Journal of Case Studies Nov. 2018, Vol. 36, No. 2, p. 144-162
www.sfcrjcs.org ISSN 2162-3171

Sears' Spinoff of Lands' End

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Introduction

Following several years of declining revenues and profits, in late 2011 Sears Holding Inc. ("Sears") began to hive off its business divisions. As part of its series of divestitures Sears announced its intention to spin off one of its clothing divisions, Lands' End, in a stock distribution to the existing Sears' shareholders on December 6th, 2013 (Sears Holding Corp., 2013b).

To explain why Sears was spinning off Lands' End, along with Sears' Auto Centers business, Sears released the following statement:

> *We believe separating the management of these two businesses from Sears Holdings would allow them to pursue their own strategic opportunities, optimize their capital structures, attract talent, and allocate capital in a more focused manner (Hammond, 2013).*

With the spinoff Sears would receive a cash payment of $500 million dollars from Lands' End which would be funded from the proceeds of a $515 million term loan from Bank of America. Each Sears shareholder received approximately 0.3 shares of Lands' End stock for each share of Sears stock that they owned and (Sears Holding Corp., 2014a). The spinoff of Lands' End would result in the same stockholders retaining their proportional ownership of the same basket of assets.

In light of the terms of the spinoff the stockholders and other stakeholders of Sears and Lands' End needed to evaluate their relationships with the firms. Should Lands' End's shareholders keep their shares or sell them? What assets were transferred from Sears to Lands' End as part of the spinoff? Would the terms of the spinoff hurt the ability of Lands' End to operate in the future?

Background of Lands' End

Lands' End was a multi-channel retailer of apparel and home products. The firm's channels of distribution were: standalone stores, stores within Sears' stores, internet, phone, and catalogs. Lands' End had operations in the US, Europe, and Asia. The firm was founded by Gary C. Comer in 1963 as a catalog retailer selling sailboat hardware and equipment. In 1977, Lands'

End began to focus its operations on clothing and luggage. In 1978, Lands' End moved its operations to Dodgeville, WI. The firm went public in 1986 and began its international operations in 1991. Through the late 1990s, Lands' End launched its website and developed innovative methods to improve the customer experience such as tools that allowed customers to create 3-D models of themselves and create custom pants.

Sears, Roebuck & Company Acquires Lands' End

Sears, Roebuck & Co. ("SRC") acquired Lands' End for approximately $1.9 billion in cash in 2002. At the time of the announcement of the acquisition, the amount provided Lands' End's shareholders with a 21.5% premium over the existing market value of the stock. The acquisition provided Lands' End the potential to grow their in-store retail sales by providing 870 new stores for their products. For SRC, the acquisition provided the opportunity to improve the brand image of its apparel and make the brand recognition for apparel more consistent with that of SRC's hardline categories (e.g. Craftsman, Diehard, and Kenmore) (CNNMoney, 2012). Ultimately, SRC's goal with the acquisition was to improve its waning sales and improve profit margins in softlines by offering higher quality apparel with existing brand recognition.

K-Mart Acquires Sears, Roebuck & Co.

In November of 2004 K-Mart announced that it was acquiring SRC for a price of approximately $11 billion, which existing SRC shareholders could receive in cash or in stock of the new Sears Holding Corporation. At the time of the announcement K-Mart and SRC had approximately 3,500 locations between them. This expansion offered Lands' End the opportunity to expand its sales (Sears Holding Corp., 2005).

Edward Lampert, the chairperson of Sears, founded ESL Investments ("ESL") in 1988 (Berner, 2004). In 2002 ESL Investments purchased a significant amount of K-Mart's debt during K-Mart's bankruptcy. When K-Mart emerged from bankruptcy in 2003, ESL owned a controlling interest in K-Mart's stock and Lampert was the new chairperson of K-Mart. In 2004 K-Mart began its acquisition of SRC. The firm resulting from the merger was renamed Sears Holding Corporation (Hays, 2004). At the time of the spinoff of Lands' End, ESL Investments owned approximately 48.5% of Sears' stock (Sears Holding Corp., 2014b).

Sears' Divestitures

The spinoff of Lands' End was the fourth divestiture in three years for Sears.
Orchard Supply Hardware ("Orchard") was spun off by Sears on December 30th, 2011. Similar to what occurred with the Lands' End spinoff, Sears' stockholders received pro rata ownership of Orchard. Specifically, Sears' stockholders received one share of Orchard's Class A Common Stock and one share of Orchard's Series A Preferred Stock for each 22.14 shares of Sears' stock that they owned. However, Orchard did not pay a dividend to Sears' as part of the divestiture. Orchard did have approximately $220 million in long-term debt at the time of the spinoff (Orchard Supply Hardware, 2012).

Sears Canada Inc. was partially spun off by Sears on November 14th, 2012. Sears distributed 44.5% of Sears Canada to the Sears' stockholders on a pro rata basis and retained approximately 51% of Sears Canada stock. Each Sears' stockholder received 0.4283 shares for each share of Sears' stock that they owned (Sears Holding Corp., 2012).

Sears Hometown and Outlet Stores ("SHOS") was divested from by Sears on October 11, 2012. Sears created and sold shares of the new company for which Sears received $346.5 million (Sears Holding Corp., 2012). Additionally, SHOS was required to pay Sears $100 million, a continuing commission of its online sales, and fees for shared services with Sears. For the first four months following the divestiture, SHOS reported that these costs were approximately $5 million. The dividend paid to Sears was financed with a long-term debt with a variable interest rate which was 4.50% as of February 2nd, 2013 (Sears Hometown and Outlet Stores, 2013).

With each of the spinoffs, the newly created firms were required to maintain a business relationship with Sears. For Lands' End this relationship included maintaining a presence in Sears' retail locations and remaining a partner in Sears' Shop Your Way® rewards program. Lands' End was required to pay for the expenses of maintaining a presence in Sears' retail locations, including the cost of personnel (Lands' End Inc., 2014).

Table 1 provides a timeline of the history of Lands' End and Sears.

Table 1. Timeline of the History of Lands' End and Sears

Date	Event
1963	Lands' End was founded by Gary C. Corner as a sailboat hardware and equipment retailer.
1977	Lands' End changed its focus to clothing and luggage.
1986	Lands' End became a publicly-traded corporation.
2002	Sears, Roebuck & Company purchased Lands' End for $1.9 billion.
2002	ESL Investments purchased a large proportion of K-Mart's debt during K-mart's bankruptcy.
2003	K-Mart emerged from bankruptcy with ESL Investments owning a controlling interest of the stock. Edward Lampert was the new chairperson.
November 2004	K-Mart announced the acquisition of Sears for approximately $11 billion.
December 30th, 2011	Orchard Supply Hardware was spun off from Sears.
October 11th, 2012	Sears Hometown and Outlet Stores was divested from Sears.
November 14th, 2012	Sears Canada Inc. was partially spun off from Sears. Sears retained approximately 51% of the stock.
December 6th, 2013	Sears announced its intention to spinoff Lands' End.

The spinoffs were seen as a Sears' response to declining performance. Prior to and following the merger of K-Mart and SRC, the combined firms faced declining sales and profitability. The divestitures of its business divisions and sales of its brands had been seen as a slow liquidation of the assets of a firm in distress. Tables 2 and 3 provide the annual income statements and balance sheets, respectively, for the five fiscal years ending January 31st, 2015.

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Table 2. Sears' Income Statements

For the Fiscal Period Ending *(amounts in millions of US Dollars)*	January 30, 2010	January 29, 2011	January 28, 2012	February 2, 2013	February 1, 2014	January 31, 2015
Revenue	43,360	42,664	41,567	39,854	36,188	31,198
Cost Of Goods Sold	31,337	30,988	30,836	29,305	27,377	23,980
Gross Profit	**12,023**	**11,676**	**10,731**	**10,549**	**8,811**	**7,218**
Selling General & Admin Exp.	10,279	10,411	10,528	10,577	9,382	8,076
Depreciation & Amort.	882	859	845	808	721	573
Other Operating Exp., Total	**11,161**	**11,270**	**11,373**	**11,385**	**10,103**	**8,649**
Operating Income	**862**	**406**	**(642)**	**(836)**	**(1,292)**	**(1,431)**
Interest Expense	(248)	(293)	(289)	(267)	(254)	(313)
Interest and Invest. Income	33	36	41	94	207	132
Net Interest Exp.	**(215)**	**(257)**	**(248)**	**(173)**	**(47)**	**(181)**
Currency Exchange Gains (Loss)	(67)	(14)	-	-	-	-
Other Non-Operating Inc. (Exp.)	6	-	(2)	1	2	4
EBT Excl. Unusual Items	**586**	**135**	**(892)**	**(1,008)**	**(1,337)**	**(1,608)**
Restructuring Charges	(131)	(36)	(911)	(175)	(289)	(284)
Impairment of Goodwill	-	-	-	(295)	-	-
Gain (Loss) On Sale Of Assets	74	67	64	468	667	207
Asset Writedown	-	-	-	-	(13)	-
Legal Settlements	32	-	-	-	-	-
Other Unusual Items	(170)	-	(12)	-	-	-
EBT Incl. Unusual Items	**391**	**166**	**(1,751)**	**(1,010)**	**(972)**	**(1,685)**
Income Tax Expense	111	27	1,369	44	144	125
Earnings from Cont. Ops.	**280**	**139**	**(3,120)**	**(1,054)**	**(1,116)**	**(1,810)**
Earnings of Discontinued Ops.	17	11	(27)	-	-	-
Extraord. Item & Account. Change	-	-	-	-	-	-
Net Income to Company	**297**	**150**	**(3,147)**	**(1,054)**	**(1,116)**	**(1,810)**
Minority Int. in Earnings	(62)	(17)	7	124	(249)	128
Net Income	**235**	**133**	**(3,140)**	**(930)**	**(1,365)**	**(1,682)**

(Standard and Poor's Capital IQ)

For the five-year period just prior to the spinoff of Lands' End revenue for Sears had fallen from $43.36 billion to $36.19 billion. While the decline in revenue may have been attributable to the prior divestitures, the divestitures did not improve the profit margins of Sears over the same period. Likewise, the divestitures may have contributed to the declining value of assets over the same period, but the continued losses on the income statement contributed to the declining value of retained earnings and total equity on the balance sheet.

As of May 3rd, 2014, Sears' corporate family debt ratings were Caa1 from Moody's Investors Service, CCC+ from Standard & Poor's Ratings Services, and CCC from Fitch Ratings. As of the same date, Sears had $159 million in commercial paper outstanding, with $150 million of that held by ESL. The portion owed to ESL included $86 million held personally by Edward Lampert. Sears' had $2.6 billion in long-term notes and debentures outstanding, of which ESL held $208 million. The remainder of Sears' interest-bearing debts consisted largely of an asset-backed revolving line of credit (Sears Holding Corp., 2014c).

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Table 3. Sears' Balance Sheets

Balance Sheet as of *(amounts in millions of US Dollars)*	January 30, 2010	January 29, 2011	January 28, 2012	February 2, 2013	February 1, 2014	January 31, 2015
ASSETS						
Cash And Equivalents	1,689	1,359	747	609	1,028	250
Accounts Receivable	652	689	695	635	553	429
Inventory	8,705	8,951	8,407	7,558	7,034	4,943
Prepaid Exp.	327	295	332	397	287	211
Deferred Tax Assets, Curr.	30	-	-	-	-	-
Restricted Cash	11	15	7	9	10	-
Other Current Assets	24	251	56	57	47	30
Total Current Assets	**11,438**	**11,560**	**10,244**	**9,265**	**8,959**	**5,863**
Gross Property, Plant & Equipment	11,392	11,329	11,210	11,244	10,109	8,313
Accumulated Depreciation	(3,683)	(4,227)	(4,633)	(5,191)	(4,715)	(3,864)
Net Property, Plant & Equipment	**7,709**	**7,102**	**6,577**	**6,053**	**5,394**	**4,449**
Long-term Investments	-	-	-	-	-	111
Goodwill	1,392	1,392	841	379	379	269
Other Intangibles	3,208	2,993	2,937	2,881	2,850	2,097
Deferred Charges, LT	-	-	-	-	-	16
Other Long-Term Assets	1,061	1,313	782	762	679	380
Total Assets	**24,808**	**24,360**	**21,381**	**19,340**	**18,261**	**13,185**
LIABILITIES						
Accounts Payable	3,335	3,046	2,912	2,761	2,496	1,621
Short-term Borrowings	325	360	1,175	1,094	1,332	614
Curr. Port. of LT Debt	482	489	230	83	12	13
Curr. Port. of Cap. Leases	-	-	-	-	71	62
Curr. Income Taxes Payable	534	546	523	480	460	380
Unearned Revenue, Current	1,012	976	964	931	900	818
Def. Tax Liability, Curr.	-	165	516	382	387	-
Other Current Liabilities	3,098	3,061	2,892	2,683	2,527	2,087
Total Current Liabilities	**8,786**	**8,643**	**9,212**	**8,414**	**8,185**	**5,595**
Long-Term Debt	1,698	2,344	2,088	1,943	2,559	2,877
Capital Leases	-	-	-	-	275	210
Unearned Revenue, Non-Current	829	794	778	843	836	739
Pension & Other Post-Retire. Benefits	2,271	2,151	2,738	2,730	1,942	2,404
Def. Tax Liability, Non-Curr.	-	-	816	955	1,109	1,195
Other Non-Current Liabilities	1,789	1,814	1,408	1,283	1,172	1,110
Total Liabilities	**15,373**	**15,746**	**17,040**	**16,168**	**16,078**	**14,130**
Common Stock	1	1	1	1	1	1
Additional Paid In Capital	10,465	10,185	10,005	9,298	9,298	9,189
Retained Earnings	4,797	4,930	1,865	885	(480)	(2,162)
Treasury Stock	(5,446)	(5,826)	(5,981)	(5,970)	(5,963)	(5,949)
Comprehensive Inc. and Other	(721)	(779)	(1,609)	(1,459)	(1,117)	(2,030)
Total Common Equity	**9,096**	**8,511**	**4,281**	**2,755**	**1,739**	**(951)**
Minority Interest	339	103	60	417	444	6
Total Equity	**9,435**	**8,614**	**4,341**	**3,172**	**2,183**	**(945)**
Total Liabilities And Equity	**24,808**	**24,360**	**21,381**	**19,340**	**18,261**	**13,185**

(Standard and Poor's Capital IQ)

Spinoff of Lands' End

Over the years of his leadership of Sears, Edward Lampert had developed a reputation for candid communications about the operations of the firm. Lampert described the relationship between Sears and Lands' End and the decision to spin off Lands' End in a blog post dated April 13, 2014. An excerpt of that blog post is provided in Table 4.

Table 4. Excerpt from Edward Lampert's April 13, 2014 Post on Sears Holdings' Blog

Sears shoppers definitely liked having Lands' End's products in Sears and loved how easily they could return or exchange the products they bought from catalogs or online in Sears' stores across the country. But this did not directly translate into higher earnings and the company and investors suffered: by 2004, Lands' End's earnings had hit their lowest level of the entire 12 year period (2002 to 2014) that Lands' End was associated with Sears. After Sears and Kmart merged in 2005, Lands' End's fortunes started to turn around. During each year from 2005 to 2010, earnings were significantly higher than they were in 2004, including several years of record profits. Dedicated shops were created inside Sears' stores to bring the Lands' End brand even more distinction, in contrast to the initial approach of having merchandise spread throughout the store. However, in 2011 and 2012 the company stumbled for a variety of reasons that were described in its public filings. Just one example: in 2011, cotton prices hit heights unseen since supply and distribution were disrupted during the Civil War (impacting most other apparel retailers as well). Lands' End's performance improved significantly in 2013, but it was clear to us that bigger changes needed to be made to really unlock the potential of the business. Sears Holdings opted for a spinoff – a legal split that allows each company to focus on managing its own business, yet still work together in some ways. Sears Holdings stockholders – I am one myself – were given approximately three shares of the new Lands' End for every ten shares of Sears Holdings they own. This gives investors a choice, and the ability to continue to participate in the results of the Lands' End business going forward. Lands' End and Sears Holdings can each focus on the management of their businesses separately and Lands' End is able to optimize its capital structure and enter capital markets independently from Sears. Lands' End will be able to invest its profits without having to distribute them to Sears Holdings. Meanwhile, Sears Holdings received $500 million in cash from Lands' End (the equivalent of many years of after-tax profits), which increases Sears Holdings' liquidity.

(Sears' Holdings blog: http://blog.searsholdings.com/eddie-lampert/spinoffs-and-lands-end/)

Lampert's blog post provided some information on the terms of the spinoff of Lands' End. A few weeks later the details of the spinoff were provided in Sears' 10-Q statement. As Lands' End was a division of Sears at the time of the spinoff, the management of Lands' End did not have a say in the terms of the spinoff. The terms of the spinoff were determined by the management of Sears. The details of the spinoff are provided in Table 5.

Table 5. Information from Sears' 10-Q on the Spinoff of Lands' End

Separation of Lands' End, Inc.
Note 1, Pg. 6.

On April 4, 2014, we completed the separation of our Lands' End business through a spin-off transaction. The separation was structured to be tax free to our U.S. shareholders for U.S. federal income tax purposes. Prior to the separation, Lands' End, Inc. ("Lands' End") entered into an asset-based senior secured revolving credit facility, which provides for maximum borrowings of approximately $175 million with a letter of credit sub-limit, and a senior secured term loan facility of approximately $515 million. The proceeds of the term loan facility were used to fund a $500 million dividend to Holdings and pay fees and expenses associated with the foregoing facilities. We accounted for this spin-off in accordance with accounting standards applicable to spin-off transactions. Accordingly, we classified the carrying value of net assets of $323 million contributed to Lands' End as a reduction of capital in excess of par value in the Condensed Consolidated Statement of Equity for the period ended May 3, 2014.

Additionally, as a result of Mr. Lampert's role as our Chairman and Chief Executive Officer, and Chairman and Chief Executive Officer of ESL Investments, Inc. (together with its affiliated funds, "ESL"), and the continuing arrangements between Holdings and Lands' End (as further described in Note 14), Holdings has determined that it has significant influence over Lands' End. Accordingly, the operating results for Lands' End through the date of the spin-off are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Condensed Consolidated Financial Statements.

Note 14, Pgs. 20-21

ESL owns approximately 49% of the outstanding common stock of Lands' End (based on publicly available information as of April 8, 2014). Holdings, and certain of its subsidiaries, entered into a transition services agreement in connection with the spin-off pursuant to which Lands' End and Holdings will provide to each other, on an interim, transitional basis, various services, which may include, but are not limited to, tax services, logistics services, auditing and compliance services, inventory management services, information technology services and continued participation in certain contracts shared with Holdings and its subsidiaries, as well as agreements related to participation in the Shop Your Way program and rental agreements.

Amounts due to or from Lands' End are non-interest bearing, and generally settled on a net basis. Holdings invoices Lands' End on at least a monthly basis.

(Sears Holding Company 10-Q dated May 3rd, 2014)

The terms of Lands' End's spinoff required Lands' End to pay an approximate $500 million cash dividend to Sears. The dividend, as well as some additional expenses, was funded using a $515 million loan from Bank of America. The terms of that loan, as well as Lands' End's other debts, are provided in Table 6.

Table 6. Lands' End Debt Related to the Spinoff from Lands' End's 10-Q

NOTE 5. DEBT. Pgs. 8 & 9

Debt Arrangements

In connection with the Separation, Lands' End entered into an asset-based senior secured credit agreement, dated as of April 4, 2014, with Bank of America, N.A., which provides for maximum borrowings of $175.0 million ("ABL Facility") for Lands' End, subject to a borrowing base, with a $30.0 million sub facility for a United Kingdom subsidiary borrower of Lands' End (the "UK Borrower"). The ABL Facility has a sub-limit of $70.0 million for domestic letters of credit and a sub-limit of $15.0 million for letters of credit for the UK Borrower. The ABL Facility is available for working capital and other general corporate purposes, and was undrawn at the Separation and at May 2, 2014, other than for letters of credit. The Company had borrowing availability under the ABL Facility of $160.2 million as of May 2, 2014, net of outstanding letters of credit of $14.8 million.

Also on April 4, 2014, Lands' End entered into a term loan credit agreement with Bank of America, N.A., which provides a senior secured term loan facility of $515.0 million (the "Term Loan Facility" and, together with the ABL Facility, the "Facilities"), the proceeds of which were used to pay a dividend of $500.0 million to a subsidiary of Sears Holdings Corporation immediately prior to the Separation and to pay fees and expenses associated with the Facilities of approximately $11.3 million, with the remaining proceeds to be used for general corporate purposes. The fees were capitalized as debt issuance costs within Other assets on the Condensed Consolidated and Combined Balance Sheets and are being amortized as an adjustment to Interest expense over the remaining life of the Facilities.

Maturity; Amortization and Prepayments

The ABL Facility will mature on April 4, 2019. The Term Loan Facility will mature on April 4, 2021 and will amortize at a rate equal to 1% per annum, and is subject to mandatory prepayment in an amount equal to a percentage of the borrower's excess cash flows in each fiscal year, ranging from 0% to 50% depending on Lands' End's secured leverage ratio, and the proceeds from certain asset sales and casualty events. The Company's aggregate scheduled maturities of the Term Loan Facility as of May 2, 2014 are as follows:

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Table 6. Continued

(in thousands)	
Less than 1 year	$ 5,150
1 - 2 years	5,150
2 - 3 years	5,150
3 - 4 years	5,150
4 - 5 years	5,150
Thereafter	489,250
	$ 515,000

Guarantees; Security

All domestic obligations under the Facilities are unconditionally guaranteed by Lands' End and, subject to certain exceptions, each of its existing and future direct and indirect domestic subsidiaries. In addition, the obligations of the UK Borrower under the ABL Facility are guaranteed by its existing and future direct and indirect subsidiaries organized in the United Kingdom. The ABL Facility is secured by a first priority security interest in certain working capital of the borrowers and guarantors consisting primarily of accounts receivable and inventory.

The Term Loan Facility is secured by a second priority security interest in the same collateral, with certain exceptions.

The Term Loan Facility also is secured by a first priority security interest in certain property and assets of the borrowers and guarantors, including certain fixed assets and stock of subsidiaries. The ABL Facility is secured by a second priority security interest in the same collateral.

Interest; Fees

The interest rate on the Term Loan Facility was 4.25% at May 2, 2014. The interest rates per annum applicable to the loans under the Facilities are based on a fluctuating rate of interest measured by reference to, at the borrowers' election, either (i) an adjusted London inter-bank offered rate ("LIBOR") plus a borrowing margin, or (ii) an alternative base rate plus a borrowing margin. The borrowing margin is fixed for the Term Loan Facility at 3.25% in the case of LIBOR loans and 2.25% in the case of base rate loans. For the Term Loan Facility, LIBOR is subject to a 1% interest rate floor. The borrowing margin for the ABL Facility is subject to adjustment based on the average excess availability under the ABL Facility for the preceding fiscal quarter, and will range from 1.50% to 2.00% in the case of LIBOR borrowings and will range from 0.50% to 1.00% in the case of base rate borrowings.

Customary agency fees are payable in respect of both Facilities. The ABL Facility fees also include (i) commitment fees, based on a percentage ranging from

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approximately 0.25% to 0.375% of the daily unused portions of the ABL Facility, and (ii) customary letter of credit fees.

(Lands' End 10-Q dated June 12th, 2014)

The management of Lands' End expressed concern over the effects that the high level of debt would have on the ability of Lands' End to operate in the future. Their concerns were detailed in the Notes to Financial Statements in Lands' End 10-K Statement from March 25th, 2014. The excerpt from the Notes to Financial Statements that describes these concerns are found in Table 7.

Table 7. Lands' End Notes on Indebtedness

Risks Related to Our Indebtedness

Our leverage may place us at a competitive disadvantage in our industry. We expect that the agreements governing our debt will contain various covenants that impose restrictions on us that may affect our ability to operate our business.

We will have substantial leverage following the spin-off and, accordingly, will have significant debt service obligations. Our debt and debt service requirements could adversely affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities. Our expected level of debt presents the following risks, among others:

- we could be required to use a substantial portion of our cash flow from operations to pay principal (including amortization) and interest on our debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, strategic acquisitions and other general corporate requirements or causing us to make non-strategic divestitures;
- our interest expense could increase if prevailing interest rates increase, because we expect a substantial portion of our debt to bear interest at variable rates;
- our substantial leverage could increase our vulnerability to economic downturns and adverse competitive and industry conditions and could place us at a competitive disadvantage compared to those of our competitors that are less leveraged;
- our debt service obligations could limit our flexibility in planning for, or reacting to, changes in our business, our industry and changing market conditions and could limit our ability to pursue other business opportunities, borrow more money for operations or capital in the future and implement our business strategies;

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Table 7. Continued

- our level of debt may restrict us from raising additional financing on satisfactory terms to fund working capital, capital expenditures, strategic acquisitions and other general corporate requirements;

- we expect that the agreements governing our debt will contain covenants that will limit our ability to pay dividends or make other restricted payments and investments;

- we expect that the agreements governing our debt will contain operating covenants that could limit our and our operating subsidiaries' ability to engage in activities that may be in our best interests in the long term, including, without limitation, by restricting our and our subsidiaries' ability to incur debt, create liens, enter into transactions with affiliates or prepay certain kinds of indebtedness. However, we expect that the credit agreements governing our debt will not contain any financial covenants unless we fall below a minimum level of borrowing availability under the ABL Facility; and

- the failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of the applicable debt, and may result in the acceleration of any other debt to which a cross-acceleration or cross-default provision applies. In the event our creditors accelerate the repayment of our borrowings, we and our subsidiaries may not have sufficient assets to repay that debt.

We may need additional financing in the future for our general corporate purposes, and such financing may not be available on favorable terms, or at all, and may be dilutive to existing stockholders.

We may need to seek additional financing for our general corporate purposes, such as to finance our international expansion and the growth of our Retail segment. We may be unable to obtain any desired additional financing on terms favorable to us, or at all. If adequate funds are not available on acceptable terms, we may be unable to fund our expansion, successfully develop or enhance our products, or respond to competitive pressures, any of which could negatively affect our business. If we raise additional funds through the issuance of equity securities, our stockholders could experience dilution of their ownership interest. If we raise additional funds by issuing debt, we may be subject to limitations on our operations due to restrictive covenants.

(Lands' End 10-K dated March 25th, 2014)

Table 8 provides financial information on Lands' End and a group of comparable firms at the time of and just prior to its acquisition by Sears, Roebuck & Co. and at the time of its spinoff and

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the prior period. The additional debt for Lands' End from the spinoff is not included in the Debt Ratio and LTD-to-Equity calculations, but is included in the calculation of the Enterprise Value as of May 2nd, 2014.

Table 8. Financial Information for Comparable Firms to Lands' End

Panel A. At the Time of Lands' End Acquisition by Sears

Dollar amounts in millions	As of Feb. 1, 2002	
Firm Name	Market Capitalization	Enterprise Value
Lands' End, Inc.	$ -	$ -
ANN INC.	$ 1,105.65	$ 1,235.24
The Children's Place, Inc.	$ 840.85	$ 839.56
HSN, Inc.	$ -	$ -
Urban Outfitters, Inc.	$ 444.79	$ 437.22
American Eagle Outfitters, Inc.	$ 1,781.87	$ 1,721.46
The Buckle, Inc.	$ 431.72	$ 329.71
Carter's, Inc.	$ -	$ -
Columbia Sportswear Company	$ 1,265.75	$ 1,241.39

Dollar amounts in millions	For the Fiscal Year 2001						
Firm Name	Revenues	Net Profit Margin	EBITDA	Current Ratio	Debt Ratio	LTD-to-Equity	Times Interest Earned
Lands' End, Inc.	$ 1,462.28	2.37%	$ 85.09	1.78	0.38	-	40.78
ANN INC.	$ 1,232.78	4.25%	$ 159.11	2.22	0.32	0.20	15.45
The Children's Place, Inc.	$ 587.39	7.27%	$ 92.19	1.71	0.28	-	61.32
HSN, Inc.	$ 3,622.92	1.83%	$ 1,306.27	1.68	0.25	0.08	5.62
Urban Outfitters, Inc.	$ 295.33	3.55%	$ 29.88	1.95	0.23	-	NM
American Eagle Outfitters, Inc.	$ 1,093.48	8.57%	$ 169.75	2.14	0.32	0.07	NM
The Buckle, Inc.	$ 393.25	8.78%	$ 62.80	4.81	0.16	-	NM
Carter's, Inc.	$ 518.51	-0.80%	$ 70.69	3.06	0.74	1.88	2.23
Columbia Sportswear Company	$ 779.58	11.39%	$ 164.92	3.83	0.26	0.07	34.62

NM stands for Not Meaningful. Market Capitalization is calculated as the number shares outstanding multiplied by the price per share. The Enterprise Value is calculated as the Market Capitalization less Cash & Short-Term Investments plus Total Debt plus Preferred Equity plus Total Minority Interest.

(Standard and Poor's Capital IQ)

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Table 8. Continued

Panel B. Following Lands' End Spinoff from Sears

Dollar amounts in millions	As of May 2, 2014	
Firm Name	Market Capitalization	Enterprise Value
Lands' End, Inc.	$ 920.70	$ 1,370.80
ANN INC.	$ 1,818.74	$ 1,621.57
The Children's Place, Inc.	$ 1,041.72	$ 805.22
HSN, Inc.	$ 2,932.73	$ 3,009.36
Urban Outfitters, Inc.	$ 5,142.03	$ 4,618.16
American Eagle Outfitters, Inc.	$ 2,235.58	$ 1,806.64
The Buckle, Inc.	$ 2,243.03	$ 2,057.96
Carter's, Inc.	$ 3,960.92	$ 4,269.68
Columbia Sportswear Company	$ 3,016.08	$ 2,472.57

Dollar amounts in millions	For the Fiscal Year 2013						
Firm Name	Revenues	Net Profit Margin	EBITDA	Current Ratio	Debt Ratio	LTD-to-Equity	Times Interest Earned
Lands' End, Inc.	$ 1,585.93	3.14%	$ 107.60	2.39	0.32	-	
ANN INC.	$ 2,375.51	4.32%	$ 264.62	1.50	0.59	-	NM
The Children's Place, Inc.	$ 1,809.49	3.50%	$ 173.12	2.85	0.33	-	111.50
HSN, Inc.	$ 3,403.98	5.24%	$ 308.14	1.82	0.60	0.43	42.07
Urban Outfitters, Inc.	$ 2,794.93	8.49%	$ 487.67	3.49	0.25	-	NM
American Eagle Outfitters, Inc.	$ 3,475.80	6.68%	$ 557.87	2.62	0.30	-	NM
The Buckle, Inc.	$ 1,124.01	14.62%	$ 292.01	2.15	0.39	-	NM
Carter's, Inc.	$ 2,638.71	6.08%	$ 370.78	3.61	0.61	0.84	22.79
Columbia Sportswear Company	$ 1,685.00	5.60%	$ 181.66	4.15	0.22	-	NM

NM stands for Not Meaningful. Market Capitalization is calculated as the number shares outstanding multiplied by the price per share. The Enterprise Value is calculated as the Market Capitalization less Cash & Short-Term Investments plus Total Debt plus Preferred Equity plus Total Minority Interest.

(Standard and Poor's Capital IQ)

Lands' End's enterprise value of $1.371 billion on May 2nd, 2014 represented a significant loss in value for Lands' End from its approximate enterprise value of $1.7 billion just prior to the acquisition announcement in 2002. Despite being a part of Sears for eleven years, Lands' End's sales in Sears' retail locations only accounted for 15% of Lands' End total sales for fiscal year 2013 (Lands' End, 2014).

Tables 9 and 10 provide the Income Statement and Balance Sheet, respectively, for Lands' End just prior to its acquisition in 2002 and just following its spinoff in 2014. As can be seen in Table 9, revenues fell slightly for the Lands' End between 2002 and 2014, while operating and net income increased. The $500 million in debt is reflected as Long-Term Debt on the May 2, 2014 balance sheet presented in Table 10. Other Intangibles consisted primarily of Trade Names, which were valued at $528.3 million on May 2nd, 2014 (Lands' End 2014).

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Table 9. Income Statement Comparison for Lands' End, Inc.

Amounts in millions of dollars	**Pre-Acquisition**	**Post-Spinoff**
For the twelve-month period ending	**Feb. 1, 2002**	**May 2, 2014**
Revenue	1,569.1	1,574.3
Cost of Goods Sold	880.2	856.6
Gross Profit	**688.8**	**717.8**
Selling General & Admin Exp.	575.7	563.2
Depreciation & Amort.	-	20.9
Other Operating Expense/(Income)	-	0.1
Other Operating Exp., Total	**575.7**	**584.2**
Operating Income	**113.2**	**133.6**
Interest Expense	(1.4)	(1.9)
Interest and Invest. Income	1.5	-
Net Interest Exp.	**0.2**	**(1.9)**
Currency Exchange Gains (Loss)	(1.7)	-
Other Non-Operating Inc. (Exp.)	(3.7)	0.2
EBT Excl. Unusual Items	**107.9**	**131.8**
Legal Settlements	-	1.6
EBT Incl. Unusual Items	**107.9**	**133.4**
Income Tax Expense	41.0	51.1
Net Income	**66.9**	**82.4**

(Standard and Poor's Capital IQ)

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Table 10. Balance Sheet Comparison for Lands' End, Inc.

Amounts in millions of dollars	**Pre-Acquisition**	**Post-Spinoff**
As of	**Feb. 1, 2002**	**May 2, 2014**
ASSETS		
Cash And Equivalents	122.1	65.0
Accounts Receivable	13.3	39.8
Inventory	227.2	327.0
Prepaid Exp.	24.1	14.2
Deferred Tax Assets, Curr.	15.9	-
Restricted Cash	-	3.3
Other Current Assets	-	15.4
Total Current Assets	**402.6**	**464.7**
Gross Property, Plant & Equipment	344.2	260.8
Accumulated Depreciation	(150.3)	(162.2)
Net Property, Plant & Equipment	**193.9**	**98.7**
Goodwill	-	110.0
Other Intangibles	-	530.7
Other Long-Term Assets	2.7	23.7
Total Assets	**599.1**	**1,227.8**
LIABILITIES		
Accounts Payable	83.4	76.1
Accrued Exp.	51.7	30.5
Short-term Borrowings	16.2	-
Curr. Port. of LT Debt	-	5.2
Curr. Income Taxes Payable	25.0	-
Unearned Revenue, Current	-	52.5
Def. Tax Liability, Curr.	-	3.7
Other Current Liabilities	9.4	20.6
Total Current Liabilities	**185.6**	**188.6**
Long-Term Debt	-	509.9
Def. Tax Liability, Non-Curr.	12.8	168.3
Other Non-Current Liabilities	-	15.6
Total Liabilities	**198.4**	**882.4**
Common Stock	0.4	0.3
Additional Paid In Capital	48.0	340.2
Retained Earnings	556.0	5.9
Treasury Stock	(206.9)	-
Comprehensive Inc. and Other	3.3	(1.1)
Total Equity	**400.7**	**345.3**
Total Liabilities And Equity	**599.1**	**1,227.8**

(Standard and Poor's Capital IQ)

Post-Financial Crisis Spinoff Activity in the United States

When a spinoff occurs the parent firm separates a division of the firm into an independent business entity with separate ownership, assets, employees, products, etc. A spinoff differs from other forms of divestitures in that the division is not being sold off to another party, but that existing shareholders of the parent firm are given shares of stock in the new business that they may choose to sell if they choose. With the spinoff of Lands' End, Sears' stockholders were given 0.3 shares in the new Lands' End for each share of Sears that the owned. Since only the existing shareholders were given shares in Lands' End, Sears' shareholders maintained their proportional ownership in Lands' End.

Carretta, Farina, Graziono, and Reale (2013) provided two reasons why firms choose to spinoff their divisions. The first is that the parent firm has attempted to sell a division, but cannot find a buyer at a price that they find reasonable. The second is that a firm with many divisions may be valued at a lower price in the market due to a conglomerate discount.

A conglomerate discount is defined as difference in the value that an investor assigns to a multi-segmented firm less the sum of the values that an investor would assign to the segments if they were not part of a conglomerate firm. Spinning off companies may result in a focus premium, which would increase the value of the firms to shareholders. The difference in values occur due to the perceived ability of management of a single segment firm to attain and utilize a higher level of expertise for a single segment and the ability of investors understand and make better decisions regarding the potential risks and rewards of a single segment compared to a multi-segment conglomerate firm (see Berger and Ofek, 1995; Burch and Nanda, 2003). Seeking a focus premium is consistent with the explanation provided by Edward Lampert, found in Table 4, that one reason for the spinoff was so that the management and stockholders of the two firms could focus on the individual firms rather than the larger conglomerate.

The spinoffs of Orchard Hardware Supply, Sears Canada, Inc., and Lands' End were part of an overall trend of increased spinoffs following the financial crisis. A study by Zenner, Junek, and Chivukula (2015) found that the pace of corporate spinoffs increased following the financial crisis. Specifically, they found that the average number of spinoffs from firms in the S&P 500 index was only two per year for the years 2008 and 2009; these increased to an average of seven per year for the years 2010 through 2012; and finally increased to an average of 15 per year for the period 2013 through the middle of 2015. Zenner et al. attributed the increase to low interest rates in the post-crisis period and an increased desire by investors to invest in well-defined single segment businesses. Studying the post spinoff returns of the parent and spun off business divisions for spinoffs that occurred for the years 2009 through 2013, Zenner et al. found that parent companies received a 2% to 4% market-adjusted increase in stock price at the time of the announcement and that the parent and spun off business divisions combined received, on average, a 10% to 15% market-adjusted increase in stock prices in the two years following the spinoff.

The reduction in interest rates resulted in decreased spreads in interest rates between investment grade and non-investment grade debt which resulted in firms being more amenable in issuing non-investment grade debt. Firms that have been spun off tend not to able to issue investment

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grade debt due to their smaller size and shorter history (Zenner et al., 2015). Table 11 provides the market interest rates for 30-year corporate bonds and LIBOR at the time of the spinoff of Lands' End. In order to get the funds to pay Sears, Lands' End had to rely on a loan from Bank of America instead of issuing a publicly traded bond, which would have likely had a lower interest rate.

Table 11. Interest Rates at the Time of Lands' End's Spinoff

Panel A. S&P Capital IQ Corporate Yield Profile

Bond Rating	Yield on 30 Year Maturity Corporate Bonds as of 5/2/2014
AAA	5.20%
AA	5.44%
A	5.54%
BBB	5.83%
BB	8.57%
B	11.15%
CCC	13.33%

From Capital IQ – All Corporates

Panel B. 12-Month London Interbank Offered Rate (LIBOR), based on the U.S. Dollar

Average 12-month LIBOR 2004 through 2013	2.47%
Average 12-month LIBOR 1994 through 2013	3.69%
12-Month LIBOR as of 5/2/2014	0.55%

From https://fred.stlouisfed.org/series/USD12MD156N

Conclusion

Sears had faced several years of poor financial performance. One response to this was the divestiture of several of its business divisions. With most of the divestitures, the new business created was required to take with it a portion of Sears' debt, make a large cash payment to Sears, or maintain a relationship with Sears and pay the expenses of that relationship. Lands' End was required to make a $500 million payment to Sears, maintain a relationship with Sears, and pay the costs of maintaining that relationship (including paying for personnel in Sears' stores).

How would these burdens affect Lands' End's ability to operate in the future? Should the shareholders retain their ownership in Lands' End? Were the assets that were transferred from Sears to Lands' End worth $500 million?

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