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# Macy's (M) Update
# Maintain BUY

Macy's provided some positive insight into the economy reopening, its current sales, and its financial position. **We are maintaining our BUY recommendation.** The company has suspended the dividend after the April 1 payment, which will save the company $350 million in cash for the rest of 2020. The capital spending budget will also be cut to about $450 million from the $1 billion forecasted saving another $550 million.

- Liquidity appears ample. Macy's cash was $1.5 billion on May 2. Net of debt, cash was only down $150 million y/y even after the stores being closed for approximately 6-weeks and that includes paying the April dividend of $117 million.

- Macy's is issuing $1.3 billion in secured debt backed by real estate due in 2025. This debt along with $200 million in cash will retire the company's current credit line of $1.5 billion. It is also closing a new asset-backed credit facility of up to $3 billion that will mature in 2024.

- With current liquidity and this new financing, Macy's expects to cover all its short-term liquidity needs, investment in the business via capital spending, and it expects to retire $1 billion in debt over two years.

- Sales are coming in ahead of forecasts as stores reopen. Expectations were for stores to open with sales down 80%-85%. Instead, sales started down 50%. Each week has seen open stores improving by 3%-5% too. Macy's expects to see sales return to normal levels in 2021. Also, competitors closing stores throws about $10 billion in sales up for grabs that Macy's hopes to partially capture.

- Omni channel of sales is working as intended. Digital sales are up 80% in stores that have reopened. Buying online for pickup at the stores is now 9% of digital sales. Macy's continues strong sales from Vendor Direct, which reduces its inventory investment while expanding offerings. Macy's continues to see strong sales in all areas except women's ready-to-wear apparel.

- Store closings will lead to a sizeable hit to sales in 1Q of about $2.5 billion. Macy's expects an operating income loss in the quarter of $900-$1.1 billion. Within that will be an inventory write-down of $300 million largely for seasonal inventory that wasn't sold while stores were closed. Nonseasonal inventory is not expected to cause many charges. This loss will also come from a slowdown in credit revenue and higher bad debt expenses. There are likely to be some impairments on intangible assets too in the 1Q results.

- Gross margin is expected to be down y/y in 2Q as margins deleverage on lower sales. Most stores did not open until after 2Q began on May 3 and the sales are still building back. Management sees gross margin rising in 3Q an 4Q.

- Macy's will continue its focus on loyalty programs and personalization of sales. The emphasis will be on higher ROI investments largely in digital as well.

- The return of the dividend will likely follow the stabilization of results and some debt reduction.

# Explanation of EQ Rating Scale

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| 6- "Exceptionally Strong" | Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises |
| 5- "Strong" | Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods. |
| 4- "Acceptable" | Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement |
| 3- "Minor Concern" | Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future. |
| 2- "Weak" | Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears. |
| 1- "Strong Concerns" | Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely. |

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

**Key Points to Understand About the EQ Score**

**The EQ Review Rating is much more than a blind, quantitative scoring method**. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

**The EQ Review Rating is not comparable to a traditional buy/sell rating**. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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