SEARS HOLDINGS

Sears Holdings' Second Quarter 2018
Pre-Recorded Conference Call Transcript
September 13, 2018

Operator:

Good day, ladies and gentlemen, and welcome to the Sears Holdings Corp. second quarter 2018 earnings conference call. [Operator instructions]

Chris Brathwaite:

Thank you, operator. Ladies and gentlemen, welcome to the Sears Holdings earnings call. I'm Chris Brathwaite, Vice President of Corporate Communications for Sears Holdings, and I'm joined today by Rob Riecker, our Chief Financial Officer. Today we released our second quarter 2018 results, which are available on the "Investors" section of our website. You can access the accompanying slide presentation for our call today through the same section of the website.

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 these 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 on the "Investors" 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, 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 the call off to Rob.

Rob Riecker:

Thanks, Chris. Good day, and thank you for joining our call.

In the second quarter, we continued to focus on our key strategic priorities, with the goal of transforming our business and improving our financial performance. While we have yet to achieve our goal of returning the Company to profitability, I'd like to highlight that we saw the effects of our operational momentum this quarter, and particularly in the months of July and August, during which we achieved positive comparable store sales of 3.0% and 2.5%, respectively.

Before we discuss progress on our transformation in more detail, let's first turn to slide 5 to review key year-over-year financial performance measures.

During the quarter, we reported a net loss attributable to Holdings' shareholders of $508 million in 2018 compared to net loss attributable to Holdings' shareholders of $250 million in 2017. Total revenues were $3.2 billion in the second quarter of 2018 compared to $4.3 billion in the corresponding quarter last year. Strategic store closures, which occurred as a result of our focus on right-sizing our store base, were again a major contributor to the year-over-year decline in total revenues.

Total comparable store sales declined 3.9% during the second quarter. Kmart comparable store sales declined 3.7%, and Sears comparable store sales declined 4.0%. In addition to delivering improvement in our comparable store sales trend in the second quarter compared to the first quarter, as I mentioned, we achieved positive comparable store sales in several categories at both Sears and Kmart formats, including apparel, footwear and jewelry.

We experienced a decrease in margin rate during the second quarter as compared to the prior year quarter primarily due to an increase in our Shop Your Way promotional offerings to better serve our customers as we move away from traditional and digital advertising. We also continued to streamline our inventory, were more aggressive in clearing our seasonal inventory levels, particularly at the Kmart format, and reduced lower-performing inventory. We believe these actions improved our inventory position as we head into the third quarter, historically one of our more challenging quarters.

Selling and administrative expenses declined by $259 million during the second quarter compared to the prior year as a result of restructuring initiatives taken in 2017 and the actions taken in 2018 associated with our previously announced $200 million cost savings initiative.

Now, let's discuss the financial and operational progress on our transformation.

Moving to slide 6, we took a number of important, proactive steps in the second quarter of 2018 to address our capital structure, enhance our liquidity position and provide the Company with additional financial flexibility as we continue to execute on our strategic transformation.

As previously announced, we entered into a Loan Agreement that provided an additional $186 million of liquidity that was used to repay the loans outstanding under our 2016 Secured Loan Facility. The Consolidated Loan Agreement matures in July 2020. Our entry into this agreement and the termination of our 2016 Secured Loan Facility effectively resulted in the extension of the maturity of nearly $325 million of loans to July 2020 and increased the availability under the general debt basket of our revolving credit facility. Subsequent to the end of the quarter, the Company also repaid the balance of a $95 million term loan. The completion of these transactions, along with amendments to other existing debt agreements, will reduce quarterly cash interest expenses and better manage cash needs into fiscal 2019.

We were also able to enhance our liquidity through a series of other transactions. We borrowed an aggregate of $125 million in additional Mezzanine loans during the second quarter.

Taken together, these actions will help extend our runway as we continue to work to transform the Company.

We also benefitted from our previously announced agreement with Citi Retail Services. Citibank paid Holdings $425 million as part of a long-term extension of our 15-year co-brand and private label credit card relationship, along with long-term marketing arrangements that include ongoing enhancements to the Shop Your Way® MasterCard rewards program. While we discussed this during our first quarter call, it is important to note that this occurred during the second quarter.

At the same time, we continued to take action during the quarter to optimize our cost structure, executing our plan to achieve $200 million of annualized cost savings while working to identify additional savings opportunities. To that end, we announced on August 22 that we have identified 46 unprofitable stores that we expect to close in November of 2018. While store closures continue to impact our top line and are not something we undertake lightly, we believe that closing underperforming stores will allow us to right-size our store footprint to a solid base from which we can operate and grow profitably as well as leverage our online and Shop Your Way platforms. We are hopeful that we can stabilize our store base at a meaningful level in the near future.

As we execute on our best store strategy, we must ensure our operating model fits the needs of a smaller store footprint. This means we will continue to simplify our organization and evaluate all areas of our cost structure for additional opportunities to achieve savings, including greater consolidation of the Sears and Kmart corporate and support functions. We expect these initiatives to result in annualized cost savings of approximately $100 million. This is in addition to the Company's $200 million annualized cost savings initiative announced earlier this year that we have exceeded. These incremental actions, along with the various financing transactions outlined in our press release and discussed throughout this call, are intended to provide Holdings' with a path forward to transform the Company.

As we note on slide 7, we also continue to focus on creating value from our assets, including monetizing our properties to further enhance liquidity.

On August 30, 2018, we amended our agreement with the Pension Benefit Guaranty Corporation to release its liens on certain real estate properties in exchange for a $32 million contribution to our pension plans. We also entered into an amendment to the Consolidated Loan Agreement and borrowed an additional $75 million and pledged certain of the released properties, together with other properties, as collateral.

In addition, we recently entered into an amendment to our Credit Agreement with UBS pursuant to which, among other things, we borrowed an additional $113 million and extended the maturity of the existing $30 million loan outstanding under the Credit Agreement to August 30, 2019, which is also the maturity date of the additional loan.

This financing, when combined with nearly $440 million of proceeds we have generated from real estate sales during the first half of fiscal 2018, demonstrates our ability to realize value from our real estate portfolio. As a reminder, more than $310 million of the proceeds from these real estate sales have been used to pay down our real estate-backed loans. We will continue to pursue additional real estate transactions to unlock the value of our real estate assets and repay amounts due on the real estate-backed loans outstanding.

We will continue to evaluate all options to optimize our cost structure and enhance our liquidity, while staying focused on our best members, best categories and best stores.

Before we move on, we have one final note on this slide. The Special Committee of the Board of Directors continues its formal process to explore the sale of the Kenmore brand and related assets, the Sears Home Improvement Products business of the Sears Home Services division and the PartsDirect business of the Sears Home Services division. On August 14th, the special committee received a non-binding proposal from ESL Investments, Inc. to acquire the Kenmore brand and related assets for $400 million and the Home Improvements business of Sears Home Services division for $80 million, subject to certain contingent matters, among other considerations. A potential transaction between ESL and the Company involving the sale of some or all of the sale of assets would be subject to a vote of our disinterested stockholders. The independent special committee, which consists solely of independent directors, is reviewing this proposal, and potentially other proposals, as part of its formal process. We do not intend to comment further on the process at this time.

Now turning to slide 8, I will review the operational progress we made in the quarter as we focused on enhancing the in-store and online shopping experiences for our members through our key priorities: our integrated retail strategy and our Shop Your Way® membership program.

In the second quarter, we continued to expand the Shop Your Way ecosystem through new partnerships that seek to meet member needs and increase engagement. We recently announced that we expanded our Sears Auto Center tire installation program with Amazon.com, which is now available nationwide, including in Alaska and Hawaii. As we've mentioned previously, Sears Auto is the first nationwide auto service center to offer Amazon customers a convenient ship-to-store tire solution integrated into Amazon's familiar checkout process. While this partnership is only a few months old, Amazon customer reviews have been positive. Importantly, more than 90 percent of the Amazon customers taking advantage of this service are new to Sears Automotive.

As part of our focus on best categories, we rolled out a fully integrated marketing campaign supporting The MOREs of Kenmore, which highlights all the outstanding offers available to members who purchase Kenmore products. We also sought to further diversify our offerings to customers by expanding the assortment of products sold by third-party sellers on the sears.com online marketplace. We now have more top brands and popular products, including new floor care brands, national shoe brands and precious metals, as well as premium bullion products.

In addition, through a strategic partnership with Rocketmiles, we launched Shop Your Way Hotels, giving members exclusive access to reserve rooms at more than 400,000 hotels around the world and receive an average of $50 CASHBACK in Shop Your Way points for each booking.

Our stores remain a critical component of our transformation strategy and we continued to take steps in the quarter to create a better in-store experience for customers.

As we progress through the second half of fiscal 2018, we have the responsibility to explore opportunities to unlock the full potential of our assets for our shareholders, including third-party partnerships or the sale of our businesses. We also remain focused on deepening our strength in key categories, enhancing our integrated retail offerings and continuing to expand the network of services and rewards for Shop Your Way members. We believe these initiatives, among other things, will help us differentiate Sears and Kmart formats in the marketplace, and thus better position Holdings for the future.

Before moving to the next slide, I'd like to provide an update on our ongoing work to support the relief efforts in Puerto Rico in the wake of Hurricanes Maria and Irma. We have been partnering closely with the Salvation Army in these efforts to help those in the region more quickly rebuild and be better prepared for the future. This has been a very successful partnership for Sears and Kmart and we are looking at ways to further expand on this relationship throughout the remainder of the rebuilding efforts, which are estimated to continue into the next five to seven years.

Moving to slide 9, at the end of the second quarter, we had total liquid availability of approximately $941 million, including availability in our credit facility and availability under the short-term borrowing basket. At August 4, 2018, the amount available to borrow under our revolving credit facility was approximately $98 million, compared to $20 million at the end of the first quarter.

To conclude today's call, we'd like to reiterate that we're encouraged by the improved comparable stores sales trend we achieved in the second quarter. Holdings' leadership – along with our associates across the country – is working hard each and every day to transform our business and enhance our financial performance, while delivering value to our members.

As we look to the second half of 2018, we will continue to take proactive steps to strengthen our balance sheet, optimize our cost structure and unlock the value of our assets, guided by our best members, best categories and best stores strategy and key priorities of Shop Your Way and integrated retail. We believe these actions will help to further extend our runway and continue our transformation to a profitable company. We look forward to updating you on our continued progress.