

## Sears Holding Corporation

NASDAQ:SHLD

**Analyst:** JACKY CHENG

**Sector:** SERVICES

### SHORT

Price Target: \$20.00

### Key Statistics as of 4/16/2015

Market Price:	\$43.50
Industry:	Department Stores
Market Cap:	\$4.53 B
52-Week Range:	\$22.45 - 48.25
Beta:	2.77

### Thesis Points:

- Diminishing Financials w/ Negative Cash Flows
- No Future Growth Outlook
- Unprofitable Company
- Decrease in Market Share in Competitive Industry

### Company Description:

Sears Holdings Corporation operates as a retailer in the United States. It operates in two segments, Kmart and Sears Domestic. The Kmart segment operates retail stores that offer a range of products, including consumer electronics, seasonal merchandise, outdoor living, toys, lawn and garden equipment, food and consumables, apparel, and in-store pharmacies. As of January 31, 2015, this segment operated approximately 979 Kmart stores located across 49 states, Guam, Puerto Rico, and the U.S. Virgin Islands. The Sears Domestic segment operates stores that provide appliances, consumer electronics/connected solutions, tools, sporting goods, outdoor living, lawn and garden equipment, apparel, footwear, jewelry, and accessories, as well as automotive services and products, such as tires, batteries, and home fashion products. It also offers appliances and services to commercial customers in the single-family residential construction/remodel, property management, multi-family new construction, and government/military sectors; appliance and plumbing fixtures to architects, designers, and new construction or remodeling customers; parts and repair services for appliances, lawn and garden equipment, consumer electronics, floor care products, and heating and cooling systems; and home improvement services, as well as protection agreements and product installation services. As of January 31, 2015, this segment operated 717 full-line stores located across 50 states and Puerto Rico. Sears Holdings Corporation was founded in 1899 and is based in Hoffman Estates, Illinois.



## Thesis

Sears Holdings Corporation has been struggling financially and it is a surprise to still see them sticking around. For the past five years, the corporation has been on a decline in sales and has been forced to close down stores and sell other assets over the past several years. Management has taken a compensation cut to keep the company alive. Overall, the story looks like a fiasco.

Full Year 2014

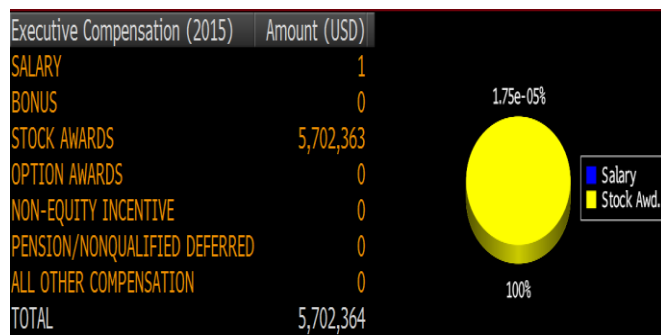
### Domestic Comparable Store Sales

Format	Full Year 2014	Drivers
Sears Domestic	-2.1%	↑ Home Appliances
		↑ Mattresses
		↓ Apparel
		↓ Auto
		↓ Consumer Electronics
Kmart	-1.4%	↑ Apparel
		↑ Jewelry
		↓ Grocery & Household
		↓ Consumer Electronics

\*Above shows the decrease in domestic sales compared to last year.

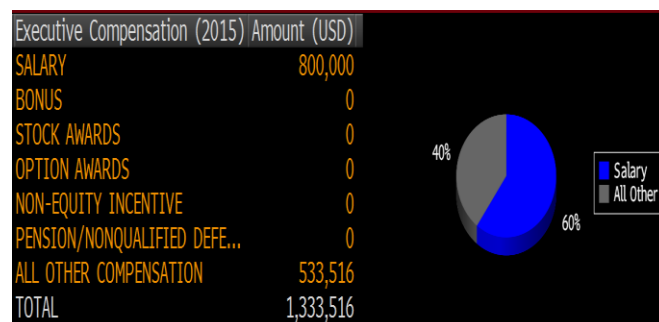
## Management

Currently, Edward S Lampert, who is the CEO and Chairman of Sears Holdings Corporation, does not have a salary and has not had one for the past three years. Eddie has been with the company. He is though, being compensated entirely in stock awards. This gives him a really imperative incentive to revive the company; otherwise his investment would be such a waste of time.



\*Above shows Eddie's Compensation of \$1 in salary and \$5 Million in stock awards.

Robert A Schrieshem, who is the CFO of Sears Holdings Corporation, has a salary of \$800,000 while the rest is in compensation. Robert has over the past year lost his bonus and stock award he once had, shrinking his total compensation from about \$5.2 million in 2012 to \$1.3 million in 2015.



\*Above shows Robert's compensation, which has been significantly less compared to previous years.

The executives are not the only one suffering from pay cuts. A lot of employees that work in Sears or K-Mart have been laid off or taken a salary cut due to the fact they are unable to pay them the salaries at the same rate or the stores are not generating a profitable margin where they end up closing the stores entirely.

## Store Closings/Sell Offs

Sears Holding Corporation has been selling off its assets and closing down stores in order to decrease its expenses, increase gross margins, and most importantly to raise capital. Recently, the corporation has started selling their properties to a REIT in order to make the company profitable. Sears Holding Corporation has also spin off Lands' End, which is a clothing line, and most of Sears Canada.

	Date	Action Type	Ticker / ID	Summary
1)	04/13/15	Divestiture	SHLD US	Unit: Sears Holdings property at the La Plaza Mall, S
2)	04/13/15	Joint Venture	SHLD US	Forming: Unnamed Joint Venture
3)	04/01/15	Joint Venture	SHLD US	Forming: Unnamed Joint Venture
4)	05/14/14	Divestiture	SHLD US	PROPOSED - Unit: Sears Canada Inc, Seller: Sears H
5)	04/07/14	Spin-off	SHLD US	Spin-off: Lands' End Inc(LE US)
6)	04/07/14	Spin-off	SEE GR	Spin-off: Lands' End Inc(LE US)
7)	04/07/14	Spin-off	SEE TH	Spin-off: Lands' End Inc(LE US)
8)	11/12/13	Divestiture	SHLD US	Unit: Berkshire Property Portfolio, Seller: Sears Hol
9)	10/31/12	Spin-off	SHLD US	Spin-off: Sears Canada Inc(SCC CN)
10)	10/31/12	Spin-off	SEE GR	Spin-off: Sears Canada Inc(SCC CN)
11)	10/31/12	Spin-off	SEE TH	Spin-off: Sears Canada Inc(SCC CN)
12)	04/18/12	Divestiture	SHLD US	Unit: Sears Stores, Seller: Sears Holdings Corp

\*Above shows Sears Holding Corporation spin-off and divestitures for the past three years.



\*Above shows graph projection with each divestiture plotted.

Despite reducing its stores, the company is unable to transform its business operations into a profitable company as the company's store sales still remain negative.

### Debt and Other Obligation

The unfunded pension obligation has been hurting the corporation as it has increased year to year. This was due to that fact that decreases in the interest rate used to measure funding status and increase in mortality rates used to compute the liability.

Sears Holdings has a frozen pension plan which provides benefits for past services

The pension obligation increased in 2014 due to a decrease in the discount rate and new mortality rates used to compute the liability

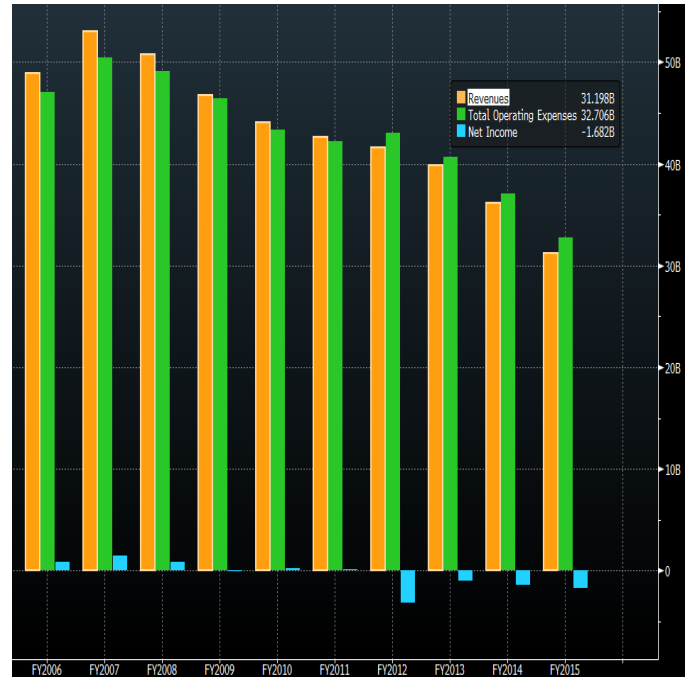
Amounts in millions	Year-End Balances					
	2014	2013	2012 <sup>(1)</sup>	2011	2010	2009
Assets	\$3,616	\$3,490	\$3,221	\$4,051	\$4,054	\$3,633
Liability	5,875	4,981	5,311	6,109	5,623	5,435
Unfunded	(\$2,259)	(\$1,491)	(\$2,090)	(\$2,058)	(\$1,569)	(\$1,802)
Discount Rate	3.70%	4.60%	4.25%	4.90%	5.75%	6.00%

▪ Note: A 100 bps increase in the discount rate would reduce the pension liability by approximately \$600 million

### Financials

Sears Holding Corporation has been suffering from terrible financials for almost ten years. Looking at the financials, revenue has been on a decline since 2007 and

operating expenses has exceeded revenue starting in 2012, resulting in negative net income.



\*Above graph shows revenue decreasing and operating expense exceeding revenue at FY2012, resulting in a negative net income.

Other indicators on their financials include the amount of cash the corporation has on hand. For 2015, Sears Holdings has only 250 million compared to 1 billion from last full year.

Other alarming indicators that are worth noting are the free cash flows and EBITDA. Both of these have been negative for the past years and have been getting worse by the year.



\*Above graph shows the decrease in cash & equivalents and free cash flows.

## Future Outlook

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Currently, Sears Holding Corporation does not look like they have a good future despite the efforts to become profitable again. Despite selling off stores and other assets, the corporation is still operating at a loss. On top of that, the competition in the department stores market is outperforming Sears Holding Corporation. K-Mart is being outperformed by companies such as Wal-Mart and Target while Sears is not competing well with companies such as Lowes and Best Buy. Not to mention, there are almost five or more times as many Wal-Mart or Target stores than a K-Mart store and the company is only diminishing their market share in the industry. Same goes with Sears compared to stores like Home Depot, Best Buy, and Macy stores that you see almost everywhere and Sears is nowhere to be in sight.

## Conclusion

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Despite the efforts to transform the corporation into a profitable company, the trend has not stopped and continues to show through the financials. The company remains unprofitable and downsizing on stores is only shrinking the market share in the industry that is already highly congested with myriads of competitors. The corporation is doing a good job raising capital by selling stores and assets, but it is not translating into revenue and most importantly net profit. For these reasons, Sears Holding Corporation is a SHORT.

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<b>Sears Holdings Corporation</b>		<b>SHLD</b>	<b>Analyst</b> <b>JACKY CHENG</b>	<b>Current Price</b> <b>\$43.50</b>	<b>Intrinsic Value</b> <b>\$20.26</b>	<b>Target Value</b> <b>\$0.00</b>	<b>Divident Yield</b> <b>0%</b>	<b>Target Return</b> <b>1-y Return: -100%</b>	<b>BEARISH</b>
<b>General Info</b>		<b>Peers</b>	<b>Market Cap.</b>		<b>Professional</b>		<b>Management</b>		<b>Comp. FY2015</b>
Sector Consumer Discretionary		Best Buy Co., Inc.		\$13,312.63	Lampert, Edward Chairman, Chief Executive Of		<b>Comp. FY2013</b>	<b>Comp. FY2014</b>	<b>Comp. FY2015</b>
Industry Multiline Retail		Staples, Inc.		\$10,384.80	Schriesheim, Robert Chief Financial Officer and Ex		\$4,309,524	\$5,702,364	\$0
Last Guidance Nov-07-2014		J. C. Penney Company, Inc.		\$2,731.86	Balagna, Jeffrey Chief Information Officer and		\$1,498,245	\$1,333,516	\$0
Next earnings date NM		Macy's, Inc.		\$23,228.80	Arora, Arun Senior Vice President and Pr		\$3,590,828	\$1,151,524	\$0
<b>Market Data</b>		Lowe's Companies Inc.		\$70,407.14	Mixon, James Senior Vice President of Supj		\$0	\$1,590,151	\$0
Enterprise value \$8,191.18		Bed Bath & Beyond Inc.		\$13,619.40	Riecker, Robert Chief Accounting Officer, Vic		\$0	\$0	\$0
Market Capitalization \$2,032.29		The Home Depot, Inc.		\$148,077.84	<b>Historical Median Performance</b>		<b>SHLD</b>		
Daily volume 0.25		Target Corp.		\$53,302.84			<b>Peers</b>	<b>Industry</b>	<b>All U.S. firms</b>
Shares outstanding 106.56		Kohl's Corp.		\$15,530.58	Growth	-5.9%	1.8%	2.5%	7.4%
Diluted shares outstanding 106.30		Advance Auto Parts Inc.		\$10,903.84	ROIC	2.0%	10.5%	13.6%	14.3%
% shares held by institutions 99.58%		<b>Current Capital Structure</b>		Total debt/market cap	NOPLAT Margin	2.9%	5.2%	3.8%	10.4%
% shares held by insiders 27.46%		Total debt/market cap		81.98%	Revenue/Invested Capital	0.70	2.03	3.62	1.37
Short interest 9.66%		Cost of Borrowing		6.05%	Excess Cash/Rev.	2.8%	4.0%	13.5%	12.9%
Days to cover short interest 14.90		Interest Coverage		1.9x	Total Cash /Rev.	2.8%	4.0%	12.3%	15.2%
52 week high \$48.25		Altman Z		1.92	Unlevered Beta	0.93	0.98	1.08	0.95
52-week low \$24.10		Debt Rating		D	TEV/REV	0.3x	0.8x	0.7x	2.5x
5y Beta 2.90		Levered Beta		3.76	TEV/EBITA	7.2x	15.8x	9.8x	13.1x
6-month volatility 68.05%		WACC (based on market value we		7.86%	PE (normalized and diluted EF	9.5x	15.6x	18.1x	23.5x
<b>Past Earning Surprises</b>		EBITDA		Norm. EPS	FYBY	0.6x	2.9x	2.5x	2.2x
Last Quarter -2.5%		0.0%		NM	<b>Non-GAAP Adjustments in estimates computations</b>				
Last Quarter-1 4.7%		0.0%		NM	Operating Leases Capitalizati	100%	Straightline	10 years	
Last Quarter -2 -1.4%		NM		NM	R&D Exp. Capitalization	0%	N/A	N/A	
Last Quarter -3 2.1%		NM		NM	Expl./Drilling Exp. Capitalizatio	0%	N/A	N/A	
Last Quarter -4 0.2%		NM		NM	SG&A Capitalization	14%	Straightline	10 years	
<b>Proforma Assumptions</b>		<b>Period</b>		<b>Rev. Growth</b>	<b>Adj. Op. Cost/Rev</b>	<b>Invested Capital</b>	<b>NOPLAT Margin</b>	<b>ROIC</b>	<b>WACC</b>
Money market rate as of today 0.54%		LTM		-13.8%	102.7%	\$17,843.54	-1%	-0.9%	7.9%
Annual increase (decrease) in interes 0.1%		NTM		-12.0%	101.2%	\$8,266.34	-3%	-4.3%	8.2%
Yield Spread acceleration 1.2		NTM-1		-10.1%	99.7%	\$7,143.15	-2%	-4.5%	8.3%
Marginal Tax Rate 37.5%		NTM-2		-8.3%	98.2%	\$6,474.90	0%	-0.7%	8.4%
Risk-Free rate 2.6%		NTM-3		-6.5%	96.7%	\$6,092.22	1%	2.3%	8.5%
Tobin's Q 0.80		NTM-4		-4.6%	95.2%	\$5,905.75	2%	5.0%	8.6%
Op. Cash/Rev. 7%		NTM-5		-2.8%	93.7%	\$5,973.77	2%	7.9%	8.7%
Growth in PPE NPPE Growth follows Revenue Growth		NTM-6		-1.0%	92.3%	\$5,956.29	3%	10.6%	8.5%
Long term Growth 4.5%		NTM-7		0.9%	90.8%	\$6,988.76	4%	13.5%	8.4%
Base Year Unlevered Beta is equal to 0.98		NTM-8		2.7%	89.3%	\$7,873.75	5%	13.4%	8.4%
Long term Unlevered Beta 0.98		Continuing Period		4.5%	87.8%	\$7,957.24	6%	10.0%	8.5%
<b>Valuation</b>		<b>Period</b>		<b>Invested Capital ± (ROIC-WACC)</b>	<b>Total Debt</b>	<b>Senior non-interest bearing clai</b>	<b>Shares Outstanding</b>	<b>Pricing Model</b>	
LTM		\$0.00		\$3,800.00	\$9,507.86	106.56	DCF (Weight = 100%)	Relative (Weight = Distress (Weight = Weighted Average Price P	
NTM		-\$2,227.12		\$4,614.59	\$5,796.74	106.56	\$20.40	\$0.00	\$75.20
NTM-1		-\$1,056.21		\$5,388.25	\$4,748.89	106.56	\$0.00	\$0.00	\$21.46
NTM-2		-\$644.79		\$5,936.32	\$4,110.78	106.56	\$0.00	\$0.00	\$28.02
NTM-3		-\$401.69		\$6,283.97	\$3,715.33	106.56	\$0.00	\$0.00	\$30.46
NTM-4		-\$214.35		\$6,436.57	\$3,474.24	106.56	\$0.00	\$0.00	\$33.33
NTM-5		-\$47.30		\$6,489.28	\$3,343.07	106.56	\$0.00	\$0.00	\$34.99
NTM-6		\$117.69		\$6,489.28	\$3,241.59	106.56	\$0.04	\$17.73	\$35.95
NTM-7		\$305.25		\$6,489.28	\$2,680.08	106.56	\$1.74	\$38.87	\$38.54
NTM-8		\$346.54		\$6,489.28	\$3,162.73	106.56	\$9.22	\$36.51	\$37.70
Continuing Value		\$2,673.63					\$15.35	\$60.47	\$36.03
<b>Monte Carlo Simulation Assumptions</b>		<b>Base</b>		<b>Stdev</b>	<b>Min</b>	<b>Max</b>	<b>Distribution</b>	<b>Monte Carlo Simulation Results</b>	
Revenue Variation		0		10%	N/A	N/A	Normal	Mean est.	\$20.40
Op. Costs Variation		0		10%	N/A	N/A	Normal	σ(ε)	\$0.32
Country Risk Premium		6%		N/A	5%	7%	Triangular	σ(ε) adjusted price	\$19.44
Long term Growth		5%		N/A	-6%	7%	Triangular	Current Price	\$43.50
								Analysts' median est.	\$0.00