

SEARS HOLDINGS CORP  
Form 10-Q  
August 18, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

X **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 30, 2011**

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Commission file number 000-51217**

**SEARS HOLDINGS CORPORATION**

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State of Incorporation)

**20-1920798**  
(I.R.S. Employer Identification No.)

**3333 BEVERLY ROAD, HOFFMAN ESTATES, ILLINOIS**  
(Address of principal executive offices)

**60179**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: (847) 286-2500**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of August 12, 2011, the registrant had 106,901,958 common shares, \$0.01 par value, outstanding.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**INDEX TO QUARTERLY REPORT ON FORM 10-Q**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
Item 1.	
<u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Operations (Unaudited) for the 13 and 26 Weeks Ended July 30, 2011 and July 31, 2010</u>	1
<u>Condensed Consolidated Balance Sheets (Unaudited) as of July 30, 2011, July 31, 2010 and January 29, 2011</u>	2
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) for the 26 Weeks Ended July 30, 2011 and July 31, 2010</u>	3
<u>Condensed Consolidated Statements of Equity (Unaudited) for the 26 Weeks Ended July 30, 2011 and July 31, 2010</u>	4
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	5
Item 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3.	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	47
Item 4.	
<u>Controls and Procedures</u>	48
<b><u>PART II OTHER INFORMATION</u></b>	
Item 1.	
<u>Legal Proceedings</u>	49
Item 2.	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
Item 5.	
<u>Other Information</u>	50
Item 6.	
<u>Exhibits</u>	51

**Table of Contents****SEARS HOLDINGS CORPORATION****Condensed Consolidated Statements of Operations**

(Unaudited)

## PART I. FINANCIAL INFORMATION

*Item 1. Financial Statements*

<i>millions, except per share data</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
<b>REVENUES</b>				
Merchandise sales and services	\$ 10,333	\$ 10,458	\$ 20,038	\$ 20,504
<b>COSTS AND EXPENSES</b>				
Cost of sales, buying and occupancy	7,668	7,635	14,772	14,851
Selling and administrative	2,644	2,606	5,203	5,161
Depreciation and amortization	227	221	445	442
Gain on sales of assets	(29)	(9)	(31)	(53)
Total costs and expenses	10,510	10,453	20,389	20,401
Operating income (loss)	(177)	5	(351)	103
Interest expense	(77)	(69)	(157)	(136)
Interest and investment income	12	6	25	21
Other income (loss)	4	5	(8)	(9)
Loss before income taxes	(238)	(53)	(491)	(21)
Income tax benefit	94	19	173	4
Net loss	(144)	(34)	(318)	(17)
(Income) loss attributable to noncontrolling interests	(2)	(5)	2	(6)
<b>NET LOSS ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	<b>\$ (146)</b>	<b>\$ (39)</b>	<b>\$ (316)</b>	<b>\$ (23)</b>
<b>LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>				
Basic and diluted loss per share	\$ (1.37)	\$ (0.35)	\$ (2.95)	\$ (0.20)
Basic and diluted weighted average common shares outstanding	106.8	112.6	107.3	113.6
See accompanying notes.				

**Table of Contents****SEARS HOLDINGS CORPORATION****Condensed Consolidated Balance Sheets**

<i>millions</i>	(Unaudited)		
	July 30, 2011	July 31, 2010	January 29, 2011
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	\$ 658	\$ 1,193	\$ 1,375
Restricted cash	21	6	15
Accounts receivable	782	754	683
Merchandise inventories	9,426	9,430	9,123
Prepaid expenses and other current assets	318	350	312
Deferred income taxes	99	28	27
<b>Total current assets</b>	<b>11,304</b>	<b>11,761</b>	<b>11,535</b>
Property and equipment, net	7,159	7,485	7,365
Goodwill	1,392	1,392	1,392
Trade names and other intangible assets	3,106	3,173	3,139
Other assets	839	1,022	837
<b>TOTAL ASSETS</b>	<b>\$ 23,800</b>	<b>\$ 24,833</b>	<b>\$ 24,268</b>
<b>LIABILITIES</b>			
Current liabilities			
Short-term borrowings	\$ 927	\$ 1,218	\$ 360
Current portion of long-term debt and capitalized lease obligations	299	590	509
Merchandise payables	3,324	3,673	3,101
Accrued expenses and other current liabilities	2,914	3,049	3,115
Unearned revenues	963	997	976
Other taxes	502	551	557
<b>Total current liabilities</b>	<b>8,929</b>	<b>10,078</b>	<b>8,618</b>
Long-term debt and capitalized lease obligations	2,413	1,378	2,663
Pension and post-retirement benefits	2,044	2,172	2,151
Other long-term liabilities	2,264	2,586	2,222
<b>Total Liabilities</b>	<b>15,650</b>	<b>16,214</b>	<b>15,654</b>
<b>EQUITY</b>			
Total Equity	8,150	8,619	8,614
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 23,800</b>	<b>\$ 24,833</b>	<b>\$ 24,268</b>

See accompanying notes.

**Table of Contents****SEARS HOLDINGS CORPORATION****Condensed Consolidated Statements of Cash Flows**

(Unaudited)

<i>millions</i>	<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (318)	\$ (17)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	445	442
Gain on sales of assets	(31)	(53)
Pension and post-retirement plan contributions	(143)	(122)
Settlement of Canadian dollar hedges	(23)	25
Change in operating assets and liabilities (net of acquisitions and dispositions):		
Merchandise inventories	(262)	(695)
Merchandise payables	201	321
Deferred income taxes	(59)	45
Income and other taxes	(280)	(119)
Mark-to-market adjustments and settlements on Sears Canada U.S. dollar option contracts	1	5
Other operating assets	88	23
Other operating liabilities	(86)	(45)
Net cash used in operating activities	(467)	(190)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales of property and investments	42	16
(Increase) decrease in investments and restricted cash	(5)	9
Purchases of property and equipment	(199)	(168)
Net cash used in investing activities	(162)	(143)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from debt issuances	39	
Repayments of long-term debt	(497)	(228)
Increase in short-term borrowings, primarily 90 days or less	567	893
Debt issuance costs	(35)	
Purchase of Sears Canada shares	(22)	(560)
Sears Canada dividend paid to minority shareholders		(34)
Purchase of treasury stock	(154)	(273)
Net cash used in financing activities	(102)	(202)
Effect of exchange rate changes on cash and cash equivalents	14	39
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(717)</b>	<b>(496)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>1,375</b>	<b>1,689</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 658</b>	<b>\$ 1,193</b>

SUPPLEMENTAL CASH FLOW DATA:

Income taxes paid, net of refunds	\$ 85	\$ 126
Cash interest paid	124	91

See accompanying notes.

**Table of Contents****SEARS HOLDINGS CORPORATION****Condensed Consolidated Statements of Equity**

(Unaudited)

<i>millions</i>	Equity Attributable to Holdings					Shareholders		Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
	Number of Shares	Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Earnings					
Balance at January 30, 2010	115	\$ 1	\$ (5,446)	\$ 10,465	\$ 4,797	\$ (721)	\$ 339	\$ 9,435		
Comprehensive income										
Net income (loss)					(23)		6	(17)		
Pension and postretirement adjustments, net of tax							25	25		
Deferred loss on derivatives, net of tax						(12)		(12)		
Cumulative translation adjustment, net of tax							41	13	54	
<b>Total Comprehensive Income</b>								<b>50</b>		
Stock awards			3	(3)						
Additional purchase of noncontrolling interest in Sears Canada				(269)		(76)	(215)	(560)		
Sears Canada dividend paid to noncontrolling shareholders							(34)	(34)		
Shares repurchased	(4)		(273)					(273)		
Other			2				(1)	1		
Balance at July 31, 2010	111	\$ 1	\$ (5,714)	\$ 10,193	\$ 4,774	\$ (743)	\$ 108	\$ 8,619		
Balance at January 29, 2011	109	\$ 1	\$ (5,826)	\$ 10,185	\$ 4,930	\$ (779)	\$ 103	\$ 8,614		
Comprehensive loss										
Net loss					(316)		(2)	(318)		
Pension and postretirement adjustments, net of tax							60	3	63	
Deferred loss on derivatives, net of tax						(6)		(6)		
Cumulative translation adjustment, net of tax							(19)	(4)	(23)	
<b>Total Comprehensive Loss</b>								<b>(284)</b>		
Stock awards			4	(2)				2		
Additional purchase of noncontrolling interest in Sears Canada				(18)		(1)	(10)	(29)		
Shares repurchased	(2)		(154)					(154)		
Associate stock purchase			2					2		
Other							(1)	(1)		
Balance at July 30, 2011	107	\$ 1	\$ (5,974)	\$ 10,165	\$ 4,614	\$ (745)	\$ 89	\$ 8,150		

See accompanying notes.





**Table of Contents****SEARS HOLDINGS CORPORATION**

## Notes to Condensed Consolidated Financial Statements

(Unaudited)

**NOTE 1 BASIS OF PRESENTATION**

Sears Holdings Corporation ( Holdings, we, us, our or the Company ) is the parent company of Kmart Holding Corporation ( Kmart ) and Sears, Roebuck and Co. ( Sears ). Holdings was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the Merger ), which was completed on March 24, 2005. We are a broadline retailer with 2,188 full-line and 1,370 specialty retail stores in the United States, operating through Kmart and Sears, and 495 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ( Sears Canada ), a 94%-owned subsidiary.

These interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ( SEC ). Accordingly, they do not include all of the information and footnotes required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full fiscal year. The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. These interim financial statements and related notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 29, 2011.

**NOTE 2 BORROWINGS**

Total borrowings were as follows:

<i>millions</i>	July 30, 2011	July 31, 2010	January 29, 2011
Short-term borrowings:			
Unsecured commercial paper	\$ 388	\$ 396	\$ 360
Secured borrowings	539	822	
Long-term debt, including current portion:			
Notes and debentures outstanding	2,151	1,352	2,575
Capitalized lease obligations	561	616	597
<b>Total borrowings</b>	<b>\$ 3,639</b>	<b>\$ 3,186</b>	<b>\$ 3,532</b>

The fair value of long-term debt was \$2.0 billion at July 30, 2011, \$1.4 billion at July 31, 2010 and \$2.5 billion at January 29, 2011. The fair value of our debt was estimated based on quoted market prices for the same or similar issues or on current rates offered to us for debt of the same remaining maturities.

*Unsecured Commercial Paper*

We borrow through the commercial paper markets. At July 30, 2011, we had outstanding commercial paper borrowings of \$388 million, of which \$240 million were held by ESL Investments, Inc. (together with its affiliated funds, ESL ), including \$120 million held by ESL for the benefit of Edward S. Lampert. See Note 14 for further discussion of these borrowings.

*Domestic Credit Agreement*

During the first quarter of 2011, we increased the borrowing capacity and extended the maturity date of our domestic credit agreement (the Original Domestic Credit Agreement ) by entering into an amended credit



**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

agreement (the Amended Domestic Credit Agreement). The Amended Domestic Credit Agreement increased the borrowing capacity of the facility to \$3.275 billion from \$2.4 billion and extended its expiration date to April 2016 from June 2012.

The Amended Domestic Credit Agreement also revised certain terms of the credit facility. Advances continue to bear interest at a rate equal to, at the election of the Borrowers, either the London Interbank Offered Rate (LIBOR) or a base rate, in either case plus an applicable margin. The amended facility's interest rates for LIBOR-based borrowings vary based on leverage in the range of LIBOR plus 2.0% to 2.5%, compared to LIBOR plus 4.0% with a 1.75% LIBOR floor under the Original Domestic Credit Agreement. Interest rates for base rate-based borrowings vary based on leverage in the range of the applicable base rate plus 1.0% to 1.5%, compared to the applicable base rate plus 3.0% under the Original Domestic Credit Agreement. Commitment fees have also been reduced to a range of 0.375% to 0.625% based on usage from the previous range of 0.75% to 1.00%.

The Amended Domestic Credit Agreement continues to include a \$1.5 billion letter of credit sub-limit and an accordion feature that gives us the flexibility, subject to certain terms and conditions, to use the existing collateral under the credit facility to obtain an aggregate amount of up to \$1.0 billion in additional borrowing capacity if we so choose. The Amended Domestic Credit Agreement is in place as a funding source for general corporate purposes and is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. (SRAC) and Kmart Corporation are the borrowers. The Amended Domestic Credit Agreement is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and determines availability pursuant to a borrowing base formula.

The Amended Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

At July 30, 2011, we had \$539 million of borrowings and \$550 million of letters of credit outstanding under the Amended Domestic Credit Agreement. As a result, our availability under the agreement was \$2.2 billion at July 30, 2011. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

*Senior Secured Notes*

In October 2010, we sold \$1 billion aggregate principal amount of senior secured notes (the Notes), which bear interest at 6 5/8% per annum and mature on October 15, 2018. Concurrent with the closing of the sale of the Notes, the Company sold \$250 million aggregate principal amount of Notes to the Company's domestic pension plan in a private placement. The Notes are guaranteed by certain subsidiaries of the Company and are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables (the Collateral). The lien that secures the Notes is junior in priority to the lien on such assets that secures obligations under the Amended Domestic Credit Agreement, as well as certain other first priority lien obligations. The Company used the net proceeds of this offering to repay borrowings outstanding under the Original Domestic Credit Agreement on the settlement date and to fund the working capital requirements of our retail businesses, capital expenditures and for general corporate purposes. The indenture under which the Notes were issued contains restrictive covenants that, among other things, (1) limit the ability of the Company and certain of its domestic subsidiaries to create liens and enter into sale and leaseback transactions and (2) limit the ability of the Company to consolidate with or merge into, or sell other than for cash or lease all or substantially all of its assets to, another person. The indenture also provides for certain events of default, which, if any were to

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

occur, would permit or require the principal and accrued and unpaid interest on all the then outstanding notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Notes at a purchase price equal to 101% of the principal amount if the borrowing base (as calculated pursuant to the indenture) falls below the principal value of the notes plus any other indebtedness for borrowed money that is secured by liens on the Collateral for two consecutive quarters or upon the occurrence of certain change of control triggering events. The Company may call the Notes at a premium based on the Treasury Rate as defined in the indenture, plus 50 basis points. We have commenced an offer to exchange the Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

*Sears Canada Credit Agreement*

In September 2010, Sears Canada entered into a five-year, \$800 million Canadian senior secured revolving credit facility (the Sears Canada Facility). The Sears Canada Facility is available for Sears Canada's general corporate purposes and is secured by a first lien on substantially all of Sears Canada's non-real estate assets. Availability under the Sears Canada Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. At July 30, 2011, we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$693 million (\$662 million Canadian) at July 30, 2011.

*Letters of Credit Facility*

On January 20, 2011, we and certain of our subsidiaries entered into a letter of credit facility (the LC Facility) with Wells Fargo Bank, National Association (Wells Fargo), pursuant to which Wells Fargo may, on a discretionary basis and with no commitment, agree to issue standby letters of credit upon our request in an aggregate amount not to exceed \$500 million for general corporate purposes. Any letters of credit issued under the LC Facility are secured by a first priority lien on cash placed on deposit at Wells Fargo pursuant to a pledge and security agreement in an amount equal to 103% of the face value of all issued and outstanding letters of credit. The LC Facility has a term ending on January 20, 2014, unless terminated sooner pursuant to its terms. Wells Fargo may, in its sole discretion, terminate the LC Facility at any time. On July 30, 2011, we had no letters of credit outstanding under the facility. We may replace any letters of credit issued under our LC Facility with letters of credit issued under the Amended Domestic Credit Agreement and as such, any cash collateral is considered unrestricted cash.

**NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS**

We use derivatives primarily as a risk management tool to decrease our exposure to fluctuations in the foreign currency market. We are exposed to fluctuations in foreign currency exchange rates as a result of our net investment in Sears Canada. Further, Sears Canada is exposed to fluctuations in foreign currency exchange rates due to inventory purchase contracts denominated in U.S. dollars.

*Earnings Effects of Derivatives on the Statements of Operations*

For derivatives that were designated as hedges of our net investment in Sears Canada, we assess effectiveness based on changes in forward currency exchange rates. Changes in spot rates on the derivatives are recorded in the currency translation adjustments line in Accumulated Other Comprehensive Income (Loss) and will remain there until we substantially liquidate or sell our holdings in Sears Canada.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Changes in the fair value of any derivatives that are not designated as hedges are recorded in earnings each period. Sears Canada mitigates the risk of currency fluctuations on offshore merchandise purchases denominated in U.S. currency by purchasing U.S. dollar denominated option contracts for a portion of its expected requirements. Since Holdings' functional currency is the U.S. dollar, we are not directly exposed to the risk of exchange rate changes due to Sears Canada's merchandise purchases, and therefore we do not account for these instruments as a hedge of our foreign currency exposure risk.

*Sears Canada Hedges of Merchandise Purchases*

As of July 30, 2011, Sears Canada had entered into foreign currency collar contracts with a total notional value of \$181 million. As discussed previously, these collar contracts are used to hedge Sears Canada's purchase of inventory under U.S. dollar denominated contracts. We record mark-to-market adjustments based on the total notional value of these outstanding collar contracts at the end of each period. We recorded mark-to-market liabilities related to these foreign currency collar contracts of \$10 million at July 30, 2011 and \$3 million at January 29, 2011, and mark-to-market assets related to these foreign currency collar contracts of \$3 million at July 31, 2010.

We record the earnings impact of mark-to-market and settlement adjustments for foreign currency collar contracts in other income (loss) at the end of each period. We recorded mark-to-market and settlement gains on these contracts of \$8 million and mark-to-market and settlement losses of \$8 million for the 13- and 26- week periods ended July 30, 2011, respectively. We recorded mark-to-market and settlement gains of \$8 million and mark-to-market settlement losses of \$7 million for these contracts for the 13- and 26- week periods ended July 31, 2010, respectively.

Sears Canada's above noted foreign currency collar contracts were entered into as a hedge of merchandise purchase contracts denominated in U.S. currency. We also record mark-to-market adjustments for the value of the merchandise purchase contracts (considered embedded derivatives under relevant accounting rules) at the end of each period. We recorded assets of \$1 million at July 30, 2011, \$1 million at July 31, 2010 and \$2 million at January 29, 2011 related to the fair value of these embedded derivatives.

We record the earnings impact of mark-to-market and settlement adjustments related to the embedded derivative in the merchandise purchase contracts in other income (loss) at the end of each period. We recorded mark-to-market and settlement losses of \$3 million and mark-to-market and settlement gains of \$1 million for the 13- and 26- week periods ended July 30, 2011, respectively. We recorded mark-to-market and settlement losses of \$3 million and \$2 million for the 13- and 26- week periods ended July 31, 2010, respectively.

At July 30, 2011 and July 31, 2010, we had net derivative mark-to-market liabilities related to the collar contracts and embedded derivatives of \$9 million and mark-to-market assets related to the collar contracts and embedded derivatives of \$4 million, respectively. We recorded total mark-to-market and settlement gains of \$5 million and total mark-to-market and settlement losses of \$7 million in other income (loss) for the 13- and 26- week periods ended July 30, 2011, respectively. We recorded total mark-to-market and settlement gains of \$5 million and total mark-to-market and settlement losses of \$9 million in other income (loss) for the 13- and 26- week periods ended July 31, 2010, respectively. See Note 4 for further information regarding fair value of these collar and merchandise purchase contracts and the respective balance sheet classifications as of July 30, 2011, July 31, 2010 and January 29, 2011.

*Hedges of Net Investment in Sears Canada*

At July 30, 2011, we had a foreign currency forward contract outstanding with a total Canadian notional value of \$629 million and with a weighted-average remaining life of one year. This contract was designated and qualified as a hedge of the foreign currency exposure of our net investment in Sears Canada. Accordingly, the aggregate

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

fair value of the forward contract as of July 30, 2011 of approximately \$9 million was recorded as a liability on our Condensed Consolidated Balance Sheet. The decline in fair value of \$9 million related to this forward contract, net of tax, was recorded as a component of other comprehensive income for the 26-week period ended July 30, 2011.

We settled a foreign currency forward contract during the second quarter of 2011 and paid a net amount of \$23 million relative to this contract settlement. As hedge accounting was applied to this contract, an offsetting amount was recorded as a component of other comprehensive income.

Certain of our currency forward contracts require collateral be posted in the event our liability under such contracts reaches a predetermined threshold. Cash collateral posted under these contracts is recorded as part of our accounts receivable balance. We had \$12 million of cash collateral posted under these contracts as of July 30, 2011, \$2 million as of July 31, 2010 and \$3 million as of January 29, 2011.

*Counterparty Credit Risk*

We actively manage the risk of nonpayment by our derivative counterparties by limiting our exposure to individual counterparties based on credit ratings, value at risk and maturities. The counterparties to these instruments are major financial institutions with credit ratings of single-A or better at July 30, 2011.

**NOTE 4 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES**

We determine fair value of financial assets and liabilities based on the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

**Level 1 inputs** unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

**Level 2 inputs** inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates.

**Level 3 inputs** unobservable inputs for the asset or liability.

Accounts receivable, merchandise payables, short-term borrowings, accrued liabilities and domestic cash and cash equivalents are reflected in the Condensed Consolidated Balance Sheets at cost, which approximates fair value due to the short-term nature of these instruments. The fair value of our debt is disclosed in Note 2 to the Condensed Consolidated Financial Statements. The following table provides the fair value measurement amounts for other financial assets and liabilities recorded in our Condensed Consolidated Balance Sheets at fair value as of July 30, 2011, July 31, 2010 and January 29, 2011:

<i>millions</i>	<b>Total Fair Value Amounts at July 30, 2011</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash equivalents <sup>(1)</sup>	\$ 181	\$ 181	\$	\$
Restricted cash <sup>(2)</sup>	21	21		

Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

Foreign currency derivative assets <sup>(3)</sup>	1	1		
Foreign currency derivative liabilities <sup>(4)</sup>	(19)	(19)		
Total	\$ 184	\$ 202	\$ (18)	\$



**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

<i>millions</i>	<b>Total Fair Value Amounts at July 31, 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash equivalents <sup>(1)</sup>	\$ 691	\$ 691	\$	\$
Restricted cash <sup>(2)</sup>	6	6		
Foreign currency derivative assets <sup>(3)</sup>	4		4	
Foreign currency derivative liabilities <sup>(4)</sup>	(7)		(7)	
<b>Total</b>	<b>\$ 694</b>	<b>\$ 697</b>	<b>\$ (3)</b>	<b>\$</b>

<i>millions</i>	<b>Total Fair Value Amounts at January 29, 2011</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash equivalents <sup>(1)</sup>	\$ 416	\$ 416	\$	\$
Restricted cash <sup>(2)</sup>	15	15		
Foreign currency derivative assets <sup>(3)</sup>	3		3	
Foreign currency derivative liabilities <sup>(4)</sup>	(3)		(3)	
<b>Total</b>	<b>\$ 431</b>	<b>\$ 431</b>	<b>\$</b>	<b>\$</b>

(1) Included within Cash and cash equivalents in our Condensed Consolidated Balance Sheets.

(2) Included within Restricted cash in our Condensed Consolidated Balance Sheets.

(3) Included within Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets.

(4) Included within Accrued expenses and other current liabilities in our Condensed Consolidated Balance Sheets.

The fair values of derivative assets and liabilities traded in the over-the-counter market are determined using quantitative models that require the use of multiple inputs including interest rates, prices and indices to generate pricing and volatility factors. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. Our derivative instruments are valued using Level 2 measurements.

**NOTE 5 SEARS CANADA***Acquisition of Noncontrolling Interest*

During the first quarter of 2010, we acquired approximately 19 million additional common shares of Sears Canada. We paid a total of \$560 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with accounting standards applicable to noncontrolling interests. Accordingly, we reclassified an accumulated other comprehensive loss from noncontrolling interest to controlling interest in the Condensed Consolidated Statement of Equity at July 31, 2010 and the Consolidated Statement of Equity at January 29, 2011.

*Sears Canada Share Repurchases*

During the second quarter of 2011, Sears Canada renewed its Normal Course Issuer Bid with the Toronto Stock Exchange that permits it to purchase for cancellation up to 5% of its issued and outstanding common shares, representing approximately 5.3 million common shares. The

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

purchase authorization expires on May 24, 2012 or on such earlier date as Sears Canada may complete its purchases pursuant to the Normal Course Issuer Bid. Sears Canada may not purchase common shares under the Normal Course Issuer Bid if they cannot be purchased at

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

prices that they consider attractive, and decisions regarding the timing of purchases will be based on market conditions and other factors. Sears Canada purchased and cancelled approximately 1.5 million common shares for \$28 million and approximately 1.6 million common shares for \$29 million during the 13- and 26- week periods ended July 30, 2011, respectively.

*Sears Holdings Ownership of Sears Canada*

At July 30, 2011 and July 31, 2010, Sears Holdings was the beneficial holder of approximately 97 million, or 94% and 97 million or 90%, respectively, of the common shares of Sears Canada.

*Dividends*

On May 18, 2010, Sears Canada announced that its Board of Directors declared a cash dividend of \$3.50 Canadian per common share, or approximately \$377 million Canadian, which was paid on June 4, 2010 to shareholders of record at the close of business on May 31, 2010. Accordingly, Holdings received dividends of \$318 million and minority shareholders in Sears Canada received dividends of \$34 million during the second quarter of 2010.

**NOTE 6 STORE CLOSINGS AND CONVERSIONS**

We made the decision to close 36 stores and change the format of 14 stores during the second quarter of 2011. The second quarter 2011 closings included 26 stores within our Sears Domestic segment and 10 stores in our Kmart segment. Also within the Sears Domestic segment are the 14 Essentials/Grand stores that will be converted to Kmart stores. For the second quarter of 2011, we recorded charges related to these store closings of \$30 million and \$10 million at Sears Domestic and Kmart, respectively, which included \$15 million and \$7 million recorded in cost of sales for inventory clearance markdowns and \$15 million and \$3 million recorded in selling and administrative expenses for store closing and severance costs. For the second quarter of 2011, we recorded impairment charges of \$8 million in depreciation expense for accelerated depreciation on assets in stores we decided to close at Sears Domestic. We did not make a decision to close any stores during the second quarter of 2010.

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which the Company no longer intends to receive any economic benefit are accrued for when the Company ceases to use the leased space. We did not record any charges related to closed store lease obligations during the second quarter of 2011. During the second quarter of 2010, we closed seven stores we previously announced would close and recorded charges of \$6 million for the related lease obligations.

For the first half of 2011, we recorded total store closing and conversion charges of \$32 million and \$10 million at Sears Domestic and Kmart, respectively, which included \$16 million and \$7 million recorded in cost of sales for inventory clearance markdowns and \$16 million and \$3 million recorded in selling and administrative expenses for store closing, severance and lease costs. We recorded impairment charges of \$8 million in depreciation expense for accelerated depreciation on assets in stores we decided to close at Sears Domestic. For the first half of 2010, we recorded total store closing charges of \$5 million and \$4 million at Sears Domestic and Kmart, respectively, which included \$1 million and \$1 million recorded in cost of sales for inventory clearance markdowns and \$4 million and \$3 million recorded in selling and administrative expenses for store closing, severance and lease costs.

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**NOTE 7 EQUITY***Share Repurchase Program*

During the 13- and 26- week periods ended July 30, 2011, we repurchased 0.8 million and 2.0 million of our common shares at a total cost of \$53 million and \$154 million, respectively, under our share repurchase program. Our repurchases for the 13- and 26- week periods ended July 30, 2011 were made at average prices of \$68.69 and \$76.65 per share, respectively. At July 30, 2011, we had \$533 million of remaining authorization under our common share repurchase program. The share repurchase program, authorized by our Board of Directors, has no stated expiration date and share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods.

*Accumulated Other Comprehensive Loss*

The following table displays the components of accumulated other comprehensive loss:

<i>millions</i>	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>January 29, 2011</b>
Pension and postretirement adjustments (net of tax of \$(451), \$(468) and \$(480), respectively)	\$ (725)	\$ (713)	\$ (783)
Cumulative unrealized derivative gain (loss) (net of tax of \$(3), \$(2) and \$0, respectively)	(5)	(3)	1
Currency translation adjustments (net of tax of \$(34), \$(20) and \$(7), respectively)	(15)	(27)	3
Accumulated other comprehensive loss	\$ (745)	\$ (743)	\$ (779)

Pension and postretirement adjustments relate to the net actuarial loss on our pension and postretirement plans recognized as a component of accumulated other comprehensive income. Accumulated other comprehensive loss attributable to noncontrolling interests at July 30, 2011, July 31, 2010 and January 29, 2011 was \$4 million, \$43 million and \$4 million, respectively.

**NOTE 8 BENEFIT PLANS***Pension and Post-retirement Benefit Plans*

We provide benefits to certain associates who are eligible under various defined benefit pension plans, contributory defined benefit pension plans and other post-retirement plans, primarily retiree medical benefits. For purposes of determining the periodic expense of our defined benefit plans, we use the fair value of plan assets as the market related value. The following table summarizes the components of total net periodic benefit expense for our retirement plans:

<i>millions</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
Components of net periodic expense:				
Benefits earned during the period	\$ 2	\$ 3	\$ 4	\$ 6

Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

Interest costs	96	107	192	208
Expected return on plan assets	(89)	(92)	(178)	(180)
Amortization of experience gains/losses	17	23	34	42
Net periodic expense	\$ 26	\$ 41	\$ 52	\$ 76

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

*Contributions*

During the 13- and 26- week periods ended July 30, 2011, we made total contributions of \$65 million and \$143 million, respectively, to our pension and post-retirement plans. During the 13- and 26- week periods ended July 31, 2010, we made total contributions of \$61 million and \$122 million, respectively, to our pension and post-retirement plans. We anticipate making aggregate contributions to our domestic and Canadian defined benefit plans of approximately \$226 million over the remainder of 2011.

**NOTE 9 INCOME TAXES**

At July 30, 2011, we had gross unrecognized tax benefits of \$200 million. Of this amount, \$97 million would, if recognized, impact our effective tax rate, with the remaining amount being comprised of unrecognized tax benefits related to gross temporary differences or any other indirect benefits. During the 13- and 26- week periods ended July 30, 2011, gross unrecognized tax benefits were decreased by \$10 million and increased by \$8 million, respectively, due to federal, foreign, and state audit activity. We expect that our unrecognized tax benefits could decrease by as much as \$26 million over the next 12 months for tax audit settlements and the expiration of the statute of limitations for certain jurisdictions.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. At July 30, 2011, the total amount of interest and penalties included in our tax accounts in our Condensed Consolidated Balance Sheets was \$62 million (\$42 million net of federal benefit). The total amount of net interest expense recognized as part of income tax expense in our Condensed Consolidated Statements of Operations for the 13- and 26- week periods ended July 30, 2011 was \$1 million (net of federal tax benefit) and \$7 million (net of federal tax benefit), respectively.

We file income tax returns in the United States, as well as various foreign jurisdictions. The U.S. Internal Revenue Service ( IRS ) is currently examining Holdings' 2008 and 2009 federal income tax returns. The IRS has completed its examination of Holdings' 2006 and 2007 federal income tax returns, and we are currently working with IRS appeals division to resolve certain matters arising from this exam. We have resolved all matters arising from prior IRS exams. In addition, Holdings and Sears are under examination by various state, local and foreign income tax jurisdictions for the years 2002-2009, and Kmart is under examination by such jurisdictions for the years 2003-2009.

At July 30, 2011, we had Federal credit carryforwards of \$356 million, which will expire between 2015 and 2031.

At the end of 2010, we had a state NOL deferred tax asset of \$250 million and a valuation allowance of \$153 million. In the first half of 2011, there were no adjustments to the state NOL deferred tax asset and valuation allowance. The Company continues to monitor its operating performance and evaluate the likelihood of the future realization of these deferred tax assets. In the event that the Company does not achieve its forecasted results for the remainder of the fiscal year, additional valuation allowances may be required. The state NOLs will predominantly expire between 2017 and 2030.

**NOTE 10 SUMMARY OF SEGMENT DATA**

These reportable segment classifications are based on our business formats, as described in Note 1. The Kmart and Sears Canada formats represent both operating and reportable segments. The Sears Domestic reportable segment consists of the aggregation of several business formats. These formats are evaluated by our Chief Operating Decision Maker to make decisions about resource allocation and to assess performance. Each of these segments derives its revenues from the sale of merchandise and related services to customers, primarily in the United States and Canada.

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

<i>millions</i>	<b>Kmart</b>	<b>13 Weeks Ended July 30, 2011</b>		
		<b>Sears Domestic</b>	<b>Sears Canada</b>	<b>Sears Holdings</b>
Merchandise sales and services	\$ 3,624	\$ 5,534	\$ 1,175	\$ 10,333
Costs and expenses				
Cost of sales, buying and occupancy	2,799	4,048	821	7,668
Selling and administrative	809	1,509	326	2,644
Depreciation and amortization	37	164	26	227
Gain on sales of assets	(5)	(24)		(29)
Total costs and expenses	3,640	5,697	1,173	10,510
Operating income (loss)	\$ (16)	\$ (163)	\$ 2	\$ (177)
Total assets	\$ 5,926	\$ 15,008	\$ 2,866	\$ 23,800
Capital expenditures	\$ 24	\$ 47	\$ 19	\$ 90

<i>millions</i>	<b>Kmart</b>	<b>13 Weeks Ended July 31, 2010</b>		
		<b>Sears Domestic</b>	<b>Sears Canada</b>	<b>Sears Holdings</b>
Merchandise sales and services	\$ 3,630	\$ 5,674	\$ 1,154	\$ 10,458
Costs and expenses				
Cost of sales, buying and occupancy	2,746	4,084	805	7,635
Selling and administrative	830	1,503	273	2,606
Depreciation and amortization	36	160	25	221
Gain on sales of assets	(1)	(8)		(9)
Total costs and expenses	3,611	5,739	1,103	10,453
Operating income (loss)	\$ 19	\$ (65)	\$ 51	\$ 5
Total assets	\$ 6,026	\$ 15,667	\$ 3,140	\$ 24,833
Capital expenditures	\$ 18	\$ 46	\$ 9	\$ 73

<i>millions</i>	<b>Kmart</b>	<b>26 Weeks Ended July 30, 2011</b>		

Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

		<b>Sears Domestic</b>	<b>Sears Canada</b>	<b>Sears Holdings</b>
Merchandise sales and services	\$ 7,103	\$ 10,746	\$ 2,189	\$ 20,038
Costs and expenses				
Cost of sales, buying and occupancy	5,433	7,792	1,547	14,772
Selling and administrative	1,598	2,976	629	5,203
Depreciation and amortization	74	320	51	445
Gain on sales of assets	(7)	(24)		(31)
Total costs and expenses	7,098	11,064	2,227	20,389
Operating income (loss)	\$ 5	\$ (318)	\$ (38)	\$ (351)
Total assets	\$ 5,926	\$ 15,008	\$ 2,866	\$ 23,800
Capital expenditures	\$ 52	\$ 109	\$ 38	\$ 199



**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

<i>millions</i>	<b>26 Weeks Ended July 31, 2010</b>			
	<b>Kmart</b>	<b>Sears Domestic</b>	<b>Sears Canada</b>	<b>Sears Holdings</b>
Merchandise sales and services	\$ 7,213	\$ 11,109	\$ 2,182	\$ 20,504
Costs and expenses				
Cost of sales, buying and occupancy	5,457	7,873	1,521	14,851
Selling and administrative	1,612	3,011	538	5,161
Depreciation and amortization	72	320	50	442
Gain on sales of assets	(6)	(47)		(53)
<b>Total costs and expenses</b>	<b>7,135</b>	<b>11,157</b>	<b>2,109</b>	<b>20,401</b>
Operating income (loss)	\$ 78	\$ (48)	\$ 73	\$ 103
<b>Total assets</b>	<b>\$ 6,026</b>	<b>\$ 15,667</b>	<b>\$ 3,140</b>	<b>\$ 24,833</b>
Capital expenditures	\$ 63	\$ 85	\$ 20	\$ 168

**NOTE 11 SUPPLEMENTAL FINANCIAL INFORMATION**

Other long-term liabilities as of July 30, 2011, July 31, 2010 and January 29, 2011 consisted of the following:

<i>millions</i>	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>January 29, 2011</b>
Unearned revenues	\$ 796	\$ 811	\$ 794
Self-insurance reserves	767	812	757
Other	701	963	671
<b>Total</b>	<b>\$ 2,264</b>	<b>\$ 2,586</b>	<b>\$ 2,222</b>

**NOTE 12 LEGAL PROCEEDINGS**

Robert F. Booth Trust, derivatively v. William C. Crowley, et al. In August 2009, a shareholder derivative lawsuit was filed in United States District Court for the Northern District of Illinois against current and former directors William C. Crowley, Edward S. Lampert, Steven T. Mnuchin, Richard C. Perry, Ann N. Reese, Kevin B. Rollins, Emily Scott and Thomas Tisch, and nominally Sears Holdings Corporation. Plaintiff alleged that by nominating for re-election to the Sears Holdings Corporation board Mr. Crowley and Ms. Reese while they were also members of the boards of AutoNation, Inc. (Crowley), AutoZone, Inc. (Crowley), and Jones Apparel Group, Inc. (Reese), defendants violated Section 8 of the Clayton Act prohibiting interlocking directorships and breached their fiduciary duty to the Company. Plaintiff sought injunctive relief and recovery of its costs, including reasonable attorney fees. The parties have settled the matter and the Court has preliminarily approved the settlement. The parties have moved for final approval of the settlement and await the Court's ruling in this regard. Also, Theodore H. Frank, a shareholder of the Company, has appealed the Court's denial of his motion to intervene. The Appellate Court has suspended briefing on Mr. Frank's appeal pending the Court's ruling concerning final approval. In agreeing to the settlement, defendants did not admit any wrongdoing and denied committing any violation of law. Defendants agreed to the settlement solely to eliminate the uncertainties, burden and expense of

further protracted litigation. The settlement does not have a material adverse effect on our annual results of operations, financial position, liquidity or capital resources.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

We are a defendant in several lawsuits containing class-action allegations in which the plaintiffs are current and former hourly and salaried associates who allege various wage and hour violations and unlawful termination practices. The complaints generally seek unspecified monetary damages, injunctive relief, or both. Further, certain of these proceedings are in jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants.

We are subject to various other legal and governmental proceedings, many involving litigation incidental to our businesses. Some matters contain class action allegations, environmental and asbestos exposure allegations and other consumer-based claims, each of which may seek compensatory, punitive or treble damage claims (potentially in large amounts), as well as other types of relief.

In accordance with accounting standards regarding loss contingencies, we accrue an undiscounted liability for those contingencies where the incurrence of a loss is probable and the amount can be reasonably estimated, and we disclose the amount accrued and the amount of a reasonably possible loss in excess of the amount accrued, if such disclosure is necessary for our financial statements to not be misleading. We do not record liabilities when the likelihood that the liability has been incurred is probable but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote.

Because litigation outcomes are inherently unpredictable, our evaluation of legal proceedings often involves a series of complex assessments by management about future events and can rely heavily on estimates and assumptions. If the assessments indicate that loss contingencies that could be material to any one of our financial statements are not probable, but are reasonably possible, or are probable, but cannot be estimated, then we disclose the nature of the loss contingencies, together with an estimate of the range of possible loss or a statement that such loss is not reasonably estimable. While the consequences of certain unresolved proceedings are not presently determinable, and an estimate of the probable and reasonably possible loss or range of loss in excess of amounts accrued for such proceedings cannot be reasonably made, an adverse outcome from such proceedings could have a material effect on our earnings in any given reporting period. However, in the opinion of our management, after consulting with legal counsel, and taking into account insurance and reserves, the ultimate liability related to current outstanding matters is not expected to have a material effect on our financial position, liquidity or capital resources.

**NOTE 13 RECENT ACCOUNTING PRONOUNCEMENTS**

*Disclosures about Fair Value Measurements*

In May 2011, the Financial Accounting Standards Board ( FASB ) issued an accounting standards update which amends the definition of fair value measurement principles and disclosure requirements to eliminate differences between U.S. GAAP and International Financial Reporting Standards. The update requires new quantitative and qualitative disclosures about the sensitivity of recurring Level 3 measurement disclosures, as well as transfers between Level 1 and Level 2 of the fair value hierarchy. The update will be effective for us in the first quarter of 2012 and will primarily impact our disclosures, but otherwise is not expected to have a material impact on our consolidated financial position, annual results of operations or cash flows.

In January 2010, the FASB issued an accounting standards update to improve disclosures about fair value measurements. The update amends existing accounting rules regarding fair value measurements and disclosures to add new requirements for disclosures related to transfers into and out of investment Levels 1 and 2, and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 investment

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

measurements. It also clarifies existing fair value disclosures about the level of disaggregation, as well as inputs and valuation techniques used to measure fair value. The update is effective for the first reporting period beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which is effective for fiscal years beginning after December 15, 2010. As this update only relates to financial statement disclosures, it did not have an impact on our results of operations, cash flows or financial position. See Note 4 for further discussion regarding our fair value measurements of financial assets and liabilities.

*Presentation of Comprehensive Income*

In June 2011, the FASB issued an accounting standards update which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in existing guidance and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the income statement format used today, and the second statement would include components of other comprehensive income ( OCI ). The update does not change the items that must be reported in OCI and its amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The guidance must be applied retrospectively for all periods presented in the financial statements. Early adoption is permitted. As this update only relates to financial statement presentation, we do not expect this update to have a material effect on our results of operations, cash flows or financial position.

**NOTE 14 RELATED PARTY DISCLOSURE**

Our Board of Directors has delegated authority to direct investment of our surplus cash to Edward S. Lampert, subject to various limitations that have been or may be from time to time adopted by the Board of Directors and/or the Finance Committee of the Board of Directors. Mr. Lampert is Chairman of our Board of Directors and Finance Committee and is the Chairman and Chief Executive Officer of ESL. Neither Mr. Lampert nor ESL will receive compensation for any such investment activities undertaken on our behalf. ESL beneficially owned 61.0% of our outstanding common stock as of July 30, 2011.

Further, to clarify the expectations that the Board of Directors has with respect to the investment of our surplus cash, the Board has renounced, in accordance with Delaware law, any interest or expectancy of the Company associated with any investment opportunities in securities that may come to the attention of Mr. Lampert or any employee, officer, director or advisor to ESL and its affiliated investment entities (each, a Covered Party ) who also serves as an officer or director of the Company other than (a) investment opportunities that come to such Covered Party s attention directly and exclusively in such Covered Party s capacity as a director, officer or employee of the Company, (b) control investments in companies in the mass merchandising, retailing, commercial appliance distribution, product protection agreements, residential and commercial product installation and repair services and automotive repair and maintenance industries and (c) investment opportunities in companies or assets with a significant role in our retailing business, including investment in real estate currently leased by the Company or in suppliers for which the Company is a substantial customer representing over 10% of such companies revenues, but excluding investments of ESL as of May 23, 2005.

Sears Holdings, through its subsidiaries, engages in commercial transactions with AutoZone, Inc. ( AutoZone ) in the ordinary course of business. In the first half of 2011, we paid AutoZone approximately \$14 million for automotive parts, accessories and other services. ESL owns approximately 29.3% of the outstanding common stock of AutoZone (based on publicly available data at July 25, 2011).

---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

During the first half of 2011, ESL purchased unsecured commercial paper issued by SRAC, an indirect wholly owned subsidiary of Sears Holdings. The weighted average of maturity, annual interest rate, and principal amount outstanding for this commercial paper in the first half of 2011 was 30.2 days, 1.00% and \$240 million, respectively. At July 30, 2011, ESL held \$240 million in principal amount of 30-day unsecured commercial paper issued by Sears Roebuck Acceptance Corp. under its commercial paper program, which includes \$120 million held by ESL for the benefit of Mr. Lampert. The commercial paper purchases were made in the ordinary course of business on substantially the same terms, including the interest rate, as terms prevailing for comparable transactions with other persons, and did not present features unfavorable to the Company.

The Company employs certain employees of ESL. William R. Harker, a Senior Vice President of the Company, serves as Executive Vice President and General Counsel of ESL and our Senior Vice President of Real Estate is employed by ESL.

**NOTE 15 SPIN-OFF OF ORCHARD SUPPLY HARDWARE STORES CORPORATION**

On June 23, 2011, we announced that Orchard Supply Hardware Stores Corporation ( Orchard ), which currently operates 89 full-service hardware stores in California, has filed a Registration Statement on Form S-1 with the Securities and Exchange Commission ( Registration Statement ) in connection with Holdings plan to spin off its interest in Orchard. The spin-off will result in Holdings shareholders owning all of the capital stock of Orchard that is owned by Holdings immediately prior to the spin-off, which will consist of common stock that will represent approximately 80% of the voting power of Orchard s outstanding capital stock and preferred stock that will represent 100% of Orchard s outstanding nonvoting capital stock. The spin-off would be effected through the pro rata distribution of the Orchard common stock and preferred stock that we hold to our shareholders. We expect that the spin-off will be tax-free to Holdings shareholders for U.S. federal income tax purposes, except for any cash received in lieu of fractional shares. The spin-off is subject to final approval by the Holdings Board of Directors and the satisfaction of certain other conditions, including the effectiveness of the Registration Statement filed by Orchard, and Holdings may, at any time until the spin-off, decide to abandon the spin-off or modify or change the terms of the spin-off.

**NOTE 16 GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION**

At July 30, 2011, the principal amount outstanding of the Company s 6 5/8% senior secured notes due 2018 was \$1.25 billion. These notes were issued in 2010 by Sears Holdings Corporation ( Parent ). The notes are guaranteed by certain of our 100% owned domestic subsidiaries (the guarantor subsidiaries ). The following condensed consolidated financial information presents the Condensed Consolidating Balance Sheets at July 30, 2011, July 31, 2010 and January 29, 2011, the Condensed Consolidating Statements of Income for the 13- and 26- week periods ended July 30, 2011 and July 31, 2010 and the Condensed Consolidating Statements of Cash Flows for the 26- week periods ended July 30, 2011 and July 31, 2010 of (i) Parent; (ii) the guarantor subsidiaries; (iii) the non-guarantor subsidiaries; (iv) eliminations and (v) the Company on a consolidated basis.

The principal elimination entries relate to investments in subsidiaries and inter-company balances and transactions including transactions with our wholly-owned non-guarantor insurance subsidiary. The Company has accounted for investments in subsidiaries under the equity method. The guarantor subsidiaries are 100% owned directly or indirectly by the Parent and all guarantees are joint, several and unconditional. Additionally, the notes are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables of the guarantor subsidiaries, and consequently may not be available to satisfy the claims of the Company s general creditors.

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Balance Sheet**

July 30, 2011

<i>millions</i>	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>					
Cash and cash equivalents	\$	\$ 422	\$ 236	\$	\$ 658
Intercompany receivables			25,233	(25,233)	
Accounts receivable	116	919	237	(490)	782
Merchandise inventories		8,321	1,105		9,426
Other current assets		262	557	(381)	438
<b>Total current assets</b>	<b>116</b>	<b>9,924</b>	<b>27,368</b>	<b>(26,104)</b>	<b>11,304</b>
Total property and equipment, net		5,609	1,550		7,159
Goodwill and intangible assets		1,750	2,748		4,498
Other assets	18	1,264	2,697	(3,140)	839
Investment in subsidiaries	20,992	25,547		(46,539)	
<b>TOTAL ASSETS</b>	<b>\$ 21,126</b>	<b>\$ 44,094</b>	<b>\$ 34,363</b>	<b>\$ (75,783)</b>	<b>\$ 23,800</b>
<b>Current liabilities</b>					
Short-term borrowings	\$	\$ 927	\$	\$	\$ 927
Current portion of long-term debt and capitalized lease obligations		270	29		299
Merchandise payables		2,774	550		3,324
Intercompany payables	11,784	13,449		(25,233)	
Other current liabilities	33	2,867	2,350	(871)	4,379
<b>Total current liabilities</b>	<b>11,817</b>	<b>20,287</b>	<b>2,929</b>	<b>(26,104)</b>	<b>8,929</b>
Long-term debt and capitalized lease obligations	1,246	2,857	462	(2,152)	2,413
Pension and postretirement benefits		1,694	350		2,044
Other long-term liabilities		856	2,396	(988)	2,264
<b>Total Liabilities</b>	<b>13,063</b>	<b>25,694</b>	<b>6,137</b>	<b>(29,244)</b>	<b>15,650</b>
<b>EQUITY</b>					
Shareholder's equity	8,063	18,400	28,226	(46,628)	8,061
Noncontrolling interest				89	89
<b>Total Equity</b>	<b>8,063</b>	<b>18,400</b>	<b>28,226</b>	<b>(46,539)</b>	<b>8,150</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 21,126</b>	<b>\$ 44,094</b>	<b>\$ 34,363</b>	<b>\$ (75,783)</b>	<b>\$ 23,800</b>



**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Balance Sheet**

July 31, 2010

<i>millions</i>	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>					
Cash and cash equivalents	\$	\$ 415	\$ 778	\$	\$ 1,193
Intercompany receivables			24,605	(24,605)	
Accounts receivable	76	852	243	(417)	754
Merchandise inventories		8,435	995		9,430
Other current assets		271	499	(386)	384
<b>Total current assets</b>	76	9,973	27,120	(25,408)	11,761
Total property and equipment, net		5,919	1,566		7,485
Goodwill and intangible assets		1,796	2,769		4,565
Other assets		1,690	2,495	(3,163)	1,022
Investment in subsidiaries	20,966	25,390		(46,356)	
<b>TOTAL ASSETS</b>	\$ 21,042	\$ 44,768	\$ 33,950	\$ (74,927)	\$ 24,833
<b>Current liabilities</b>					
Short-term borrowings	\$	\$ 1,218	\$	\$	\$ 1,218
Current portion of long-term debt and capitalized lease obligations		351	239		590
Merchandise payables		3,193	480		3,673
Intercompany payables	12,530	12,075		(24,605)	
Other current liabilities		2,164	3,236	(803)	4,597
<b>Total current liabilities</b>	12,530	19,001	3,955	(25,408)	10,078
Long-term debt and capitalized lease obligations		2,862	393	(1,877)	1,378
Pension and postretirement benefits		1,959	213		2,172
Other long-term liabilities		2,033	1,839	(1,286)	2,586
<b>Total Liabilities</b>	12,530	25,855	6,400	(28,571)	16,214
<b>EQUITY</b>					
Shareholder's equity	8,512	18,913	27,550	(46,463)	8,512
Noncontrolling interest				107	107
<b>Total Equity</b>	8,512	18,913	27,550	(46,356)	8,619
<b>TOTAL LIABILITIES AND EQUITY</b>	\$ 21,042	\$ 44,768	\$ 33,950	\$ (74,927)	\$ 24,833





**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Balance Sheet****January 29, 2011**

<i>millions</i>	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>					
Cash and cash equivalents	\$ 140	\$ 778	\$ 457	\$	\$ 1,375
Intercompany receivables			25,010	(25,010)	
Accounts receivable	65	722	236	(340)	683
Merchandise inventories		8,026	1,097		9,123
Other current assets	1	435	474	(556)	354
<b>Total current assets</b>	<b>206</b>	<b>9,961</b>	<b>27,274</b>	<b>(25,906)</b>	<b>11,535</b>
Total property and equipment, net		5,809	1,556		7,365
Goodwill and intangible assets		1,773	2,758		4,531
Other assets	19	1,229	2,692	(3,103)	837
Investment in subsidiaries	21,199	25,417		(46,616)	
<b>TOTAL ASSETS</b>	<b>\$ 21,424</b>	<b>\$ 44,189</b>	<b>\$ 34,280</b>	<b>\$ (75,625)</b>	<b>\$ 24,268</b>
<b>Current liabilities</b>					
Short-term borrowings	\$	\$ 360	\$	\$	\$ 360
Current portion of long-term debt and capitalized lease obligations		474	35		509
Merchandise payables		2,566	535		3,101
Intercompany payables	11,641	13,369		(25,010)	
Other current liabilities	26	2,233	3,285	(896)	4,648
<b>Total current liabilities</b>	<b>11,667</b>	<b>19,002</b>	<b>3,855</b>	<b>(25,906)</b>	<b>8,618</b>
Long-term debt and capitalized lease obligations	1,246	2,841	579	(2,003)	2,663
Pension and postretirement benefits		1,822	329		2,151
Other long-term liabilities		1,677	1,645	(1,100)	2,222
<b>Total Liabilities</b>	<b>12,913</b>	<b>25,342</b>	<b>6,408</b>	<b>(29,009)</b>	<b>15,654</b>
<b>EQUITY</b>					
Shareholder's equity	8,511	18,847	27,872	(46,719)	8,511
Noncontrolling interest				103	103
<b>Total Equity</b>	<b>8,511</b>	<b>18,847</b>	<b>27,872</b>	<b>(46,616)</b>	<b>8,614</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 21,424</b>	<b>\$ 44,189</b>	<b>\$ 34,280</b>	<b>\$ (75,625)</b>	<b>\$ 24,268</b>



**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Income****For the 13 Weeks Ended July 30, 2011**

<i>millions</i>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Merchandise sales and services	\$	\$ 8,994	\$ 2,227	\$ (888)	\$ 10,333
Cost of sales, buying and occupancy		6,791	1,302	(425)	7,668
Selling and administrative		2,428	679	(463)	2,644
Depreciation and amortization		176	51		227
Gain on sales of assets		(29)			(29)
Total costs and expenses		9,366	2,032	(888)	10,510
Operating income (loss)		(372)	195		(177)
Interest expense	(54)	(92)	(34)	103	(77)
Interest and investment income (loss)		9	106	(103)	12
Other income			4		4
Income (loss) before income taxes	(54)	(455)	271		(238)
Income taxes	19	127	(52)		94
Equity in earnings in subsidiaries	(109)	148		(39)	
Net income (loss)	(144)	(180)	219	(39)	(144)
Income attributable to noncontrolling interests				(2)	(2)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	\$ (144)	\$ (180)	\$ 219	\$ (41)	\$ (146)

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Income****For the 13 Weeks Ended July 31, 2010**

<i>millions</i>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Merchandise sales and services	\$	\$ 9,074	\$ 2,252	\$ (868)	\$ 10,458
Cost of sales, buying and occupancy		6,756	1,300	(421)	7,635
Selling and administrative		2,383	670	(447)	2,606
Depreciation and amortization		171	50		221
Gain on sales of assets		(9)			(9)
Total costs and expenses		9,301	2,020	(868)	10,453
Operating income (loss)		(227)	232		5
Interest expense	(38)	(108)	(31)	108	(69)
Interest and investment income (loss)		10	104	(108)	6
Other income			5		5
Income (loss) before income taxes	(38)	(325)	310		(53)
Income taxes	14	77	(72)		19
Equity in earnings in subsidiaries	(10)	164		(154)	
Net income (loss)	(34)	(84)	238	(154)	(34)
Income attributable to noncontrolling interests				(5)	(5)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	\$ (34)	\$ (84)	\$ 238	\$ (159)	\$ (39)

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Income****For the 26 Weeks Ended July 30, 2011**

<i>millions</i>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Merchandise sales and services	\$	\$ 17,480	\$ 4,329	\$ (1,771)	\$ 20,038
Cost of sales, buying and occupancy		13,116	2,525	(869)	14,772
Selling and administrative	1	4,741	1,363	(902)	5,203
Depreciation and amortization		344	101		445
Gain on sales of assets		(31)			(31)
Total costs and expenses	1	18,170	3,989	(1,771)	20,389
Operating income (loss)	(1)	(690)	340		(351)
Interest expense	(110)	(192)	(67)	212	(157)
Interest and investment income (loss)		22	215	(212)	25
Other loss			(8)		(8)
Income (loss) before income taxes	(111)	(860)	480		(491)
Income taxes	39	222	(88)		173
Equity in earnings in subsidiaries	(246)	242		4	
Net income (loss)	(318)	(396)	392	4	(318)
Loss attributable to noncontrolling interests				2	2
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	<b>\$ (318)</b>	<b>\$ (396)</b>	<b>\$ 392</b>	<b>\$ 6</b>	<b>\$ (316)</b>

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Income****For the 26 Weeks Ended July 31, 2010**

<i>millions</i>	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Merchandise sales and services	\$	\$ 17,864	\$ 4,360	\$ (1,720)	\$ 20,504
Cost of sales, buying and occupancy		13,195	2,498	(842)	14,851
Selling and administrative	1	4,713	1,325	(878)	5,161
Depreciation and amortization		342	100		442
Gain on sales of assets		(51)	(2)		(53)
Total costs and expenses	1	18,199	3,921	(1,720)	20,401
Operating income (loss)	(1)	(335)	439		103
Interest expense	(72)	(206)	(64)	206	(136)
Interest and investment income (loss)		23	204	(206)	21
Other loss			(9)		(9)
Income (loss) before income taxes	(73)	(518)	570		(21)
Income taxes	26	104	(126)		4
Equity in earnings in subsidiaries	30	295		(325)	
Net income (loss)	(17)	(119)	444	(325)	(17)
Income attributable to noncontrolling interests				(6)	(6)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	\$ (17)	\$ (119)	\$ 444	\$ (331)	\$ (23)

**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Cash Flows****For the 26 Weeks Ended July 30, 2011**

<i>millions</i>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$	\$ (896)	\$ 429	\$	\$ (467)
Proceeds from sales of property and investments		42			42
Net increase in investments and restricted cash			(5)		(5)
Purchases of property and equipment		(154)	(45)		(199)
Net investing with Affiliates			(102)	102	
Net cash provided by (used in) investing activities		(112)	(152)	102	(162)
Proceeds from debt issuances			39		39
Repayments of long-term debt		(319)	(178)		(497)
Increase in short-term borrowings, primarily 90 days or less		567			567
Debt issuance costs		(35)			(35)
Purchase of Sears Canada shares			(22)		(22)
Purchase of treasury stock		(154)			(154)
Net borrowing with Affiliates	(140)	593	(351)	(102)	
Net cash provided by (used in) financing activities	(140)	652	(512)	(102)	(102)
Effect of exchange rate changes on cash and cash equivalents			14		14
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(140)</b>	<b>(356)</b>	<b>(221)</b>		<b>(717)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>140</b>	<b>778</b>	<b>457</b>		<b>1,375</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$</b>	<b>\$ 422</b>	<b>\$ 236</b>	<b>\$</b>	<b>\$ 658</b>



**Table of Contents****SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**Condensed Consolidating Statement of Cash Flows****For the 26 Weeks Ended July 31, 2010**

<i>millions</i>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$	\$ (667)	\$ 477	\$	\$ (190)
Proceeds from sales of property and investments		16			16
Net decrease in investments and restricted cash		3	6		9
Purchases of property and equipment		(143)	(25)		(168)
Net investing with Affiliates			(100)	100	
Net cash provided by (used in) investing activities		(124)	(119)	100	(143)
Repayments of long-term debt		(24)	(204)		(228)
Increase in short-term borrowings, primarily 90 days or less		893			893
Purchase of Sears Canada shares		(560)			(560)
Purchase of treasury stock		(273)			(273)
Sears Canada dividend paid to noncontrolling shareholders		318	(352)		(34)
Net borrowing with Affiliates		482	(382)	(100)	
Net cash provided by (used in) financing activities		836	(938)	(100)	(202)
Effect of exchange rate changes on cash and cash equivalents			39		39
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		<b>45</b>	<b>(541)</b>		<b>(496)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>		<b>370</b>	<b>1,319</b>		<b>1,689</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$</b>	<b>\$ 415</b>	<b>\$ 778</b>	<b>\$</b>	<b>\$ 1,193</b>

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010***Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with Part II, Item 7 of our Annual Report on Form 10-K for the year ended January 29, 2011.

**OVERVIEW OF HOLDINGS**

Holdings, the parent company of Kmart and Sears, was formed in connection with the March 24, 2005 Merger of these two companies. We are a broadline retailer with 2,188 full-line and 1,370 specialty retail stores in the United States, operating through Kmart and Sears, and 495 full-line and specialty retail stores in Canada operating through Sears Canada Inc. (Sears Canada), a 94%-owned subsidiary. We conduct our operations in three business segments: Kmart, Sears Domestic and Sears Canada. The nature of operations conducted within each of these segments is discussed within the Business Segments section of Part I, Item 1 of our Annual Report on Form 10-K for the year ended January 29, 2011.

**CONSOLIDATED RESULTS OF OPERATIONS**

<i>millions, except per share data</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
<b>REVENUES</b>				
Merchandise sales and services	\$ 10,333	\$ 10,458	\$ 20,038	\$ 20,504
<b>COSTS AND EXPENSES</b>				
Cost of sales, buying and occupancy	7,668	7,635	14,772	14,851
Gross margin dollars	2,665	2,823	5,266	5,653
<i>Gross margin rate</i>	<i>25.8%</i>	<i>27.0%</i>	<i>26.3%</i>	<i>27.6%</i>
Selling and administrative	2,644	2,606	5,203	5,161
<i>Selling and administrative expense as a percentage of total revenues</i>	<i>25.6%</i>	<i>24.9%</i>	<i>26.0%</i>	<i>25.2%</i>
Depreciation and amortization	227	221	445	442
Gain on sales of assets	(29)	(9)	(31)	(53)
<b>Total costs and expenses</b>	<b>10,510</b>	<b>10,453</b>	<b>20,389</b>	<b>20,401</b>
Operating income (loss)	(177)	5	(351)	103
Interest expense	(77)	(69)	(157)	(136)
Interest and investment income	12	6	25	21
Other income (loss)	4	5	(8)	(9)
Loss before income taxes	(238)	(53)	(491)	(21)
Income tax benefit	94	19	173	4
Net loss	(144)	(34)	(318)	(17)
(Income) loss attributable to noncontrolling interests	(2)	(5)	2	(6)
<b>NET LOSS ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	<b>\$ (146)</b>	<b>\$ (39)</b>	<b>\$ (316)</b>	<b>\$ (23)</b>
<b>LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>				
Diluted loss per share	\$ (1.37)	\$ (0.35)	\$ (2.95)	\$ (0.20)
Diluted weighted average common shares outstanding	106.8	112.6	107.3	113.6

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

References to comparable store sales amounts within the following discussion include sales for all stores operating for a period of at least 12 full months, including remodeled and expanded stores, but excluding store relocations and format changes.

Beginning with the first quarter of 2011, we now include in comparable stores sales online sales from sears.com and kmart.com shipped directly to customers. These online sales increased 32% for the second quarter and 27%

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

for the first half of 2011 compared to the prior year. The change resulted in a positive benefit of approximately 60 basis points and approximately 55 basis points to total domestic comparable sales for the second quarter and first half of 2011, respectively, predominately in the Sears Domestic Segment.

*Net Loss Attributable to Holdings Shareholders, Loss per Share Summary and Adjusted EBITDA*

We recorded a net loss attributable to Holdings shareholders for the second quarter of \$146 million, or \$1.37 loss per diluted share, in 2011 and \$39 million, or \$0.35 loss per diluted share, in 2010. We recorded a net loss attributable to Holdings shareholders for the first half of the year of \$316 million, or \$2.95 loss per diluted share, in 2011 and \$23 million, or \$0.20 loss per diluted share, in 2010.

In addition to our net loss determined in accordance with GAAP, for purposes of evaluating operating performance, we use an Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ( Adjusted EBITDA ) measurement computed as net income (loss) attributable to Sears Holdings Corporation appearing on the statements of operations excluding income (loss) attributable to noncontrolling interest, income tax expense (benefit), interest and investment income, other (income) loss, interest expense, gain on sales of assets and depreciation and amortization. In addition, it is adjusted to exclude certain significant items as set forth below. Our management uses Adjusted EBITDA to evaluate the operating performance of our businesses, as well as executive compensation metrics, for comparable periods. Adjusted EBITDA should not be used by investors or other third parties as the sole basis for formulating investment decisions as it excludes a number of important cash and non-cash recurring items.

While Adjusted EBITDA is a non-GAAP measurement, management believes that it is an important indicator of operating performance because:

EBITDA excludes the effects of financings and investing activities by eliminating the effects of interest and depreciation costs;

Management considers gains/(losses) on the sale of assets to result from investing decisions rather than ongoing operations; and

Other significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, which affects comparability of results.

Adjusted EBITDA was determined as follows:

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Net loss attributable to SHC per statement of operations	\$ (146)	\$ (39)	\$ (316)	\$ (23)
Income (loss) attributable to noncontrolling interest	2	5	(2)	6
Income tax benefit	(94)	(19)	(173)	(4)
Interest expense	77	69	157	136
Interest and investment income	(12)	(6)	(25)	(21)
Other (income) loss	(4)	(5)	8	9
<b>Operating income (loss )</b>	<b>(177)</b>	<b>5</b>	<b>(351)</b>	<b>103</b>
Depreciation and amortization	227	221	445	442
Gain on sales of assets	(29)	(9)	(31)	(53)

Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

Before excluded items	21	217	63	492
Domestic pension expense	18	31	37	57
Closed store reserve and severance	40	6	42	9
Adjusted EBITDA as defined	\$ 79	\$ 254	\$ 142	\$ 558
<i>% to revenues</i>	0.8%	2.4%	0.7%	2.7%

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

Adjusted EBITDA for our segments are as follows:

	13 Weeks Ended			
	Adjusted EBITDA		% To Revenues	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Kmart	\$ 26	\$ 57	0.7%	1.6%
Sears Domestic	25	121	0.5%	2.1%
Sears Canada	28	76	2.4%	6.6%
Total Adjusted EBITDA	\$ 79	\$ 254	0.8%	2.4%

	26 Weeks Ended			
	Adjusted EBITDA		% To Revenues	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Kmart	\$ 82	\$ 148	1.2%	2.1%
Sears Domestic	47	287	0.4%	2.6%
Sears Canada	13	123	0.6%	5.6%
Total Adjusted EBITDA	\$ 142	\$ 558	0.7%	2.7%

The following tables set forth results of operations on a GAAP and As Adjusted basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Condensed Consolidated Statements of Operations during the second quarter and first half of 2011 and 2010.

<i>millions, except per share data</i>	GAAP	13 Weeks Ended July 30, 2011				As Adjusted
		Domestic Pension Expense	Closed Store Reserve and Severance	Mark-to-Market Gains	Gain on Sales of Real Estate	
Cost of sales, buying and occupancy impact	\$ 7,668	\$	\$ (22)	\$	\$	\$ 7,646
Selling and administrative impact	2,644	(18)	(18)			2,608
Depreciation and amortization impact	227		(8)			219
Gain on sales of assets impact	(29)				21	(8)
Operating loss impact	(177)	18	48		(21)	(132)
Other income impact	4			(2)		2
Income tax benefit impact	94	(7)	(19)	1	8	77
Noncontrolling interest impact	(2)					(2)
After tax and noncontrolling interest impact	(146)	11	29	(1)	(13)	(120)
Diluted loss per share impact	\$ (1.37)	\$ 0.10	\$ 0.27	\$ (0.01)	\$ (0.12)	\$ (1.13)

13 Weeks Ended July 31, 2010

Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

<i>millions, except per share data</i>	<b>GAAP</b>	<b>Domestic Pension Expense</b>	<b>Closed Store Reserve and Severance</b>	<b>Mark-to-Market Gains</b>	<b>As Adjusted</b>
Selling and administrative impact	\$ 2,606	\$ (31)	\$ (6)	\$	\$ 2,569
Operating income impact	5	31	6		42
Other income impact	5			(8)	(3)
Income tax benefit impact	19	(12)	(2)	2	7
Noncontrolling interest impact	(5)			1	(4)
After tax and noncontrolling interest impact	(39)	19	4	(5)	(21)
Diluted loss per share impact	\$ (0.35)	\$ 0.17	\$ 0.04	\$ (0.05)	\$ (0.19)

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

<i>millions, except per share data</i>	GAAP	26 Weeks Ended July 30, 2011				As Adjusted
		Domestic Pension Expense	Closed Store Reserve and Severance	Mark-to-Market Losses	Gain on Sales of Real Estate	
Cost of sales, buying and occupancy impact	\$ 14,772	\$	\$ (23)	\$	\$	\$ 14,749
Selling and administrative impact.	5,203	(37)	(19)			5,147
Depreciation and amortization impact	445		(8)			437
Gain on sales of assets impact	(31)				21	(10)
Operating loss impact	(351)	37	50		(21)	(285)
Other loss impact	(8)			10		2
Income tax benefit impact	173	(13)	(18)	(3)	7	146
Noncontrolling interest impact	2			(1)		1
After tax and noncontrolling interest impact	(316)	24	32	6	(14)	(268)
Diluted loss per share impact	\$ (2.95)	\$ 0.22	\$ 0.30	\$ 0.06	\$ (0.13)	\$ (2.50)

<i>millions, except per share data</i>	GAAP	26 Weeks Ended July 31, 2010				As Adjusted
		Domestic Pension Expense	Closed Store Reserve and Severance	Mark-to-Market Losses	Gain on Sales of Real Estate	
Cost of sales, buying and occupancy impact	\$ 14,851	\$	\$ (2)	\$	\$	\$ 14,849
Selling and administrative impact.	5,161	(57)	(7)			5,097
Gain on sales of assets impact	(53)				35	(18)
Operating income impact	103	57	9		(35)	134
Other loss impact	(9)			2		(7)
Income tax benefit impact	4	(21)	(3)	(1)	13	(8)
Noncontrolling interest impact	(6)					(6)
After tax and noncontrolling interest impact	(23)	36	6	1	(22)	(2)
Diluted loss per share impact	\$ (0.20)	\$ 0.32	\$ 0.06	\$ 0.01	\$ (0.20)	\$ (0.01)

Contributions to our pension plans remain a significant use of our cash on an annual basis. While Sears Holdings' pension plan is frozen, and thus associates do not currently earn pension benefits, we have a legacy pension obligation for past service performed by Kmart and Sears, Roebuck and Co. associates. The annual pension expense included in our financial statements related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, our domestic pension expense was \$120 million in 2010 and \$170 million in 2009.

**13-week period ended July 30, 2011 compared to the 13-week period ended July 31, 2010****Total Revenues and Comparable Store Sales**

Total revenues decreased \$125 million to \$10.3 billion for the quarter ended July 30, 2011, as compared to total revenues of \$10.5 billion for the quarter ended July 31, 2010. The decline in total revenue for the quarter was primarily a result of a 0.7% decrease in domestic comparable store sales and the effect of having fewer Kmart and Sears Full-line stores in operation, in addition to a 5.8% decline in comparable store sales at Sears Canada, partially offset by an increase of \$86 million due to changes in the Canadian foreign exchange rate.

The domestic comparable store sales results included a decrease at Sears Domestic of 1.2%, while sales at Kmart were flat. Decreases in sales for the quarter at Sears Domestic were primarily driven by consumer electronics.





---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

Excluding the consumer electronics decline, domestic comparable store sales would have been flat. The Kmart quarterly comparable store sales included increases in several categories, such as outdoor living, grocery and household, tools, appliances and footwear, which were offset by decreases in the consumer electronics, pharmacy and drug categories.

*Gross Margin*

For the quarter, we generated gross margin of \$2.7 billion in 2011 and \$2.8 billion last year. The total decline in gross margin dollars of \$158 million was primarily driven by decreases in the gross margin rate at Kmart and Sears Domestic and included an increase of \$26 million related to the impact of foreign currency exchange rates on gross margin at Sears Canada and a \$22 million charge for markdowns recorded in connection with store closings announced during the second quarter of 2011.

Kmart's gross margin rate declined 160 basis points mainly due to increased promotional and clearance markdowns in apparel and home, as well as declines in other categories. Sears Domestic's gross margin rate declined 110 basis points mainly due to reduced margins in the home appliance category, driven primarily by increased promotional activity, including the use of instant free delivery, increased promotional markdowns in apparel and declines in home services. Sears Canada's gross margin rate for the quarter was flat to last year.

*Selling and Administrative Expenses*

For the quarter, our selling and administrative expenses increased \$38 million as compared to the second quarter in 2010. Selling and administrative expenses at Sears Canada increased \$53 million from last year, and included an increase of \$22 million related to the impact of foreign currency exchange rates. On a Canadian dollar basis, selling and administrative expenses increased by \$31 million primarily due to increased investment in strategic projects, partially offset by reductions in payroll and advertising expenses. This increase was partially offset by reductions at Sears Domestic.

Selling and administrative expenses for the second quarter of 2011 included domestic pension plan expense of \$18 million and store closing costs and severance of \$18 million. Selling and administrative expenses for the second quarter of 2010 included domestic pension plan expense of \$31 million and store closing costs and severance of \$6 million.

For the quarter, our selling and administrative expenses as a percentage of total revenues (selling and administrative expense rate) was 25.6% in 2011, as compared to 24.9% in 2010, and increased primarily as a result of the above noted increase in selling and administrative expenses at Sears Canada, as well as the decline in revenues.

*Gain on Sales of Assets*

We recorded total gains on sales of assets for the quarter of \$29 million in 2011 and \$9 million in 2010. Gains on sales of assets for the second quarter of 2011 include a gain of \$21 million recognized on the sale of two stores in California operated under The Great Indoors format.

*Operating Income/Loss*

We reported an operating loss for the quarter of \$177 million in 2011 compared to operating income for the quarter of \$5 million in 2010. The decline in operating income of \$182 million was primarily the result of a

---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

decline in our gross margin dollars, given lower overall sales and a decline in our gross margin rate of 120 basis points and an increase in selling and administrative expenses at Sears Canada. Operating loss for the second quarter of 2011 included expenses of \$66 million related to domestic pension plans, store closings and severance, as well as a gain on sale of assets of \$21 million. Our operating income for the second quarter of 2010 included expenses of \$37 million related to domestic pension plans and store closings and severance.

*Interest Expense*

We incurred \$77 million and \$69 million in interest expense during the second quarter of 2011 and 2010, respectively. The increase is due to higher average outstanding borrowings as a result of our \$1.25 billion senior secured notes offering in October 2010, partially offset by repayment of debt by Sears Domestic and Sears Canada.

*Other Income*

Other income is primarily comprised of mark-to-market and settlement gains on Sears Canada hedge transactions (see Notes 3 and 4 to the Condensed Consolidated Financial Statements for further information regarding these transactions). Total net mark-to-market and settlement gains of \$5 million were recorded on these transactions in the second quarter of both 2011 and 2010.

***26-week period ended July 30, 2011 compared to the 26-week period ended July 31, 2010***

*Total Revenues and Comparable Store Sales*

For the first half of 2011, total revenues decreased \$466 million, or 2.3%, to \$20.0 billion, as compared to total revenues of \$20.5 billion for the first half of 2010. The decline in total revenue for the first half was primarily a result of a 2.1% decrease in domestic comparable store sales and the effect of having fewer Kmart and Sears Full-line stores in operation, in addition to a 7.4% decline in comparable store sales at Sears Canada, partially offset by an increase of \$139 million due to changes in the Canadian foreign exchange rate.

The domestic comparable store sales decrease includes a decrease at Sears Domestic of 3.2% and a decrease at Kmart of 0.8%. Decreases in sales for the first half of 2011 at Sears Domestic were primarily driven by decreases in the appliances, consumer electronics and apparel categories. The Kmart decrease in comparable store sales was primarily driven by decreases in the pharmacy, lawn and garden and apparel categories.

*Gross Margin*

For the first half of the year, we generated gross margin of \$5.3 billion in 2011 and \$5.7 billion last year. The total decline in gross margin dollars of \$387 million was primarily driven by decreases in gross margin rate and included an increase of \$42 million related to the impact of foreign currency exchange rates on gross margin at Sears Canada and a \$23 million and \$2 million charge for markdowns recorded in connection with store closings announced during the first half of 2011 and 2010, respectively.

Sears Domestic's gross margin rate declined 160 basis points mainly due to reduced margins in the home appliance category, driven primarily by increased promotional activity, including the use of instant free delivery, increased promotional markdowns in apparel and declines in home services. Kmart's gross margin rate declined 80 basis points mainly due to increased promotional and clearance markdowns in apparel and home, as well as declines in other categories. Sears Canada's gross margin rate declined 100 basis points mainly due to increased promotional markdowns.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

*Selling and Administrative Expenses*

For the first half of 2011, our selling and administrative expenses increased \$42 million as compared to the first half in 2010. Selling and administrative expenses at Sears Canada increased \$91 million from last year, and included an increase of \$37 million related to the impact of foreign currency exchange rates. On a Canadian dollar basis, selling and administrative expenses increased by \$54 million primarily due to increased investment in strategic projects, partially offset by reductions in payroll and advertising expenses. This increase was partially offset by reductions at Sears Domestic.

Selling and administrative expenses for 2011 include domestic pension plan expense of \$37 million and store closing costs and severance of \$19 million. Selling and administrative expenses for 2010 were impacted by domestic pension plan expense of \$57 million and store closing costs and severance of \$7 million.

Our selling and administrative expense rate was 26.0% for the first half of 2011, as compared to 25.2% for the first half of 2010, and increased primarily as a result of the above noted increase in selling and administrative expenses at Sears Canada, as well as the decline in revenues.

*Gain on Sales of Assets*

We recorded total gains on sales of assets for the first half of \$31 million in 2011 and \$53 million in 2010. Gains on sales of assets for the first half in 2011 included a gain of \$21 million recognized on the sale of two stores in California operated under The Great Indoors format. Gains on sales of assets for the first half in 2010 included the recognition of a previously deferred gain on sales of assets. We sold a Sears Auto Center in October 2006, at which time we leased back the property for a period of time. Given the terms of the contract, for accounting purposes, the excess of proceeds received over the carrying value of the associated property was deferred. We closed our operations at this location during the first quarter of 2010 and, as a result, recognized a gain of \$35 million on this sale at that time.

*Operating Income/Loss*

We reported an operating loss for the first half of \$351 million in 2011 and operating income for the first half of \$103 million in 2010. The decline in operating income of \$454 million was primarily the result of a decline in our gross margin dollars, given lower overall sales and a decline in our gross margin rate of 130 basis points. Holdings' operating loss for the first half of 2011 includes above-noted expenses of \$87 million related to domestic pension plans and store closings and severance, as well as a gain on sale of assets of \$21 million. Our operating income for the first half of 2010 includes above-noted expenses of \$66 million related to domestic pension plans and store closings and severance, as well as a gain on sale of assets of \$35 million.

*Interest Expense*

We incurred \$157 million and \$136 million in interest expense during the first half of 2011 and 2010, respectively. The increase is due to higher average outstanding borrowing as a result of our \$1.25 billion senior secured notes offering in October 2010, partially offset by repayment of debt by Sears Domestic and Sears Canada.

*Other Loss*

Other loss is primarily comprised of mark-to-market and settlement losses on Sears Canada hedge transactions (see Notes 3 and 4 to the Condensed Consolidated Financial Statements for further information regarding these transactions). Total net mark-to-market and settlement losses of \$7 million and \$9 million were recorded on these transactions in the first half of 2011 and 2010, respectively.

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010***Income Tax Benefit*

Our effective tax benefit rate for the first half was a benefit of 35.2% in 2011 and a benefit of 19.0% in 2010. The increase in our tax benefit rate was primarily due to the increase in our loss before income taxes in 2011.

**SEGMENT OPERATIONS**

The following discussion of our business segment results is organized into three reportable segments: Kmart, Sears Domestic and Sears Canada.

**Kmart**

Kmart results and key statistics were as follows:

<i>millions, except number of stores</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
Merchandise sales and services	\$ 3,624	\$ 3,630	\$ 7,103	\$ 7,213
Cost of sales, buying and occupancy	2,799	2,746	5,433	5,457
Gross margin dollars	825	884	1,670	1,756
Gross margin rate	22.8%	24.4%	23.5%	24.3%
Selling and administrative	809	830	1,598	1,612
Selling and administrative expense as a percentage of total revenues	22.3%	22.9%	22.5%	22.3%
Depreciation and amortization	37	36	74	72
Gain on sales of assets	(5)	(1)	(7)	(6)
Total costs and expenses	3,640	3,611	7,098	7,135
Operating income (loss)	\$ (16)	\$ 19	\$ 5	\$ 78
Adjusted EBITDA	\$ 26	\$ 57	\$ 82	\$ 148
Number of stores			1,304	1,309

**13-week period ended July 30, 2011 compared to the 13-week period ended July 31, 2010***Total Revenues and Comparable Store Sales*

For the quarter, Kmart's total sales decreased by \$6 million, while comparable store sales were flat. The decline in revenue was primarily due to the impact of Kmart having fewer stores in operation during the second quarter of 2011. Comparable store sales included increases in several categories, such as outdoor living, grocery and household, tools, appliances and footwear, which were offset by decreases in the consumer electronics, pharmacy and drug categories.

*Gross Margin*

For the quarter, Kmart generated \$825 million in gross margin in 2011 and \$884 million in 2010. The decrease in gross margin dollars of \$59 million was primarily driven by a decline in the gross margin rate during the second quarter of 2011 and included charges of \$7 million for markdowns recorded in connection with store closings announced during the second quarter of 2011. No store closings were announced during the second quarter of 2010.

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

Kmart's gross margin rate for the quarter was 22.8% in 2011 and 24.4% in 2010. The decline of 160 basis points was mainly due to increased promotional and clearance markdowns in apparel and home, as well as declines in other categories.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

*Selling and Administrative Expenses*

For the quarter, Kmart's selling and administrative expenses decreased \$21 million as compared to the second quarter in 2010, due primarily to reductions in advertising and insurance expenses. Selling and administrative expenses included store closing costs and severance of \$3 million in both 2011 and 2010.

Kmart's selling and administrative expense rate for the quarter was 22.3% in 2011 and 22.9% in 2010.

*Operating Income/Loss*

For the quarter, Kmart recorded an operating loss of \$16 million in 2011 and operating income of \$19 million in 2010. The decrease in Kmart's operating income was primarily the result of a decline in gross margin dollars, driven by a decline in the gross margin rate and revenues, partially offset by a decrease in selling and administrative expenses. Kmart's operating income for the second quarter included expenses related to store closing costs and severance of \$10 million in 2011 and \$3 million in 2010.

***26-week period ended July 30, 2011 compared to the 26-week period ended July 31, 2010***

*Total Revenues and Comparable Store Sales*

For the first half of 2011, Kmart's total sales decreased by \$110 million, while comparable store sales decreased 0.8%. The decline in revenue was also due to the impact of Kmart having fewer stores in operation during the first half of 2011. The decrease in comparable store sales was primarily driven by decreases in the pharmacy, lawn and garden and apparel categories.

*Gross Margin*

For the first half of the year, Kmart generated \$1.7 billion in gross margin in 2011 and \$1.8 billion in 2010. The \$86 million decrease was primarily due to a decline in the gross margin rate during the first half of 2011 and included charges of \$7 million and \$1 million for markdowns recorded in connection with store closings announced during the first half of 2011 and 2010, respectively.

Kmart's gross margin rate for the first half of the year was 23.5% in 2011 and 24.3% in 2010. The decline of 80 basis points was mainly due to increased promotional and clearance markdowns in apparel and home, as well as declines in other categories.

*Selling and Administrative Expenses*

For the first half of the year, Kmart's selling and administrative expenses decreased \$14 million as compared to the first half in 2010. Selling and administrative expenses were impacted by store closing costs and severance of \$3 million in both 2011 and 2010. The decrease primarily reflects a reduction in insurance expense of \$14 million and a decrease in advertising expense of \$8 million, as well as declines in a number of other expense categories, partially offset by an increase in payroll and benefits expense of \$16 million.

Kmart's selling and administrative expense rate for the first half of the year was 22.5% in 2011 and 22.3% in 2010, and increased in 2011 primarily as a result of Kmart's decline in revenues.

*Operating Income*

For the first half of 2011, Kmart recorded operating income of \$5 million, as compared to operating income of \$78 million for the first half of 2010. The decrease in Kmart's operating income was primarily the result of a





**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

decline in gross margin dollars, driven by the decline in the gross margin rate and revenues, partially offset by a decrease in selling and administrative expenses. Kmart's operating income for the first half includes expenses related to store closing costs and severance of \$10 million in 2011 and \$4 million in 2010.

**Sears Domestic**

Sears Domestic results and key statistics were as follows:

<i>millions, except number of stores</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
Merchandise sales and services	\$ 5,534	\$ 5,674	\$ 10,746	\$ 11,109
Cost of sales, buying and occupancy	4,048	4,084	7,792	7,873
Gross margin dollars	1,486	1,590	2,954	3,236
<i>Gross margin rate</i>	26.9%	28.0%	27.5%	29.1%
Selling and administrative	1,509	1,503	2,976	3,011
<i>Selling and administrative expense as a percentage of total revenues</i>	27.3%	26.5%	27.7%	27.1%
Depreciation and amortization	164	160	320	320
Gain on sales of assets	(24)	(8)	(24)	(47)
Total costs and expenses	5,697	5,739	11,064	11,157
Operating loss	\$ (163)	\$ (65)	\$ (318)	\$ (48)
Adjusted EBITDA	\$ 25	\$ 121	\$ 47	\$ 287
Number of :				
Full-line Stores <sup>(1)</sup>			884	897
Specialty Stores			1,370	1,335
Total Domestic Sears Stores			2,254	2,232

<sup>(1)</sup> The period ended July 30, 2011 includes 837 Full-line stores and 47 Sears Essentials/Grand stores; The period ended July 31, 2010 includes 842 Full-line stores and 55 Sears Essentials/Grand stores

**13-week period ended July 30, 2011 compared to the 13-week period ended July 31, 2010***Total Revenues and Comparable Store Sales*

For the quarter, Sears Domestic's total sales decreased by \$140 million, while comparable store sales decreased 1.2%. The decline in revenue is mainly due to a decline in comparable store sales and the impact of having fewer Sears Full-line stores in operation. The decrease in comparable store sales was primarily driven by the consumer electronics category.

*Gross Margin*

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

For the quarter, Sears Domestic generated gross margin dollars of \$1.5 billion in 2011 and \$1.6 billion in 2010. The decrease of \$104 million was mainly a result of a decline in the gross margin rate during the second quarter of 2011 and included charges of \$15 million for markdowns recorded in connection with store closings announced during the second quarter of 2011. No store closings were announced during the second quarter of 2010.

Sears Domestic's gross margin rate during the second quarter was 26.9% in 2011 and 28.0% in 2010. The decline of 110 basis points was mainly due to reduced margins in the home appliance category, driven primarily by increased promotional activity, including the use of instant free delivery, increased promotional markdowns in apparel and declines in home services.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

*Selling and Administrative Expenses*

For the quarter, Sears Domestic's selling and administrative expenses increased \$6 million. The increase is mainly due to increases of \$19 million in payroll and benefit expenses, \$14 million in Home Services selling and administrative expenses, \$9 million in insurance expenses and \$9 million in other expense categories, partially offset by a decline of \$43 million in advertising expenses. Selling and administrative expenses for the second quarter of 2011 were also impacted by domestic pension plan expense of \$18 million and store closing costs and severance of \$15 million. Selling and administrative expenses for the second quarter of 2010 were also impacted by domestic pension plan expense of \$31 million and store closing costs and severance of \$3 million.

Sears Domestic's selling and administrative expense rate for the quarter was 27.3% in 2011 and 26.5% in 2010, and increased primarily due to the above noted declines in sales.

*Operating Loss*

For the quarter, Sears Domestic reported an operating loss of \$163 million in 2011 and \$65 million in 2010. Sears Domestic's operating loss increased primarily as a result of lower gross margin dollars, driven by a decline in gross margin rate and revenues, and an increase in selling and administrative expenses. Sears Domestic's operating loss for the second quarter included expenses related to domestic pension plans and store closing costs and severance of \$56 million in 2011 and \$34 million in 2010.

***26-week period ended July 30, 2011 compared to the 26-week period ended July 31, 2010***

*Total Revenues and Comparable Store Sales*

For the first half of the year, Sears Domestic's total sales decreased by \$363 million to \$10.7 billion, while comparable store sales decreased 3.2%. The decline in revenue is mainly due to the decrease in comparable store sales, as well as the impact of having fewer Sears Full-line stores in operation. The decrease in comparable store sales was primarily driven by decreases in the appliances, consumer electronics and apparel categories.

*Gross Margin*

For the first half of the year, Sears Domestic generated \$3.0 billion in gross margin dollars in 2011 and \$3.2 billion in 2010. The decrease of \$282 million was mainly a result of a decline in Sears Domestic's gross margin rate during the first half of 2011 and included charges of \$16 million taken to markdown inventory in connection with store closings. Gross margin for the first half of fiscal 2010 included a \$1 million charge for markdowns recorded in connection with store closings.

Sears Domestic's gross margin rate during the first half of the year was 27.5% in 2011 and 29.1% in 2010. The decline of 160 basis points was mainly due to reduced margins in the home appliance category, driven primarily by increased promotional activity, including the use of instant free delivery, increased promotional markdowns in apparel and declines in home services.

*Selling and Administrative Expenses*

For the first half of the year, Sears Domestic's selling and administrative expenses decreased \$35 million. The decrease is mainly due to a decline of \$59 million in advertising expenses and \$7 million in payroll expenses, partially offset by a \$29 million increase in Home Services selling and administrative expenses. Selling and administrative expenses included domestic pension plan expense of \$37 million in 2011 and \$57 million in 2010 and store closing costs and severance of \$16 million in 2011 and \$4 million in 2010.

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

Sears Domestic's selling and administrative expense rate for the first half was 27.7% in 2011 and 27.1% in 2010, and increased primarily due to the above noted declines in sales.

*Gain on Sales of Assets*

Sears Domestic recorded total gains on sales of assets for the first half of the year of \$24 million in 2011 and \$47 million in 2010. The gains on sales of assets in 2011 include a gain of \$21 million recognized on the sale of two stores in California operated under The Great Indoors format. The gains on sales of assets in 2010 is due to the recognition of a previously deferred gain from the October 2006 sale of one of our Sears Auto Centers. At the time of the sale, we leased back the property for a period of time. Given the terms of the contract, for accounting purposes, the excess of proceeds received over the carrying value of the associated property was deferred. We closed our operations at this location during the first quarter of 2010 and, as a result, recognized a gain of \$35 million on this sale at that time.

*Operating Loss*

For the first half of the year, Sears Domestic reported an operating loss of \$318 million in 2011 and \$48 million in 2010. The increase in Sears Domestic's operating loss was primarily the result of lower gross margin dollars, driven by a decline in gross margin rate and revenues, partially offset by a reduction in selling and administrative expenses. Sears Domestic's operating loss for the first half includes expenses related to domestic pension plans and store closing costs and severance of \$77 million in 2011 and \$62 million in 2010.

**Sears Canada**

Sears Canada, a consolidated, 94%-owned subsidiary of Sears, conducts similar retail operations as Sears Domestic. Sears Canada results and key statistics were as follows:

<i>millions, except number of stores</i>	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>July 30, 2011</b>	<b>July 31, 2010</b>
Merchandise sales and services	\$ 1,175	\$ 1,154	\$ 2,189	\$ 2,182
Cost of sales, buying and occupancy	821	805	1,547	1,521
Gross margin dollars	354	349	642	661
<i>Gross margin rate</i>	<i>30.1%</i>	<i>30.2%</i>	<i>29.3%</i>	<i>30.3%</i>
Selling and administrative	326	273	629	538
<i>Selling and administrative expense as a percentage of total revenues</i>	<i>27.7%</i>	<i>23.7%</i>	<i>28.7%</i>	<i>24.7%</i>
Depreciation and amortization	26	25	51	50
Total costs and expenses	1,173	1,103	2,227	2,109
Operating income (loss)	\$ 2	\$ 51	\$ (38)	\$ 73
Adjusted EBITDA	\$ 28	\$ 76	\$ 13	\$ 123
Number of :				
Full-line Stores			122	122
Specialty Stores			373	316
Total Sears Canada Stores			495	438



**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

***13-week period ended July 30, 2011 compared to the 13-week period ended July 31, 2010***

*Total Revenues*

Sears Canada's total revenues increased \$21 million for the second quarter of 2011, as compared to the same period last year and included an \$86 million increase due to the impact of exchange rates during the quarter. On a Canadian dollar basis, revenues decreased by \$65 million, due to a 5.8% decline in comparable store sales driven by weaker consumer spending in Canada and aggressive competition, the effects of the strong Canadian dollar motivating consumers to cross-border shop and higher cost of staples such as fuel and food, which have cut into Canadian discretionary income.

*Gross Margin*

Total gross margin dollars for the second quarter increased \$5 million in 2011 and includes a \$26 million increase due to the impact of exchange rates during the quarter. Gross margin decreased \$21 million on a Canadian dollar basis as a result of a decline in revenues, due mainly to industry wide price compression as well as increased promotional and clearance activity to drive sales in the challenging retail environment. For the quarter, Sears Canada's gross margin rate declined 10 basis points to 30.1%, from 30.2% in 2010.

*Selling and Administrative Expenses*

For the second quarter of 2011, Sears Canada's selling and administrative expenses increased \$53 million, including an increase of \$22 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses increased by \$31 million primarily due to increased investment in strategic projects, partially offset by reductions in payroll and advertising expenses.

Sears Canada's selling and administrative expense rate for the quarter was 27.7% in 2011 and 23.7% in 2010, and increased primarily due to the above noted increase in expenses.

*Operating Income*

Sears Canada recorded operating income of \$2 million in 2011 and \$51 million in 2010. The \$49 million decline in operating income primarily reflects the above noted declines, on a Canadian dollar basis, in sales and gross margin, and the increase in selling and administrative expenses.

***26-week period ended July 30, 2011 compared to the 26-week period ended July 31, 2010***

*Total Revenues*

Sears Canada's total revenues increased \$7 million for the first half of 2011, as compared to the same period last year and included a \$139 million increase due to the impact of exchange rates during the first half of 2011. On a Canadian dollar basis, revenues decreased by \$132 million, due to a 7.4% decline in comparable store sales driven by weaker consumer spending in Canada and aggressive competition, the effects of the strong Canadian dollar motivating consumers to cross-border shop and higher cost of staples such as fuel and food, which have cut into Canadian discretionary income.

*Gross Margin*

Total gross margin dollars for the first half of 2011 decreased \$19 million and include a \$42 million increase due to the impact of exchange rates during this period. Gross margin decreased \$61 million on a Canadian dollar basis primarily as a result of a decline in revenues due mainly to industry wide price compression as well as



**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

increased promotional and clearance activity to drive sales in the challenging retail environment. For the first half of 2011, Sears Canada's gross margin rate decreased 100 basis points to 29.3%, from 30.3% in 2010 mainly due to increased promotional markdowns.

*Selling and Administrative Expenses*

For the first half of 2011, Sears Canada's selling and administrative expenses increased \$91 million, and include an increase of \$37 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses increased by \$54 million primarily due to increased investment in strategic projects, partially offset by reductions in payroll and advertising expenses.

Sears Canada's selling and administrative expense rate for the first half of the year was 28.7% in 2011 and 24.7% in 2010, and increased primarily due to the above noted increase in expenses.

*Operating Income/Loss*

Sears Canada recorded an operating loss of \$38 million in 2011 and operating income of \$73 million in 2010. The \$111 million decrease in operating income primarily reflects the above noted declines, on a Canadian dollar basis, in sales, gross margin, and the increase in selling and administrative expenses.

**ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION****Cash Balances**

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. Our cash balances as of July 30, 2011, July 31, 2010 and January 29, 2011 are detailed in the following table.

<i>millions</i>	<b>July 30, 2011</b>	<b>July 31, 2010</b>	<b>January 29, 2011</b>
<b><i>Domestic</i></b>			
Cash and equivalents	\$ 250	\$ 305	\$ 465
Cash posted as collateral	21	10	325
Credit card deposits in transit	206	187	169
<b>Total domestic cash and cash equivalents</b>	<b>477</b>	<b>502</b>	<b>959</b>
Sears Canada	181	691	416
<b>Total cash and cash equivalents</b>	<b>658</b>	<b>1,193</b>	<b>1,375</b>
Restricted cash	21	6	15
<b>Total cash balances</b>	<b>\$ 679</b>	<b>\$ 1,199</b>	<b>\$ 1,390</b>

We had total cash balances of \$679 million at July 30, 2011, \$1.2 billion at July 31, 2010 and \$1.4 billion at January 29, 2011. Primary uses of cash during the first half of 2011 include \$199 million for capital expenditures, \$154 million for share repurchases, contributions to our pension and post-retirement benefit plans of \$143 million, and working capital increases. These uses of cash were funded in part by an increase in short-term borrowings of \$567 million reduced by long-term debt repayments of \$497 million.



## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

At various times, we have posted cash collateral for certain outstanding letters of credit and self-insurance programs. Such cash collateral is classified within cash and cash equivalents given we have the ability to substitute letters of credit at any time for this cash collateral and it is therefore readily available to us.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

Credit card deposits in transit include deposits in-transit from banks for payments related to third-party credit card and debit card transactions.

Restricted cash consists of cash related to Sears Canada's balances, which have been pledged as collateral for letters of credit obligations issued under its offshore merchandise purchasing program and with counterparties related to outstanding derivative contracts, as well as funds held in trust in accordance with regulatory requirements governing advance ticket sales related to Sears Canada's travel business.

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash balances when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit were \$100 million, \$91 million and \$122 million as of July 30, 2011, July 31, 2010 and January 29, 2011, respectively.

**Operating Activities**

During the first half of 2011, Holdings used \$467 million of cash in its operations compared to \$190 million used in the first half of 2010. Our primary source of operating cash flows is the sale of goods and services to customers, while the primary use of cash in operations is the purchase of merchandise inventories. We used more cash in operations in the first half of 2011 than the first half last year mainly as a result of an increase in our net loss and an increase in contributions to our pension and post-retirement benefit plans.

Merchandise inventories were \$9.4 billion at both July 30, 2011 and July 31, 2010. Merchandise payables were \$3.3 billion at July 30, 2011 and \$3.7 billion as of July 31, 2010. Our Domestic inventory balances decreased approximately \$75 million from \$8.6 billion at July 31, 2010. The decrease was primarily at Sears Domestic and was due to decreases in the consumer electronics, appliances and home categories. These decreases were partially offset by increased apparel inventory at both Lands' End and Kmart. Sears Canada's inventory levels increased approximately \$70 million from July 31, 2010 to \$872 million at July 30, 2011 primarily due to the change in exchange rates.

**Investing Activities**

For the first half of 2011, we used \$199 million of cash for capital expenditures compared to \$168 million used during the first half of 2010. For the first half of 2011, we also used \$5 million of cash as a result of changes in restricted cash requirements at Sears Canada compared to cash received of \$9 million in the first half of 2010. These uses of cash were partially offset by proceeds from the sales of property of \$42 million in the first half of 2011 compared to \$16 million during the first half of 2010.

**Financing Activities**

During the 26-week period ended July 30, 2011, we repurchased 2.0 million of our common shares at a total cost of \$154 million under our share repurchase program. At July 30, 2011, we had \$533 million of remaining authorization under our common share repurchase program. The share repurchase program, authorized by our Board of Directors, has no stated expiration date and share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods. During the 26-week period ended July 31, 2010, we repurchased 3.6 million of our common shares at a total cost of \$273 million under our share repurchase program. We have repurchased approximately 57.7 million of our common shares at a total cost of \$6.0 billion since the third quarter of 2005, when Holdings' repurchase plan was first approved.

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

During the first quarter of 2010, we increased our controlling interest in Sears Canada to 90%, from 73%, by acquiring approximately 19 million common shares. We paid a total of \$560 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with accounting standards on noncontrolling interests.

During the first quarter of 2010, Sears Canada announced that its Board of Directors declared a cash dividend of \$3.50 Canadian per common share, or approximately \$377 million Canadian. The dividend was paid during the second quarter of 2010 to shareholders of record at the close of business on May 31, 2010. Accordingly, Sears Canada paid \$34 million to minority shareholders during the second quarter of 2010 in connection with the dividend.

During the first half of 2011, short-term borrowings increased by \$567 million, while long-term debt decreased by \$497 million. During the first half of 2010, we made repayments on long-term debt of \$228 million. We borrowed \$703 million under our Original Domestic Credit Agreement during the first half of 2010 to meet seasonal working capital needs while, at the same time, continuing to invest in our businesses, repurchase our stock, make payments on our term debt and complete our acquisition of additional noncontrolling interest in Sears Canada.

Our outstanding borrowings as of July 30, 2011, July 31, 2010 and January 29, 2011 were as follows:

<i>millions</i>	July 30, 2011	July 31, 2010	January 29, 2011
Short-term borrowings:			
Unsecured commercial paper	\$ 388	\$ 396	\$ 360
Secured borrowings	539	822	
Long-term debt, including current portion:			
Notes and debentures outstanding	2,151	1,352	2,575
Capitalized lease obligations	561	616	597
Total borrowings	\$ 3,639	\$ 3,186	\$ 3,532

**Liquidity**

Our primary need for liquidity is to fund working capital requirements of our businesses, capital expenditures and general corporate purposes, including debt repayment, pension plan contributions and common share repurchases. We believe that these needs will be adequately funded by our operating cash flows, credit terms received from vendors and borrowings under our credit agreements (described below). See our Annual Report on Form 10-K for the fiscal year ended January 29, 2011 for additional information regarding our sources of liquidity.

*Debt Ratings*

Our corporate family debt ratings at July 30, 2011 appear in the table below:

	Moody's Investors Service	Standard & Poor's Ratings Services	Fitch Ratings
<i>Unsecured Commercial Paper</i>	Ba3	B+	B

We borrow through the commercial paper markets. At July 30, 2011, we had outstanding commercial paper borrowings of \$388 million, of which \$240 million were held by ESL Investments, Inc. (together with its



**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

affiliated funds, (ESL), including \$120 million held by ESL for the benefit of Edward S. Lampert. See Note 14 for further discussion of these borrowings.

*Domestic Credit Agreement*

During the first quarter of 2011, we increased the borrowing capacity and extended the maturity date of our domestic credit agreement (the Original Domestic Credit Agreement) by entering into an amended credit agreement (the Amended Domestic Credit Agreement). The Amended Domestic Credit Agreement increased the borrowing capacity of the facility to \$3.275 billion from \$2.4 billion and extended its expiration date to April 2016 from June 2012.

The Amended Domestic Credit Agreement also revised certain terms of the credit facility. Advances continue to bear interest at a rate equal to, at the election of the Borrowers, either the London Interbank Offered Rate (LIBOR) or a base rate, in either case plus an applicable margin. The amended facility's interest rates for LIBOR-based borrowings vary based on leverage in the range of LIBOR plus 2.0% to 2.5%, compared to LIBOR plus 4.0% with a 1.75% LIBOR floor under the Original Domestic Credit Agreement. Interest rates for base rate-based borrowings vary based on leverage in the range of the applicable base rate plus 1.0% to 1.5%, compared to the applicable base rate plus 3.0% under the Original Domestic Credit Agreement. Commitment fees have also been reduced to a range of 0.375% to 0.625% based on usage from the previous range of 0.75% to 1.00%.

The Amended Domestic Credit Agreement continues to include a \$1.5 billion letter of credit sub-limit and an accordion feature that gives us the flexibility, subject to certain terms and conditions, to use the existing collateral under the credit facility to obtain an aggregate amount of up to \$1.0 billion in additional borrowing capacity if we so choose. The Amended Domestic Credit Agreement is in place as a funding source for general corporate purposes and is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. (SRAC) and Kmart Corporation are the borrowers. The Amended Domestic Credit Agreement is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and determines availability pursuant to a borrowing base formula.

The Amended Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

At July 30, 2011, we had \$539 million of borrowings and \$550 million of letters of credit outstanding under the Amended Domestic Credit Agreement. As a result, our availability under the agreement was \$2.2 billion at July 30, 2011. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

*Senior Secured Notes*

In October 2010, we sold \$1 billion aggregate principal amount of senior secured notes (the Notes), which bear interest at 6 5/8% per annum and mature on October 15, 2018. Concurrent with the closing of the sale of the Notes, the Company sold \$250 million aggregate principal amount of Notes to the Company's domestic pension plan in a private placement. The Notes are guaranteed by certain subsidiaries of the Company and are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables (the Collateral). The lien that secures the Notes is junior in priority to the lien on such assets that secures obligations under the Amended Domestic Credit Agreement, as well as certain other first priority lien obligations. The Company used the net proceeds of this offering to repay borrowings outstanding under the Original Domestic Credit Agreement on the settlement date and to fund the working capital requirements of our

---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

retail businesses, capital expenditures and for general corporate purposes. The indenture under which the Notes were issued contains restrictive covenants that, among other things, (1) limit the ability of the Company and certain of its domestic subsidiaries to create liens and enter into sale and leaseback transactions and (2) limit the ability of the Company to consolidate with or merge into, or sell other than for cash or lease all or substantially all of its assets to, another person. The indenture also provides for certain events of default, which, if any were to occur, would permit or require the principal and accrued and unpaid interest on all the then outstanding notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Notes at a purchase price equal to 101% of the principal amount if the borrowing base (as calculated pursuant to the indenture) falls below the principal value of the notes plus any other indebtedness for borrowed money that is secured by liens on the Collateral for two consecutive quarters or upon the occurrence of certain change of control triggering events. The Company may call the Notes at a premium based on the Treasury Rate as defined in the indenture, plus 50 basis points. We have commenced an offer to exchange the Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

*Sears Canada Credit Agreement*

In September 2010, Sears Canada entered into a five-year, \$800 million Canadian senior secured revolving credit facility (the Sears Canada Facility). The Sears Canada Facility is available for Sears Canada's general corporate purposes and is secured by a first lien on substantially all of Sears Canada's non-real estate assets. Availability under the Sears Canada Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. At July 30, 2011, we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$693 million (\$662 million Canadian) at July 30, 2011.

*Letters of Credit Facility*

On January 20, 2011, we and certain of our subsidiaries entered into a letter of credit facility (the LC Facility) with Wells Fargo Bank, National Association (Wells Fargo), pursuant to which Wells Fargo may, on a discretionary basis and with no commitment, agree to issue standby letters of credit upon our request in an aggregate amount not to exceed \$500 million for general corporate purposes. Any letters of credit issued under the LC Facility are secured by a first priority lien on cash placed on deposit at Wells Fargo pursuant to a pledge and security agreement in an amount equal to 103% of the face value of all issued and outstanding letters of credit. The LC Facility has a term ending on January 20, 2014, unless terminated sooner pursuant to its terms. Wells Fargo may, in its sole discretion, terminate the LC Facility at any time. On July 30, 2011, we had no letters of credit outstanding under the facility. We may replace any letters of credit issued under our LC Facility with letters of credit issued under the Amended Domestic Credit Agreement and as such, any cash collateral is considered unrestricted cash.

*Domestic Pension Plan Funding*

In our Annual Report on Form 10-K for the fiscal year ended January 29, 2011, we disclosed that we expected our contributions to our domestic pension plans to increase to approximately \$340 million in 2011 and then to \$320 million in 2012, though the ultimate amount of pension contributions could be affected by further changes in the applicable regulations and financial market and investment performance.

**Critical Accounting Policies**

Our critical accounting policies are described in our Annual Report on Form 10-K for the fiscal year ended January 29, 2011 as supplemented by the following paragraph.

---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

*Goodwill*

The Company performs its annual goodwill impairment tests as of November 30, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. As part of its interim review for indicators of impairment, management analyzed potential changes in value of individual reporting units based on each reporting unit's operating results for the six months ended July 30, 2011 compared to expected results as of November 30, 2010. In addition, management considered how other key assumptions, including discount rates and expected long-term growth rates, used in last year's impairment analysis, could be impacted by changes in market conditions, economic events and reporting unit operating results. Based on this interim assessment, management concluded that as of July 30, 2011, no events or changes in circumstances indicated that it was more likely than not that the fair value for any reporting unit had declined below its carrying value. Significant changes in global economic conditions and reporting unit operating results could result in changes to expectations of future financial results and key valuation assumptions. These changes could result in revisions of management's estimates of the fair value of the Company's reporting units and could result in a review for impairment of goodwill prior to November 30, 2011, the Company's next annual measurement date. Any required interim impairment reviews could result in a material goodwill impairment charge.

**Recent Accounting Pronouncements**

See Part I, Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements, Note 13 Recent Accounting Pronouncements, for information regarding new accounting pronouncements.

***CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION***

Certain statements made in this Quarterly Report on Form 10-Q and in other public announcements by us contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Forward-looking statements include information concerning our future financial performance, business strategy, plans, goals and objectives. Statements preceded or followed by, or that otherwise include, the words believes, expects, anticipates, intends, estimates, plans, forecast, is likely to and similar expressions or future or conditional verbs such as will, could are generally forward-looking in nature and not historical facts. Such statements are based upon the current beliefs and expectations of Holdings management and are subject to significant risks and uncertainties. Actual results may differ materially from those set forth in the forward-looking statements.

The following factors, among others, could cause actual results to differ from those set forth in the forward-looking statements: our ability to offer merchandise and services that our customers want, including our proprietary brand products; our ability to successfully implement initiatives to improve inventory management and other capabilities; competitive conditions in the retail and related services industries; worldwide economic conditions and business uncertainty, including the impact of rising fuel prices, the availability of consumer and commercial credit, changes in consumer confidence, tastes, preferences and spending, and changes in vendor relationships, including the impact of increases in the cost of raw materials experienced by certain of our vendors; the impact of seasonal buying patterns, including seasonal fluctuations due to weather conditions, which are difficult to forecast with certainty; our dependence on sources outside the United States for significant amounts of our merchandise; our extensive reliance on computer systems to process transactions, summarize results and manage our business; our reliance on third parties to provide us with services in connection with the administration of certain aspects of our business; impairment charges for goodwill and intangible assets or fixed-asset impairment for long-lived assets; our ability to properly implement and realize the expected benefits from

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

our organizational structure and operating model; our ability to attract, motivate and retain key executives and other associates; the outcome of pending and/or future legal proceedings, including product liability claims and bankruptcy claims, including proceedings with respect to which the parties have reached a preliminary settlement; and the timing and amount of required pension plan funding.

Certain of these and other factors are discussed in more detail in our filings with the Securities and Exchange Commission and the Annual Report on Form 10-K of Sears Holdings Corporation for the fiscal year ended January 29, 2011, which may be accessed through the Commission's website at [www.sec.gov](http://www.sec.gov).

While we believe that our forecasts and assumptions are reasonable, we caution that actual results may differ materially. We intend the forward-looking statements to speak only as of the time made and do not undertake to update or revise them as more information becomes available.

*Item 3. Quantitative and Qualitative Disclosures about Market Risk*

We face market risk exposure in the form of interest rate risk and foreign currency risk. These market risks arise from our derivative financial instruments and debt obligations.

*Interest Rate Risk*

We manage interest rate risk through the use of fixed and variable-rate funding and interest rate derivatives. All debt securities and interest-rate derivative instruments are considered non-trading. At July 30, 2011, 33% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at July 30, 2011, which totaled approximately \$1 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by \$12 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

*Foreign Currency Risk*

At July 30, 2011, we had a foreign currency forward contract outstanding, totaling \$629 million Canadian notional value and with a weighted average remaining life of one year, designed to hedge our net investment in Sears Canada against adverse changes in exchange rates. The fair value of the forward contract at July 30, 2011 was negative \$9 million. A hypothetical 1% adverse movement in the level of the Canadian exchange rate relative to the U.S. dollar at July 30, 2011, with all other variables held constant, would have resulted in a fair value of this contract of approximately negative \$15 million at July 30, 2011, a decrease of \$6 million. Certain of our currency forward contracts require collateral be posted in the event our liability under such contracts reaches a predetermined threshold. Cash collateral posted under these contracts is recorded as part of our accounts receivable balance. We had \$12 million of cash collateral posted under our contract at July 30, 2011.

Sears Canada mitigates the risk of currency fluctuations on offshore merchandise purchases denominated in U.S. currency by purchasing U.S. dollar denominated collar contracts for a portion of its expected requirements. As of July 30, 2011, these contracts had a notional value of approximately \$181 million and a weighted average remaining life of 0.2 years. The aggregate fair value of the collar contracts at July 30, 2011 was negative \$10 million. A hypothetical 1% adverse movement in the level of the Canadian exchange rate relative to the U.S. dollar as of July 30, 2011, with all other variables held constant, would have resulted in a fair value for these contracts of approximately negative \$12 million as of July 30, 2011, a decrease of \$2 million.



**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended July 30, 2011 and July 31, 2010**

*Counterparties*

We actively manage the risk of nonpayment by our derivative counterparties by limiting our exposure to individual counterparties based on credit ratings, value at risk and maturities. The counterparties to these instruments are major financial institutions with credit ratings of single-A or better. In certain cases, counterparty risk is also managed through the use of collateral in the form of cash or U.S. government securities.

*Item 4. Controls and Procedures*

Our management, with the participation of our principal executive and financial officers, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report (the Evaluation Date). Based on this evaluation, the principal executive and financial officers concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

In addition, based on that evaluation, no changes in our internal control over financial reporting have occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****SEARS HOLDINGS CORPORATION****PART II. OTHER INFORMATION***Item 1. Legal Proceedings*

Item 103 of SEC Regulation S-K requires that we disclose legal proceedings to which the Company and a governmental authority is a party and that arise under laws dealing with the discharge of materials into the environment or the protection of the environment, if the proceeding reasonably involves potential monetary sanctions of \$100,000 or more. Disclosure also is required as to any such proceedings known by us to be contemplated by governmental authorities. In that connection, we note that our Orchard Supply Hardware subsidiary ( OSH ) has received a notice of violation from the California South Coast Air Quality Management District ( SCAQMD ) alleging that OSH stores that are located in the SCAQMD jurisdiction sold architectural coating products that exceed the current SCAQMD limitations on volatile organic compounds. The parties are currently negotiating toward a resolution of this matter.

See Part I, Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements, Note 12 Legal Proceedings, for additional information regarding legal proceedings, which information is incorporated herein by this reference.

*Item 2. Unregistered Sales of Equity Securities and Use of Proceeds*

The following table provides information about shares of common stock we acquired during the second quarter of 2011. During the 13 weeks ended July 30, 2011, we repurchased 0.8 million of our common shares at a total cost of \$53 million under our common share repurchase program. As of July 30, 2011, we had \$533 million of remaining authorization under the program.

	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program <sup>(2)</sup>	Average Price Paid per Share for Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
May 1, 2011 to May 28, 2011	243,104	\$ 70.87	239,793	\$ 70.66	
May 29, 2011 to July 2, 2011	537,058	67.83	533,980	67.80	
July 3, 2011 to July 30, 2011					
<b>Total</b>	<b>780,162</b>	<b>\$ 68.77</b>	<b>773,773</b>	<b>\$ 68.69</b>	<b>\$ 533,018,085</b>

<sup>(1)</sup> Includes 6,389 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock. These shares were acquired during the quarter as follows:

May 1, 2011 to May 28, 2011	3,311
May 29, 2011 to July 2, 2011	3,078
July 3, 2011 to July 30, 2011	
<b>Total</b>	<b>6,389</b>

<sup>(2)</sup>

## Edgar Filing: SEARS HOLDINGS CORP - Form 10-Q

Our common share repurchase program was initially announced on September 14, 2005 and has a total authorization since inception of the program of \$6.5 billion, including the authorizations to purchase up to an additional \$500 million of common stock on each of December 17, 2009 and May 2, 2011. The program has no stated expiration date.

The Amended Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, if availability under the credit facility, as defined, is less than 15%. It also imposes various

---

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

*Item 5. Other Information*

On August 16, 2011, the Board of Directors of Sears Holdings Corporation (the Company) appointed Robert A. Schriesheim as Executive Vice President, effective August 16, 2011, and Executive Vice President and Chief Financial Officer, effective August 22, 2011. William K. Phelan will continue to serve as the Company's acting Chief Financial Officer until August 22, 2011, and thereafter will remain with the Company as Senior Vice President, Controller and Chief Accounting Officer.

Mr. Schriesheim, age 51, has served as a member of a number of corporate boards after serving as the Chief Financial Officer of Hewitt Associates, Inc., a global human resources consulting and outsourcing company, from January 2010 to October 2010. From October 2006 to December 2009, he served as Executive Vice President and Chief Financial Officer of Lawson Software, Inc., an ERP software provider. From August 2002 to October 2006, he was affiliated with ARCH Development Partners, LLC, a seed stage venture capital fund. Before joining ARCH, Mr. Schriesheim held executive positions at Global TeleSystems, SBC Equity Partners, Ameritech, AC Nielsen and Brooke Group Ltd. Mr. Schriesheim has served as a director of Skyworks Solutions, Inc. since May 2006 and is chairman of its audit committee; and a director of Lawson Software, Inc. from May 2006 to July 2011. He also served as a director of Dobson Communications Corp. from 2004 to 2007, a director and Co-Chairman of MSC Software Corporation from 2007 to 2009 and a director of Georgia Gulf Corporation from 2009 to 2010.

Mr. Schriesheim will receive an annual base salary of \$800,000, with a sign-on bonus of \$350,000 (gross). He will be required to repay the Company the sign-on bonus if, within 24 months of his start date, he voluntarily terminates his employment with the Company (other than for Good Reason) or if he is terminated by the Company for Cause (each capitalized term as defined in his Executive Severance Agreement). He is eligible to participate in the Company's Annual Incentive Plan (AIP) with a target award of 150% of his base salary. His 2011 target incentive award, if payable, will be subject to pro-ration based on his start date. Mr. Schriesheim will be eligible to receive a special incentive award for fiscal year 2011 equal to the greater of (a) the actual incentive earned and payable under the 2011 AIP or (b) 100% of his prorated 2011 target incentive award; which special incentive award will be reduced by any amount payable to him under the 2011 AIP. To receive the special incentive award, Mr. Schriesheim must be actively employed at the payment date or be terminated by the Company (other than for Cause) after the last day of fiscal year 2011 and prior to the payment date. Mr. Schriesheim will be eligible to receive a special retention award for fiscal year 2012 equal to the greater of (a) the actual incentive earned and payable under the 2012 AIP or (b) 50% of his 2012 target incentive award; which special retention award will be reduced by any amount payable to him under the 2012 AIP. To receive the special retention award, Mr. Schriesheim must be actively employed at the payment date. In addition, on August 22, 2011, Mr. Schriesheim will receive a restricted stock award under the Company's 2006 Stock Plan valued at \$4,000,000, with one-third of the shares granted vesting on each of the first three anniversaries of the grant date. He will be eligible to receive an additional restricted stock award on each of August 16, 2012 and August 16, 2013, valued at \$500,000 each, each of which will vest in full on the second anniversary of the applicable grant date.

Mr. Schriesheim has entered into an Executive Severance Agreement with the Company, which provides, among other things, that if he is involuntarily terminated by the Company for any reason other than for Cause, death or Disability or he voluntarily terminates his employment for Good Reason (a) before completing 12 months of employment, he will be eligible for 12 months of salary continuation equal to his annual base salary rate or (b) after completing 12 months of employment, he will be eligible for 12 months of salary continuation equal to his annual base salary rate plus his target bonus amount. The Executive Severance Agreement also provides that

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

if he is terminated by the Company other than for Cause or he terminates his employment for Good Reason within 12 months of a Transfer of Shareholdings (as defined in the Executive Severance Agreement), he will vest on the termination date in any equity-based award that was scheduled to vest within 12 months of the termination date. The Executive Severance Agreement also includes customary non-compete, non-solicitation and non-disclosure covenants.

A copy of the letter from the Company to Mr. Schriesheim relating to employment dated August 15, 2011, and a copy of the Executive Severance Agreement between the Company and Mr. Schriesheim dated August 15, 2011, are attached hereto as Exhibit 10.2 and Exhibit 10.3, respectively, and are incorporated herein by this reference. The foregoing description of the terms of the letter and the Executive Severance Agreement is qualified in its entirety by reference to the full text of the letter and the Executive Severance Agreement.

On August 15, 2011, the Compensation Committee of the Board of Directors of the Company approved the grant of an incentive award to each of Mr. Phelan, Dane A. Drobny, Senior Vice President, General Counsel and Corporate Secretary, and William R. Harker, Senior Vice President, in the amount of \$400,000, \$651,000 and \$750,000, respectively. Each award will be granted on September 1, 2011 and consists of restricted stock issued under the Company's 2006 Stock Plan valued at 50% of the total award amount, and cash in the amount of 50% of the total award amount. Mr. Phelan's award vests 25% on each of the first and second anniversaries of the grant date and 50% on the third anniversary of the grant date, subject to employment with the Company on the vesting dates. The awards granted to Messrs. Drobny and Harker vest one-third on each of the first, second and third anniversaries of the grant date, subject to employment with the Company on the vesting dates. Also on August 15, 2011, the Compensation Committee approved an increase in Mr. Phelan's annual base salary to \$525,000.

*Item 6. Exhibits*

Certain of the agreements filed with or incorporated by reference into this report contain representations and warranties and other agreements and undertakings by us and third parties. These representations and warranties, agreements and undertakings have been made as of specific dates, may be subject to important qualifications and limitations agreed to by the parties to the agreement in connection with negotiating the terms of the agreement, and have been included in the agreement for the purpose of allocating risk between the parties to the agreement rather than to establish matters as facts. Any such representations and warranties, agreements, and undertakings have been made solely for the benefit of the parties to the agreement and should not be relied upon by any other person.

(a) Exhibits.

An Exhibit Index has been filed as part of this Report on Page E-1.

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SEARS HOLDINGS CORPORATION

(Registrant)

August 18, 2011

By

/s/ **WILLIAM K. PHELAN**  
**William K. Phelan**

**Senior Vice President, Acting Chief Financial**

**Officer and Controller**

**(Principal Accounting Officer and duly**

**authorized officer of Registrant)**

**Table of Contents**

**SEARS HOLDINGS CORPORATION**

**EXHIBIT INDEX**

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000- 51217)).
- 3.2 Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated December 2, 2009, filed on December 4, 2009 (File No. 000-51217)).
- \*10.1 Form of Sears Holdings Corporation Restricted Stock Award Agreement.
- \*10.2 Letter from Registrant to Robert A. Schriesheim relating to Employment dated August 15, 2011.
- \*10.3 Executive Severance Agreement, dated August 15, 2011, between Sears Holdings Corporation and its affiliates and subsidiaries and Robert A. Schriesheim.\*\*
- \*31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- \*\*\*101 The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 2011, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Statements of Operations (Unaudited) for the 13 and 26 Weeks Ended July 30, 2011 and July 31, 2010; (ii) the Condensed Consolidated Balance Sheets (Unaudited) as of July 30, 2011, July 31, 2010 and January 29, 2011; (iii) the Condensed Consolidated Statements of Cash Flows (Unaudited) for the 26 Weeks Ended July 30, 2011 and July 31, 2010; (iv) the Condensed Consolidated Statements of Equity (Unaudited) for the 26 Weeks Ended July 30, 2011 and July 31, 2010; and (v) the Notes to the Condensed Consolidated Financial Statements (Unaudited).

\* Filed herewith.

\*\* Portions of Exhibit 10.3 have been omitted pursuant to a request for confidential treatment. The omitted material has been filed separately with the Securities and Exchange Commission.

\*\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.