SIENA college

BJORKLUND FUND

March 31, 2017

Sears Holdings: SHLD

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Sector: Consumer Discretionary
Industry: Retailing
Current Price: $11.49
Target Price: $1.57

Sears Holdings (NYSE:SHLD) is a holding composed primarily by two US based retail stores called Sears and Kmart. The holding was created by Edward Lampart in early 2000's when I acquired both of these firms though his investing firm called ESL investment. Both Sears and Kmart are selling consumer discretionary in approximatively 1,500 stores altogether.

SELL

Current Price:	$11.49
Target Price:	$1.57
Market Cap:	1.23B
Beta:	0.99

Thesis:

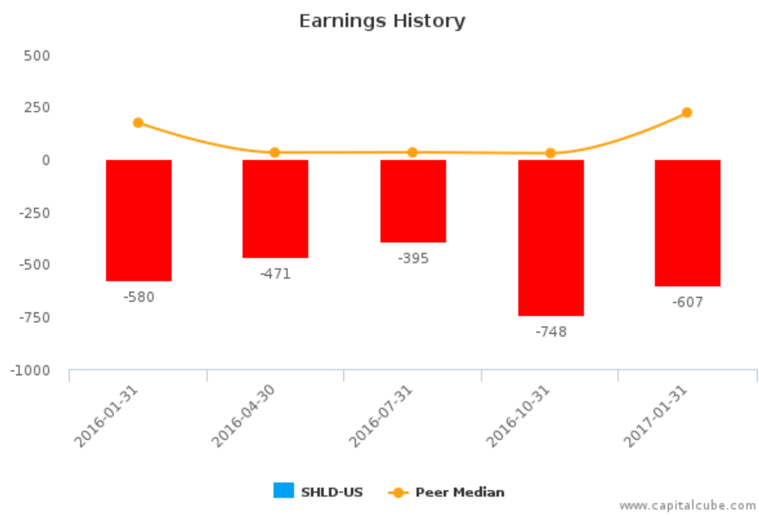
In all of the company's recent public statement, management has been trying to appease investors and the market as a whole despite reporting frightening quarterly results. But one can argue that at this point in struggle, only figures and number can talk, and in that case earnings call from the last 2 years speak for themselves. In addition, the company admitted for the very first time that "substantial doubts exist related to company's ability to continue as a going concern" The company has been poorly performing for years, therefore that are a lot of reasonable doubt that the company could go bankrupt by the end of 2017. Hence the reason I believe that Sears Holding is currently depicting a perfect sell opportunity.

Catalysts:

- **2017 earnings call coming in may**
- **Debt (bonds) refinancing with a lower credit rating might turn out to be too expensive.**
- **Wal-Mart and Target growth will slowly kill Sears no matter what**

Earnings Performance:

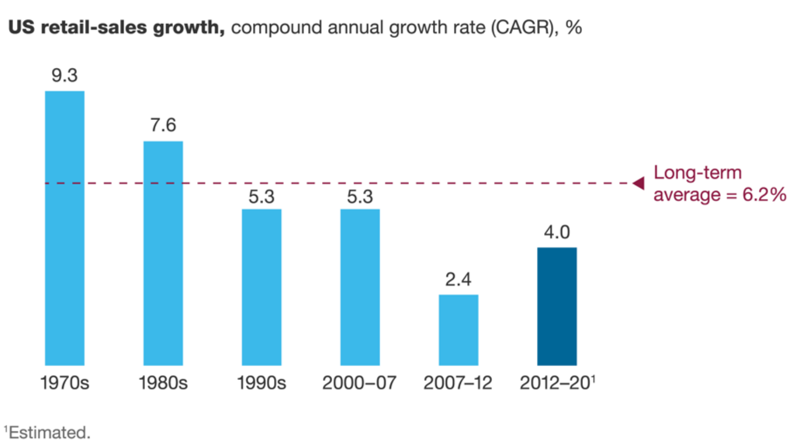
During the last 2 years, Sears has continuously been falling short on recovery expectations. If the company has been beating estimates over the last 4 consecutive quarters it is solely on the back of extremely low yearly guidance. Long story short, the revenues has been steadily dropping but simply less than anticipated. In Q3 2016, revenue fell 12.5% to $5b representing a loss of $748 million. In Q4 of the same year, revenue fell by 10.3% overall with a decline in sales in both Kmart and Sears. In Q3 cash equivalent fell to $258 million from above $1.5 b TTM. In regards to the horrific results posted by Sears the growing idea in the market's mind is that it is now most likely too late to reverse it, and it is therefore the time to jump out the sinking boat.



"We understand the concerns related to our operating performance, we have fallen short on our own timetable for achieving the profitability that we believe the company is capable of generating. With that said, the team remains fully committed to restoring profitability to our company and creating meaningful value." Said James Hollar, CFO of Sears holdings in their most recent earnings call transcript.

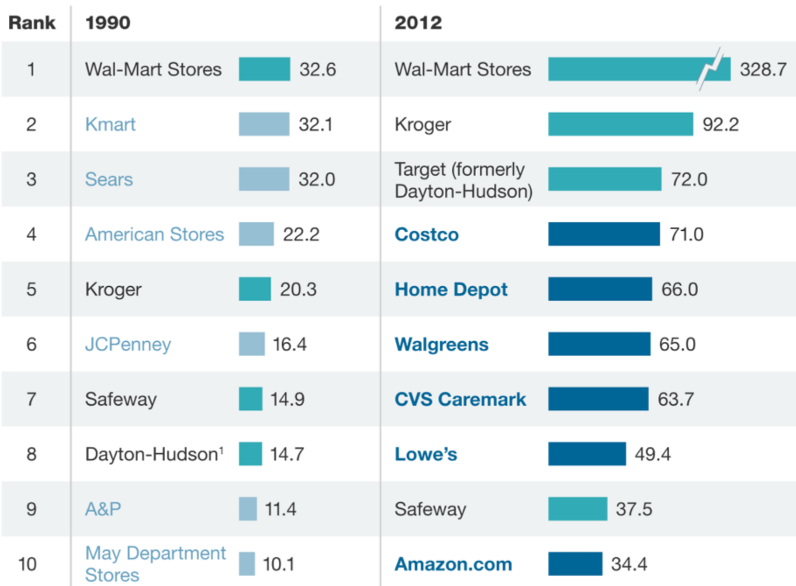
Retail Industry:

Sears Holdings is operating in one of the toughest sector in the last 2 decades. The chart here is depicting the inevitable decrease in growth of the industry. In an increasing globalized economy, consumers are seeing their shopping experience enhanced, when retailers on their end or suffering from an increasing competition. As seen on the graph, the CAGR went down to 4% from roughly 10% in the 1970's. It is hard to refer this industry as a dying industry purely based on the fact that consumers will forever have to consume by definition. On the other hand, it is clear that a paradigm shift has happened and companies that did not adapt their business model accordingly are taking a hit these days. Indeed, as I mentioned earlier a globalized economy made it tougher for domestic retailers, but more recently, the advent the Internet era also operated another shift in the sector. In this transforming, low growth market, companies



are trying to find any possible ways to boost their profits and expand both growth and market shares. Unfortunately for Sears, if the market is viewed as a pie, then the thriving firms (Wal-Mart, Target etc.) are slowly but surely killing competitors. There are four major catalyst tied to the retailing industry. Those catalysts are by definition triggering positive or negative impact on companies results. Those catalysts are as follows:

- Technology
- The Economy
- Consumers confidences
- The Platform (shopping experience)



Many analysts, and the finest industry connoisseurs are sharing the idea that both Kmart and Sears missed the technological train hence the reason why the Holding lost all its market shares. As you can spot on the graph on the left, Kmart and Sears went to second and third biggest market competitors respectively in 1990 to one the weakest 20 years later. Management of the firm indicated in early 2017 that their restructuring plan would aim at rectifying the missed shot at increase AI support in the coming years, but we will touch on this matter later on. Just like Kodak and the numerical revolution in the 2000's, I believe that Sears and Kmart missed the technological train, and it is therefore too late the catch-up with the eight hundred pound gorillas such as Wal-Mart, Kroger and Target. To go back to the industry outlook, the consumer confidence as well as the Economy are set to increase in a near future, but regarding the two other catalysts (Tech and Platforms) Sears and Kmart are less likely to benefits from the positive outlook as consumers will likely turn their heels towards to best performers with the most shopping enabling technologies and platforms.

Suppliers:

In completion of operating in what appears like as on the toughest industry, Sears also has a business model that heavily relies on its suppliers. Sears is selling products that varies on a wide range from Electrical appliances to apparel, and home furniture. All those different products are implying as much different suppliers. Now with increasing concerns over bankruptcy Sears and Kmart suppliers mostly decided to cut shipments and inventory delivery. Indeed, these suppliers are highly exposed to the bankruptcy risk attached to the companies they do business with. In case the company fill for bankruptcy Sears obligation to pay for the services completed and products delivered vanish into thin air. In that particular case, the major suppliers (Samsung, Apple, Under Armour etc.) could suffer from a loss of several millions of dollars. All in all, Sears has entered an awful vicious circle that can't seem to have end. Investors had fears over the business, but the seeing the suppliers expressing the same concerns are only making things worse. If some suppliers are reducing deal amount to hedge themselves from risk, some others are going further by simply suspending sales of their products. The name of Jakks Pacific Inc. (Toy manufacturer) ceased doing business with Kmart due to concerns over the company's financial health. Jason Hollar CFO of Sears responded that this was due to a dispute on other factors such as prices, allocation of products etc. The concerns of suppliers are based to reports made the major credit rating agencies. Fitch said that the default risk of Sears was increasing and the company could likely go bankrupt in the next 12 to 24 month. Moody's simply downgraded the company to C showing increase risk of default on loans. In order to reinsure its suppliers (and investors) Jason Hollar emphasized on the fact that the company always paid for its orders and never defaulted to this day.

Restructuring Plan:

In February 2017, Eddie Lampart announced what appears to be the last rescue plan. The company presented its 2017 restructuring plan aiming as improve profitability of the firm. The plan announces savings approaching $1b mainly it cost savings from inventory management and supply chain. There are many things that indicates from the very beginning that this number seems unrealistic, first one being that supplier are not backing up the company's initiatives. As I mentioned above, suppliers are cutting their amount of supplies which makes it more difficult for sears cost efficiencies (the lower the amount of transaction, the higher the price per items) this relationship indicates that sears margins and therefore profitability will most likely suffer a hit. Sears Holdings CEO Eddie Lampart Said "To capture these savings, we plan to reduce our corporate overhead, more closely integrate our Sears and Kmart operations and improve our merchandising, supply chain and inventory management (…) we believe the actions outlined ... will reduce our overall cash funding requirements and ensure that Sears Holdings becomes a more agile and competitive retailer with a clear path toward profitability." The first step to ignition is to close 150 stores in the United States (both Kmart and Sears).

- 108 Kmart stores
- 42 Sears stores

The company had a little bit less than 2,000 stores in 2015 with more than 1,300 Kmart and 600 Sears stores spread throughout the north American continent. This restructuring plan intend to simplify the companies structure as well as the consolidation of Sears and Kmart corporate functions. The company also wants to improve accountability of profitability in stores but also online (brick and mortar and e-com). Furthermore, the companies want to adopt the AI cited as a catalyst and implement an integrated model in order to enhance pricing, supply chain and inventory management. Ultimately the plan aims at using enhancing technologies to analyze data (data analytics software) in order to focus on their best-selling departments and highest returns categories. The company said in a statement "We expect these actions will enable us to focus our investments on driving our strategic transformation and enhancing the value of our Shop Your Way program for our millions of members and the strategic partners that we attract to the program," But this plan was not what the market wanted judging by the selloff that occurred the following days (-15%). as I mentioned earlier I believe that now is too late, in a sense that tech employed but the firm is to far behind its competitors.

Doom to Fail:

All in all, the restructuring plan of Sears is largely seen as a last attempt to bail the company but is doom to fail for so many reasons. As a said earlier, suppliers are feeling confidents which makes things more difficult for Sears. Furthermore, Sears wants to update and enhance both inventory and supply chain management but these are time as well as cash consuming, two variables than Sears cannot afford at the present moment. Indeed, the plan is the save $1b over the course of the year but the plan is going to come with sinking cost that sears did purposely not disclosed to the public. These costs attached outweighs the savings by a lot and are not visible on Sears NPV for the restructuring plan. Yet these costs are going to have to appear on the company's operating cash flow and Income Statement. Forecasts are already projecting the company to burn $1.6 b (in cash) for 2107 altogether while seeing its credit downgraded to a C due to increasing risk of default. In completion to this endless vicious circle, the company has accumulated a massive amount of debt that only worsen the equation. In 2015, sears debt reached $5b against $126m in shareholder's equity. The debt to equity showed a horrific ratio of 29.12 in 2015. The current ratio stands below 1 which says that the company will be unable to cover its short-term debt with its current assets. Approximately 3$ billion of the debt is due in October of next years, which means that the company have to refinance them with a bad credit rating. In 2015, the bonds maturing after 2027 were trading slightly above $50 cents which shows that the market firm believe that the company will not be around by then. The debt rating has been downgrading not less than 20 times over the last 15 years by all the rating agencies and his presently rates as junk. The company has maintained decent gross margins (that's before suppliers abandon) but their massive SG&A over the last 4 years resulted in operating loss and EBIT going south. Presently the business model of sears is literally eating cash which is never a good sign.

DEFAULT PROBABILITY	
HY1	0.52% - 0.88%
HY2	0.88% - 1.50%
HY3	1.50% - 2.40%
HY4	2.40% - 4.00%
HY5	4.00% - 6.00%
HY6	6.00% - 10.00%

Table 1. Bloomberg rankings of default probability. Bloomberg

Name (BI Peers)	Sales Growth Yoy (%)	EBITDA Margin (%)	5Y CAGR Sales Growth	Sales Growth (Qtr %)	Same Store Sales	Sales Spread (Qtr %)	Inv. to Sales Spread	# of Locations (Qtr)	Advertising Expenses (Ann)	Rental Expenses (Ann)
Average	-5.61%	6.44%	-3.29%	-6.58%	-5.01%	-1.56	2.50	829.86	484.38M	237.11M
SEARS HOLDINGS CORP	-11.96%	-3.15%	-13.48%	-17.13%	-10.30%	-6.83	-6.32	1.43k	850.00M	623.00M
DILLARDS INC-CL A	-4.98%	8.92%	-0.28%	-6.30%	-6.00%	-0.30	8.63	293.00	43.00M	25.95M
BON-TON STORES INC/THE	-4.13%	4.18%	-2.26%	-5.29%	-4.70%	-0.59	7.09	263.00	137.29M	87.61M
J.C. PENNEY CO INC	-0.62%	8.17%	-6.10%	-0.88%	-0.70%	-0.18	5.76	1.01k	769.00M	241.00M
STAGE STORES INC	-10.08%	3.95%	-1.05%	-9.59%	-8.50%	-1.09	3.48	798.00	91.00M	87.23M
KOHLS CORP	-2.70%	11.56%	0.61%	-2.85%	-2.20%	-0.65	-3.17	1.18k	1.02B	276.00M
MACY'S INC	-4.80%	11.42%	-0.48%	-3.99%	-2.70%	-1.29	2.05	829.00	--	319.00M

The table above shows horrific figures even the entire industry is taking a hit, Sears clearly appears as the worst-in-class. Sales declined at 12% against 5% for the industry. Other companies manage to generate positive EBITDA margins which indicates a slightly positive trend, but Sears is still dying here with a decrease of 3.15%. Same store sales decreased by 10.3% accordingly to their last earnings call. The number of stores is still well above competitors and here closing premises as mentioned in the restructuring plan appears to be fit to save the ship.

Conclusion:

There is nothing left to conclude with the full company breakdown is showing an inevitable fate for sears. ESL investments (own by Lampart) bailed out Sears by investing $300 million that the cash consuming business model will eat in the blink of eye. This rescue from ESL received positive feedback from the markets with the stock price shooting up 15% this week. Most naïve investors believed that proof of insider transactions showed confidence on the hand of management (insiders). But I strongly believe that this was exactly Lampart's idea and I view this as a lure, throwing dust in people's eyes. Numbers are self-explanatory, and it is only natural that management tries everything on their power to save the day. I believe that now is perfect time to sell Sears as there is little or no upside potential, besides market overreaction that would end corrected within days. At some point the company will most likely be worth more dead than alive if managers fill for bankruptcy before it's too late. Hence the reason I believe that the document will be filed rather soon. All in all, it is only a matter of time before the company collapse, so it might be time for current stakeholders to call it a day and leave the boat, and let the short sellers do their job.

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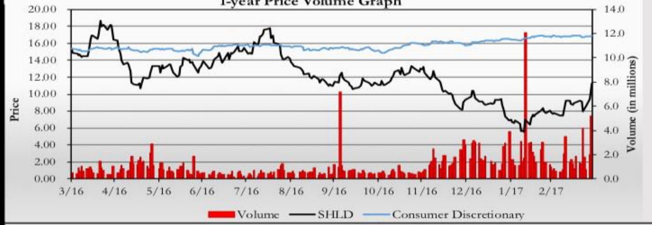
Sears Holdings Corporation (SHLD)

CENTER FOR GLOBAL FINANCIAL STUDIES

BEARISH

Analysis by Alexandre Thiam	Current Price:	$11.49	Intrinsic Value	$0.65	Target 1 year Return: -75.63%
3/31/2017	Divident Yield:	10.8%	Target Price	$1.57	Probability of Price Increase: 25.2%

1-year Price Volume Graph



Description

Sears Holdings Corporation operates as an integrated retailer in the United States.

General Information

Sector	Consumer Discretionary
Industry	Multiline Retail
Last Guidance	November 3, 2015
Next earnings date	June 8, 2017
Estimated Country Risk Premium	6.25%
Effective Tax rate	40%
Effective Operating Tax rate	26%

Market Data

Market Capitalization	$1,259.01
Daily volume (mil)	2.15
Shares outstanding (mil)	107.15
Diluted shares outstanding (mil)	106.90
% shares held by institutions	62%
% shares held by investments Managers	10%
% shares held by hedge funds	69%
% shares held by insiders	34.85%
Short interest	16.39%
Days to cover short interest	8.65
52 week high	$19.12
52-week low	$5.50
Levered Beta	2.06
Volatility	64.74%

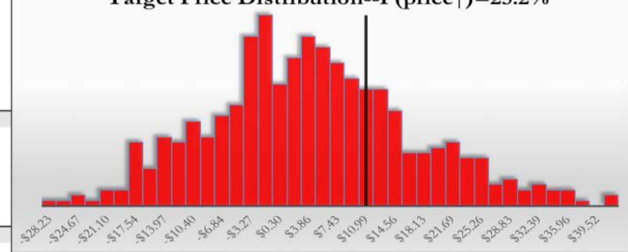
Past Earning Surprises

Quarter ending	Revenue	EBITDA
1/30/2016	0.61%	-144.81%
4/30/2016	2.63%	-218.20%
7/30/2016	4.23%	-208.18%
10/29/2016	1.65%	-287.42%
1/28/2017	-0.79%	-247.54%
Mean	1.67%	-221.23%
Standard error	0.9%	23.6%

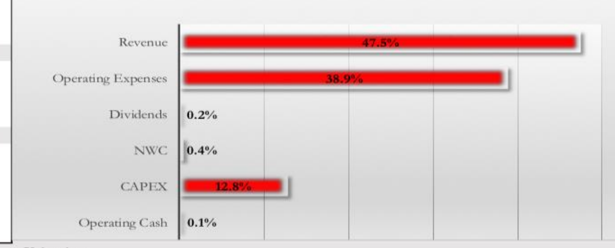
Peers

Macy's, Inc.
J. C. Penney Company, Inc.
Nordstrom, Inc.
Ross Stores, Inc.
Kohl's Corporation
Costco Wholesale Corporation
Amazon.com, Inc.
Wal-Mart Stores, Inc.

Target Price Distribution--P(price↑)=25.2%



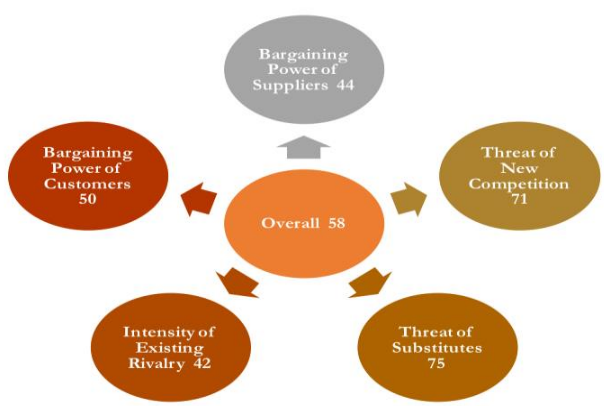
Sensitivity Attribution Analysis



Management	Position	Total compensations growth	Total return to shareholders
Lampert, Edward	Chairman and Chief Executive	-100% per annum over 2y	-31.73% per annum over 2y
Munjal, Leena	Senior Vice President of Cus	N/M	0% per annum over 0y
Lakshman, Girish	President of Fulfillment for	N/M	0% per annum over 0y
Hollar, Jason	Chief Financial Officer	N/M	N/M
Babb, Jonathan	Deputy General Counsel, Vice	N/M	N/M
Brathwaite, Chris	Vice President of Corporate	N/M	N/M

Profitability	SHLD (LTM)	SHLD (5 years historical average)	Industry (LTM)
ROIC	-18.2%	-3.96%	11.69%
NOPAT Margin	-4%	-0.24%	4.7%
Revenue/Invested Capital	4.27	16.18	2.51
ROE	396.3%	-34.22%	15.36%
Adjusted net margin	-6%	-1.31%	4.0%
Revenue/Adjusted Book Value	-61.84	26.09	3.86
Invested Funds	**SHLD (LTM)**	**SHLD (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	4.5%	4.5%	12%
Estimated Operating Cash/Total Capital	4.5%	3.7%	N/A
Non-cash working Capital/Total Capital	9.7%	9.7%	3%
Invested Capital/Total Capital	76.3%	78.5%	93%
Capital Structure	**SHLD (LTM)**	**SHLD (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	9.25	1.99	0.45
Cost of Existing Debt	13.02%	10.05%	5.95%
Estimated Cost of new Borrowing	12.16%	9.65%	5.95%
CGFS Risk Rating	F	F	C
Unlevered Beta (LTM)	0.75	1.28	0.62
WACC	10.11%	11.18%	7.16%

Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	-12.0%	-4.3%	-1.80
1/28/2018	-18.0%	-4.1%	-1.13
1/28/2019	-8.2%	-2.1%	-0.58
1/28/2020	-8.6%	-2.3%	-0.44
1/28/2021	-7.0%	0.0%	0.00
1/28/2022	-5.4%	2.2%	0.39
1/28/2023	-3.9%	4.4%	0.78
1/28/2024	-2.3%	6.7%	1.16
1/28/2025	-0.7%	8.9%	1.51
1/28/2026	0.8%	11.1%	1.87
1/28/2027	2.4%	13.4%	2.30
Continuing Period	4.0%	15.7%	2.74

Period	Invested Capital	Net Claims	Price per share
Base Year	$12,294.98	$7,731.82	-$13.70
1/28/2018	$11,835.70	$7,808.09	-$2.31
1/28/2019	$11,761.06	$9,669.42	$5.92
1/28/2020	$7,935.27	$10,064.36	$16.05
1/28/2021	$5,179.98	$10,371.28	$27.48
1/28/2022	$4,882.49	$10,394.55	$39.72
1/28/2023	$4,596.74	$10,306.11	$52.69
1/28/2024	$5,973.79	$10,215.65	$66.41
1/28/2025	$5,728.70	$9,943.37	$80.86
1/28/2026	$5,696.04	$9,424.32	$95.74
1/28/2027	$5,561.15	$8,795.03	$110.71
Continuing Period			