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PRESENTATION

Operator

Good morning and welcome to the Office Depot's fourth-quarter and full-year 2016 earnings conference call. (Operator Instructions). At the request of Office Depot, today's call is being recorded.

I would like to introduce Richard Leland, Vice President, Investor Relations, and Treasurer. Mr. Leland, you may now begin.

Richard Leland - *Office Depot, Inc. - VP IR, Treasurer*

Good morning and thank you for joining us. This is Rich Leland and I'm here with Gerry Smith, our newly appointed CEO, and Steve Hare, our Executive Vice President and CFO.

On today's call, Gerry will begin with some opening remarks, and then Steve will review the Company's fourth-quarter and full-year financial results and 2017 outlook. Following Steve's discussion, Gerry will return for some closing comments, and then we'll open up the line for questions.

Before I begin, I need to inform you that certain comments made on this call include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the Company's current expectations regarding future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially. A detailed discussion of these factors and uncertainties is contained in the Company's filings with the Securities and Exchange Commission.

During this call, we'll use some non-GAAP financial measures as we describe business performance. The SEC filings, as well as the earnings press release, presentation slides that accompany today's comments, and reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures, are all available on our website at investor. OfficeDepot.com. Today's call and slide presentation is being simulcast on our website and will be archived there for one year.

Before we begin the call, I wanted to provide a brief introduction of Gerry, who officially joined us as CEO on Monday of this week. Gerry comes to Office Depot from Lenovo Group, a $45 billion leading global technology company, where he most recently served as Executive Vice President and Chief Operating Officer of its personal computer and smart devices unit. At Lenovo, Gerry was responsible for operations across the global product portfolio and led Lenovo to the top position in worldwide PC sales, while delivering record market share and profits to Lenovo's Americas group.

Prior to Lenovo, Gerry held a number of executive positions at Dell during his 12-year tenure. In total, Gerry brings more than 30 years of significant operating experience leading large complex organizations, with a strong track record of driving revenue growth and increasing profitability and market share. We are pleased to have him join the Office Depot team and look forward to his leadership.

And now, I'd like to turn the call over to Office Depot's new CEO, Gerry Smith.

Gerry Smith - *Office Depot, Inc. - CEO*

Thank you for that wonderful introduction, Rich, and good morning to everyone on the call. I am very happy to be here today with you to discuss Office Depot's fourth-quarter results.

While Steve will cover the financials in detail, I did want to share my perspective on the business, including some of the key opportunities that attracted me to Office Depot.

Beginning on slide four in the presentation, the Company has a balanced North America business portfolio split roughly evenly between the retail and business solutions division. And while both businesses have significant size and scale on their own, I was impressed with the Company's focus on creating a true omnichannel approach to leverage the inherent benefits of each division.

This seamless approach to meet customer needs regardless of how or where they choose to shop is a key differentiator against pure online competitors and one that I believe can be further enhanced in the future. This is especially true in expanding our current base of services and solutions. For example, we provide consumers and small business customers with their copy and print needs in our retail stores and deliver high volumes and more complex premium services to our larger customers from our dedicated regional print facilities. We have similar service capabilities in tech repair and office furniture design.

I believe there is significant potential to further develop the omnichannel delivery of these services going forward in order to provide a wider range of solutions to customers of all sizes.

I was also impressed by the strong customer relationships that the Company has built over many years. These customers rely on timely and accurate delivery of our products and services to keep their businesses running. Today, many of these relationships are focused primarily on office products. As you know from the three-year strategic plan that was developed last year, a significant opportunity exists to expand these relationships and grow our share of wallet with these customers.

Increasingly, customer demands pull us into adjacent categories to leverage our purchasing power, selling expertise, and supply-chain capabilities. Having run large complex selling and supply-chain organizations in the past, I believe that we have many of the building blocks necessary to further capitalize on these opportunities and become an even more important vendor to our customers in the future.

As an outsider looking in, I am very interested in the Company's outlook on the future of retail. Across the industry, almost every retailer is grappling with this same question. While the Company has done an excellent job improving the profitability of the retail business, for me the potential came to light when I first visited the Company's new store of the future model. In addition to being a smaller footprint, these stores are easier to shop, with a more curated assortment, better signage, product adjacencies, and a focus on higher-quality products, services, and expertise. They play an important role in the omnichannel approach that I mentioned earlier and have space dedicated to expand its service capabilities.

I'm pleased to see that the customer feedback has been quite favorable and I'm anxious to add my ideas and perspective to this evolving platform as we expand the test in 2017.

Lastly, as I was evaluating this opportunity, I was encouraged by the Company's strong balance-sheet position and free cash flow generation. These will be important assets going forward and provide a substantial amount of both flexibility and opportunity. There is a tremendous amount of financial discipline in place within the organization and a focus on creating shareholder value that I plan to continue.

Turning to slide five, I want to touch briefly on some of the Company's main accomplishments in 2016. First, despite facing some significant business disruption during the year related to the Staples acquisition attempt, I am very pleased that the Company was able to deliver continued improvements in profitability for both the fourth quarter and full year.

Diluted earnings per share from continuing operations in the fourth quarter were $0.10 per share, compared to $0.06 per share in 2015, with operating income improving to $57 million in the quarter. Gross margins for the year improved by 20 basis points and a strong focus on cost-reduction initiatives helped to improve adjusted operating margins by 60 basis points. This is the third consecutive year of adjusted operating margin improvement for the Company.

Contributing to this improvement was the substantial synergy that the Company has been able to realize from the OfficeMax merger. Approximately $100 million in incremental benefits were realized in 2016, bringing the total amount of synergies realized to $700 million. The integration remains on track and is expected to be substantially complete by the end of 2017.

Next, the Company successfully closed on the sale of its European business in late 2016 and is making progress in selling substantially all the remaining international businesses. These strategic actions enable us to focus our resources going forward on the greatest opportunities from growth within the North American market.

And lastly, a compelling new three-year strategic plan was developed to guide the Company going forward. Some of the initiatives that are planned have already been implemented, while others are well underway. It contains a balanced mix of growth initiatives, profitability improvements, and a commitment to shareholder return. I look forward to working with the management team and continuing to drive execution of the plan over the coming years.

Before I turn the call over to Steve, on slide six I want to point out the substantial improvement in profitability that has been accomplished by the team over the past three years. The merger of Office Depot and OfficeMax joined two businesses operating at breakeven levels of profitability and created a combined entity that today generates almost $0.5 billion of adjusted operating income. This is in large part due to the hard work that my predecessor, Roland Smith, and the management team he assembled.

I want to thank Roland for his many contributions and turning over the Company with such a significantly improved profitability profile. I'm excited about the opportunities that lie ahead of us, and I look forward to continuing this momentum and position the Company for future growth.

I will now turn the call over to our CFO, Steve Hare, who can provide more details on our financial performance. Steve?

Steve Hare - *Office Depot, Inc. - EVP, CFO*

Thank you, Gerry, and good morning, everyone. I'm happy to be here today to discuss with you our fourth-quarter and full-year results.

Turning to slide eight, we have highlighted some key performance measures for the fourth quarter. As you may remember from our last earnings call, we made the strategic decision to sell substantially all of the operations previously included in our international division. Accordingly, results from these businesses in the current period and prior-year periods have been reclassified and are reported as discontinued operations in our financial statements. As a result of the European sale that was completed in December 2016, the European business will not be included in the Company's future financial statements.

As I talk about our fourth-quarter and full-year results, I will focus primarily on the performance from our continuing operations.

Reported total Company sales declined 2% in the quarter compared to the same period last year. Sales in the fourth quarter of 2016 benefited by approximately $143 million from the inclusion of an additional 53rd week in the fiscal year. Excluding the impact from planned US retail store closures, foreign currency translation, and the 53rd-week benefit, adjusted sales declined 4% in the quarter. The decline was primarily due to customer losses in our contract business stemming from the Staples business disruption last year, as well as lower traffic in our retail stores.

Operating income in the quarter increased to $57 million, compared to $42 million in the fourth quarter of the prior year. During the quarter, the Company incurred $55 million of operating expenses related to restructuring activities, the OfficeMax integration, asset impairments, and executive transition cost. Excluding these special items, our adjusted operating income in the fourth quarter was $111 million, an increase of $28 million or 34% compared to the prior-year period.

Adjusted operating margins in the quarter also improved 110 basis points versus the fourth quarter of the prior year, driven primarily by the benefits from store closures, merger integration synergies, and other expense reductions from our cost-savings initiatives. In addition, the Company benefited by approximately $15 million as a result of the 53rd-week impact, primarily in the North American retail division.

Combined, these actions helped to more than offset the negative flowthrough impact from lower sales.

Net income from continuing operations for the fourth quarter was $55 million or $0.10 per diluted share, compared to $31 million or $0.06 per share in the fourth quarter of 2015. Results for discontinued operations, net of tax, was $25 million in the fourth quarter of 2016. Excluding the after-tax effect of all of these special items, fourth-quarter adjusted net income from continuing operations was $59 million or $0.11 per diluted share, compared to $35 million or $0.06 per share in the prior year.

As noted on slide nine, same-store sales in the North American retail division declined 4% in the quarter compared to the prior year. The comp sales decline was mainly driven by lower store traffic and a slightly lower average order value during the period. We also made the decision this year to close our retail stores on Thanksgiving day to allow our associates to spend time with their families. Sales in the fourth quarter included a 53rd-week benefit of approximately $87 million.

Excluding the 53rd week and the impact of planned store closures, total retail sales in the quarter decreased 3% versus the prior year.

Looking at our performance by product category, retail sales decreased in ink, toner, and other technology items, as well as in supplies. Our cleaning and break room and furniture product groups were relatively flat to the prior-year period.

The North American retail division reported operating income of $62 million in the fourth quarter of 2016, relatively flat to the prior-year period. Fourth-quarter results in both years contained one-time items, including approximately $14 million of benefit related to the 53rd week in 2016 and about $17 million of favorable legal settlements recorded in 2015. Excluding these special items, fourth-quarter operating income increased compared to the prior year, with operating margins improving 20 basis points as the negative flowthrough impact from lower sales and a lower gross margin rate were offset by lower selling, general, and administrative expenses, including payroll and advertising.

During the quarter, we closed 65 stores that were part of the second phase of our retail store optimization plan and ended 2016 with a total count of 1,441 stores in the North American retail division.

As highlighted on slide 10, Phase II of our store closure plan is underway and we closed 72 stores in the second half of the year as part of our three-year strategic plan to optimize and reinvent our retail business. In total, we anticipate closing 300 stores as part of this program, with approximately 75 store closures planned for 2017.

Sales transfer rates remain above our expectations, in part due to the successful management by our closure teams executing on all aspects of the process, including directing customers to visit our remaining retail stores in the area and providing them with incentives to encourage future purchases.

We also have actions underway to further optimize our retail business model. The buy online/pick up in store program continues to grow and sales exceeded $100 million in 2016 as customers increasingly choose this convenience offering. In addition, we have also rolled out our ship-from-store program to approximately half of the retail chain. This program allows online customer purchases to be fulfilled by a local retail store, thereby extending our supply-chain network and inventory efficiency to capture a sale that otherwise would have been potentially lost due to an out-of-stock item in the warehouse.

During the fourth quarter, we also completed the rollout of a new workforce management tool to all of our stores. This tool delivers two main benefits to our retail store managers. First, the tool will recommend the optimum labor structure for each specific store, allowing store managers to spend less time on staff scheduling and more time assisting customers. And second, the tool will allocate labor needs based on customer demand and traffic patterns to ensure we match associate labor hours and skills to meet customer needs as efficiently as possible, while moving other non-selling tasks to off-peak hours. We expect to realize significant productivity benefits and lower operating costs going forward as a result of this tool.

Lastly, we converted 25 stores in 2016 to our new, smaller, 15,000-square-foot store of the future format. The feedback continues to be very positive, with customers valuing the improved navigation, better signage, and enhanced arrangement of curated products that the new format offers. These new formats also place a greater emphasis and significantly more space dedicated towards our key service offerings, such as copy, print, and tech services.

We remain encouraged by the financial results we have seen so far and plan to convert an additional 75 stores to this new format in 2017. With this larger group of approximately 100 stores, we can better determine the investment returns this format can potentially create. A listing of the store of the future locations is available on our Investor Relations website and we encourage you to visit one if you are in the area.

Slide 11 shows the performance of our business solutions division, or BSD. Sales in the fourth quarter of 2016 were $1.4 billion, relatively flat compared to the prior year. Sales in the quarter included approximately $56 million of benefit from the 53rd week. Excluding the 53rd-week benefit, sales declined 5% from the prior-year quarter in constant currency. The sales decline was principally in the contract channel and largely driven by customer attrition and fewer new customer additions during the period of business disruption related to the Staples acquisition attempt earlier in the year.

We did, however, see some sequential improvement, with enhanced customer retention and a strengthening customer pipeline during the quarter.

In the direct channel, sales improved mainly due to strong online sales during the holiday period, partly offset by the ongoing reduction in catalog sales and higher sales from our buy online/pick up in store and ship-from-store programs that are recorded in our North American retail division.

Looking at our performance by product category, BSD sales decreased versus the prior year across most of our product categories; however, we did experience continued positive sales growth in copy and print and in our cleaning and break room category.

Fourth-quarter sales in the US contract channel also increased in our K-12 education customer group again, compared to the prior period last year. This area of our business continues to deliver positive sales growth and strong overall performance and is a key initiative for expansion within the contract channel.

The BSD division reported operating income of $75 million in the fourth quarter of 2016, an increase of $36 million compared to the prior-year period. The 53rd-week benefit in 2016 positively impacted results by $4 million. Excluding the 53rd-week benefit, operating margin in the fourth quarter improved by approximately 260 basis points compared to the prior year.

The negative flowthrough impact of lower sales was more than offset by a higher gross margin rate and lower selling, general, and administrative expenses from actions taken during the year to improve operating-model efficiencies. In comparison with the prior year, operating income was negatively impacted by the recognition of certain customer acquisition costs in the fourth quarter of 2015.

Turning to slide 12, accelerating contract is one of the key growth initiatives in our three-year strategic plan and we are making significant progress rebuilding our contract channel sales pipeline. As we discussed in our last earnings call, our customer commitments in the third quarter reached a two-year high and continued to be strong in the fourth quarter and above 2014 levels. Our sales teams are fully engaged in winning new business and we have clearly regained our momentum in contract; however, implementation of new customers can take up to several months before revenue in the pipeline is realized.

The migration of the legacy OfficeMax contract customers onto the Office Depot platform is well underway. Over 70% of accounts have either started or completed the migration process, and customer feedback and sales trends are positive, based on the platform's enhanced functionality and assortment. We are on track to be substantially complete with the customer migrations by the end of 2017.

In addition, we have closely aligned the customer migration process with our supply-chain consolidation plan. Conversions of our legacy OfficeMax distribution facilities to the Office Depot order management system are proceeding ahead of schedule, and we expect to have the process completed in the second quarter. Having all of our facilities on a common platform enables us to not only improve our service to customers, but it also enables us to realize additional efficiencies by optimizing delivery routes based on ZIP Codes. Furthermore, a consistent platform enables us to better manage inventory levels and free up capacity to expand our jan/san product assortment.

Expanding into adjacent categories is a key growth initiative under our three-year strategic plan and we are building capabilities across the organization to support this initiative. This includes expanding our sales and service resources to increase our focus on the cleaning and break room categories and providing our sales reps with additional training and support to be able to successfully win new business.

In addition, we are working with our key vendors and suppliers to develop an expanded assortment of product SKUs in these areas. As we have mentioned in the past, we are planning to significantly expand our product offering in the jan/san category in order to capture additional share of wallet opportunities with our customers as they look to consolidate their vendor relationships. We have project plans in place across the organization, including supply chain, marketing, and sales operations in order to support this important initiative.

Turning to Slide 13, as you recall we made the strategic decision in 2016 to sell off substantially all of our international operations in order to focus our resources on the growth opportunities in the North American market. During the fourth quarter, we successfully completed the sale of our European business and therefore the results from those operations will no longer be included in the Company's financial statements. While that transaction generated nominal cash proceeds, it eliminated most of our future exposure to liabilities of the business and also generated a significant tax asset of approximately $200 million that can be used to offset capital gains in the future.

We are actively marketing for sale the remaining international businesses located in Australia, New Zealand, South Korea, and mainland China. For the full-year 2016, these businesses generated approximately $600 million of combined revenue and a small operating loss. We expect to complete the disposition of these businesses before the end of the year.

As we have stated previously, we currently intend to retain our sourcing and trading operations in Asia and the results from these operations are reported as other continuing operations outside of the North American segments. These retained operations contributed $18 million in sales and $1 million in operating income for the full-year 2016.

On slide 14, you will find a summary of our 2016 full-year results. As Gerry mentioned earlier, we were able to deliver full-year adjusted operating income that exceeded our guidance, despite the topline challenges we faced during the year. Overall, total Company sales declined 6% in 2016 compared to the prior year. Excluding the impacts from US retail store closures, foreign currency translation, and the 53rd week, adjusted sales declined 4% for the full year. The decline was primarily due to the business disruption in our contract business arising from the Staples acquisition attempt beginning in 2015 and continuing through the first half of 2016, as well as lower traffic in our retail stores.

GAAP operating income for the full year increased to $531 million, compared to $183 million in the prior year. In 2016, the Company recorded a net credit of $59 million, primarily as a result of the Staples termination fee of $250 million, partially offset by expenses related to the acquisition, restructuring activities, the OfficeMax integration, asset impairments, and executive transition cost. Excluding these special items, our full-year 2016 adjusted operating income was $471 million, an increase of $33 million or 8% compared to the prior year.

Operating margins for the year also improved 60 basis points versus 2015, with improved gross margins, synergies from the OfficeMax integration, and lower expenses more than offsetting the negative flowthrough impact from lower sales.

Net income from continuing operations for the full year 2016 was $679 million or $1.24 per diluted share, compared to $92 million or $0.16 per diluted share in 2015. Net income from continuing operations includes the reversal of the valuation allowances recorded in prior years and other tax benefits. Excluding the after-tax effect of all of these special items, including the after-tax effect of the loss on extinguishment of debt, full-year adjusted net income from continuing operations was $251 million or $0.46 per diluted share, compared to $222 million or $0.40 per diluted share in the prior year. This is a 15% year-over-year improvement in earnings per share.

Turning to the balance sheet and cash flow highlights on slide 15, we ended 2016 with total liquidity of $1.8 billion, consisting of $800 million in cash and cash equivalents associated with continuing operations and $1 billion available under our asset-based lending facility. At the end of 2016, debt was $387 million, excluding $798 million in nonrecourse debt related to the timber notes.

For the full year 2016, cash provided by operating activities of continuing operations was $492 million. This included the $250 million termination fee paid by Staples, partially offset by $122 million in acquisition-related expenses, $113 million in OfficeMax merger integration costs, and $47 million in restructuring costs. Capital expenditures were $111 million in 2016, $27 million of which related to the OfficeMax merger integration.

As part of our shareholder return initiative, the Company repurchased a total of 37 million shares of its outstanding common stock during the year for a total cost of $132 million. In addition, the Company paid quarterly cash dividends of $0.025 per share on September 15 and December 15 to shareholders of record, totaling approximately $26 million of dividends paid in 2016.

As shown on slide 16, in 2016 the Company realized $700 million in integration synergies from the OfficeMax merger that began about three years ago. The remaining integration activities include completing the supply-chain consolidation, customer migration process, and, finally, decommissioning the remaining IT systems that currently support the OfficeMax part of the business today. Our integration efforts are proceeding as planned, and we still expect to be substantially complete by the end of 2017 and achieve our over $750 million in total synergy benefits.

As I mentioned earlier, Phase II of our store closure program is already underway, as well as a number of initiatives in each division to streamline our operating models for greater efficiencies. In the fourth quarter, we began a detailed review process to identify cost-savings opportunities in our approximate $2 billion of annual indirect procurement spend. Our procurement teams are working with business leaders across the organization and reviewing vendor contracts to ensure we are fully leveraging all of our Company's assets and purchasing power. We believe we can generate significant future savings from this initiative and have already realized several quick wins.

And finally, as part of the cost-savings programs we reviewed opportunities to right-size our organization and reduce our general and administrative costs. These reviews started in the fourth quarter of 2016 and we took action in the first quarter of 2017 to simplify operations and remove redundancies in our support functions.

In total, these programs are expected to produce over $250 million of annual run rate savings by the end of 2018. Several of these cost-reduction strategies were initiated in the fourth quarter and have already produced incremental savings. Together with the benefits we plan to achieve from the OfficeMax integration, we expect to deliver over $1 billion in total annual cost-savings benefits to the Company.

Turning to slide 17, during 2016 we took several actions to return capital to shareholders and enhance shareholder value. First, we redeemed our 9.75% senior secured notes for $262 million in September. By retiring this high coupon debt, we will realize approximately $24 million in annual cash interest savings.

Second, in August of last year our Board of Directors approved the initiation of a quarterly cash dividend of $0.025 per share on the common stock of the Company. Dividends were paid out in September and December of 2016 and the Board has recently approved our next dividend, which will be paid on March 15.

And lastly, the Board also approved a share repurchase program authorizing up to $250 million in buybacks. Through the end of 2016, we repurchased approximately 37 million shares of common stock for a total cost of about $132 million at an average weighted price of $3.58 per share. Approximately $118 million remains on our current authorization. Including the debt repayment, dividends, and share repurchase activities in the year, we have utilized approximately $420 million of cash in 2016 to improving shareholder returns.

Slide 18 outlines the key components of our 2017 outlook, which is consistent with the preliminary guidance that we provided on our last earnings call. We anticipate sales in 2017 will be lower than 2016, primarily as a result of our retail store closures, continued sales declines in our business solutions division due to prior-year contract customer losses, as well as one less selling week. However, we expect the rate of sales decline in the contract channel to improve throughout the year as we continue to strengthen our sales pipeline, win new business, and translate those customer commitments into revenue in the latter part of the year.

The Company continues to expect to achieve approximately $500 million of adjusted operating income in 2017. Excluding the estimated $15 million 53rd-week operating income benefit in 2016, this is a comparable year-over-year increase of about 10%.

We also expect to generate more than $300 million in free cash flow from continuing operations in 2017. This includes about $200 million in capital expenditures to support the Company's critical priorities and investments in our store of the future concept, as well as approximately $150 million in depreciation and amortization expense.

Lastly, our non-GAAP annual effective tax rate is expected to be approximately 41% in fiscal 2017, but the rate will depend on the mix and timing of income. Cash tax rates are anticipated to be approximately 15% as we continue to utilize available tax operating loss carryforwards and credits.

Now I'll turn the call back over to Gerry for his closing comments. Gerry?

Gerry Smith - *Office Depot, Inc. - CEO*

Thanks, Steve. I'm very pleased with how the Company finished out the year and the momentum we are carrying into 2017.

I'm also comfortable with the outlook we have provided here on today's call, and clearly one of my priorities is to ensure that we deliver on our 2017 operating plan. That includes continuing to focus the organization on executing against our critical priorities -- successfully completing the OfficeMax integration, continuing to execute on the multi-year cost-savings programs that are underway, optimizing the retail business to become more efficient and customer focused, validating the store of the future opportunity for potential rollouts, accelerating growth in the contract business with both new and existing customers, and expanding on opportunities in adjacencies and services.

Ultimately, our goal is to expand our customer base and become a more important vendor to our customers in order to stabilize and eventually begin to grow at the topline. In the coming weeks and months, I will be digging deeper into our business and meeting with our many suppliers, customers, shareholders, and associates. I'm excited by the potential we have as an organization, the opportunities that have already been identified as part of the Company's three-year strategic plan, and I look forward to building on these efforts to position the Company for future success.

I will now turn the call back over to the operator and we can take on your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Matt Fassler, Goldman Sachs.

Chani Lutra - *Goldman Sachs - Analyst*

Hi, this is [Chani Lutra] on behalf of Matt Fassler. Steve and Gerry, as we entered the new year, what are you seeing in terms of contracts in the BSD segment that are up for renewals from customers that were perhaps holding off last year due to the looming merger activity? I guess what I'm asking is, are you seeing more activity in the market? And also, could you perhaps talk about if you are seeing any changes in the competitive landscape in the contract segment, particularly any increasing activity from Amazon? Thank you.

Gerry Smith - *Office Depot, Inc. - CEO*

Thank you for the question, and since it's day three for me, I'm going to let Steve jump in on that as well.

Steve Hare - *Office Depot, Inc. - EVP, CFO*

Gerry, glad to take that one. Yes, I think in terms of the pace, on the last earnings call we had talked about that there had been some pent-up, I think, demand in terms of from a contract standpoint because of the pending Staples announcement.

I think once -- now we've been through that. I think the market has stabilized and we're more in a normal course. We clearly have our contract sales force out there now able to compete and we're competing quite effectively, and as we talked about last time and in this quarter, our pipeline now is back above the premerger discussion level, which is a healthy sign for us going forward.

Operator

Simeon Gutman, Morgan Stanley.

Ben Zimmerman - *Morgan Stanley - Analyst*

This is Ben Zimmerman on for Simeon. Thanks for taking my questions. I just had a couple here, one on the competing category. Momentum has been pretty solid at an industry level. Can you talk about trends you've seen in the last few quarters? Have you been gaining share or what has the competitive landscape been?

Steve Hare - *Office Depot, Inc. - EVP, CFO*

I think overall, as we've talked about from a product category standpoint, our total sales decline has been across most of the categories, I think, with the exception of in particular cleaning and break room areas that we are seeing growth there.

I think from a competitive standpoint it remains very, very competitive out there, including the technology sector for us, and we continue to work hard as part of our store of the future initiative to look at ways in which we can present our technology offering in a more compelling way.

Gerry Smith - *Office Depot, Inc. - CEO*

The thing I'll add as well is I have 30-plus years experience in the tech space, and so one of the reasons why I'm excited to be here is just the cash position, the balance sheet, the supply-chain opportunities, but I think I can leverage a lot of CEO-to-CEO relationships to help us build opportunities in that business going forward. When I see you guys next week, and in the future we'll talk more about that, but I'm absolutely excited with the opportunities to build the tech business even more.

Ben Zimmerman - *Morgan Stanley - Analyst*

Great. Thanks, guys. And then, just one more question. Gerry, I know you've only been around for a short period of time, but given the month, month and a half you've been there, what are the biggest opportunities you see for Office Depot? And given that the space has been in flux for many years and secular headwinds are widely believed to persist, where do you see this business five years down the line? Whether it's shrinking retail footprint and driving greater sales online, how do you see the evolution progressing over the next three to five years?

Gerry Smith - *Office Depot, Inc. - CEO*

Just for clarity for the people on the phone, my last day at Lenovo was Sunday; this is my third day. So I found my badge and the bathroom and had a great all-hands meeting with all our associates across the Company, staff meetings, meeting the team, meeting with vendors, so, to be candid, it's too early for me to comment.

My focus on the first 90 days is to listen and learn and talk to associates, talk to partners, talk to customers. I have been to 10 stores and I'm going to go see our top 10 or 15 customers in the next 90 days, and I'm going to continue to talk to our key technology partners, as well as our print partners, our paper partners, and I think -- I'll come back to you on the next call.

But, obviously, I came here for a couple reasons. I came here because I think there's been tremendous efforts by the last three years of the Company; our balance sheet is in great position. Our operating income has improved dramatically over the last three years. I think there's a B2B element that a lot of companies don't have in retail that we have here, and I think that's a huge asset.

And all of them are vehicles for growth, and the last one, I think, is really important where I use my experience in the past is supply chain and having 1,441 stores and having the opportunity to take that supply chain and get that last mile, and as Steve said in his piece we're growing click and pick in one hour and that's a huge opportunity. I'm excited by using supply chain as a weapon, using our sales -- we have sellers in every state of the union and Canada and Puerto Rico, and I think we can use those as weapons as well to small and medium business and corporate accounts.

But I'll stop there because I'm excited. I think you can hear it, but I literally am on day three. So I would ask you to -- look forward to meeting you next week and definitely it will come up and see you in the future and we can talk more about this.

Operator

Michael Lasser, UBS.

Ahbo Misrai - *UBS - Analyst*

This is actually [Ahbo Misrai] filling in for Mike Lasser. Thanks a lot for taking our questions. So the retail comp in the fourth quarter was a little worse than in the prior few quarters. Do you think that was because the market for certain product categories got worse or was there less sales transfer from the closed stores?

Steve Hare - *Office Depot, Inc. - EVP, CFO*

On the retail side of the business, we clearly saw lower traffic in the fourth quarter. Part of that, as we said, was reflected by being closed on Thanksgiving day, but overall we saw the holiday season very competitive and we saw an ongoing shift over to online, and as a result we did see a pickup and a benefit on our direct channel, but we did see a softening trend on retail, primarily from a traffic standpoint through the holiday season.

Ahbo Misrai - *UBS - Analyst*

Okay. Thank you. And as my follow-up, your guidance for FY17 implies continued margin expansion. Can you break that out for us? In particular, I'm interested to know whether this will be more SG&A driven or are you expecting higher gain on the gross margin line? Thank you.

Steve Hare - *Office Depot, Inc. - EVP, CFO*

I think, as you can see from the comments we've made, we look forward in 2017 to sort of completing the Max merger integration. There are additional synergies that we have targeted for 2017 that will help on the margin side, and then our newly initiated $250 million cost-savings program goes across indirect purchasing, it goes across with the real estate closures, and then does get at SG&A.

As we talked about on the call, we did begin in the fourth quarter another right-sizing exercise of our G&A in particular, and we have made most of that happen in the first quarter so we will get the benefit of that lower SG&A going forward as we realize that $250 million, and we roughly think we'll get half that benefit in 2017 and then half in 2018. That will go to help offset the lower sales outlook that we have and, we think, allow us to continue to improve operating margin.

As Gerry said on the call, we've got a good track record of improving our overall operating margins over the last couple years despite the challenging sales environment that we're competing in.

Operator

(Operator Instructions). That concludes the Q&A session for today. I now turn the call back over to Gerry Smith for any closing remarks.

Gerry Smith - *Office Depot, Inc. - CEO*

I just want to thank you all for joining the call this morning. I'm excited to be here with this leadership team. As I said before, I look forward to meeting some of you next Tuesday, and available to meet in the coming weeks and months, and we'll update you and I'm optimistic with our annual operating income plan and our 2017 strategic one as well. A lot of confidence in the business, so thank you and have a great day.

Operator

Thank you for your participation. This concludes the call. You may now disconnect.
