

Lampert Sees Investors Check Out

Sears CEO's Hedge Fund Is Returning Billions of Dollars to Goldman Clients

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Edward S. Lampert, struggling to stem heavy losses at Sears Holdings Corp., is facing an exodus of money from his hedge fund.

Mr. Lampert's hedge fund is returning billions to clients of Goldman Sachs Group Inc. who had invested with ESL Investments Inc. in 2007, according to people with knowledge of the matter. Under that deal, Goldman's clients, such as corporate pension plans, put roughly \$3.5 billion with Mr. Lampert, and they have asked for it back.

The investors are receiving part of their funds in stock rather than all-cash, a redemption technique Mr. Lampert has used before. In June, ESL paid departing investors in part with the stock of a small company that ESL was invested in -- Orchard Supply Hardware Stores Corp., a Sears spinoff. A week later, Orchard filed for bankruptcy protection.

The recent events mark a reversal for Mr. Lampert, a lauded investor whose fund has made a huge bet that he can revive Sears. Mr. Lampert, Sears's longtime chairman, took over as the retailer's chief executive in January but hasn't been able to turn around the company.

In 2007, when Goldman's clients were offered access to Mr. Lampert's fund, he was a star of the hedge-fund world, commanding some of its strictest terms -- a minimum \$25 million investment and the ability to lock up investors' money for five years.

The redemption requests from the Goldman clients were submitted last year in advance of the expiration of the lockups. Without the money raised through Goldman, more than \$2.5 billion in outside investor money is expected to remain, the people said.

Mr. Lampert, a former Goldman trader, also invests billions of his money in ways that mirror the positions in the fund.

The exit of Goldman's investors largely returns Mr. Lampert's investor base to what it was before 2007: a core group of wealthy, individual investors who have profited handsomely by investing with him over many years.

One exception: longtime investor Michael Dell of Dell Inc., whose multibillion-dollar family office has pulled out of ESL as it sheds its outside investments in favor of putting money to work directly.

Some people said their faith in Mr. Lampert is intact.

"This might be the time people should consider investing" with Mr. Lampert, said one client on Thursday, describing Mr. Lampert as one of the most talented investors he knew.

Another person familiar with Mr. Lampert described him as an investing visionary and noted that even Steve Jobs was fired from Apple Inc. at one point.

ESL has notched annualized returns of more than 20% a year for 20 years, according to a person familiar with Mr. Lampert, one of the strongest long-term track records in the industry.

The returns of late have been volatile, including a 33% loss in 2008, then 55% and 16% gains in 2009 and 2010, and a 12% loss in 2011. ESL has posted gains this year and last, according to people familiar with the firm, who didn't provide figures.

Mr. Lampert is a so-called value investor who makes concentrated bets intended to pay out over the long-term. He has long subscribed to the philosophy that his clients were paying him to invest their money profitably, not to explain his thinking on those investments, said a person familiar with Mr. Lampert.

Goldman's clients earned profits with ESL, beating the S&P 500, according to people familiar with the matter. But they defected in part because of the fund's lower-than-expected returns during their investment period, even though Mr. Lampert had cautioned during marketing meetings in 2007 not to expect his historic high returns, the people said.

Some of the investors requested redemptions in 2008 during the financial crisis, when many institutions and individuals were strapped for cash, and they were frustrated when ESL refused, the people said.

One of his highest-profile investments was in Kmart Corp., which he helped bring out of bankruptcy proceedings in 2003 at the equivalent of \$17 a share and then helped merge with Sears, Roebuck & Co. in 2005 to create Sears Holdings.

The deal was seen as a savvy bet on the company's real estate and a short-term validation of Mr. Lampert's theories for running a retailer. Sears shares surged to \$163.50 in 2005.

Since the merger, revenue has plunged by more than \$13 billion as of the end of the company's last fiscal year, and Sears is on track to book its third consecutive year of losses. "The confidence I had over 10 years of what's possible, it has been shaken over time," Mr. Lampert said at the company's annual meeting.

Despite the weakening performance, Sears stock is up about 20.8% on the year, but is down 21.3% this week. Mr. Lampert said Tuesday that he was paying some of his departing investors in Sears stock, rather than cash.

The move reduced his total stake in the company to 48.4%, and sparked a sell-off in Sears shares, which dropped 7.7% in heavy volume that day. It closed Thursday at \$49.98, down 94 cents, or 1.8%.

Fund managers typically will give back such "in-kind distributions" when doing so is either advantageous to their investors for tax reasons, lawyers say, when they are limited in what they can sell because of securities rules or when a manager is trying to meet redemption requests while avoiding a fire-sale of assets.

"In general, investors don't like in-kind distributions," said Bert Fry, a partner at Pryor Cashman LLP who focuses on hedge funds. "At a minimum, it puts them in the position of having to make the exact investment decision that they'd hired a portfolio manager to make."

In the case of Orchard, the company signaled early in June that a bankruptcy filing was possible. Its shares closed at \$2.48 June 10, the day ESL or related entities distributed them to clients "on a pro rata basis to limited partners that elected to redeem all or a portion of their interest," according to a regulatory filing.

The company filed for bankruptcy protection on June 17. Its assets were acquired by Lowe's Cos. in August.