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CORPORATE PARTICIPANTS

Gerry P. Smith *Office Depot, Inc. - CEO and Director*

Richard Leland *Office Depot, Inc. - VP of Finance & IR and Treasurer*

Stephen E. Hare *Office Depot, Inc. - CFO and EVP*

CONFERENCE CALL PARTICIPANTS

Atul Maheswari *UBS Investment Bank, Research Division - Associate*

Brian William Nagel *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Chandni Luthra *Goldman Sachs Group Inc., Research Division - Research Analyst*

Daniel Thomas Binder *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

Michael Allen Baker *Deutsche Bank AG, Research Division - Research Analyst*

Simeon Ari Gutman *Morgan Stanley, Research Division - Executive Director*

PRESENTATION

Operator

Good morning, and welcome to the Office Depot's First Quarter 2017 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 of Finance & IR and Treasurer*

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

On today's call, Gerry will summarize the first quarter results and provide an update on the business, including thoughts from his first 60 days on the job. Steve will then review the company's quarterly financial results and outlook. Following Steve's discussion, we'll have some closing comments and then open up the line for questions.

Before we 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 concerning 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 U.S. Securities and Exchange Commission.

During the 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 at least 1 year.

I'll now turn the call over to Office Depot's CEO, Gerry Smith.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Thank you, Rich, and good morning to everyone on the call. I'm very happy to be here with you today to discuss Office Depot's first quarter results, and especially pleased that we were able to continue our positive earnings momentum in this quarter.

Beginning on Slide 4. Total sales in the quarter were $2.7 billion, a decrease of 7% from the first quarter of 2016. The planned U.S. retail store closures accounted for approximately 3 percentage points of this total sales decline as adjusted sales were down 4%.

Operating income in the first quarter increased to $127 million compared to $85 million in the prior year while adjusted operating income increased to $151 million compared to $124 million in the first quarter of 2016. The benefit from store closures, expense reductions and merger integration synergies more than offset the negative flow-through impact from lower sales. As a result, adjusted operating margins in the first quarter increased 130 basis points to 5.6%.

Earnings per share from continuing operations increased approximately 27% in the quarter to $0.14 per share compared to $0.11 per share in the prior year. Adjusted net earnings per share were also up to $0.16 per share compared to $0.12 per share in the first quarter of 2016.

I'm very pleased with the progress we made during the quarter and moving forward to complete the international divestitures. The proceeds from the international divestitures will further enhance our financial flexibility as we focus on our strategic growth initiatives in North America.

Turning to Slide 5. Pivoting the business towards growth is my #1 priority as the CEO. The merger with OfficeMax was incredibly successful over the past 3 years in dramatically transforming the profitability of the combined company. It is now time to take the next step and focus our attention on generating profitable top line growth. Over the past 60 days, I have been doing deep dives across the business as well as visiting our stores, distribution centers, customers and suppliers and partners. Most importantly, I've been doing a lot of listening and learning, and I wanted to share with you some of my initial impressions.

One of the things that initially attracted me to Office Depot was that we are more than just a retail company. Our revenue today is almost evenly split between retail and the delivery side of the business. And with the delivery comes 2 very important strategic assets to me: First, is a nationwide supply chain; and second is a deep and talented sales force. Both of these are critical to the customer experience.

As I was out visiting with our sales teams over the past 2 months, I saw years of extensive sales experience, incredible go-to-market capabilities, and most importantly, a strong connection to the customer. As we know from the strategic plan that was developed last year, we believe there's a significant opportunity to expand on these relationships with our existing customers by leveraging our purchasing power, selling expertise and supply chain capabilities. I believe we're also well-equipped going forward as we look to capitalize on the opportunity to cross-sell and increase our share of wallet with these customers and expand to adjacent services and products.

Having an integrated business model provides our customers with a number of benefits, but it is also a strategic advantage for us versus online and distribution-only competitors. I view our retail store base as an important asset, not a liability, that many of our competitors don't have. And I believe we can leverage our stores as part of an extended supply chain strategy to serve an additional 1,400 distribution points across the country. Let me say that again: 1,400 distribution points, getting closer to the customers.

Having run large and complex supply chains in the past, companies always try to position their supply chain as close to the customer as possible in order to deliver products and services to customers as quickly as possible and also to have the low-cost business model. I believe our stores provide us with that distinct distribution advantage: To be much faster than many of our competitors, and we're already seeing these benefits based on the rapid adoption of our buy online and pick up in store functionality. This 1,400 distribution point advantage is a key asset for Office Depot moving forward.

In addition to being a better and more efficient distributor of products, I also see an opportunity to expand our service offerings as a way to differentiate ourselves from the competition and as a way to ultimately become more important and relevant to our customers. And we are building from an attractive mix of service offerings that we already offer today.

For example, we provide consumers and small business customers with their copy and print needs in our retail stores, deliver high-volume and more complex printing services to our large customers from our dedicated regional print centers and offer managed print solutions to customers of all sizes. We have similar service capabilities in tech repair and office furniture design and have an initiative underway with IBM to provide educational solutions with our K through 12 customers.

I believe there is significant potential to grow each of these categories by investing in some additional tools and training as well as do a better job of promoting our capabilities across channels. And I also believe that we can add additional new services to the platform in the future in order to provide an even wider range of solutions and services to our customers of all sizes. Ultimately, our customers rely on the timely and accurate delivery of our products and services to keep their businesses running.

From what I've seen, we operate an effective supply chain network today, and I believe we have an opportunity to be great in the future. The team has done a tremendous job over the past 3 years of consolidating the legacy OfficeMax and Office Depot facilities as part of the merger integration. This process will be largely complete in the next several months, with the entire network operating on a common platform.

With the foundation in place, I now want to take our supply chain to the next level. Many of our most talented associates were involved in leading the consolidation effort and they will soon be freed up to return to the business and begin driving process improvements and cycle time reductions across the supply chain network.

We have also recently hired John Gannfors as Executive Vice President of Transformation and Strategic Sourcing to focus on driving process improvements and cost reduction opportunities in the strategic sourcing of our products and services from our key vendor partners. John and I worked together at Lenovo, and he has a proven track record of creating value in these areas. I'm very confident that we have the opportunities for greater efficiency and cash flow in the future as we implement business process improvements across the organization.

Lastly and probably most importantly, over the past 60 days, I've had the opportunity to meet with hundreds of our associates here at the company headquarters, in the distribution facilities across the country, sales offices and stores across the network as well. I'm impressed time and time again with the talent, engagement and resilience that I've seen from our associates. The team is energized and focused on winning, especially the sales force, as they continue to successfully bring in new customers.

Overall, the past 60 days have not only reinforced my initial impressions coming into the company, but it also made me even more optimistic about the opportunities ahead of us. I believe we have many of the strategic assets already in place to allow us to continue the transformation of Office Depot from a product company to a services and product company as we look to pivot toward profitable growth in the future.

Turning to Slide 6. I will now highlight for you some of the initiatives going on across the business, starting with Retail. During the first quarter, operating margins continued to benefit from our actions to optimize the Retail business model. This includes savings from a number of initiatives, including occupancy savings from closing stores and negotiating leases and transportation savings from optimizing store deliveries.

In addition, we are beginning to realize the efficiencies from our new workforce management tool that was rolled out last year. The focus is to reduce the number of non-selling tasks in the store so that our associates can spend more time servicing customers during peak hours, and I believe we are making very good progress in this area.

As I mentioned earlier, I think we have a strong strategic advantage in utilizing our 1,400 retail stores as distribution points in an extended supply chain network. Our customers continue to see the benefits of the strategy as our buy online-pick up in store program grew approximately 40% in the first quarter compared to the prior year. And we are extending our omni-channel capabilities even further by extending the ship from store program to the rest of the chain later this year. This seamless approach to meeting customer needs, regardless of how or where they choose to shop, is a key differentiator for us against pure online competitors and one I believe can be further enhanced in the future.

We will also be launching a number of new product innovations to drive customer excitement and store traffic. Our own line of TUL private brand writing instruments has been extremely successful for us as we expanded into adjacent categories, including notebooks and organizers. We are now enhancing the assortment even further with new colors to provide customers with the right balance of style and performance.

During the second quarter, we are also rolling out our own private brand height-adjustable desk, consistent with the trend toward a more ergonomic and healthy workplace. These desks, along with some new and innovative designs in furniture and seating, are all part of our lineup of an active workplace solution. Importantly, these are exclusive, private brand products and accessories that can only be found at Office Depot.

And on the services side, we're expanding our in-store printing capabilities by rolling out wide format printing and scanning functionality across the entire chain. We now have the ability to quickly print up to 44-inch-wide posters and banners, where previously, these could only be printed at our regional print centers. We expect to have these enhanced capabilities implemented in all of our stores by the end of the year.

And lastly, we will begin hosting a number of in-store events as a way to further drive excitement and traffic in the stores. Our first event was an interactive demonstration of making Slime that was held in late March. The marketing teams noticed the Slime trend building in February on social media and we saw a corresponding increase in our glue sales. We reacted quickly to increase our glue inventory and partnered with Elmer's to create a kid-friendly recipe using baking soda and contact solutions instead of harsh chemicals, like borax.

The first event was held on Saturday, March 25, and was backed by a 360-degree promotional plan with in-store, traditional media and digital marketing across e-mail and social media. It was a big success with approximately 15,000 people participating in the stores during the 2-hour event and an additional 56,000 viewers taking part in the live video stream on Facebook. In fact, we sold more glue in the first quarter than we did in the entire year of 2016. I don't think Slime is going to make or break our year, but it is an important example of how we intend to use the stores differently in the future and use social media as a way to identify and capitalize on customer trends in the marketplace.

Turning to Slide 7. I'd like to give you an update on the Store of the Future test that we have underway. At the end of the first quarter, we had 30 stores converted into the new format. During the second quarter, we are planning on converting an additional 16 stores. With this larger test group of approximately 50 stores, we can better evaluate the results of the test and further adjust the format as needed in order to determine the investment returns that this format can potentially create. As we mentioned in the past, these new formats also place a greater emphasis and dedicate significantly more space towards our key service offerings.

The test results remain positive, especially in services, where we're seeing a very attractive sales lift in our copy and print and tech service businesses versus a controlled group of stores. The customer feedback and satisfaction scores continue to be very favorable, and I encourage you to visit one if you are in the area and share your thoughts with me directly.

Turning to Slide 8. Accelerating contract is one of our key growth initiatives as we continue to make significant progress rebuilding our contract channel sales pipeline. Our customer commitments in the first quarter were very strong and we continued to regain momentum in contract as our sales teams are fully engaged in winning new business. Implementation of new wins are expected to ramp up as we continue to forecast improving revenue trends for this business in the second half of the year.

We are also aggressively pursuing growth in our adjacent category expansion strategy and are building capabilities across the organization to support this opportunity. We recently hired a new executive with deep industry experience in cleaning and breakroom and are reallocating additional selling resources toward this initiative. We have also partnered directly with key vendors to add approximately 10,000 new SKUs to our assortment in order to have the necessary products available to capture additional share of wallet opportunities with our customers as they look to consolidate their vendor relationships. All of this is supported by improvements we have made to our supply chain in order to safely handle and transport these products.

Lastly, the OfficeMax integration remains on track and we continue to expect the process to be substantially complete by the end of 2017. As I mentioned earlier, the supply chain integration is well underway and expected to be completed by midyear. Much of the remaining integration is focused on the migration of the legacy OfficeMax contract customers on to the Office Depot platform. Over 70% of the accounts have either started or completed the migration process, and customer feedback and sales trends remain positive, based on the platform's enhanced functionality and assortment. We are on track to be substantially complete with the customer migration by the end of 2017 and then begin the final process of decommissioning the legacy IT system.

Before I turn the call over to Steve, I want to briefly touch on the cost and efficiency programs shown on Slide 9 that we have underway across the organization. We continue to expect that they will provide us with over $250 million in incremental cost savings, and many of these initiatives are already well underway and starting to provide benefits. I've already touched on several of these, such as the additional operating model efficiencies I believe are possible from business process improvements and the additional procurement savings potential in strategic sourcing.

As you know, we have a free cash flow target this year to generate more than $300 million, and much of this free cash flow is being generated from operating income. While that is an attractive starting point, I think we have an opportunity in the future to drive additional free cash flow from improvements in working capital. As I look at our payables, receivables and inventory positions, I believe we have room to become even more efficient in our working capital utilization and cash conversion cycle. I have personally been successful in driving improvements in these areas in the past and freeing up capital to drive shareholder value.

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

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

Thank you, Gerry, and good morning, everyone. I'm happy to be here today to discuss with you our first quarter results. Turning to Slide 11, we have highlighted some key performance measures for the first quarter. As I have mentioned in previous calls, I will primarily focus my comments on the performance from our continuing operations as we fully divest our remaining international businesses that are currently for sale.

Total company sales declined 7% in the quarter compared to the same period last year. Excluding the impact from planned U.S. retail store closures in the prior 12-month period and foreign currency translation, adjusted sales declined 4% in the quarter compared to the prior year. The decline was primarily due to customer losses during the period of business disruption last year in our contract business as well as lower traffic in our retail stores.

Operating income in the quarter increased to $127 million compared to $85 million in the first quarter of the prior year. During the quarter, the company incurred $24 million of operating expenses related to the OfficeMax merger integration, restructuring activities and executive transition cost. Excluding these items, our adjusted operating income in the first quarter was $151 million, an increase of $27 million or 22% compared to the prior year period.

Adjusted operating margins in the quarter also improved 130 basis points versus the first quarter of the prior year, driven primarily by improved product margins, the benefits from store closures, merger integration synergies and other expense reductions and efficiencies realized from our comprehensive business review initiatives. This is another quarter of year-over-year margin improvement for the company.

Net income from continuing operations for the first quarter was $74 million or $0.14 per share compared to $62 million or $0.11 per share in the first quarter of 2016. And excluding the $14 million after-tax effect of these items, first quarter adjusted net income from continuing operations was $88 million or $0.16 per share compared to $69 million or $0.12 per share in the prior year. This is a year-over-year improvement of 33% in adjusted earnings per share.

As noted on Slide 12, comparable sales in the North American Retail Division declined 5% in the quarter compared to the prior year. The comp sales decline was mainly driven by lower store traffic, partly due to a reduction of certain marketing activity, as well as a slightly lower average order value during the period. Total retail sales in the quarter decreased 10% versus the prior year due to the impact from the planned store closures in the prior 12-month period.

Looking at our performance by product category, retail sales decreased across most of our product categories, primarily in ink, toner and other technology items. However, we did see sales increase in our furniture and seating product categories compared to the prior year period.

The North American Retail Division reported operating income of $112 million in the first quarter of 2017 compared to $102 million in the prior year period, with margins up 140 basis points to 8.2%. This year-over-year improvement was primarily driven by a higher gross margin rate from an improved product mix and lower occupancy costs, as well as lower selling, general and administrative expenses, including payroll and advertising, that more than offset the negative flow-through impact from lower sales.

During the quarter, we closed 2 stores and ended the first quarter with a total count of 1,439 stores in the North American Retail Division.

Slide 13 shows the performance of our Business Solutions Division, or BSD. Sales in the first quarter of 2017 were $1.3 billion, a decrease of 4% from the prior year period as reported and in constant currency. The sales decline was driven by the contract channel, while sales in the direct channel were approximately flat to the prior year. The sales decline in the contract channel was primarily driven by the impact of customer attrition during the period of business disruption related to the acquisition attempt last year.

Similar to the last 2 quarters, we again experienced sequential improvement in the year-over-year sales rate in the first quarter, helped by stronger customer retention and the implementation of new customer wins. We are pleased that the sales pipeline continues to improve and expect further sales improvements in the future as additional new customer wins are fully implemented.

In the direct channel, positive online sales growth was offset by the ongoing reduction in catalog sales and higher sales from our buy online-pick up in store and ship from store programs, which are recorded in our North American Retail Division. These 2 programs continue to grow in popularity with our customers compared to the prior year.

Looking at our performance by product category, BSD sales decreased versus the prior year across most of our product categories, but we continue to achieve positive sales growth in copy and print and in our cleaning and breakroom category.

First quarter sales in the U.S. contract channel also increased again in our K through 12 education customer group compared to the same period last year. We continue to focus on growing this area of our business, as recently demonstrated by our new partnership with Silverback Learning Solutions that was announced in March. Through partnerships like this, we continue to consistently deliver positive sales growth with our education customers.

The BSD division reported operating income of $58 million in the first quarter of 2017 compared to $46 million in the prior year period. Operating margin also improved by 100 basis points in the quarter compared to the prior year. Cost savings and efficiencies resulted in lower selling, general and administrative expenses, including payroll, which coupled with a flat gross margin rate to more than offset the negative flow-through impact from lower sales.

Moving to Slide 14. On April 18, we announced an agreement to sell the operations in Australia and New Zealand to Platinum Equity, a leading global private equity firm. The transaction is subject to regulatory approval in each country, and we expect the transaction to close within the next several months.

In addition, on April 26, we successfully completed the sale of our business in South Korea to Excelsior Capital Asia, a Hong Kong and Korea-based direct investment firm. The proceeds from these 2 transactions will provide us with additional liquidity that can be used to grow our North American business.

Our remaining business in mainland China continues to be actively marketed for sale. Once we have completed the divestiture of these remaining businesses, we can fully dedicate our resources to capitalizing on opportunities in the North American market. As we have stated previously, we intend to retain our sourcing and trading operations in Asia. These businesses contributed $3 million in sales and an operating loss of $1 million in the first quarter of 2017. The results from these operations are reported as an other segment outside of the North American segments.

Turning to the balance sheet and cash flow highlights on Slide 15. We ended the first quarter of 2017 with total liquidity of $1.7 billion, consisting of $700 million in cash and cash equivalents associated with continuing operations and $1 billion available under our asset-based lending facility. Total debt at the end of the quarter was $381 million, excluding $792 million in non-recourse debt related to the timber notes.

For the first quarter of 2017, cash provided by operating activities of continuing operations was $88 million. This included spending $19 million in cash on the OfficeMax merger integration cost and an additional $19 million in cash restructuring activities. Capital expenditures were $30 million in the first quarter, $7 million of which related to the OfficeMax merger integration.

As part of our shareholder return initiative, the company repurchased 2 million shares of its outstanding common stock during the quarter for a total cost of $10 million. Since the program began in May of last year, we have repurchased 39 million shares of common stock for a total cost of approximately $142 million at an average price of $3.62 per share. In addition, a quarterly cash dividend of $0.025 per share was paid on March 15 to shareholders of record for a total of approximately $13 million.

Slide 16 outlines the key components of our 2017 outlook. We anticipate total company sales in 2017 will be lower than 2016 on a comparable 52-week basis. This decline is primarily as a result of our planned retail store closures and prior year contract customer losses within our Business Solutions Division. However, as our contract channel pipeline continues to improve and we continue to win and implement new customers, we expect the rate of sales decline in our BSD division to improve throughout the year.

The company continues to expect adjusted operating income of approximately $500 million in 2017 as we execute on our strategic growth initiatives. This is a 10% year-over-year increase, excluding the 53rd week operating income benefit of approximately $15 million realized in 2016. The adjusted operating income expected this year includes a non-GAAP annual effective tax rate of approximately 41%, though the rate will depend on the mix and timing of income.

We also expect to generate more than $300 million in free cash flow from continuing operations in 2017. This includes a cash tax rate of approximately 15% as we continue to utilize available tax operating loss carryforwards and credits.

We also anticipate spending about $200 million in capital expenditures to support the company's critical priorities and continued investments in our Store of the Future test program, as well as approximately $150 million in depreciation and amortization expense.

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

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Thanks, Steve. I'm very pleased with our execution in the first quarter and being able to deliver a strong earnings performance. Clearly, one of my priorities is to ensure that we continue this momentum and deliver on our full 2017 operating plan. That includes focusing the organization on executing against our critical near-term and longer-term priorities, continuing to build our customer base and set the foundation for profitable future top line growth, leverage the distribution model across the company to fully utilize our distribution centers and retail stores to serve customers quickly and efficiently as possible, expand on the attractive growth opportunities that we have identified in adjacent products and services, execute on our cost savings and efficiency programs to deliver the full financial benefits and drive additional margin and free cash flow improvements across the business to deliver shareholder value.

As I mentioned earlier, my goal is to expand our customer base and become more important to our customers in order to stabilize and eventually pivot toward profitable top line growth and ultimately position Office Depot for long-term future success. I look forward to updating you on our progress in the future quarters.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Brian Nagel from Oppenheimer.

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

So I've got a couple of questions here. First off, with respect to gross margins. So we saw another nice tick up here in the quarter. The second now, second consecutive quarter. Maybe just some color there. And I know you touched on this a bit in your prepared comments, but some further color on just the drivers. And how should we think about the sustainability of those gross margin increases against the backdrop of what you're doing to improve the business? And I have a follow-up.

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

Yes. Brian, this is Steve. I think in terms of the gross margin performance you saw in the first quarter, you saw about a 30 basis point improvement on a consolidated basis. I would say directionally, I think we saw more of the improvement on the retail side. But overall, it's a combination, I think, of managing our pricing in a challenging marketplace. And also, you're seeing flow-through of lower occupancy cost. And I think that's a benefit that ties a little bit to the store closure program and the work that we're doing really across the system as we look at reducing the square footage of the stores and working with our landlords to optimize the cost that we're paying for our retail space. And so some of that is a benefit. And that benefit should recur for us. So we should continue to see the benefits of lower occupancy cost that I think will allow us to continue to show good performance around gross margin.

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay. Great. Perfect, Steve. And that's a great segue to my second question, too. So Gerry, in your prepared comments, you talked about your fleet of stores. So Office depot, like a lot of other retailers, has been in a program of closing stores. It sounded to me, maybe you're more committed to stores now than the investment community had thought obviously it was previously. So I guess maybe just a little more color on how -- as you continue to look into this and study the business...

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Yes, please. And first of all, I hate to walk away from any type of profitable revenue streams. Any. And I think we demonstrated in this quarter that Troy and the team are doing a great job of driving operating income. I also believe that the stores are an asset. Let me take -- I touched on it in the prepared comments, but I'll give you more color here, as I see 1,439 distribution points, and our buy online-pick up in store in 1 hour is rapidly accelerating, and it's up 40% year-over-year, and we're going to expand that to the rest of the chain. And I also think it's an opportunity from -- it's an integrated channel. And we're doing a lot of work. And I won't give a lot of details, but we're going to invest even more in building that from a partnership perspective and using our stores as: number one, a supply chain distribution point for all our customers, whether it's SMB, whether it's corporate or whether it's a consumer; b, really drive Store of the Future and our opportunity to change the assortment and the footprint; and c, I think even more exciting, as I mentioned a couple times in the prepared comments is, a stronger pivot to services in the store, whether it's copy and print, whether it's tech services, and there's -- and I'll just say -- I'll be coy a little bit and say more services to come as well. So I view it as an asset, not a liability, and I view that as -- I think that last mile is very, very important. And I think that Office Depot has a strategic advantage others don't have. We've got a great channel, we've got a great B2B sales force, plus, we have a great retail footprint that gives us an integrated channel others don't have.

Operator

Your next question comes from the line of Dan Binder from Jefferies.

Daniel Thomas Binder - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

It's Dan Binder. I was just curious, given that you held a lot of the accounts with U.S. Communities even after it switched hands, and now it seems to have switched hands again, what you're seeing on the Amazon front in the contract space. Do they now have a front-end system, much like our own, to deal with larger accounts? And are you running into them in other areas as you bid for large contract business?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Well first, Dan, when they all say in all the calls is we always respect our competitors. And -- but we're going to focus on Office Depot as well. They're a specific competitor in the space. From a U.S. Communities perspective, that was ended in 2010. So this is not really impacted -- they're not impacting the current earnings with that account. But the reality is they are a competitor going forward, we're going to use our integrated channel to compete. We're going to use the last mile which, to be honest, I don't believe a lot of the online retailers have. We're going to be aggressive with our structure around -- from a cost perspective and drive to a low-cost model. And we've got 1,800 very experienced sellers out there that are going to off and we're going to pivot to growth. And so we're going to push hard to compete every day. And we have a distinct advantage. What I found in my first 57 days is we do desktop delivery to a lot of our corporate customers, where other online retailers aren't able to do that at this time. And so there's a lot of advantage as we have pivoting more into our private fleet where we can go into these large corporate accounts or these relationship customers and provide a service that an online retailer can't do. And we're going to work very, very hard to leverage that strength and grow the business going forward.

Daniel Thomas Binder - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

And then just a follow-up question with regard to winning new accounts. Historically, a lot of office products resellers, including Office Depot, have gone in and aggressively bid with lower margins and then with the expectation of growing that margin portfolio over time through mix and substitutions and things like that, that I think has become tougher through the years with the transparency on the web. I'm just curious what your philosophy is on pricing as you bid for new business and what your expectations are around growing margin in those newly acquired accounts.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

It's a great question, Dan, and I think this is true in almost every space I've ever dealt with. In the tech space, where I came from, very similar methodology, very similar opportunities. I always believed in defending top line growth and then obviously, providing services and expertise. And one of the things that I've said in the prepared notes is we're going to expand our aperture. What I mean by that, we're going to offer more products and services. So we absolutely will continue to be aggressive on the top line to make sure we maintain accounts. And our job is to give a great customer experience for that customer where they want to buy more products and services over time. I think it's the nature of the industry, and I think it's a nature of any industry from a corporate account perspective. Again, I participated in a number of verticals and they're all the same. And we're going to be aggressive to make sure we, a, acquire more business, and we're starting to see those wins and we mentioned that; and b, is grow and develop those businesses by partnering with people. And again, we have to give a superior customer experience. We're doing that by desktop delivery. We do that by listening to customers. And I've been out in the field talking to our largest customers, and we're going to make sure we're sticky with those customers. And we'll do what it takes to acquire them. But we'll also make sure that we're committed to hit our AOI this year and we'll continue to drive profitable growth over time.

Daniel Thomas Binder - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

And then one last question, if I could, on management. I think you had a departure of your senior merchant this quarter. I'm just curious the plans to replace, and if you, as the new CEO, relatively new CEO of the company, anticipate more changes in the ranks, if it's necessary in your view.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

I've got a very solid leadership team. We've added John Gannfors, who -- John's a supply chain and cost expert. I've got a fantastic CFO with Steve and I'm very pleased with Michael and Troy and Steve Caulkins and the rest of the team and Tim. And think I have a world-class team and I don't foresee any changes in the future. In fact, we spent last week offsite talking about the future strategy, and extremely fired up with how the team gelled and our focus on growing the top line and being a different company 2 or 3 years down the road. We're going to be a company that isn't just a product company or viewed just as a retailer, we're going to be a distributor of services and products that drives the integrated channel approach. And we have -- one of the biggest shocks I had, to be candid, was the number of e-commerce customers we have is we have millions of e-commerce customers. I won't give a specific number, but if I was a startup in the Valley, I'd want to come to Office Depot because we have so many e-commerce customers that are active. And we're going to go take that asset and we're going to look for partnerships. We have hundreds of thousands of corporate customers as well, and so that's -- it's one of my biggest surprises, but it's happy surprise, how big of an opportunity we have with existing customer base that just -- to be honest, we need to pivot to growth and pivot differently how we handle those customers to give them more services, more products, more opportunity. More to come on that. We're already busy looking for partnerships in inorganic growth and organic growth opportunities.

Operator

Your next question comes from the line of Matt Fassler from Goldman Sachs.

Chandni Luthra - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Chandni Luthra on behalf of Matt Fassler. Gerry, just some very quick question questions. Within your BSG (sic) business, you guys highlighted a lingering impact from the merger process last year in terms of customer attrition and pipeline, et cetera. When do you think these issues will be fully behind you?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Well first, it's getting -- it's improving our pipeline in our acquisitions, and it's gotten much better in the last 90 days. It's a long tail, a long cycle. I think there's less of an impact this last quarter than there was previously. And our goal is to drive that out so there's no excuses going forward or no tailing impact. But it's a long cycle. The sales cycle for these product are long, and we will continue to be aggressive, a, to defend our accounts; and b, to acquire new accounts. And so internally, we're focused on -- that's the past and we're focused on profitable growth going forward.

Chandni Luthra - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Got it. Very helpful. And then one quick follow-up from me. Within your Retail business, you guys witnessed comp weakness, the trend sort of decelerated versus the last quarter, but there is a significant margin improvement. Were any product categories that you guys deliberately stayed away from? And if there are mix changes, how should we think about the mix of the business evolving from here?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

I'll touch on it, but I'll let Steve follow-up as well if he'd like to. But there's no product categories that we're not focusing on. And I think there's some secular declines in some areas. One of our goals is to, from a retail footprint perspective, and Troy and his team are working hard on this, is to curate even more but really start pivoting to what other services can we offer in the store to, a, drive store traffic, whether they're events, like we talked about Slime, which obviously from a demographic perspective, doesn't hit all our customers, but hits an important customer for us, the family, as well as -- so we'll continue to schedule more and more activities and we'll continue to build more and more services into the store to pull customers in. And in the next earning call, we'll have some pretty significant or exciting announcements on some things we're doing from a services perspective, but I won't talk about this at time. But retail is an important market for us, and I think that we've demonstrated our ability to generate operating income. And we will start pivoting even harder to top line growth. Steve, why don't you add some comments as well?

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

Sure. And Gerry, what I would add is just that I think in terms of the -- if you look at the comp for the quarter, while it moved down a little bit from where we were in the fourth quarter, I think the trends were very similar. The biggest issue we've got is just the core weakness in products, ink, toner and some of the other related technology categories. That's what we're working through. Bright spot in the quarter probably was on the furniture side. But it's not a wholesale movement within the categories. I think it's a slugging it out in a very, very competitive environment.

Operator

Your next question comes from the line of Simeon Gutman.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Simeon Gutman, Morgan Stanley. Gerry, so there's a lot of plans that were already underway for 2017. My question is are you -- when you look at the business, do you see other areas that you'd like to invest faster? Or for that matter, slower? And then in the context of the $250 million in savings that have been targeted, is that enough capacity to reposition this business? You mentioned looks like a different business over the next 2 to 3 years. Do you have capacity? Or does it make sense to invest sort of above and beyond so that you can restore to growth in a couple of years?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Yes. Great question, Simeon. And one of the things I want to highlight and -- I hope you all caught it, is I see significant -- I'm not going to give a number because you guys are going to ask Steve and I for a number. But I see significant opportunity to generate additional working capital, especially around the cash conversion cycle. And so John and I have done this before and some of the team here have done this before. So we're going to -- I believe there is significant upside that will also help us, above the $300 million, to pivot to growth even harder. That's number one. Number two is, from an acceleration perspective, obviously, B2B is very important for us to grow. We're going to make some significant investments in that area. And I think there is opportunities of pivoting to more and more services as a company. And what I mean by that is we need to take care of a company's business. I think it's not just paper and ink and toner. As I've visited a larger -- a number of our large accounts, the customers are asking us to do more, more services. As we deliver our private fleet or third-party fleets and have a truck going into those accounts and do desktop delivery, that truck's empty coming back. So there's all kinds of opportunities for additional services to go off and do that. And so we're going to go either partner, invest or acquire those capabilities going forward. But obviously on the retail side, as we talked about before, it's really pushing and pivoting more to Store of the Future, honing that model in and obviously increasing store traffic and making sure we have the services in a Store of the Future that draw people in so we can take of their business for them as well. So the vision is us to be the one-stop shop. If you want a start a business, you come to Office Depot to start that business, whether it's -- we'll provide, whether it's the technology, the paper, the ink, the other services around that to allow you to quickly ramp your business so you can -- so our customers can focus on their business and we'll focus on running their business for them.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Okay. That's fair. And I guess your best guess as of today, are you able to make these investments within sort of the confines of the cost savings that have been targeted?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

I believe we're able to make those investments within the confines of the cost savings. I think there will be additional cost savings and free cash flow savings. And Steve and I are very committed to meeting our $500 million AOI plan as well.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Okay. And then just one quick follow-up on -- with a previous question regarding the sales in the contracts channel and rebuilding the pipeline. You mentioned it takes some time. Can you just share with us? It's more of a nuance, but is it taking longer than you would have expected? And then you mentioned that there's been a nice buildup in the last 90 days. Does that mean we should see a marked improvement or sequential improvement by the second quarter?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Well, I think it's -- I think over the course of the year, you're going to see improvement across the year. I mean, I've lived in this space before in previous lives, and this is not something you see dramatic swings, but you see step function improvement, and that what I think we'll see. It's day 57, and I'm happy with the pipeline I see from the sales team. And I think it's a nice rising slope from a curve perspective. It's not going to be a giant sawtooth jump, but we're building momentum, which is important. Steve, do you want to add a comment to that as well?

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

What I would say is that we've been, I think, pleasantly surprised with the pace of rebuilding the pipeline. But I think as we've seen the impact and the lingering impact of the accounts that we've lost and just the overall contraction of usage by some of our accounts, that's been harder to overcome than I think we had hoped for as we went into it. But I think overall, eventually, the impact of the growing pipeline will allow us -- and that's why we have a favorable outlook for improvement throughout the year.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

But another thing just to add to that, as we generate this additional working capital, we're going to plow that working capital back into top line growth, whether it's on retail, whether it's e-commerce or whether it's B2B as well. So we're going to increase the war chest, team and guys and make it much more -- we'll deliver to our plan, plus that additional, plow that into top line growth.

Operator

(Operator Instructions) Your next question comes from the line of Mike Baker from Deutsche Bank.

Michael Allen Baker - *Deutsche Bank AG, Research Division - Research Analyst*

So I think you guys are up to about a 4.3% operating margin on a trailing 12-month basis, something in that range. As good as it's been in 10 years and getting close to your biggest competitor. As you think about the next couple of years in transforming the company, how profitable do you think this company can be? And part b of that is do you need top line -- when do you need top line growth to make that happen?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

I'll take the first part then I'll have Steve comment as well. I think the key is to have a balanced approach. We wanted -- and we were very happy with we're at from an OpInc percentage perspective. We are kicking off additional initiatives to drive even greater, I'll say, COGS and cash opportunities. There's tremendous efforts already in place, but as an operator, it's always important to continue to focus and have the low-cost model. I have one comment, if you look at our SG&A, I was really pleased it's come down about below 20%. I think we'll continue to focus on that and try to make sure SG&A stays competitive. But we're going -- I believe, with the additional opportunities we've identified, we'll be able to, number one, drive profitable top line growth. And obviously, as we grow top line, we're going to scale better. And I think there's potential for accretive opportunities in the future. But we have to grow the top line long term in this company to keep us in the game, and to be honest, to make it -- to give Office Depot a chance to continue to grow profitability across the business. Scale helps you tremendously in a lot of ways. And as we pivot to that, I don't think we sacrifice our bottom line as a result that. Steve?

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

Yes, Mike, I would say, if you look at our outlook for the year, we are suggesting about a 10% year-over-year improvement on a 52-week basis of operating income on an adjusted basis, and that will be on, as we've said, a lower sales base again this year, given the trends that we're seeing and the time it will need to affect the transition, the transformation that Gerry's talking about. So we're looking at a year where we should be able to further improve margins. But I mean, to be fair, we're doing that through aggressive cost savings programs, the remainder of the merger synergies from Max as we finish up that program, and we're able to achieve those cost savings over and above the amount of sales deleverage that we're seeing from the contraction in our core categories and our traditional focus on office supplies. So I think as Gerry talks about the transformation, what we'd like to see is that margin improvement come, but being driven by first, flattening out the sales top line so we don't have the sales deleverage to offset every year, and then to move into profitable growth categories going forward. That's the model we want to get to.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Well said, Steve.

Michael Allen Baker - *Deutsche Bank AG, Research Division - Research Analyst*

Agreed. And so I guess, the follow-up to that is, and maybe you're not ready to put a time frame on it, but for instance in 2018, can you grow your profit dollars another 10% or whatever amount without growing the top line?

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Obviously, as the CEO, we're not going to comment or commit to that. We're just going to say that we're going to continue to stay with our strategy of pivoting the business to a services and product company, looking for additional working capital, free cash flow, and continuing to squeeze cost out of the business. But we're going to be aggressive to grow the top line and pivot the company. And we'll provide guidance, obviously, later in the year as we go into the new year. We're excited with the quarter, and I think there's tremendous opportunities for additional growth opportunities that will give us scale and leverage going forward. And as we get closer to Q3 and Q4, Rich and Aly and Steve and I will come back to you guys with a commitment for the next year.

Michael Allen Baker - *Deutsche Bank AG, Research Division - Research Analyst*

Understood. Well, one more quick housekeeping one. You talked about 75 store closures this year previously. Have you talked about closures beyond this year? Can you just remind me? I know you did 400 over the last couple of years.

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

Yes, what our announcement had been, if we completed the first phase of the store closures and then we announced a target over the next 3 years of an additional 300 stores, of which the 75 will be a subset. As Gerry has talked about, we're obviously taking a fresh look at the role of stores and looking at the dynamics there as we work to improve the profitability. And as you saw, the retail margins were quite favorable in the first quarter.

So we'll continue to -- that's a dynamic process going through our real estate portfolio. And the stores that are keepers, obviously our preference is to keep good stores open. But we've -- at this point, we have an overall program of 300 in which the 75 is the first phase.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

But as I said earlier, we're going to reevaluate -- I don't like walking away from revenue growth, and we'll continue to evaluate those carefully going forward.

Operator

And we have time for one more question, Michael Lasser from UBS.

Atul Maheswari - *UBS Investment Bank, Research Division - Associate*

Actually, it's Atul Maheswari filling in for Michael Lasser. So my question is also on your cost-cutting initiatives. And clearly, these initiatives have helped drive strong profitability growth in the last year or so. So how much of this savings is directly flowing into the bottom line as of now, versus how much are you investing in price and in other areas of your business?

Stephen E. Hare - *Office Depot, Inc. - CFO and EVP*

We don't break out the components there, and that's a fairly dynamic equation. But I think the good news and what you're seeing in the first quarter is that the cost-savings program, most recently the $250 million cost-savings program, is clearly having an effect. And we jumped on the initiatives around that program early in the year so that we would get a full year benefit from that. And you're seeing that -- those savings flow through in Q1. And I think that gives us comfort as we share with you our outlook for the year that we can, even in a challenged sales environment, continue to show a 10% year-over-year improvement on adjusted operating income. So as I said, the cost savings, remember, we still have the last leg of merger synergies from OfficeMax from some of those initiatives that we had to hold off during the period where the combination with Staples was being discussed. And we're now full on to try to get most of that work done this year. And there's an additional amount of synergies that will flow through for this year. So those programs continue and we're quite pleased with those. But obviously, as we talked about the challenges, what else can we do now to start growing the business at the top line.

Gerry P. Smith - *Office Depot, Inc. - CEO and Director*

Well said, Steve. And I'll just add a couple of comments. We're going to continue to drive to ensure we have a low-cost model. I believe the low-cost model in an integrated distributed supply chain is a key to our success. And as we generate those additional savings, obviously, we don't want our competitors to know our whole game plan and -- our strategy, so we're going have a balanced approach to driving operating income growth as well as top line growth as well.

All right. I'll go ahead and wrap up. First of all, I want to thank everyone for being on the phone today. It's a pleasure to have you on.

I'm extremely excited and optimistic about the results in Q1. It's very important that, as we -- as Steve and I said, we're still committing to our $500 million AOI plan for the year. We are going to continue to drive and really focus and pivot to profitable top line growth. We believe there's additional opportunities for working capital and free cash flow that are significant, but obviously, we're not going to commit to a number, but we'll use that additional working capital to help us grow the business as well.

I continue to believe that we'll drive to the operational excellence and low-cost model. We're going to use our supply chain and our retail footprint as an asset, and we're going to continue to soar into the future with the ability to drive growth across the business.

So thank you for the time this morning. And we're very optimistic as we go forward with our plan.

Operator

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