SEARS HOLDINGS

Sears Holdings' First Quarter 2018
Pre-Recorded Conference Call Transcript
May 31, 2018

Operator:

Good day, ladies and gentlemen, and welcome to the Sears Holdings Corp. first 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 first quarter 2018 results, which are available on the Investors section of our website under "Events & Presentations." 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 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, 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 first quarter of 2018, our key strategic priorities have continued to guide our transformation efforts. While we have remained focused on our strategic transformation, this is an ongoing process, and there is still more work to be done. We are concentrating on continuing our operational momentum and strengthening our financial position, with the goal of successfully transforming our business and returning to profitability.

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 $424 million in 2018 compared to net income attributable to Holdings’ shareholders of $245 million in 2017. The prior year first quarter included a gain of $492 million that was recognized in conjunction with the sale of the Craftsman brand. Total revenues were $2.9 billion in the first quarter of 2018 compared to $4.2 billion in the corresponding quarter last year. Strategic store closures, which occurred as a result of our focus on right sizing our store base, contributed to nearly two thirds of the decline in total revenues. Moving forward, we will continue to focus on our best stores, which remain a critical component of our transformation strategy as we shift to a member-centric integrated retail model.

Total comparable store sales declined 11.9% during the first quarter. Kmart comparable store sales decreased 9.5%, and Sears comparable store sales declined 13.4%. The Company did, however, experience positive comparable store sales in several categories – including apparel, footwear and jewelry – at both Sears and Kmart stores.

Selling and administrative expenses declined by $315 million during the first 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.

As we’ve stated before, our top priority is successfully executing our transformation to return to profitability and remain a competitive retailer for years to come. While we had a challenging first quarter, we remain focused on improving our financial performance and enhancing our liquidity, both of which are critical to our long-term success.

Our transformation strategy is designed to make Sears Holdings a new kind of retailer – one that is innovative, truly integrated and optimally positioned to meet the needs and preferences of today’s shoppers. As we work to achieve this goal, we will continue to explore creative ways to unlock the full potential of our Company’s assets, including through game-changing partnerships.

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 first quarter of 2018 to address our capital structure, enhancing our liquidity position and provide the Company with additional financial flexibility as we continue to execute on our strategic transformation.

As previously announced, we completed private exchange offers for our outstanding 8% Senior Unsecured Notes due 2019 and 6.625% Senior Secured Notes due 2018 to improve the terms of our non-first lien debt. The completion of these exchange offers, along with amendments to other existing debt agreements, will reduce quarterly cash interest expenses and extend maturity dates. During the first quarter of 2018, we also repaid $300 million on our Term Loan due in 2019.

In addition, to further strengthen our balance sheet and improve our capital structure, we executed an agreement with a third-party insurance company in which the insurance company assumed certain of Holdings’ insurance liabilities in exchange for $206 million. As a result, we were able to reduce approximately $254 million of letters of credit outstanding that had been previously required to support the insurance liabilities.

We were able to enhance our liquidity through a series of other transactions completed in the first quarter. We raised nearly $710 million in financing in the first quarter of 2018 under the Secured and Mezzanine Loan facilities and the FILO loan. The Company contributed $282 million of the proceeds from the Secured and Mezzanine Loans to the Sears pension plans and deposited $125 million in an escrow account for the benefit of those pension plans.

In addition, we recently announced that we entered into an agreement with Citi Retail Services for 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. Citibank paid the Company $425 million in conjunction with the extension.

As always, we continue to evaluate strategic options across our portfolio to unlock value from our assets, brands and businesses. In the first quarter, we raised nearly $290 million of proceeds from real estate sales, with the majority used to pay down our real estate-backed loans.

While we are pleased with the progress on our capital structure initiatives, we are continuously exploring additional opportunities to further streamline operations and adjust inventory and operating expenses. As I said earlier, our stores are – and will remain – a critical component in our transformation. But to best meet our members' evolving needs and to drive profitability, we will need to continue to right-size our store base and focus on our best stores, including our new smaller store formats.

To that end, one of the difficult, but necessary actions we will be taking is to close additional non-profitable Sears and Kmart stores, as indicated in our earnings release. These stores are expected to close by the end of the third quarter. Continuing to evaluate our store network and other initiatives will allow us to optimize our cost structure and enhance our liquidity, while staying focused on our best members, best categories and best stores.

Turning to slide 7, I will provide more detail around the progress we have made on our operations. Our Shop Your Way membership program and Integrated Retail Strategy remain key priorities for us, and our goal is to continue to enhance our members' in-store and online shopping experience. To that end, we continue to look for new ways to leverage our Shop Your Way ecosystem to drive improvements in value for our members and to increase the frequency and amount of their engagement.

In the first quarter, we've been able to improve member engagement through more personalized Shop Your Way point awards and the expansion of our FREECASH incentive program for our best members. We continued to provide members using the Shop Your Way 5-3-2-1 Mastercard with everyday value by expanding usage across the gas, dining, and grocery categories. Notably, we launched three new Shop Your Way ecosystem partnerships that meet key needs for our members:

- With Truxx, we ensure that our members with local moving or transportation needs always have a buddy with a truck available within minutes.

- Amid rising gas prices, our platform integration with GasBuddy helps our members find the lowest price and get industry-leading savings on every fill-up.

- Our partnership with fuboTV enables our members to "cut the cord" on cable and stream their entertainment directly to any of their screens.

In addition to launching these strategic partnerships in the first quarter, we expanded our LEASE IT program to become the only national full-service retailer to offer a full assortment of products to lease both online and in-store, and expanded our exclusive apparel lines with celebrity brand icon Jaclyn Smith. As we continue to transform into a truly member-centric organization, we will look for new and innovative ways to better serve our members and offer them industry-leading savings and convenience.

In fact, just last week, Citi and the Company announced the 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 our Shop Your Way Mastercard rewards program. Shop Your May Mastercard cardholders will now enjoy generous benefits every day that previously were only available on a promotional basis. We continue to make our member shopping experience as convenient as possible through a continued and growing emphasis on value-adds, such as our Buy Online, Pick Up In Store service as well as our local pick-up and local delivery.

As you may know, in the wake of the hurricanes, our dedicated associates worked hard to reopen our Kmart and Sears stores in Puerto Rico and elsewhere in order to serve the impacted communities. Notably, we continue to see strong engagement and business growth in our hurricane-impacted markets. In Puerto Rico, we opened new stores and new concepts, such as a Sears Home Improvement store in Fajardo.

We introduced new categories, such as Solar and Home Retail, and also scaled our Sears Appliances, Mattress, Tools, and Lawn & Garden categories across more than 20 Kmart locations. Our local partnerships continued, as Shop Your Way sponsored a two-game series that took place in Puerto Rico in mid-April between the Cleveland Indians and the Minnesota Twins while we continued our grass-roots programs, with FEMA Support Centers now established in several of our stores. Amid the recovery, we are seeing engagement, revenue and margin growth above last year and above plan.

Subsequent to the end of the quarter, we announced an exciting collaboration with Amazon.com to provide full-service tire installation and balancing for customers who purchase any brand of tires, including our DieHard brand, on Amazon.com. This makes Sears Auto the first nationwide auto service center to offer Amazon.com customers a convenient ship-to-store tire solution integrated into Amazon's familiar checkout process. This builds on the success of our earlier launches of Kenmore and DieHard products on Amazon.com, which significantly expanded the reach of those brands.

During the remainder of 2018 and beyond, we will continue to explore opportunities to unlock the full potential of our assets for our shareholders. This includes exploring third-party partnerships involving several of our businesses – such as Sears Home Services, Innovel, Kenmore and DieHard – and gaining further momentum around our new smaller store formats that blend brick-and and-mortar and online experiences. We believe these initiatives, among others, will help us better position Sears Holdings for the future.

Moving to slide 8, at the end of the first quarter, we had total liquid availability of approximately $457 million, including availability in our credit facility and availability under the short-term borrowing basket.

At May 5, 2018, the amount available to borrow under our revolving credit facility was approximately $20 million, compared to $69 million at the end of the fourth quarter. On a pro forma basis, the amount available to borrow under our revolving credit facility would have been $420 million if you take into account the cash we received from Citi on May 18 under the agreement.

There is one more thing I'd like to mention before my concluding remarks. As we previously announced, a special committee of our Board of Directors has initiated a 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. As part of its review, the independent special committee continues to evaluate the April 20th letter the Company received from ESL Investments expressing interest in participating as a purchaser of all or a portion of the aforementioned assets. We do not intend to comment further on the process at this time.

So to conclude today's call, while the first quarter was challenging, Sears' leadership continues to work hard each and every day on enhancing our financial performance and making progress on our transformation. To extend our runway as we work to transform and position our business to better compete in today's retail environment, we will continue to take proactive steps to strengthen our balance sheet through various capital structure and liquidity initiatives.

We will also drive improvements in our business while executing against our strategy of focusing on best members, best categories and best stores, and continue to evaluate opportunities to unlock the earnings potential of our assets across our portfolio. We remain fully committed to restoring Sears Holdings to profitable Adjusted EBITDA in 2018 and to unlock the full potential of our assets for our shareholders. We look forward to reporting progress on that front.