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Will Kmart walk away a winner with Sears deal?

By Bruce Horovitz
USA TODAY

Kmart has just pulled the rough equivalent of a refrigerator out of its hat.

Make that a Kenmore brand refrigerator from Sears. And maybe some Craftsman tools. And some DieHard batteries, too.

All this came to be when Kmart — yes, the same Kmart that almost went belly up less than two years ago — announced plans Wednesday to purchase Sears Roebuck for $11 billion. The deal would create the nation's No. 3 retailer, behind No. 1 Wal-Mart and No. 2 Home Depot.

While it's yet to be decided which Sears and Kmart brands will be sold where, there's plenty of speculation that most of the two retailers' major exclusive lines eventually will be sold at all locations of both chains.

Welcome to 21st century retailing at its most cutthroat. The combined chains will now try to squeeze better prices out of suppliers. They'll whittle distribution costs. They'll shutter poor-performing stores. They'll lay off workers whose duties become redundant. And they'll be able to convert poorly performing Kmarts into Sears' newly created, off-mall Sears Grand stores, which have shown promising results.

But can Kmart and Sears together work enough magic to pull in new customers? And can they together establish two viable store brands that stand for something distinctive in consumers' minds?

Maybe. Maybe not. But one thing's for sure: It won't be an easy presto chango. Their cultures are too different. Their sizes too big. Their problems too many.

“This may be a merger on the road to mutual demolition,” says Pam Murtaugh, a corporate branding and image expert.

The deal essentially presumes that Kmart, the folks who might have sold you your newest tablecloth or pair of underwear, can fully understand the retail complexities of Sears, the folks who might have sold you your latest dishwasher — and runs a huge national service business to keep all your appliances humming.

Sears is the place that carries Kenmore appliances, Craftsman tools, DieHard batteries and, more recently, Lands' End apparel (a selection from the Sears-owned catalog and Web retailer). Kmart is the place to get Martha Stewart home products, Jaclyn Smith fashions and the popular Joe Boxer line. Not necessarily a match made in retail heaven.

Then, again, it could work.

The deal nudged one frequent shopper of both chains to lick his chops in anticipation of every consumer's greatest hope: less hassle.

"If I could find those name brands in one location, I think it would improve the shopping experience," says Chris Olson, 40, of Clear Lake, Iowa. "I'm willing to pay more for those things if I can get in and out of the store quicker."

Some retail analysts are impressed, too.

"This is a clever move in changing the retail landscape," says Marshal Cohen, industry analyst for apparel at The NPD Group, a marketing information company that tracks consumer buying habits. "There really is opportunity to take advantage of strength in numbers and put this jigsaw puzzle together."

The deal sent shares of both companies soaring.

"These guys may have figured out an opportunity for getting back in the game," says Alexi Sarnevitz, retail director for consulting firm AMR Research.

But a workable merger would require re-establishing one of the most difficult of things for any retailer to achieve and hold: relevance for the consumer.

Perhaps nothing is more telling than this simple fact: Few folks can so much as utter the slogan of either of these retailing giants.

Nope, Kmart's isn't "The Stuff of Life." That was two years ago. Then, until three months ago, it was "Right Here. Right Now."Then, the store dumped that and hasn't replaced it. And Sears has long since abandoned its once-popular "Softer Side of Sears." It's current slogan: "Good Life, Great Price."

Those are both a far cry from Wal-Mart's simple, easily grasped motto: "Always low prices. Always."

"Two negative forces do not somehow make a positive," says David Szymanski, director of the Center for Retailing Studies at Texas A&M University.

Of course, the more cosmic question in the whole deal involves elementary math: Will one plus one equal two — or one? That is, will one of these brands eventually be swallowed up by the other?

Many experts are betting that the Sears brand name has the edge on long-term survival.

“Kmart has been dying for 15 years. Maybe this will finally shutter it,” Szymanski says. “Kmart could become a distant memory, something only people's parents know about.”

One branding guru agrees. “Long term, Kmart goes away,” says Robert Passikoff, president of Brand Keys, which tracks consumer loyalty to brand names. “It's a tainted brand.”

Some analysts have been making that bet for years. But in the push and pull of which name might win out — or disappear — sometimes the answers are best read between the lines.

The man who orchestrated the deal, Kmart Chairman and Sears shareholder Edward Lampert, appeared to at least hint on Wednesday that Sears has more muscle.

“We want to make sure the uniqueness of each brand is preserved,” Lampert said. But, he added, “The opportunity for Kmart stores to become Sears is far greater” than Sears stores becoming Kmarts.

Even then, retail experts say a slew of other branding issues have to be dealt with. Among them:

•**What do the brands stand for?** Everyone knows that Wal-Mart stands for low prices. And Target stands for fashionable stuff.

“But with Kmart and Sears, there's no sense what they're about,” says Steven Addis, CEO of Addis Group, a brand strategy firm. “Kmart stands for the poor man's Wal-Mart when there's no Wal-Mart near you.”

•**Who is the competition?** Perhaps both Sears and Kmart need to reconsider “the brand experience” and compete less on price and more on specialized merchandise, suggests Murtaugh. Perhaps one of the chains could target minorities such as Hispanics and Asians, she says.

•**Should the chains mix brands?** They probably will. But not all the brands. “Lands' End continues in the same context that we bought it in,” says Sears CEO Alan Lacy, who will be vice chairman and CEO of the new company.

And mixing too many brands in too many stores can be risky. “If you start selling Craftsman at Kmart, that can hurt brand equity,” Szymanski says.

•**Which concepts work — and which don't?** There is wide speculation that some Kmarts will be converted into the new-concept Sears Grand stores, which feature things that few Sears have stocked before, including a grocery section, racks of DVDs and CDs, and garden centers. Sears has four such stores.

•**How can they convince current consumers this is good thing?** The best way: with good values. If prices appear to rise in either of the chains without very good reason, there could be consumer backlash.

•**How can they entice new customers?** “The joke is that people go to Kmart because they can get good parking,” Szymanski says. “They need better reasons than that.”

•**Are malls the future — or the past?** “There's an endless opportunity to get Sears out of the mall and out into suburban locations,” says Gary Ruffing, senior director at BBK, a retail consulting firm.

But some consumers remained blasé about the deal.

“I don't think it will affect me in any way,” says Kristen McGrew, who was shopping Wednesday afternoon at a Kmart on 34th Street in Manhattan, where many shoppers knew nothing about the deal. “I assume the only difference is for people who own stock.”

Some question deal's long-term prospects

By Greg Farrell
USA TODAY

The bullish response of investors to Wednesday's $11 billion merger announcement between Kmart and Sears left some academics and business strategists scratching their heads. At the close of trading, Kmart's stock had jumped 7.7%, while Sears was up 17%.

The new entity will boast 3,500 stores in the USA, third behind Wal-Mart and Home Depot. But some 60% of business mergers result in failure, at least when measured by share price over time, says William Duggan, professor at Columbia Business School.

The key here, Duggan says, is whether the deal's mastermind, Kmart Chairman Edward Lampert, has a grand strategy for making it work. "What I like to look for is what exactly is in the mind of the person who figured this out," he says. "I call it strategic intuition, and it's very hard for executives to explain in detail what it is. If you go back to AOL and Time Warner, I'm not sure whose idea it was, but the idea was thin."

The merger of Compaq and Hewlett-Packard made more sense, Duggan argues, because H-P CEO Carly Fiorina "seemed to have a much more in-depth understanding of all the things they could do."

Supporters of Wednesday's deal might draw comfort from Fiorina's success but should remember that before being acquired by H-P, Compaq entered into an ill-fated merger with Digital Equipment.

"That was a desperation play," says Jeffrey Sonnenfeld, associate dean at the Yale School of Management. "Far be it from me to doubt Eddie Lampert, given his personal track record and genius, but history is not on his side."

Sonnenfeld finds puzzling the deal's support in the analyst community. "I don't know if this is a certain market intoxication with a hot investor (Lampert) or a value that every single analyst missed last year."

Another precedent for the Kmart/Sears merger is that of Burroughs and Sperry in 1986 to form Unisys. In the short term, it was a disaster: A $3 billion company plus a $9 billion company became a $4 billion company. But Unisys has found its market niche.

"That merger was very difficult," says Harbir Singh, professor of management at the Wharton School, "but one can make the argument that neither company would have survived independently."

As for the new Sears Holdings, "My sense is that what they will need to do is create a business model that will bridge the two organizations and take care of the weaknesses that each has," Singh says. "There will have to be some difficult decisions made relatively soon, such as closing locations, discontinuing certain lines of merchandise, changing supplier relationships and redefining the concept of what the stores are."

Find this article at:
http://www.usatoday.com/printedition/money/20041118/2b_deal18.art.htm

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Kmart, Sears chronology

Milestones in the histories of Kmart Holding and Sears Roebuck:

1899: S.S. Kresge Co. founded by Sebastian Kresge; first store in Detroit.

1918: S.S. Kresge becomes publicly traded company, listed on the New York Stock Exchange.

1962: Company opens first Kmart discount department store in Detroit suburb.

1966: Sales top $1 billion. Number of stores climbs to 915, including 162 Kmarts.

1976: Sales at Kmart stores account for 94.5% of company's domestic sales.

1977: Company name changed from S.S. Kresge to Kmart.

1987: Kmart sells off last remaining Kresge stores in the USA.

2002: Kmart files for Chapter 11 bankruptcy protection. Move led to closing of about 600 of more than 2,100 stores and termination of 57,000 employees.

2003: Kmart exits Chapter 11 as Kmart Holding.

2004: Kmart announces plans to acquire Sears Roebuck.

1886: Richard Sears, a railroad station agent who sells coal as a sideline, buys unwanted watches from jeweler and founds R.W. Sears Watch Co. in Minneapolis.

1887: Sears moves to Chicago, hires watchmaker Alvah Roebuck.

1893: Company incorporates as Sears Roebuck, offering products by mail order to rural residents at lower-than-general-store prices.

1896: Issues first general catalog.

1925: First Sears retail store opens, on Chicago's West Side.

1927: Launches Craftsman and Kenmore brands.

1931: Establishes Allstate Insurance.

1945: Sales pass $1 billion.

1973: Moves headquarters to Sears Tower, then world's tallest building.

1985: Discover Card makes debut.

1991: Loses No. 1 retailer spot to Wal-Mart.

1993: Catalog discontinued.

1994: Announces plans to sell Sears Tower.

1995: Headquarters move to Hoffman Estates, Ill.

2004: Announces merger with Kmart.

Sources: The companies, Associated Press

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About the companies

Headquarters: Hoffman Estates, Ill.

Chairman and CEO: Alan Lacy

Description: Department store and hardware retailer

Exclusive brands: Kenmore, Craftsman, DieHard, Lands' End, Covington and Apostrophe

Q3 2004 revenue: $8.3 billion

Q3 2004 net loss: -$61 million

Stores: 1,970

Employees: 201,000

Headquarters: Troy, Mich.

Chairman: Edward Lampert

CEO: Aylwin Lewis

Description: Retailer with about 1,500 locations

Exclusive brands: Martha Stewart Everyday, Joe Boxer, Sesame Street, Jaclyn Smith, Thalia Sodi, Route 66

Q3 2004 revenue: $4.4 billion

Q3 2004 net income: $553 million ($59 million excluding one-time gains, primarily from store sales)

Stores: 1,515

Employees: 144,000

1 - 2003 annual report; Sources: the companies

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Shareholders get chance to show faith — or not

By David Lieberman
USA TODAY

NEW YORK — Spreadsheet calculations alone won't necessarily show whether Kmart's $11 billion acquisition of Sears Roebuck makes sense. In the end, shareholders will vote with their wallets on whether they have faith in Kmart Chairman Edward Lampert.

The merged company, called Sears Holdings, will be his show. Lampert will control about 44% of the stock and keep the chairman title. He'll pick seven of the 10 board members. The rest will come from Sears.

Lampert can draw from a well of investor enthusiasm based on the market's response Wednesday. Shares in Kmart and Sears soared, and so did those of some key suppliers. Kmart partner Martha Stewart Living Omnimedia was up 6.3% to $18.49 (a gain of $33 million on the 60.5% of shares owned by the imprisoned Martha Stewart). Whirlpool, which makes Sears' Kenmore appliances, was up 4.6% to $66.43.

But Lampert faces the same challenges from rivals such as Wal-Mart, Home Depot, Target, J.C. Penney, Kohl's and Best Buy.

“The retail businesses are stuck in a rut, and that isn't going to change much,” says Sid Doolittle, founding partner of retail strategy firm McMillan/Doolittle.

Bondholders, for example, may see little reason to cheer. Interest rates on Sears' debt could rise as Fitch Ratings warned that it may downgrade the company's paper to “junk” status.

“There are going to be a lot of moving parts and pieces to integrate these companies,” says Jeffrey Stinson of FTN Midwest Research. “That's always an issue in mergers, and anyone who says otherwise hasn't lived through one.”

Yet Lampert's deal gives Sears shareholders an option: If they believe in him, they can swap each current share for half a share in Sears Holdings. If not, he'll give them $50 a share. The relative value of cash vs. stock could change dramatically by the time the deal closes, expected by March 2005. There's no collar on the deal.

The choice may prove illusory, though. Kmart doesn't want to pay out more than $4.7 billion in cash. So the acquisition plan calls for 55% of Sears shares to be converted into stock and 45% into cash. If investor preferences differ, they'll get a mix of cash and stock pro-rated to hit those targets.

Kmart investors will get one share in the new company for each current Kmart share.

While both boards unanimously endorsed the deal, there's little penalty for backing out. If Sears gets cold feet, it'll owe Kmart $400 million. And if Lampert changes his mind, he'll fork over $380 million.

But he acknowledges the hurdles he must overcome. “I can understand that there ought to be skepticism because this is a significant task we're undertaking,” he told analysts.

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Leaner, meaner and focused: Lampert bailed out Kmart and sculpted it to his will

By Lorrie Grant
USA TODAY

Edward Lampert, a Yale graduate, is chairman of Kmart Holding, parent company of the struggling chain of discount stores. The company is 53% owned by Lampert's $9 billion hedge fund, ESL Investments.

But if the $11 billion deal he cut Wednesday with Sears gets expected approval by regulators, he'll be chairman and in control of newly created Sears Holdings, the third-largest U.S store owner.

He took the helm of Kmart last year after a cash infusion from his fund brought Kmart out of bankruptcy court.

Since then, he has made Kmart leaner — shuttering hundreds of underperforming stores — and meaner — adding hip brands to draw new customers and touting the strength of old brands.

Last month, he hired Aylwin Lewis, a whiz at managing multiple brands, to be CEO.

That move, as well as the pile of cash he built up from store sales, caused industry leaders to speculate that Lampert, 42, planned to use Kmart for an acquisition spree.

The deal Wednesday confirmed those suspicions in a spectacular way.

Lampert, whose ESL already held 15% of Sears, says the potential for bigger scale, greater influence with suppliers and lower prices is behind the deal.

“It's important to figure out how to make the business run better,” he said in an interview.

“The competition is pretty ferocious, and at some point we want to be setting the bar.”

Better merchandise can make that happen, he says, noting that the old Kmart let the quality fall too far and pushed away customers. “There's an opportunity here not to reposition Kmart, but to invite back people who were disinvited by the merchandise,” he says.

Pulling it off may cement his reputation as shrewd and focused.

Henry Miller, when he was a financial adviser to Kmart during its time in bankruptcy court, dealt with Lampert as the largest creditor.

“If he was a football player, he would be a fullback because he sees the goal line and you can't stop him,” says Miller, chairman and managing director of Miller Buckfire Lewis Ying.

The surprising, headline-grabbing deal creates more brouhaha than the low-profile father of two usually wants.

His office for 16-year-old ESL in Greenwich, Conn., doesn't have signs.

Security is very tight, not the least because last year he was kidnapped at gunpoint while leaving work and held for ransom for two days before being rescued unhurt.

He bounced back. Shortly after, he began investing in Kmart.