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Seritage Growth Properties
Form 10-Q
May 03, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-37420

SERITAGE GROWTH PROPERTIES

(Exact name of registrant as specified in its charter)

Maryland 38-3976287
(State of Incorporation) (I.R.S. Employer Identification No.)

500 Fifth Avenue, Suite 1530, New York, New York 10110
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (212) 355-7800

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbols	Name of each exchange on which registered
Class A common shares of beneficial interest, par value \$0.01 per share	SRG	New York Stock Exchange
7.00% Series A cumulative redeemable preferred shares of beneficial interest, par value \$0.01 per share	SRG-PA	New York Stock Exchange

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 30, 2019, the registrant had the following common shares outstanding:

Class	Shares Outstanding
Class A common shares of beneficial interest, par value \$0.01 per share	35,689,708
Class B common shares of beneficial interest, par value \$0.01 per share	1,322,365
Class C common shares of beneficial interest, par value \$0.01 per share	0

SERITAGE GROWTH PROPERTIES

QUARTERLY REPORT ON FORM 10-Q

QUARTER ENDED MARCH 31, 2019

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

SERITAGE GROWTH PROPERTIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, amounts in thousands, except share and per share amounts)

	March 31, 2019	December 31, 2018
ASSETS		
Investment in real estate		
Land	\$682,176	\$ 696,792
Buildings and improvements	912,767	900,173
Accumulated depreciation	(147,679)	(137,947)
	1,447,264	1,459,018
Construction in progress	327,006	292,049
Net investment in real estate	1,774,270	1,751,067
Real estate held for sale	7,510	3,094
Investment in unconsolidated joint ventures	419,528	398,577
Cash and cash equivalents	442,625	532,857
Tenant and other receivables, net	41,740	36,926
Lease intangible assets, net	101,452	123,656
Prepaid expenses, deferred expenses and other assets, net	52,700	29,899
Total assets	\$2,839,825	\$ 2,876,076
LIABILITIES AND EQUITY		
Liabilities		
Term Loan Facility, net	\$1,598,171	\$ 1,598,053
Accounts payable, accrued expenses and other liabilities	118,674	127,565
Total liabilities	1,716,845	1,725,618
Commitments and contingencies (Note 9)		
Shareholders' Equity		
Class A common shares \$0.01 par value; 100,000,000 shares authorized;		
35,689,708 and 35,667,521 shares issued and outstanding		
as of March 31, 2019 and December 31, 2018, respectively	357	357
Class B common shares \$0.01 par value; 5,000,000 shares authorized;		
1,322,365 shares issued and outstanding		
as of March 31, 2019 and December 31, 2018	13	13
Series A preferred shares \$0.01 par value; 10,000,000 shares authorized;		
2,800,000 shares issued and outstanding as of March 31, 2019 and		

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December 31, 2018; liquidation preference of \$70,000

Additional paid-in capital	1,124,457	1,124,504
Accumulated deficit	(362,606)	(344,132)
Total shareholders' equity	762,249	780,770
Non-controlling interests	360,731	369,688
Total equity	1,122,980	1,150,458
Total liabilities and equity	\$2,839,825	\$ 2,876,076

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SERITAGE GROWTH PROPERTIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, amounts in thousands, except per share amounts)

	Three Months Ended March 31,	
	2019	2018
REVENUE		
Rental revenue	\$43,578	\$53,777
Management and other fee income	282	—
Total revenue	43,860	53,777
EXPENSES		
Property operating	10,237	7,241
Real estate taxes	10,192	11,381
Depreciation and amortization	26,216	34,667
General and administrative	9,759	7,797
Provision for doubtful accounts	—	61
Total expenses	56,404	61,147
Gain on sale of real estate, net	21,261	41,831
Equity in income (loss) of unconsolidated joint ventures	1,222	(2,582)
Interest and other income	2,598	680
Interest expense	(23,454)	(16,419)
Change in fair value of interest rate cap	—	165
(Loss) income before income taxes	(10,917)	16,305
Provision for income taxes	23	(104)
Net (loss) income	(10,894)	16,201
Net income (loss) attributable to non-controlling interests	3,927	(5,873)
Net loss (income) attributable to Seritage	\$(6,967)	\$10,328
Preferred dividends	(1,225)	(1,228)
Net (loss) income attributable to Seritage common shareholders	\$(8,192)	\$9,100
Net (loss) income per share attributable to Seritage Class A		
and Class C common shareholders - Basic	\$(0.23)	\$0.26
Net (loss) income per share attributable to Seritage Class A		
and Class C common shareholders - Diluted	\$(0.23)	\$0.26
Weighted average Class A and Class C common shares outstanding - Basic	35,671	35,414
Weighted average Class A and Class C common shares outstanding - Diluted	35,671	35,501

The accompanying notes are an integral part of these condensed consolidated financial statements.

SERITAGE GROWTH PROPERTIES

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited, amounts in thousands)

	Class A Common Shares		Class B Common Shares		Class C Common Shares		Series A Preferred Shares		Additional Paid-In Capital	Accumulated Deficit	Non- Controlling Interests	Total Equity
Balance at January 1, 2018	32,416	\$324	1,329	\$13	3,151	\$31	2,800	\$28	\$1,116,060	\$(229,760)	\$434,164	\$1,320,860
Net Income	—	—	—	—	—	—	—	—	—	10,328	5,873	16,201
Common dividends and distributions declared (\$0.25 per share and unit)	—	—	—	—	—	—	—	—	—	(8,992)	(5,054)	(14,046)
Preferred dividends declared (\$0.4375 per share)	—	—	—	—	—	—	—	—	—	(1,228)	—	(1,228)
Vesting of restricted share units	14	—	—	—	—	—	—	—	—	—	—	—
Share-based compensation	—	—	—	—	—	—	—	—	869	—	—	869
Preferred stock offering costs	—	—	—	—	—	—	—	—	(88)	—	—	(88)
Share class exchanges, net (2,779,121 common shares)	2,779	28	—	—	(2,779)	(27)	—	—	—	—	—	1
Balance at March 31, 2018	35,209	\$352	1,329	\$13	372	\$4	2,800	\$28	\$1,116,841	\$(229,652)	\$434,983	\$1,322,569
	35,668	\$357	1,322	\$13	—	\$—	2,800	\$28	\$1,124,504	\$(344,132)	\$369,688	\$1,150,458

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Balance at January 1, 2019													
Net loss	—	—	—	—	—	—	—	—	—	(6,967)	(3,927)	(10,894)	
Cumulative effect of accounting change (see Note 2)	—	—	—	—	—	—	—	—	—	(1,286)	—	(1,286)	
Common dividends and distributions declared (\$0.25 per share and unit)	—	—	—	—	—	—	—	—	—	(8,996)	(5,030)	(14,026)	
Preferred dividends declared (\$0.4375 per share)	—	—	—	—	—	—	—	—	—	(1,225)	—	(1,225)	
Vesting of restricted share units	(23)	—	—	—	—	—	—	—	(1,613)	—	—	(1,613)	
Share-based compensation	45	—	—	—	—	—	—	—	1,566	—	—	1,566	
Balance at March 31, 2019	35,690	\$357	1,322	\$13	—	\$—	2,800	\$28	\$1,124,457	\$(362,606)	\$360,731	\$1,122,980	

The accompanying notes are an integral part of these condensed consolidated financial statements.

SERITAGE GROWTH PROPERTIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, amounts in thousands)

	Three Months Ended March 31,	
	2019	2018
CASH FLOW FROM OPERATING ACTIVITIES		
Net (loss) income	\$(10,894)	\$16,201
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in (income) loss of unconsolidated joint ventures	(1,222)	2,582
Distributions from unconsolidated joint ventures	781	—
Gain on sale of real estate, net	(21,261)	(41,831)
Unrealized (gain) loss on interest rate cap	—	(165)
Share-based compensation	1,532	869
Depreciation and amortization	26,216	34,667
Amortization of deferred financing costs	118	1,720
Amortization of above and below market leases, net	(104)	(234)
Straight-line rent adjustment	(3,355)	(2,453)
Change in operating assets and liabilities		
Tenants and other receivables	484	1,034
Prepaid expenses, deferred expenses and other assets	(248)	(4,229)
Accounts payable, accrued expenses and other liabilities	(8,818)	(502)
Net cash (used in) provided by operating activities	(16,771)	7,659
CASH FLOW FROM INVESTING ACTIVITIES		
Investment in unconsolidated joint ventures	(9,140)	(1,616)
Distributions from unconsolidated joint ventures	389	2,110
Net proceeds from sale of real estate	37,569	60,435
Development of real estate	(85,413)	(85,983)
Net cash used in by investing activities	(56,595)	(25,054)
CASH FLOW FROM FINANCING ACTIVITIES		
Repayment of mortgage loans payable	—	(73,034)
Payment of deferred financing costs	—	(363)
Purchase of shares related to stock grant recipients' tax withholdings	(1,613)	—
Preferred dividends paid	(1,225)	—
Common dividends paid	(8,998)	(8,877)
Non-controlling interests distributions paid	(5,030)	(5,055)
Net cash used in financing activities	(16,866)	(87,329)
Net decrease in cash, cash equivalents, and restricted cash	(90,232)	(104,724)
Cash, cash equivalents, and restricted cash, beginning of period	532,857	417,234
Cash, cash equivalents, and restricted cash, end of period	\$442,625	\$312,510

SERITAGE GROWTH PROPERTIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Unaudited, amounts in thousands)

	Three Months Ended March 31,	
	2019	2018
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for interest	\$28,000	\$21,105
Capitalized interest	5,666	6,862
Income taxes paid	25	104
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING		
ACTIVITIES		
Development of real estate financed with accounts payable	\$17,438	\$19,964
Common dividends and OP unit distributions declared and unpaid	14,026	14,046
Preferred dividends declared and unpaid	1,225	—
Decrease in real estate, net resulting from deconsolidated properties		
Real estate, net	(14,656)	(58,190)
Tenants and other receivables, net	(2)	—
Prepaid expenses, deferred expenses and other assets, net	(84)	—
Accounts payable, accrued expenses and other liabilities	6	—
Transfer to real estate assets held for sale	4,416	—
Transfer of below market asset to Right of Use Asset	(11,005)	—
Recording of Lease Right of Use Assets	19,373	—
Recording of Lease Liabilities	(8,368)	—
RECONCILIATION OF CASH AND CASH EQUIVALENTS AND		
RESTRICTED CASH		
Cash and cash equivalents	442,625	135,091
Restricted cash	—	177,419
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	\$442,625	\$312,510

The accompanying notes are an integral part of these condensed consolidated financial statements.

SERITAGE GROWTH PROPERTIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 – Organization

Seritage Growth Properties (“Seritage” or the “Company”) was organized in Maryland on June 3, 2015. The Company is a fully-integrated, self-administered, self-managed real estate investment trust (“REIT”) primarily engaged in the real property business through its investment in Seritage Growth Properties, L.P. (the “Operating Partnership”), a Delaware limited partnership that was formed on April 22, 2015. Unless the context otherwise requires, “Seritage” and the “Company” refer to Seritage, the Operating Partnership, and its subsidiaries.

On June 11, 2015, Sears Holdings Corporation (“Sears Holdings”) effected a rights offering to Sears Holdings stockholders to purchase common shares of Seritage in order to fund, in part, the \$2.7 billion acquisition of (i) 234 of Sears Holdings’ owned properties and one of its ground leased properties (the “Acquired Properties”), and (ii) Sears Holdings’ 50% interests in three joint ventures that collectively owned 28 properties, ground leased one property and leased two properties (the “Acquired JV Properties”). Concurrent with the acquisition, the Company leased back to Sears Holdings space at 224 of the Acquired Properties under a master lease agreement (the “Original Master Lease”) and space at all 31 Acquired JV Properties under multiple master lease agreements (the “Original JV Master Leases”).

The rights offering ended on July 2, 2015, and the Company’s Class A common shares were listed on the New York Stock Exchange (“NYSE”) on July 6, 2015. On July 7, 2015, the Company completed the transactions with Sears Holdings and commenced operations. The Company did not have any operations prior to the completion of the rights offering and the transactions with Sears Holdings.

On October 15, 2018, Sears Holdings and certain of its affiliates filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code with the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”). On February 11, 2019, Transform Holdco LLC (“Holdco”), an affiliate of ESL Investments, Inc. (“ESL”), completed the acquisition of an approximately 425-store retail footprint and other assets and component businesses of Sears Holdings on a going-concern basis (the “Holdco Acquisition”). In connection with the Holdco Acquisition, Holdco acquired certain designation rights with respect to certain executory contracts and leases of Sears Holdings, including the Original Master Lease. On February 28, 2019, the Company and certain affiliates of Holdco executed a master lease with respect to 51 Acquired Properties (the “Holdco Master Lease”). The Holdco Master Lease became effective on March 12, 2019, when the Bankruptcy Court issued an order approving the rejection of the Original Master Lease. For accounting purposes, the Holdco Master Lease is treated as a modification to the Original Master Lease.