance sheet.

We reached an agreement with our lenders to amend our existing Second Lien Credit Agreement to provide for the creation of a $500 million Line of Credit Loan Facility. Seven investors have made loans to the Company under the Line of Credit Facility, including affiliates of ESL investments and certain of our directors and companies affiliated with them. The facility also generated interest from external parties – investments from certain unaffiliated third parties are included in the $330 million outstanding at the end of the second quarter.

Earlier this month, we also entered into an amendment to our secured standby letter of credit facility to extend the original maturity date of December 28, 2017 to December 28, 2018, eliminate the unused portion of the facility and release the real estate collateral that previously secured the facility. The letter of credit facility permits the lenders to syndicate all or a portion of their commitments to other lenders. As of today, $140 million of the LC facility has been syndicated to unaffiliated third-party lenders, again underscoring the external interest in our Company from third-party investors.

During the second quarter, we took further action to de-risk our balance sheet by paying down $276 million of real estate loans. As mentioned, subsequent to quarter end, we completed additional assets sales which generated cash proceeds of nearly $160 million, with approximately $25 million used to pay down our real estate loan, with the remainder used to pay down a portion of the balance on the Company's revolving credit facility.

Lastly, in August 2017, the Company reached an agreement with Metropolitan Life Insurance Company to annuitize an additional $512 million of its pension liability, under which MetLife will pay future pension benefits to an additional approximately 20,000 retirees. This action is expected to have an immaterial impact on the funded status of our total pension obligations, but will serve to further reduce the size of the Company's combined pension plan, reduce future cost volatility and reduce future plan administrative expenses.

Moving to the next slide, I would like to review our financial position in light of the various actions we have taken during the quarter.

At the end of the second quarter, we had cash and cash equivalents of $212 million, compared to $276 million at the end of the prior year quarter.

At July 29, 2017, the amount available to borrow under our revolving credit facility was approximately $191 million, compared to $165 million at January 28, 2017.

We ended the quarter with $407 million in short-term borrowings available under our general debt basket, compared to $250 million of availability at January 28, 2017.

Our total debt, including short-term borrowings and capital lease obligations, was $4.0 billion, compared to $4.2 billion at January 28, 2017.

So, to conclude, let's move on to slide 9.

In summary, we remain fully committed to returning the Company to profitability and further improving financial flexibility to remain competitive in a very challenging retail environment.

We are seeing progress in our strategic restructuring and transformation, which enabled us to achieve substantial improvements in both Adjusted EBITDA and net loss in the second quarter of 2017 compared to the second quarter of 2016.

We continue to evaluate innovative ways to unlock value from our assets, including our brands and businesses. Our recent agreement with Amazon.com is perfectly aligned with this strategy, as it significantly expands the reach and supports the growth of our Kenmore brand and our Sears Home Services and Innovel Solutions businesses.

As we continue to take action to reduce our operating losses and to improve our performance, we are also committed to taking further decisive steps to strengthen our financial flexibility, and to reduce and de-risk our debt and pension obligations.

As we sharpen our focus on our best stores, best categories and best members, we will build on the momentum of our actions to date and be better equipped to support our continued transformation.

We are increasingly confident in our future and remain committed to delivering more value and better services for our members through our integrated retail offerings.

We look forward to continuing to report progress on our actions.