UPDATE: Sears Results Renew Questions Of Retailer's Future

August 28, 2008: 01:56 PM EST

DOWJONES

(Adds information throughout, including comments about the company's future.)

By Karen Talley

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NEW YORK -(Dow Jones)- Sears Holdings Corp. (SHLD) reported a 62% drop in second-quarter earnings and indicated sales and margins are likely to remain under pressure, leading to new questions about whether the iconic value retailer is becoming obsolete.

Sears Holdings, the three-year old combination of storied Sears Roebuck & Co. and Kmart, said a reserve reversal and strength in Canada failed to offset weakness at domestic stores. It also projected weak fiscal-year sales.

The company said its full-year guidance for operating earnings before taxes and other items, or Ebitda, assumes flat to modest declines in comparable-store sales for the rest of the year. That is comparable to, but no longer exceeds, last year's showing.

Interim Chief Executive W. Bruce Johnson said the results "reflect the continued effects of a slowing economy," but analysts say there is much more hampering the retailer, whose roots go back to the 19th century.

On the heels of buying Kmart Holdings in 2003, hedge fund manager Edward Lampert bought Sears, Roebuck and Co. three years ago. Since then, revenues have been stagnant, hurt by an ongoing decline in same-store sales.

Sears Holdings "is now the Acme of the 21st Century," said Robert Passikoff, president of Brands Keys Inc., which assesses brands and customer loyalty.

And it has become time for the company to be dismantled, a number of analysts say.

"Eddie Lampert is holding an empire that belongs to a bygone era," said Claire Gruppo, president of Gruppo, Levey & Co., a retail advisor and investment banking firm. "The general merchandise retailer has almost gone away and Sears hasn't evolved in an ever-evolving market. At the same time, Lampert is no retailer, which furthers the company's difficulties."

Other chains have evolved in terms of service, looks, quality and diversity of offerings, Passikoff said. "Sears is like a big warehouse, a holding bay for a limited assortment of a wide range of products that may not even be the best 'value' propositions anymore."

Indeed, chains like Wal-Mart Stores Inc. (WMT) and Target Inc. (TGT) appear to be more successful at smartening up their looks and trying to provide low-cost, good-quality fashions by adding exclusive designer lines, developing their own apparel brands and adding more name brands, Passikoff said.

And when it comes to value and breadth, retailers like Best Buy (BBY) and Home Depot (HD) offer much more diversity within the categories they carry.

The pieces of Sears Holdings, including apparel brand Land's End, Craftsman tools and Kenmore appliances, along with vast real estate holdings because of its more than 3,500 stores, "are worth more than the whole," Passikoff said.

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While Lampert has made no direct indications about his current plans and could not be reached for this article, Sears has taken certain steps. The company has consolidated major brands such as Kenmore, Craftsman, and Diehard into a single unit, which may indicate that they may be licensed or distributed through other outlets.

Sears is also undergoing an extensive reorganization, which analysts say could be a way of sprucing up the company for a sale.

But Sears' fate may end up being out of Lampert's hands. "If we have a prolonged economic downturn, that company is very vulnerable" to failing, Gruppo said.

For the quarter ended Aug. 2, Sears Holdings posted net income of $65 million, or 50 cents a share, down from $173 million, or $1.15 a share, a year earlier. The overturning of a 2007 verdict in a bond-redemption case led Sears to reverse a $62 million reserve, boosting the latest quarter's earnings by 29 cents a share.

Revenue fell 4.1% to $11.76 billion, as domestic same-store sales declined 6.2% - down 6.7% at namesake stores and 5.6% at the Kmart discount chain. Still, the declines were less than in the first quarter.

On average, analysts polled by Thomson Reuters were looking for earnings of 33 cents a share on $11.71 billion in revenue.

Gross margin slid to 26.5% from 27.7%, which Sears said reflects "increased markdown activity as a result of the intense competition for consumer business."

Ebitda - a gauge of cash flow from core operations - was $366 million, up 76% from the first quarter but down 38% from a year earlier.

Looking forward, the company said sales and gross margin "will likely continue to be pressured" by unfavorable economic factors for the rest of the year.

Sears has been struggling with waning business and rising complaints about stores and service that made it hard to stop customer losses to more focused rivals. The retailer's namesake and Kmart stores have been plagued by a reputation for shoddy customer service, high out-of-stock levels and poor presentation.

Amid the troubles, Moody's Investors Service in June lowered its rating outlook on Sears to negative from stable, citing a "lackluster operating performance for the past three quarters, which has resulted in deteriorating debt protection measures." The ratings firm noted that despite having acquired Kmart more than three years ago, the combination "remains very much a work in progress."

To recover, Sears has been under a massive restructuring into a five-unit holding company, while also trimming its marketing expenses and work force. The revamping is intended to make the 121-year-old retail pioneer a more nimble and profitable company. But investors and analysts are still wary, as dwindling cash flows have prompted them to consider the worst scenario - suppliers possibly wondering whether Sears has the cash to pay them.

The company has also seen significant turnover in its executive ranks and is still looking for a replacement for Johnson, its interim chief executive.

Shares of Sears were recently up 3.85, or 4.43%, to $90.83, part of a rise for retailers after a stronger-than-expected report on economic growth and a surprise turnaround in energy prices.

But don't count on the momentum continuing, some analysts say. Sears Holdings "remains one of the most vulnerable stocks in our sector," Credit Suisse said in a recent report.

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(Donna Kardos contributed to this story.)


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08-28-08 1356ET
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