

SEARS HOLDINGS CORP  
Form 10-Q  
August 25, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended August 1, 2009**  
**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 ☐

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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 21, 2009, the registrant had 118,811,028 common shares, \$0.01 par value, outstanding.

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(Unaudited)

**PART I. FINANCIAL INFORMATION***Item 1. Financial Statements*

	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>August 1, 2009</b>	<b>August 2, 2008</b>
<i>millions, except per share data</i>				
<b>REVENUES</b>				
Merchandise sales and services	\$ 10,551	\$ 11,762	\$ 20,606	\$ 22,830
<b>COSTS AND EXPENSES</b>				
Cost of sales, buying and occupancy	7,756	8,640	14,938	16,685
Selling and administrative	2,630	2,694	5,203	5,509
Depreciation and amortization	228	247	454	495
Gain on sales of assets	(5)	(6)	(59)	(38)
Total costs and expenses	10,609	11,575	20,536	22,651
Operating income (loss)	(58)	187	70	179
Interest expense	(63)	(65)	(122)	(131)
Interest and investment income	14	20	19	31
Other loss	(31)	(1)	(47)	(2)
Income (loss) before income taxes	(138)	141	(80)	77
Income tax (expense) benefit	52	(56)	28	(28)
Net income (loss)	(86)	85	(52)	49
Income attributable to noncontrolling interest	(8)	(20)	(16)	(40)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	<b>\$ (94)</b>	<b>\$ 65</b>	<b>\$ (68)</b>	<b>\$ 9</b>
<b>EARNINGS (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>				
Basic and diluted earnings (loss) per share	\$ (0.79)	\$ 0.50	\$ (0.57)	\$ 0.07
Basic and diluted weighted average common shares outstanding	119.1	128.8	120.0	130.3
See accompanying notes.				

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

	(Unaudited)		
	August 1, 2009	August 2, 2008	January 31, 2009
<i>millions</i>			
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	\$ 1,189	\$ 1,534	\$ 1,173
Restricted cash	103		124
Accounts receivable	896	1,020	839
Merchandise inventories	9,377	9,754	8,795
Prepaid expenses and other current assets	390	468	458
Deferred income taxes	32	29	27
<b>Total current assets</b>	<b>11,987</b>	<b>12,805</b>	<b>11,416</b>
Property and equipment, net	7,867	8,568	8,091
Goodwill	1,392	1,660	1,392
Trade names and other intangible assets	3,244	3,322	3,283
Other assets	1,270	434	1,160
<b>TOTAL ASSETS</b>	<b>\$ 25,760</b>	<b>\$ 26,789</b>	<b>\$ 25,342</b>
<b>LIABILITIES</b>			
Current liabilities			
Short-term borrowings	\$ 1,015	\$ 974	\$ 442
Current portion of long-term debt and capitalized lease obligations	283	390	345
Merchandise payables	3,361	3,494	3,006
Accrued expenses and other current liabilities	3,088	3,340	3,226
Unearned revenues	1,029	1,106	1,069
Other taxes	468	569	424
<b>Total current liabilities</b>	<b>9,244</b>	<b>9,873</b>	<b>8,512</b>
Long-term debt and capitalized lease obligations	1,941	2,250	2,132
Pension and post-retirement benefits	2,045	1,135	2,057
Other long-term liabilities	2,883	3,008	2,942
<b>Total Liabilities</b>	<b>16,113</b>	<b>16,266</b>	<b>15,643</b>
<b>EQUITY</b>			
<b>Total Equity</b>	<b>9,647</b>	<b>10,523</b>	<b>9,699</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 25,760</b>	<b>\$ 26,789</b>	<b>\$ 25,342</b>

See accompanying notes.

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

(Unaudited)

	<b>26 Weeks Ended</b>	
	<b>August 1, 2009</b>	<b>August 2, 2008</b>
<i>millions</i>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (52)	\$ 49
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	454	495
Gain on sales of assets	(59)	(38)
Pension and post-retirement plan contributions	(96)	(135)
Settlement of Canadian dollar hedges		(64)
Change in operating assets and liabilities (net of acquisitions and dispositions):		
Deferred income taxes	32	(17)
Merchandise inventories	(486)	180
Merchandise payables	307	23
Income and other taxes	(98)	(138)
Mark-to-market adjustments on Sears Canada U.S. dollar option contracts	59	
Other operating assets	45	52
Other operating liabilities	(178)	(409)
Net cash used in operating activities	(72)	(2)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales of property	10	75
Decrease (increase) in investments and restricted cash	61	(13)
Purchases of property and equipment	(122)	(277)
Net cash used in investing activities	(51)	(215)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from debt issuances		5
Repayments of long-term debt	(302)	(184)
Increase in short-term borrowings, primarily 90 days or less	573	812
Debt issuance costs	(81)	
Additional purchase of noncontrolling interest	(7)	
Purchase of treasury stock	(134)	(477)
Net cash provided by financing activities	49	156
Effect of exchange rate changes on cash and cash equivalents	90	(27)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>16</b>	<b>(88)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>1,173</b>	<b>1,622</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 1,189</b>	<b>\$ 1,534</b>

SUPPLEMENTAL CASH FLOW DATA:

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Income taxes paid, net of refunds	\$ 120	\$ 178
Cash interest paid	85	106
See accompanying notes.		

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

(Unaudited)

		Equity Attributable to Holdings			Shareholders		Accumulated Other Comprehensive Income (Loss)		Noncontrolling Interest	Total
<i>millions</i>		Number of Shares	Common Stock	Capital in Excess of Par Value	Retained Earnings	Treasury Stock				
Balance at February 2, 2008	as reported	132	\$ 1	\$ 10,419	\$ 4,509	\$ (4,331)	\$ 69	\$		\$ 10,667
Effects of adoption of SFAS No. 160									313	313
Balance at February 2, 2008	as adjusted	132	\$ 1	\$ 10,419	\$ 4,509	\$ (4,331)	\$ 69	\$	313	\$ 10,980
Comprehensive income										
Net income					9				40	49
Cumulative translation adjustment							(15)		(10)	(25)
Total Comprehensive Income										24
Shares repurchased		(6)				(477)				(477)
Other				(14)		10				(4)
Balance at August 2, 2008		126	\$ 1	\$ 10,405	\$ 4,518	\$ (4,798)	\$ 54	\$	343	\$ 10,523
Balance at January 31, 2009	as reported	122	\$ 1	\$ 10,441	\$ 4,562	\$ (5,012)	\$ (612)	\$		\$ 9,380
Effects of adoption of SFAS No. 160									319	319
Balance at January 31, 2009	as adjusted	122	\$ 1	\$ 10,441	\$ 4,562	\$ (5,012)	\$ (612)	\$	319	\$ 9,699
Comprehensive income										
Net income (loss)					(68)				16	(52)
Pension and postretirement adjustments, net of tax							19			19
Cumulative translation adjustment							79		42	121
Total Comprehensive Income										88
Canadian shares purchased				(2)					(5)	(7)
Shares repurchased		(3)				(134)				(134)
Other				35		(31)	(3)			1
Balance at August 1, 2009		119	\$ 1	\$ 10,474	\$ 4,494	\$ (5,177)	\$ (517)	\$	372	\$ 9,647

See accompanying notes.



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## 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 approximately 2,300 full-line and 1,250 specialty retail stores in the United States, operating through Kmart and Sears, and approximately 390 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ( Sears Canada ), a 73%-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 accordance with Statement of Financial Accounting Standard ( SFAS ) No. 165, Subsequent Events, we performed an evaluation of subsequent events for the accompanying Condensed Consolidated Financial Statements and Notes through August 24, 2009, the date this report was issued. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Certain prior period amounts have been reclassified to conform to the current interim period presentation. 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 31, 2009.

**NOTE 2 BORROWINGS**

Total borrowings were as follows:

<i>millions</i>	August 1, 2009	August 2, 2008	January 31, 2009
Short-term borrowings:			
Unsecured commercial paper	\$ 20	\$ 174	\$ 7
Secured borrowings	995	800	435
Long-term debt, including current portion:			
Notes and debentures outstanding	1,560	1,935	1,813
Capitalized lease obligations	664	705	664
<b>Total borrowings</b>	<b>\$ 3,239</b>	<b>\$ 3,614</b>	<b>\$ 2,919</b>

The fair value of long-term debt and capitalized lease obligations was \$2.0 billion at August 1, 2009, \$2.1 billion at August 2, 2008 and \$2.0 billion at January 31, 2009. 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.

*Credit Agreement*

During the second quarter, we extended the maturity date of our credit agreement ( Original Credit Agreement ) by entering into an amended credit agreement (the Amended Credit Agreement ) which has an expiration date of June 22, 2012. The Amended Credit Agreement is a revolving credit facility under which Sears Roebuck Acceptance Corp. ( SRAC ) and Kmart Corporation are the borrowers. Our Original Credit Agreement, which was to expire on March 24, 2010, provided \$4.0 billion of borrowing capacity, however only approximately \$3.8 billion



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#### **Notes to Condensed Consolidated Financial Statements (Continued)**

(Unaudited)

had been available since September 2008 when an affiliate of Lehman Brothers notified us it would no longer fund its proportionate share of commitments under the Original Agreement. Also during the second quarter of fiscal 2009, we agreed, for a fee, to allow one of the lenders in our Amended Credit Agreement to exit its commitment, which decreased our total borrowing capacity by \$65 million at August 1, 2009. As a result of the amendment and changes to the facility during the second quarter, our total borrowing capacity increased to \$4.1 billion at August 1, 2009. The fee we received related to the exit of one of our lenders was recorded as a reduction to interest expense during the second quarter of fiscal 2009.

The amended terms and conditions of the asset based credit facility provide for a bifurcation of the \$4.1 billion Amended Credit Agreement into a \$2.4 billion tranche maturing on June 22, 2012 and bearing an interest rate of the London Interbank Offered Rate ( LIBOR ) plus 4.00% (the Extended Tranche ), with a LIBOR floor of 1.75%, and a \$1.7 billion tranche maturing March 24, 2010, bearing an initial interest rate of LIBOR plus 0.875% (the Existing Tranche ). The bifurcation into the Extended Tranche provides Holdings and its subsidiaries more than adequate liquidity for standby letters of credit and working capital needs. The Amended Credit Agreement also gives us the flexibility, subject to certain terms and conditions, to increase the size of the credit facility or add a term loan tranche to the Amended Credit Agreement in an aggregate amount of up to \$1.0 billion. The amendment and extension revises certain terms of the credit agreement to reflect current market conditions. It imposes various requirements, including a requirement that, if availability under the credit facility is beneath a certain threshold, the fixed charge ratio as of the last day of any fiscal quarter be not less than 1.0 to 1.0, a cash dominion requirement if excess availability on the revolver falls below designated levels, and limitations on our ability to make restricted payments, including dividends and share repurchases. In connection with the Amended Credit Agreement, the Company agreed to limit the amount of cash accumulated when borrowings are outstanding under the credit facility. Similar to the Original Credit Agreement, the Amended Credit Agreement has a \$1.5 billion letter of credit sub-limit, 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.

At August 1, 2009, we had \$995 million of borrowings and \$801 million of letters of credit outstanding under the Amended Credit Agreement. Our availability under the agreement, given total outstanding borrowings and letters of credit of \$1.8 billion, was \$2.3 billion at August 1, 2009. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

#### *Orchard Supply Hardware LLC ( OSH LLC ) Credit Agreement*

In November 2005, OSH LLC entered into a five-year, \$130 million senior secured revolving credit facility (the OSH LLC Facility ), which includes a \$25 million letter of credit sub-limit. The OSH LLC Facility was amended in December 2006 to expire in December 2011. The OSH LLC Facility is available for OSH LLC 's general corporate purposes and is secured by a first lien on substantially all of OSH LLC 's non-real estate assets. Availability under the OSH LLC Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. As of August 1, 2009, there were no borrowings outstanding under the OSH LLC Facility and \$6 million in outstanding letters of credit.

### **NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS**

On February 1, 2009, we adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133. The standard supplements the required disclosures provided under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, with additional qualitative and quantitative information. Accordingly, the disclosures that follow should be read along with our existing disclosure in Note 5 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended January 31, 2009.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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. As a result, we primarily use derivatives as a risk management tool to decrease our exposure to fluctuations in the foreign currency market. While we have some variable rate debt, our use of derivatives to hedge exposure to changes in interest rates is not material.

*Earnings Effects of Derivatives on the Statements of Operations*

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

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.

*Hedges of Net Investment in Sears Canada*

We, from time to time, enter into foreign currency forward contracts, which have typically been designated and qualify as hedges of the foreign currency exposure of our net investment in Sears Canada. We had no such foreign currency forward contracts outstanding as of August 1, 2009, August 2, 2008 or January 31, 2009.

*Sears Canada Hedges of Merchandise Purchases*

At August 1, 2009, Sears Canada had entered into foreign currency option contracts with a total notional value of \$305 million. We recorded a mark-to-market asset related to the option contracts of \$15 million at August 1, 2009, \$5 million at August 2, 2008 and \$74 million at January 31, 2009. We recorded mark-to-market and settlement losses on these contracts of \$43 million and \$66 million in other loss for the 13- and 26- week periods ended August 1, 2009, respectively.

In addition, we recorded a mark-to-market asset and gains on Sears Canada's U.S. dollar denominated merchandise purchase contracts (considered to be embedded derivatives under relevant accounting rules), which the foreign currency option contracts are designed to hedge. We recorded an asset of \$10 million at August 1, 2009 and a liability of \$6 million at January 31, 2009 related to these embedded derivatives. We recorded mark-to-market gains of \$10 million and \$15 million for the 13- and 26- week periods ended August 1, 2009, respectively, related to the change in the fair value of this embedded derivative. See Note 4 for further information regarding fair value of these derivatives and the respective balance sheet classifications as of August 1, 2009.

*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 as of August 1, 2009.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**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, as prescribed by SFAS No. 157, Fair Value Measurements, 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.

Cash and cash equivalents, accounts receivable, merchandise payables, credit facility borrowings and accrued liabilities are reflected in the Condensed Consolidated Balance Sheet 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 on our Condensed Consolidated Balance Sheet at fair value as of August 1, 2009, August 2, 2008 and January 31, 2009:

<i>millions</i>	<b>Total Fair Value Amounts at August 1, 2009</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Short-term investments <sup>(1)</sup>	\$ 16	\$	\$ 16	\$
Foreign currency derivative assets <sup>(1)</sup>	25		25	
<b>Total</b>	<b>\$ 41</b>	<b>\$</b>	<b>\$ 41</b>	<b>\$</b>

<i>millions</i>	<b>Total Fair Value Amounts at August 2, 2008</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Foreign currency contracts <sup>(1)</sup>	\$ 5	\$	\$ 5	\$
<b>Total</b>	<b>\$ 5</b>	<b>\$</b>	<b>\$ 5</b>	<b>\$</b>

<i>millions</i>	<b>Total Fair Value Amounts at January 31, 2009</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Short-term investments <sup>(1)</sup>	\$ 38	\$	\$ 38	\$
Foreign currency derivative assets <sup>(1)</sup>	74		74	

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Foreign currency derivative liabilities <sup>(2)</sup>	(6)	(6)
Total	\$ 106	\$ 106

<sup>(1)</sup> Included within Prepaid expenses and other current assets on the Condensed Consolidated Balance Sheet.

<sup>(2)</sup> Included within Other current liabilities on the Condensed Consolidated Balance Sheet.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Short-term investments are typically valued at the closing price in the principal active market as of the last business day of the quarter. Short-term investments at August 1, 2009 and January 31, 2009 include \$16 million and \$38 million, respectively, on deposit with The Reserve Primary Fund, a money market fund that has temporarily restricted withdrawals while it liquidates its holdings to generate cash to distribute. The fair value of this investment was determined by using estimates based on the values of similar assets and information obtained from The Reserve Primary Fund.

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.

Investments in equity securities are typically valued at the closing price in the principal active market as of the last business day of the quarter. Principal active markets for equity prices include published exchanges such as NASDAQ and the New York Stock Exchange. We do not adjust prices to reflect after-hours market activity. Our investments in equity securities are valued using Level 1 measurements.

**NOTE 5 ACQUISITION OF NONCONTROLLING INTEREST IN SEARS CANADA**

During the first quarter of fiscal 2009, the Company increased its controlling interest in Sears Canada by acquiring approximately 0.5 million common shares in open market transactions. The Company paid a total of \$7 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin ( ARB ) No. 51. The acquisition of the additional interest in Sears Canada was not material to our financial position. We did not purchase any additional shares of Sears Canada during the second quarter of fiscal 2009. Our majority interest in Sears Canada remains at 73%.

**NOTE 6 STORE CLOSINGS**

We made the decision to close 28 underperforming stores during the second quarter of fiscal 2009. These closings include 22 stores in our Kmart segment and 6 stores in our Sears segment. We recorded charges related to these store closings of \$33 million in the second quarter of 2009. The charges include \$17 million of inventory markdowns recorded in cost of sales and \$16 million recorded in selling and administrative expenses for store closing and severance costs. We expect to record an additional charge of approximately \$5 million related to these store closings during the second half of 2009 as the stores complete operations.

During the second quarter of 2009, we closed 24 stores we originally announced would close during the fourth quarter of fiscal 2008, as well as other small support locations throughout the U.S. In accordance with SFAS No. 146, Accounting for 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 recorded a charge of \$28 million for future rent payments in the second quarter when we vacated the retail space at these locations. During the first quarter of fiscal 2009, we closed 4 stores we previously announced would close and recorded a charge of \$3 million for the related under-utilized leased space, which, when added to the charges incurred for the 24 stores in the second quarter of 2009, resulted in a total charge for the first half of 2009 of \$31 million.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Total store closing charges recorded during the first half of fiscal 2009 were \$78 million, of which \$17 million was recorded in cost of sales for inventory markdowns and \$61 million was recorded in selling and administrative expenses for store closing and severance costs.

**NOTE 7 CLAIMS RESOLUTION AND BANKRUPTCY-RELATED SETTLEMENTS**

On May 6, 2003, Kmart Corporation (the Predecessor Company), a predecessor operating company of Kmart, emerged from reorganization proceedings under Chapter 11 of the federal bankruptcy laws pursuant to the terms of a plan of reorganization (the Plan of Reorganization). The Predecessor Company is an indirect, wholly owned subsidiary of Kmart and an indirect, wholly owned subsidiary of Holdings.

During fiscal 2008, we completed the settlement of all of the claims associated with the discharge of the Predecessor Company's liabilities subject to compromise pursuant to the Plan of Reorganization. Accordingly, all of the 31.9 million shares set aside for distribution to creditors as part of the Plan of Reorganization have been distributed as of this date.

**NOTE 8 SHAREHOLDERS' EQUITY***Share Repurchase Program*

During the 13- and 26- week periods ended August 1, 2009, we repurchased 1.7 million and 2.7 million of our common shares at a total cost of \$94 million and \$134 million, respectively, under our share repurchase program. Our repurchases for the 13- and 26- week periods ended August 1, 2009 were made at average prices of \$54.87 and \$49.90 per share, respectively. As of August 1, 2009, we had \$371 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.

**NOTE 9 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. The following table summarizes the components of total net periodic benefit expense for our retirement plans:

	13 Weeks Ended		26 Weeks Ended	
<i>millions</i>	August 1, 2009	August 2, 2008	August 1, 2009	August 2, 2008
Components of net periodic expense:				
Benefits earned during the period	\$ 4	\$ 6	\$ 8	\$ 13
Interest costs	105	109	209	218
Expected return on plan assets	(72)	(108)	(143)	(215)
Amortization of experience gains/losses	16		31	
Net periodic expense	\$ 53	\$ 7	\$ 105	\$ 16





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**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

*Contributions*

During the 13- and 26- week periods ended August 1, 2009, we made total contributions of \$44 million and \$96 million, respectively, to our pension and post-retirement plans. During the 13- and 26- week periods ended August 2, 2008, we made total contributions of \$50 million and \$135 million, respectively, to our pension and post-retirement plans. We anticipate making aggregate contributions of approximately \$140 million over the remainder of fiscal 2009.

**NOTE 10 INCOME TAXES**

At August 1, 2009, we had gross unrecognized tax benefits of \$343 million. Of this amount, \$134 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. Included in the \$134 million are \$55 million of tax liabilities, net of federal tax benefit, related to uncertain tax positions of previously acquired entities taken prior to their acquisition by Holdings that would, with the adoption of SFAS 141(R), Business Combinations which revised SFAS No. 141, Business Combinations, impact our effective tax rate if recognized (see Note 14). During the 13- and 26- week periods ended August 1, 2009, we reduced gross unrecognized tax benefits by \$15 million and \$17 million, respectively, for federal and state tax settlements. We expect that our unrecognized tax benefits could decrease up to \$63 million over the next 12 months for federal and state settlements and for federal and state tax positions related to prior business dispositions due to both the expiration of the statute of limitations for certain jurisdictions as well as expected related settlements.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. At August 1, 2009, the total amount of interest and penalties recognized on our condensed consolidated balance sheet was \$93 million (\$60 million net of federal benefit). The total amount of interest and penalties recognized in our Condensed Consolidated Statements of Operations for the 13- and 26- week periods ended August 1, 2009 was \$1 million (net of federal tax benefit) and \$3 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 ) has commenced an audit of the Holdings' federal income tax returns for the fiscal years 2006 and 2007. The IRS has completed its examination of Sears' federal income tax returns for the fiscal years 2002 - 2005 and Holdings' federal income tax return for the fiscal year 2005. We have resolved with the IRS all matters arising from these exams. In addition, Holdings and Sears are under examination by various state, local and foreign income tax jurisdictions for the fiscal years 2001 - 2007, and Kmart is under examination by such jurisdictions for the fiscal years 2003 - 2007.

At August 1, 2009, we had Federal net operating loss ( NOL ) carryforwards from the Predecessor Company of approximately \$269 million subject to an overall annual section 382 limitation of \$96 million, generating deferred tax assets of approximately \$94 million. The federal NOL carryforwards will expire in 2021, 2022, 2023, and 2028. We also have credit carryforwards of \$108 million, which will expire between 2015 and 2028.

At the end of fiscal 2008, we had a state NOL deferred tax asset of \$186 million and a valuation allowance of \$117 million. In the first half of fiscal 2009, there were no adjustments to the state NOL deferred tax asset and valuation allowance. The state NOL s will predominantly expire between 2017 and 2028.

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

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

**NOTE 11 SUMMARY OF SEGMENT DATA**

We have three reportable segments: Kmart, Sears Domestic and Sears Canada.

<i>millions</i>	<b>Kmart</b>	<b>For the 13 Weeks Ended August 1, 2009</b>		<b>Sears Holdings</b>
		<b>Domestic</b>	<b>Canada</b>	
Merchandise sales and services	\$ 3,756	\$ 5,701	\$ 1,094	\$ 10,551
Costs and expenses				
Cost of sales, buying and occupancy	2,927	4,082	747	7,756
Selling and administrative	845	1,532	253	2,630
Depreciation and amortization	36	167	25	228
Gain on sales of assets	(1)	(3)	(1)	(5)
Total costs and expenses	3,807	5,778	1,024	10,609
Operating income (loss)	\$ (51)	\$ (77)	\$ 70	\$ (58)
Total assets	\$ 6,135	\$ 16,143	\$ 3,482	\$ 25,760

<i>millions</i>	<b>Kmart</b>	<b>For the 13 Weeks Ended August 2, 2008</b>		<b>Sears Holdings</b>
		<b>Domestic</b>	<b>Canada</b>	
Merchandise sales and services	\$ 4,005	\$ 6,367	\$ 1,390	\$ 11,762
Costs and expenses				
Cost of sales, buying and occupancy	3,087	4,590	963	8,640
Selling and administrative	863	1,524	307	2,694
Depreciation and amortization	34	181	32	247
Gain on sales of assets	(1)	(5)		(6)
Total costs and expenses	3,983	6,290	1,302	11,575
Operating income	\$ 22	\$ 77	\$ 88	\$ 187
Total assets	\$ 6,284	\$ 17,095	\$ 3,410	\$ 26,789

**For the 26 Weeks Ended**

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<i>millions</i>	<b>Kmart</b>	<b>August 1, 2009</b>		<b>Sears Holdings</b>
		<b>Domestic</b>	<b>Canada</b>	
Merchandise sales and services	\$ 7,349	\$ 11,273	\$ 1,984	\$ 20,606
Costs and expenses				
Cost of sales, buying and occupancy	5,662	7,907	1,369	14,938
Selling and administrative	1,659	3,060	484	5,203
Depreciation and amortization	72	333	49	454
Gain on sales of assets	(10)	(4)	(45)	(59)
Total costs and expenses	7,383	11,296	1,857	20,536
Operating income (loss)	\$ (34)	\$ (23)	\$ 127	\$ 70
Total assets	\$ 6,135	\$ 16,143	\$ 3,482	\$ 25,760

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

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

<i>millions</i>	<b>Kmart</b>	<b>For the 26 Weeks Ended August 2, 2008</b>		<b>Sears Holdings</b>
		<b>Domestic</b>	<b>Canada</b>	
Merchandise sales and services	\$ 7,738	\$ 12,467	\$ 2,625	\$ 22,830
Costs and expenses				
Cost of sales, buying and occupancy	5,953	8,919	1,813	16,685
Selling and administrative	1,719	3,178	612	5,509
Depreciation and amortization	67	364	64	495
Gain on sales of assets	(2)	(4)	(32)	(38)
Total costs and expenses	7,737	12,457	2,457	22,651
Operating income	\$ 1	\$ 10	\$ 168	\$ 179
Total assets	\$ 6,284	\$ 17,095	\$ 3,410	\$ 26,789

**NOTE 12 SUPPLEMENTAL FINANCIAL INFORMATION**

Accrued expenses and other current liabilities at August 1, 2009, August 2, 2008 and January 31, 2009 consisted of the following:

<i>millions</i>	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>January 31, 2009</b>
Payroll and benefits payable	\$ 341	\$ 355	\$ 339
Outstanding checks in excess of funds on deposit	203	261	228
Current portion of self-insurance reserves	369	374	364
Customer deposits	303	366	362
Accrued expenses and other current liabilities	1,872	1,984	1,933
Total	\$ 3,088	\$ 3,340	\$ 3,226

Other long-term liabilities as of August 1, 2009, August 2, 2008 and January 31, 2009 consisted of the following:

<i>millions</i>	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>January 31, 2009</b>
Unearned revenues	\$ 856	\$ 923	\$ 889
Self-insurance reserves	850	829	826
Other	1,177	1,256	1,227
Total	\$ 2,883	\$ 3,008	\$ 2,942

**NOTE 13    LEGAL PROCEEDINGS**

*Maurice Levie, individually and on behalf of all others similarly situated v. Sears, Roebuck & Co., et al.* Following the announcement of the Merger on November 17, 2004, a lawsuit was filed in the United States District Court for the Northern District of Illinois relating to the transaction. This suit asserts claims under the federal securities laws on behalf of a class of former Sears stockholders against Sears, Alan J. Lacy, Edward S. Lampert and ESL Partners, L.P. for allegedly failing to make timely disclosure of merger discussions during the period September 9 through November 16, 2004, and seeks damages. On July 17, 2007, the Court granted in part and denied in part plaintiffs motion for class certification, certifying a class of Sears stockholders who sold

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**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

shares of Sears stock between September 9, 2004 and November 16, 2004, excluding short sellers who covered their positions during the class period. On September 24, 2007, the Seventh Circuit Court of Appeals denied defendants' petition for leave to appeal the class certification order. Merits and expert discovery are concluded. Defendants have filed motions for summary judgment and decertification. Briefing on the motions is scheduled to conclude in September 2009 with a decision tentatively scheduled for November 2, 2009.

*In re: Sears Holdings Corporation Securities Litigation* In May and July 2006, two class action lawsuits, which each name as defendants Sears Holdings Corporation and Edward S. Lampert, were filed in United States District Court for the Southern District of New York, purportedly on behalf of a class of persons that sold shares of Kmart Holding Corporation stock on or after May 6, 2003 through June 4, 2004. The plaintiffs in each case allege that Kmart's Plan of Reorganization and Disclosure Statement filed on January 24, 2003 and amended on February 25, 2003 misrepresented Kmart's assets, particularly its real estate holdings, as evidenced by the prices at which Kmart subsequently sold certain of its stores in June 2004 to Home Depot and Sears. The plaintiffs seek damages for alleged misrepresentations. On December 19, 2006, the Court consolidated the actions and plaintiffs filed their consolidated complaint. On April 15, 2008, the Court denied without prejudice defendants' motion to dismiss. After taking some additional discovery, defendants filed another motion to dismiss. On July 21, 2009, the Court granted defendants' motion to dismiss and entered a final order of dismissal. Plaintiffs filed a notice of appeal on August 20, 2009.

*AIG Annuity Insurance Company, et al. v. Sears, Roebuck and Co.* On October 12, 2004, an action was filed against Sears in the District Court, 192nd Judicial District, Dallas County, Texas by several holders of certain bonds issued by Sears from 1991 through 1993. Plaintiffs purport to allege under theories of breach of contract and misrepresentation, that Sears prematurely redeemed the bonds in 2004 following Sears' sale of the credit business in 2003. On February 2, 2007, a jury in the case reached a verdict against Sears and the Court subsequently awarded plaintiffs \$61 million plus post-judgment interest. Sears then filed a notice of appeal. On August 21, 2008, the appellate court reversed the trial court's judgment and entered judgment in favor of Sears on all counts. Plaintiffs' subsequent motion for rehearing was denied. Plaintiffs have filed a petition for review with the Texas Supreme Court. Briefing on the petition is completed and we await a decision from the Court.

As previously reported in Kmart's Annual Report on Form 10-K for its fiscal year ended January 26, 2005, the staff of the Securities and Exchange Commission had been investigating, and the U.S. Attorney for the Eastern District of Michigan had undertaken an inquiry into, the manner in which Kmart recorded vendor allowances before a change in accounting principles at the end of fiscal 2001 and the disclosure of certain events bearing on the Predecessor Company's liquidity in the fall of 2001. Kmart cooperated with the SEC and U.S. Attorney's office with respect to these matters. The Company understands the SEC's and U.S. Attorney's investigations into Kmart are now closed. As previously reported, on August 23, 2005, the SEC filed a complaint in the United States District Court for the Eastern District of Michigan against the Predecessor Company's former chief executive officer Charles Conaway and its former chief financial officer John McDonald alleging that they misled investors about the Predecessor Company's liquidity and related matters in the months preceding its bankruptcy in violation of federal securities law. Kmart was not named as a defendant in the action. Mr. McDonald agreed to settle with the SEC shortly before trial in the matter. On June 1, 2009 and following a jury trial in the matter, Mr. Conaway was found liable on all counts. Although Mr. Conaway has filed post-judgment motions seeking to overturn the verdict, based on these developments, the Company believes that all outstanding securities regulatory matters concerning the Predecessor Company have been concluded.

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

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**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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. One of these class-action lawsuits described above is *Moldowan, et al. v. Sears, Roebuck and Company, et al.*, a lawsuit filed on August 12, 2004 in the Superior Court of the State of California, County of Sonoma in which plaintiffs allege that Sears failed to pay them for all hours worked and otherwise failed to pay them correctly for work performed in accordance with California law. Plaintiffs seek monetary damages in an unspecified amount, together with attorneys' fees, interest, statutory penalties and punitive damages. The parties have settled the matter and the Court has approved the settlement. 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. We previously established a reserve for the expected settlement and it did not have a material adverse effect on our annual results of operations, financial position, liquidity or capital resources.

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 SFAS No. 5, *Accounting for 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 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, these assessments often involve a series of complex assessments by management about future events and can rely heavily on estimates and assumptions. While the consequences of certain unresolved proceedings are not presently determinable, an adverse outcome from certain matters could have a material adverse 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 is not expected to have a material adverse effect on our financial position, liquidity or capital resources.

**NOTE 14 RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2007, the FASB issued SFAS No. 141(R), which we adopted on February 1, 2009. SFAS No. 141(R) has a significant impact on the accounting for transaction costs, restructuring costs as well as the initial recognition of contingent assets and liabilities assumed during a business combination. The provisions of SFAS No. 141(R) are applied prospectively from the date of adoption, except for adjustments to valuation allowances recorded on previously acquired entities' deferred tax assets and uncertain tax position balances occurring outside the measurement period, which are recorded as a component of income tax expense in the period of adjustment, rather than goodwill. We expect SFAS 141(R) will have an impact on our consolidated financial statements, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions we consummate after the effective date. As of August 1, 2009, we have recorded \$57 million of unrecognized tax benefits and \$8 million of related interest, net of federal tax benefit, for tax positions of the Predecessor Company and tax positions of acquired entities taken prior to their acquisition by Holdings. Liabilities settled for different amounts will affect our income tax expense in the period of settlement or reversal. Settlements recorded in the first half of 2009 did not have a material impact on our results of operations.

On February 1, 2009 we adopted SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51, which amends ARB No. 51, *Consolidated Financial Statements*, to establish



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**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

new standards that govern the accounting for and reporting of noncontrolling interests in partially-owned consolidated subsidiaries and the loss of control of subsidiaries. SFAS No. 160 requires that: (1) noncontrolling interest, previously referred to as minority interest, be reported as part of equity in the consolidated financial statements; (2) losses be allocated to a noncontrolling interest even when such allocation might result in a deficit balance, reducing the losses attributed to the controlling interest; (3) changes in ownership interests be treated as equity transactions if control is maintained; (4) changes in ownership interests resulting in gain or loss be recognized in earnings if control is gained or lost; and (5) in a business combination the noncontrolling interest's share of net assets acquired be recorded at the fair value, plus its share of goodwill. The provisions of SFAS No. 160 are prospective upon adoption, except for the presentation and disclosure requirements. The presentation and disclosure requirements must be applied retrospectively for all periods presented. Accordingly, our Condensed Consolidated Balance Sheets as of August 2, 2008 and January 31, 2009, our Condensed Consolidated Statements of Operations for the three and six months ended August 2, 2008, and Condensed Consolidated Statements of Cash Flows and Condensed Consolidated Statements of Equity for the six months ended August 2, 2008 have been retrospectively adjusted to reflect noncontrolling interests in Sears Canada and OSH (which represent 27% and 19.9% of the subsidiaries' ownership, respectively).

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. We adopted SFAS No. 161 on February 1, 2009. See Note 3 to the Condensed Consolidated Financial Statements for further discussion.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. We adopted SFAS No. 165 during the second quarter of fiscal 2009. SFAS No. 165 incorporates the principles and accounting guidance for recognizing and disclosing subsequent events that originated as auditing standards into the body of authoritative literature issued by the FASB as well as prescribes disclosure regarding the date through which subsequent events have been evaluated. We are required to evaluate subsequent events through the date our financial statements are issued. As SFAS No. 165 is not intended to significantly change the current practice of reporting subsequent events, it did not have an impact on our results of operations, cash flows or financial positions. As disclosed in Note 1, we performed an evaluation of subsequent events for the accompanying Condensed Consolidated Financial Statements and Notes through August 24, 2009, the date this report was issued.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification (Codification) and the Hierarchy of GAAP, which replaces SFAS No. 162, The Hierarchy of GAAP and establishes the Codification as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. SEC rules and interpretive releases also continue to be sources of authoritative GAAP for SEC registrants. SFAS No. 168 modifies the GAAP hierarchy to include only two levels of GAAP: authoritative and non-authoritative. SFAS No. 168 is effective beginning for periods ended after September 15, 2009. As SFAS No. 168 is not intended to change or alter existing GAAP, it is not expected to impact our results of operations, cash flows or financial position. We will adjust historical GAAP references in our Quarterly Report on Form 10-Q for the third quarter 2009 to reflect accounting guidance references included in the codification.

In April 2009, the FASB issued FSP FAS No. 107-1 and Accounting Principles Board (APB) No. 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, and requires disclosures about fair value of financial instruments for interim reporting periods as well as for annual financial statements. Additionally, this FSP amends APB Opinion No. 28, Interim Financial Reporting, and requires those disclosures in summarized financial information at

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Notes to Condensed Consolidated Financial Statements (Continued)

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interim reporting periods. These disclosures are required for interim reporting periods ending after June 15, 2009. We adopted FSP FAS No. 107-1 and APB No. 28-1 in the second quarter of 2009. As this FSP provides only disclosure requirements, the adoption of this standard will not have a material impact on our financial condition or operating results.

In December 2008, the FASB issued FSP FAS No. 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets, which requires additional disclosures for employers' pension and other postretirement benefit plan assets. As pension and other postretirement benefit plan assets were not included within the scope of SFAS No. 157, the FSP requires employers to disclose information about fair value measurements of plan assets similar to the disclosures required under SFAS No. 157, the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. FSP FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009. As FSP FAS 132(R)-1 provides only disclosure requirements, the adoption of this standard will not have a material impact on our financial condition or operating results.

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended August 1, 2009 and August 2, 2008***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 31, 2009.

**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 approximately 2,300 full-line and 1,250 specialty retail stores in the United States operating through Kmart and Sears and approximately 390 full-line and specialty retail stores in Canada operating through Sears Canada, a 73%-owned subsidiary. We currently 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 31, 2009.

**CONSOLIDATED RESULTS OF OPERATIONS**

	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>August</b>	<b>August</b>	<b>August</b>	<b>August</b>
	<b>1,</b>	<b>2,</b>	<b>1,</b>	<b>2,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<i>millions, except per share data</i>				
<b>REVENUES</b>				
Merchandise sales and services	\$ 10,551	\$ 11,762	\$ 20,606	\$ 22,830
<b>COSTS AND EXPENSES</b>				
Cost of sales, buying and occupancy	7,756	8,640	14,938	16,685
Gross margin dollars	2,795	3,122	5,668	6,145
Gross margin rate	26.5%	26.5%	27.5%	26.9%
Selling and administrative	2,630	2,694	5,203	5,509
Selling and administrative expense as a percentage of total revenues	24.9%	22.9%	25.2%	24.1%
Depreciation and amortization	228	247	454	495
Gain on sales of assets	(5)	(6)	(59)	(38)
Total costs and expenses	10,609	11,575	20,536	22,651
Operating income (loss)	(58)	187	70	179
Interest expense	(63)	(65)	(122)	(131)
Interest and investment income	14	20	19	31
Other loss	(31)	(1)	(47)	(2)
Income (loss) before income taxes	(138)	141	(80)	77
Income tax (expense) benefit	52	(56)	28	(28)
Net income (loss)	(86)	85	(52)	49
Income attributable to noncontrolling interest	(8)	(20)	(16)	(40)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS</b>	<b>\$ (94)</b>	<b>\$ 65</b>	<b>\$ (68)</b>	<b>\$ 9</b>

**EARNINGS (LOSS) PER COMMON SHARE ATTRIBUTABLE TO  
HOLDINGS SHAREHOLDERS**

Diluted earnings (loss) per share	\$ (0.79)	\$ 0.50	\$ (0.57)	\$ 0.07
Diluted weighted average common shares outstanding	119.1	128.8	120.0	130.3

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**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

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.

*Net Income (Loss) Attributable to Holdings Shareholders and Earnings (Loss) per Share Summary*

We recorded a net loss attributable to Holdings shareholders for the second quarter of 2009 of \$94 million (\$0.79 loss per diluted share) as compared to a net income attributable to Holdings shareholders of \$65 million (\$0.50 per diluted share) in the second quarter of 2008. The net loss attributable to Holdings shareholders for the first half of 2009 was \$68 million (\$0.57 loss per diluted share) as compared to net income attributable to Holdings shareholders of \$9 million (\$0.07 per diluted share) in the first half of 2008. Our second quarter and first half results in fiscal 2009 and 2008 were affected by a number of significant items, including:

domestic pension plan expense of \$42 million (\$26 million after tax or \$0.22 per diluted share) for the second quarter of 2009 and \$84 million (\$55 million after tax or \$0.46 per diluted share) for the first half of 2009;

mark-to-market losses on Sears Canada hedge transactions of \$22 million (\$10 million after tax and noncontrolling interest or \$0.08 per diluted share) for the second quarter of 2009 and \$36 million (\$17 million after tax or \$0.14 per diluted share) for the first half of 2009;

a charge for costs associated with store closings and severance of \$61 million (\$38 million after tax or \$0.32 per diluted share) for the second quarter of 2009 and \$78 million (\$50 million after tax and noncontrolling interest or \$0.41 per diluted share) for the first half of 2009;

a previously deferred gain on the August 2007 sale of Sears Canada's former headquarters building of \$44 million (\$21 million after tax and noncontrolling interest or \$0.17 per diluted share) was recognized during the first half of 2009 as Sears Canada ceased use of the building under the lease-back agreement signed at the time of the sale; and

the positive impact of the reversal of a \$62 million (\$37 million after tax, or \$0.29 per diluted share, for the second quarter of 2008; and \$39 million after tax, or \$0.30 per diluted share, for the first half of 2008) reserve during the second quarter of 2008 because of the overturning of a February 2, 2007 adverse jury verdict relating to the redemption of certain Sears, Roebuck and Co. bonds in 2004.

As we previously reported, the Company has 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 recent years. However, due to the severe decline in the capital markets that occurred in the latter part of 2008 our domestic pension expense will increase by an estimated \$160 to \$175 million in 2009.

***13-week period ended August 1, 2009 compared to the 13-week period ended August 2, 2008***

***Comparable Store Sales and Total Revenues***

For the second quarter in fiscal 2009, total revenues declined \$1.2 billion, or 10.3%, to \$10.6 billion, as compared to \$11.8 billion for the second quarter of fiscal 2008. The decrease was primarily due to lower comparable store sales and includes a \$126 million decline due to foreign currency exchange rates.

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Domestic comparable store sales declined 8.6% in the aggregate, with Sears Domestic comparable store sales declining 12.5% and Kmart comparable store sales declining 3.9%. The decline at Sears Domestic continues to be driven by categories impacted by housing market conditions (including the home appliances category) as well

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### **SEARS HOLDINGS CORPORATION**

#### **13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

as lower apparel sales. The decline in comparable store sales at Kmart was driven by a decline in apparel, partially offset by an increase in sales of home electronics, as well as the benefit of assuming the operations of its footwear business from a third party effective January 2009. See further discussion in the Segment Operations section below regarding changes in revenue in each of our segments.

#### *Gross Margin*

For the second quarter of fiscal 2009, we generated \$2.8 billion in gross margin, as compared to \$3.1 billion in the second quarter of fiscal 2008. The total decline of \$327 million primarily reflects the impact of lower overall sales on our gross margin and includes a \$40 million decline related to the impact of foreign currency exchange rates on gross margin at Sears Canada, as well as \$17 million for markdowns recorded in connection with store closings announced during the quarter.

While gross margin dollars declined, our gross margin rate remained flat at 26.5% and included an increase in gross margin rate of 50 basis points at Sears Domestic and 100 basis points at Sears Canada, mainly as a result of improved inventory management, as well as an increase in gross margin rate in the home electronics category for Sears Domestic. These increases were offset by a decline in gross margin rate of 80 basis points at Kmart due to markdowns recorded in connection with store closings announced during the quarter.

#### *Selling and Administrative Expenses*

For the quarter, our selling and administrative expenses decreased \$64 million as compared to the second quarter in fiscal 2008. Selling and administrative expenses for the second quarter of 2009 include expenses incurred for domestic pension plans of \$42 million and store closing costs and severance of \$44 million. Selling and administrative expenses for the second quarter of 2008 include the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, selling and administrative expenses declined \$212 million and mainly reflects our focus on controlling costs. The decrease includes a reduction in payroll and benefits expense of \$92 million and a reduction in advertising expenses of \$45 million (primarily due to reductions at Sears Canada), as well as a \$23 million decline related to the impact of foreign currency exchange rates at Sears Canada. Our selling and administrative expenses as a percentage of total revenues (selling and administrative expense rate) was 24.9% for the second quarter of fiscal 2009, as compared to 22.9% for the second quarter of fiscal 2008. The increase in our selling and administrative expense rate is primarily the result of the above noted significant items, as well as lower expense leverage given lower overall sales results.

#### *Depreciation and Amortization*

Depreciation and amortization expense decreased by \$19 million during the second quarter of fiscal 2009 as compared to the same period in fiscal 2008. The decrease is primarily attributable to additional property and equipment becoming fully depreciated since the second quarter of fiscal 2008, thereby decreasing our depreciable asset base.

#### *Operating Income / Loss*

For the quarter, we reported an operating loss of \$58 million, as compared to operating income of \$187 million for the second quarter of fiscal 2008. The operating loss for the second quarter of 2009 includes expenses of \$103 million related to domestic pension plans and store closings and severance. Operating income for the second quarter of 2008 includes the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, operating income decreased \$80 million and was primarily the result of lower gross margin dollars given lower overall sales, partially offset by reduced selling and administrative expenses.

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*Interest and Investment Income*

We earned \$14 million in interest and investment income for the second quarter of fiscal 2009, as compared to \$20 million for the second quarter of fiscal 2008. Interest and investment income for the second quarter of fiscal 2009 and 2008 includes a pre-tax dividend of \$5 million and \$10 million, respectively, received in connection with our investment in Sears Mexico. The second quarter decrease in fiscal 2009 is also due to lower levels of interest income as a result of reduced cash and cash equivalent balances.

*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 \$33 million were recorded on these transactions in the second quarter of fiscal 2009.

***26-week period ended August 1, 2009 compared to the 26-week period ended August 2, 2008***

*Comparable Store Sales and Total Revenues*

For the first half of fiscal 2009, total revenues declined \$2.2 billion, or 9.7%, to \$20.6 billion, as compared to \$22.8 billion for the first half of fiscal 2008. The decrease was primarily due to lower comparable store sales and includes a \$340 million decline due to foreign currency exchange rates.

Domestic comparable store sales declined 8.0% in the aggregate, with Sears Domestic comparable store sales declining 12.1% and Kmart comparable store sales declining 3.0% for the first half of fiscal 2009. The decline at Sears Domestic continues to be driven by categories directly impacted by housing market conditions (including the home appliances category) and lower apparel sales. The decline in comparable store sales at Kmart was driven by a decline in apparel, partially offset by an increase in sales of home electronics, as well as the benefit of assuming the operations of its footwear business from a third party effective January 2009. If the overall retail environment continues to be impacted by unfavorable economic factors, our sales will likely continue to be pressured throughout the remainder of fiscal 2009. See further discussion in the Segment Operations section below regarding changes in revenue in each of our segments.

*Gross Margin*

For the first half of fiscal 2009, we generated \$5.7 billion in gross margin, as compared to \$6.1 billion in the first half of fiscal 2008. The total decline of \$477 million primarily reflects the impact of lower overall sales on our gross margin and includes a \$106 million decline related to the impact of foreign currency exchange rates on gross margin at Sears Canada, as well as \$17 million for markdowns recorded in connection with store closings.

While gross margin dollars declined, our gross margin rate increased 60 basis points to 27.5% in the first half of fiscal 2009, as compared to 26.9% for the first half of fiscal 2008. The increase in gross margin rate includes increases of 140 basis points at Sears Domestic and 10 basis points at Sears Canada, mainly as a result of improved inventory management. These increases were offset by a decline in gross margin rate of 10 basis points at Kmart due to markdowns recorded in connection with store closings announced during the quarter.

*Selling and Administrative Expenses*

For the first half of fiscal 2009, our selling and administrative expenses decreased \$306 million as compared to the first half in fiscal 2008. Selling and administrative expenses for the first half of 2009 include expenses



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**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

incurred for domestic pension plans of \$84 million and store closing costs and severance of \$61 million. Selling and administrative expenses for the first half of 2008 include the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, selling and administrative expenses declined \$513 million and mainly reflects our focus on controlling costs. The decrease includes a reduction in payroll and benefits expense of \$176 million, a reduction in advertising expenses of \$153 million, and an \$63 million decline related to the impact of foreign currency exchange rates at Sears Canada. Our selling and administrative expense rate was 25.2% for the first half of fiscal 2009, as compared to 24.1% for the first half of fiscal 2008. The increase in our selling and administrative expense rate is primarily the result of the above noted significant items, as well as lower expense leverage given lower overall sales results.

*Depreciation and Amortization*

Depreciation and amortization expense decreased by \$41 million during the first half of fiscal 2009 as compared to the same period in fiscal 2008. The decrease is primarily attributable to additional property and equipment becoming fully depreciated since the first half of fiscal 2008, thereby decreasing our depreciable asset base.

*Gains on Sales of Assets*

We recorded total gains on sales of assets of \$59 million during the first half of fiscal 2009, as compared to \$38 million in the first half of fiscal 2008. The increase in gains on sales of assets was due to a \$44 million gain recognized by Sears Canada on the sale of its former headquarters.

Sears Canada sold its headquarters office building and adjacent land in Toronto, Ontario in August 2007. Sears Canada leased back the property under a leaseback agreement through March 2009, at which time it finished its relocation of all head office operations to previously underutilized space in the Toronto Eaton Centre, Ontario. Given the terms of the leaseback, for accounting purposes, the excess of proceeds received over the carrying value of the associated property was deferred, and the resulting gain was recognized when Sears Canada no longer occupied the associated property.

*Operating Income / Loss*

For the first half of fiscal 2009, we reported operating income of \$70 million, as compared to operating income of \$179 million for the first half of fiscal 2008. The operating income for the first half of 2009 includes expenses of \$162 million related to domestic pension plans and store closings and severance, as well as a gain on sale of assets at Sears Canada of \$44 million. Operating income for the first half of 2008 includes the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, operating income increased \$71 million and was primarily the result of reductions in selling and administrative expenses, partially offset by lower gross margin dollars given lower overall sales.

*Interest and Investment Income*

We earned \$19 million in interest and investment income for the first half of fiscal 2009, as compared to \$31 million for the first half of fiscal 2008. Interest and investment income for the first half of fiscal 2009 includes a dividend of \$5 million from our cost method investment in Sears Mexico and interest income of \$2 million. Interest and investment income for the first half of fiscal 2008 is mainly comprised of a dividend of \$10 million from our cost method investment in Sears Mexico and interest income of \$16 million. The decrease in interest income in the first half of fiscal 2009 was primarily due to reduced cash and cash equivalent balances.

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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 \$51 million were recorded on these transactions in the first half of fiscal 2009.

**SEGMENT OPERATIONS**

The following discussion of our business segment results is organized into three 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>August 1, 2009</b>	<b>August 2, 2008</b>	<b>August 1, 2009</b>	<b>August 2, 2008</b>
Merchandise sales and services	\$ 3,756	\$ 4,005	\$ 7,349	\$ 7,738
Cost of sales, buying and occupancy	2,927	3,087	5,662	5,953
Gross margin dollars	829	918	1,687	1,785
Gross margin rate	22.1%	22.9%	23.0%	23.1%
Selling and administrative	845	863	1,659	1,719
Selling and administrative expense as a percentage of total revenues	22.5%	21.5%	22.6%	22.2%
Depreciation and amortization	36	34	72	67
Gain on sales of assets	(1)	(1)	(10)	(2)
Total costs and expenses	3,807	3,983	7,383	7,737
Operating income (loss)	\$ (51)	\$ 22	\$ (34)	\$ 1
Number of stores			1,352	1,382

**13-week period ended August 1, 2009 compared to the 13-week period ended August 2, 2008**

*Comparable Store Sales and Total Revenues*

For the quarter, Kmart's comparable store sales and total sales declined 3.9% and 6.2%, respectively. The decline in total revenues primarily reflects the impact of lower comparable store sales. The 3.9% decline in Kmart comparable store sales during the second quarter of fiscal 2009 was primarily driven by a high single digit percentage decline recorded within the apparel category, partially offset by a modest percentage increase in the home electronics category and the benefit of assuming the operations of its footwear business from a third party effective January 2009.

*Gross Margin*

For the quarter, Kmart generated \$829 million in gross margin in fiscal 2009, as compared to \$918 million in the second quarter of fiscal 2008. The \$89 million decline is mainly a result of the impact of lower overall sales on Kmart's gross margin and includes a \$14 million charge for

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markdowns recorded in connection with store closings. For the second quarter of fiscal 2009, Kmart's gross margin rate was 22.1%, as compared to 22.9% for

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the second quarter of fiscal 2008, a decrease of 80 basis points. The decrease in gross margin rate was mainly due to markdowns recorded in connection with store closings announced during the quarter.

*Selling and Administrative Expenses*

For the quarter, Kmart's selling and administrative expenses decreased \$18 million as compared to the second quarter in fiscal 2008. The decline in Kmart's selling and administrative expenses primarily reflects a reduction in payroll expenses of \$16 million and includes expenses incurred for store closing and severance of \$16 million. Kmart's selling and administrative expense rate was 22.5% for fiscal 2009, as compared to 21.5% for the second quarter of fiscal 2008, and increased primarily as a result of lower expense leverage given lower overall sales results, as well as the above noted charge for store closing and severance.

*Operating Income / Loss*

For the quarter, Kmart recorded an operating loss of \$51 million, as compared to operating income of \$22 million in the second quarter of fiscal 2008, a decrease of \$73 million. The decline in Kmart's operating income for the second quarter of 2009 as compared to the second quarter of 2008 is mainly due to the sales decline noted above and expenses incurred for store closings and severance of \$30 million.

***26-week period ended August 1, 2009 compared to the 26-week period ended August 2, 2008***

*Comparable Store Sales and Total Revenues*

For the first half of fiscal 2009, Kmart's comparable store sales and total sales declined 3.0% and 5.0%, respectively. The decline in total revenues primarily reflects the impact of lower comparable store sales. The 3.0% decline in Kmart comparable store sales during the first half of fiscal 2009 was primarily driven by a high single digit percentage decline recorded within the apparel category, partially offset by a modest percentage increase in the home electronics category and the benefit of assuming the operations of its footwear business from a third party effective January 2009.

*Gross Margin*

For the first half, Kmart generated \$1.7 billion in gross margin in fiscal 2009, as compared to \$1.8 billion in the first half of fiscal 2008. The \$98 million decline is mainly a result of the impact of lower overall sales on Kmart's gross margin and includes a \$14 million charge for markdowns recorded in connection with store closings. For the first half of fiscal 2009, Kmart's gross margin rate was 23.0%, as compared to 23.1% for the first half of fiscal 2008, a decrease of 10 basis points. The decrease in gross margin rate was mainly the result of markdowns recorded in connection with store closings announced during the quarter.

*Selling and Administrative Expenses*

For the first half of fiscal 2009, Kmart's selling and administrative expenses decreased \$60 million as compared to the first half of fiscal 2008. The decline in selling and administrative expenses mainly reflects a reduction in payroll expenses of \$34 million and a reduction in advertising expenses of \$33 million, and mainly reflects our focus on controlling costs. These reductions were somewhat offset by expenses incurred for store closing and severance of \$20 million. Our selling and administrative expense rate was 22.6% for the first half of fiscal 2009, as compared to 22.2% for the first half of fiscal 2008, and increased primarily as a result of the above noted significant items, as well as lower expense leverage given lower overall sales results.

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For the first half of fiscal 2009, Kmart recorded an operating loss of \$34 million, as compared to operating income of \$1 million in the first half of fiscal 2008, a decrease of \$35 million. The decrease is mainly due to lower gross margin dollars generated as a result of lower overall sales and the significant items noted above, partially offset by reductions in selling and administrative expenses.

**Sears Domestic**

Sears Domestic results and key statistics were as follows:

	<b>13 Weeks Ended</b>		<b>26 Weeks Ended</b>	
	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>August 1, 2009</b>	<b>August 2, 2008</b>
<i>millions, except number of stores</i>				
Merchandise sales and services	\$ 5,701	\$ 6,367	\$ 11,273	\$ 12,467
Cost of sales, buying and occupancy	4,082	4,590	7,907	8,919
Gross margin dollars	1,619	1,777	3,366	3,548
Gross margin rate	28.4%	27.9%	29.9%	28.5%
Selling and administrative	1,532	1,524	3,060	3,178
Selling and administrative expense as a percentage of total revenues	26.9%	23.9%	27.1%	25.5%
Depreciation and amortization	167	181	333	364
Gain on sales of assets	(3)	(5)	(4)	(4)
Total costs and expenses	5,778	6,290	11,296	12,457
Operating income (loss)	\$ (77)	\$ 77	\$ (23)	\$ 10
Number of:				
Full-line Stores <sup>(1)</sup>			915	933
Specialty Stores			1,253	1,177
Total Domestic Sears Stores			2,168	2,110

<sup>(1)</sup> The period ended August 1, 2009 includes 852 Full-line stores and 63 Sears Essentials/Grand stores;  
The period ended August 2, 2008 includes 858 Full-line stores and 75 Sears Essentials/Grand stores  
**13-week period ended August 1, 2009 compared to the 13-week period ended August 2, 2008**

*Comparable Store Sales and Total Revenues*

For the quarter, Sears Domestic's comparable store sales and total sales declined 12.5% and 10.5%, respectively. The decline in total revenues primarily reflects the impact of lower comparable store sales. Comparable store sales declines were driven by low double digit percentage declines in categories impacted by housing market conditions (including the home appliances category) as well as a low double digit percentage

decline recorded in the apparel category.

*Gross Margin*

Sears Domestic's gross margin dollars declined \$158 million in the second quarter of 2009 as compared to the second quarter of 2008. The decline is mainly a result of the impact of lower overall sales on Sears Domestic's gross margin and includes a \$3 million charge for markdowns recorded in connection with store closings. Sears

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**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

Domestic's gross margin rate was 28.4% during the second quarter of fiscal 2009, as compared to 27.9% in the second quarter of fiscal 2008, an increase of 50 basis points. The increase in gross margin rate was mainly the result of improved inventory management, as well as increases in our gross margin rate in the home electronics category.

*Selling and Administrative Expenses*

For the quarter, our selling and administrative expenses increased \$8 million as compared to the second quarter in fiscal 2008. Selling and administrative expenses for the second quarter of 2009 include expenses incurred for domestic pension plans of \$42 million and store closing costs and severance of \$28 million. Selling and administrative expenses for the second quarter of 2008 include the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, selling and administrative expenses declined \$124 million. The decrease includes a decrease in payroll and benefits expense of \$75 million and mainly reflects our focus on controlling costs. Our selling and administrative expense rate was 26.9% for fiscal 2009, as compared to 23.9% for the second quarter of fiscal 2008. The increase in our selling and administrative expense rate is primarily the result of the significant items noted above, as well as lower expense leverage given lower overall sales results.

*Depreciation and Amortization*

Depreciation and amortization expense decreased by \$14 million during the second quarter of fiscal 2009 as compared to the same period in fiscal 2008. The decrease is primarily attributable to additional property and equipment becoming fully depreciated since the second quarter of 2008, thereby decreasing our depreciable asset base.

*Operating Income / Loss*

For the quarter, we reported an operating loss of \$77 million, as compared to operating income of \$77 million for the second quarter of fiscal 2008. Sears Domestic's operating loss for the second quarter of 2009 includes expenses of \$73 million related to domestic pension plans and store closings and severance. Operating income for the second quarter of 2008 includes the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, operating income decreased \$19 million and was primarily the result of lower gross margin dollars given lower overall sales.

**26-week period ended August 1, 2009 compared to the 26-week period ended August 2, 2008**

*Comparable Store Sales and Total Revenues*

For the first half, Sears Domestic's comparable store sales and total sales declined 12.1% and 9.6%, respectively. The decline in total revenues primarily reflects the impact of lower comparable store sales. Comparable store sales declines were driven by low double digit percentage declines in categories impacted by housing market conditions (including the home appliances category) as well as a low double digit percentage decline recorded in the apparel category.

*Gross Margin*

Sears Domestic's gross margin dollars declined \$182 million in the first half of 2009 as compared to the first half of 2008. The decline is mainly a result of the impact of lower overall sales on Sears Domestic's gross margin and includes a \$3 million charge for markdowns recorded in connection with store closings. Sears Domestic's gross

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margin rate was 29.9% during the first half of fiscal 2009, as compared to 28.5% in the first half of fiscal 2008, an increase of 140 basis points. The increase in gross margin rate was mainly the result of improved inventory management.

*Selling and Administrative Expenses*

For the first half of fiscal 2009, our selling and administrative expenses decreased \$118 million as compared to the first half in fiscal 2008. Selling and administrative expenses for the first half of 2009 include expenses incurred for domestic pension plans of \$84 million and store closing costs and severance of \$33 million. Selling and administrative expenses for the first half of 2008 include the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, selling and administrative expenses declined \$297 million and mainly reflects our focus on controlling costs. The decrease includes a decrease in payroll and benefits expense of \$142 million as well as a decrease in advertising expenses of \$67 million. Our selling and administrative expense rate was 27.1% for the first half of fiscal 2009, as compared to 25.5% for the first half of fiscal 2008. The increase in our selling and administrative expense rate is primarily the result of the significant items noted above, as well as lower expense leverage given lower overall sales results.

*Depreciation and Amortization*

Depreciation and amortization expense decreased by \$31 million during the first half of fiscal 2009 as compared to the same period in fiscal 2008. The decrease is primarily attributable to additional property and equipment becoming fully depreciated since the first half of 2008, thereby decreasing our depreciable asset base.

*Operating Income / Loss*

For the first half of fiscal 2009, we reported operating loss of \$23 million, as compared to an operating income of \$10 million for the first half of fiscal 2008. The operating loss for the first half of 2009 includes expenses of \$120 million related to domestic pension plans and store closings and severance. Operating income for the first half of 2008 includes the positive impact of the reversal of a \$62 million reserve because of a favorable verdict in connection with a pre-merger legal matter. Excluding these items, operating income increased by \$149 million and was primarily the result of reductions in selling and administrative expenses, partially offset by lower gross margin dollars given lower overall sales.

**Sears Canada**

Sears Canada, a consolidated, 73%-owned subsidiary of Sears, conducts similar retail operations as Sears Domestic.



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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>August 1, 2009</b>	<b>August 2, 2008</b>	<b>August 1, 2009</b>	<b>August 2, 2008</b>
Merchandise sales and services	\$ 1,094	\$ 1,390	\$ 1,984	\$ 2,625
Cost of sales, buying and occupancy	747	963	1,369	1,813
Gross margin dollars	347	427	615	812
Gross margin rate	31.7%	30.7%	31.0%	30.9%
Selling and administrative	253	307	484	612
Selling and administrative expense as a percentage of total revenues	23.1%	22.1%	24.4%	23.3%
Depreciation and amortization	25	32	49	64
Gain on sales of assets	(1)		(45)	(32)
Total costs and expenses	1,024	1,302	1,857	2,457
Operating income	\$ 70	\$ 88	\$ 127	\$ 168
Number of:				
Full-line Stores			122	122
Specialty Stores			267	260
Total Sears Canada Stores			389	382

*13-week period ended August 1, 2009 compared to the 13-week period ended August 2, 2008*

*Total Revenues*

Sears Canada's total revenues decreased 21.3% for the second quarter of fiscal 2009 as compared to the same period last year. The decrease in total revenues of \$296 million includes a \$126 million decline due to the impact of exchange rates during the quarter. On a Canadian dollar basis, revenues decreased by \$170 million, reflecting lower comparable stores sales across all major categories. We believe the decline in comparable store sales is mainly the result of declining consumer confidence and rising unemployment in Canada during the second quarter of 2009.

*Gross Margin*

Total gross margin dollars decreased \$80 million for the second quarter of fiscal 2009 as compared to the same period last year and include a \$40 million decline due to the impact of exchange rates during the quarter. Gross margin decreased \$40 million on a Canadian dollar basis as a result of lower overall sales. For the quarter, Sears Canada's gross margin rate increased to 31.7% from 30.7% in the second quarter of fiscal 2008 primarily as a result of improved inventory management.

*Selling and Administrative Expenses*

For the second quarter of fiscal 2009, Sears Canada's selling and administrative expenses declined \$54 million, which primarily reflects a decline of \$29 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses decreased by \$25 million and primarily reflects a reduction in advertising expenses during the second quarter of 2009.



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*Operating Income*

Sears Canada's operating income decreased \$18 million for the second quarter of fiscal 2009. The decrease in operating income includes an \$8 million decline due to the impact of foreign currency exchange rates and reflects the above noted decreases in sales and gross margin, which were partially offset by a decrease in selling and administrative expenses.

***26-week period ended August 1, 2009 compared to the 26-week period ended August 2, 2008***

*Total Revenues*

Sears Canada's total revenues decreased 24.4% for the first half of fiscal 2009 as compared to the same period last year. The decrease in total revenues of \$641 million includes a \$340 million decline due to the impact of exchange rates during the first half. On a Canadian dollar basis, revenues decreased by \$301 million, reflecting lower comparable stores sales across all major categories. We believe the decline in comparable store sales is mainly the result of declining consumer confidence and rising unemployment in Canada during the first half of 2009.

*Gross Margin*

Total gross margin dollars decreased \$197 million for the first half of fiscal 2009 as compared to the same period last year and include a \$106 million decline due to the impact of exchange rates during the first half. Gross margin decreased \$91 million on a Canadian dollar basis as a result of lower overall sales. For the first half of fiscal 2009, Sears Canada's gross margin rate increased to 31.0% from 30.9% in the first half of fiscal 2008 primarily as a result of improved inventory management.

*Selling and Administrative Expenses*

For the first half of fiscal 2009, Sears Canada's selling and administrative expenses declined \$128 million and includes severance expenses of \$8 million recorded during the first half of 2009. The decrease in expenses primarily reflects a decline of \$83 million due to the impact of exchange rates as well as Sears Canada's response to reduce expenses as a result of declining revenues in a difficult economic environment.

*Gains on Sales of Assets*

Sears Canada recorded total gains on sales of assets of \$45 million during the first half of 2009, as compared to \$32 million in the first half of fiscal 2008. During the first half of 2009, Sears Canada recognized a \$44 million gain related to the August 2007 sale of its former headquarters. During the first half of fiscal 2008, Sears Canada benefited from a \$32 million gain from the sale of its Calgary downtown full-line store.

*Operating Income*

Sears Canada's operating income decreased \$41 million for the first half of fiscal 2009. The decrease in operating income includes a \$22 million decline due to the impact of foreign currency exchange rates and reflects the above noted decreases in sales and gross margin, which were partially offset by a decrease in selling and administrative expenses.

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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 August 1, 2009, August 2, 2008 and January 31, 2009 are detailed in the following table.

<i>millions</i>	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>January 31, 2009</b>
<b><i>Domestic</i></b>			
Cash and equivalents	\$ 276	\$ 579	\$ 337
Cash posted as collateral	12	14	14
Credit card deposits in transit	180	178	159
<b>Total domestic cash and cash equivalents</b>	<b>468</b>	<b>771</b>	<b>510</b>
Sears Canada	721	763	663
<b>Total cash and cash equivalents</b>	<b>1,189</b>	<b>1,534</b>	<b>1,173</b>
Restricted cash	103		124
<b>Total cash balances</b>	<b>\$ 1,292</b>	<b>\$ 1,534</b>	<b>\$ 1,297</b>

We had total cash balances of \$1.3 billion at August 1, 2009 as compared to \$1.5 billion at August 2, 2008 and \$1.3 billion at January 31, 2009. Primary uses of cash during the first half of fiscal 2009 include cash used for share repurchases of \$134 million, contributions to our pension and post-retirement benefit plans of \$96 million, capital expenditures of \$122 million and debt issuance costs of \$81 million. These amounts were offset by a net increase in borrowings of \$271 million.

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.

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 certain Sears Canada cash accounts, 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 Travel.

Our August 1, 2009 and January 31, 2009 cash balances exclude \$16 million and \$38 million, respectively, on deposit with The Reserve Primary Fund, a money market fund which has temporarily restricted withdrawals while it liquidates its holdings to generate cash to distribute. As a result, we reclassified these amounts from cash to the prepaid expenses and other current assets line within our Condensed Consolidated Balance Sheets at August 1, 2009 and January 31, 2009. We expect to receive our remaining \$16 million investment during fiscal 2009.

We classify outstanding checks within other current liabilities and reduce cash and cash equivalents when these checks clear the bank on which they were drawn. Outstanding checks were \$203 million, \$261 million and \$228 million as of August 1, 2009, August 2, 2008 and January 31, 2009, respectively.



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**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

**Operating Activities**

Holdings used \$72 million of cash for its operations during the first half of fiscal 2009. For the first half of fiscal 2008, our operations used cash of \$2 million. 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. While these items are the primary contributors to our operating cash flows on a recurring basis, the decrease in operating cash flows in the first half of fiscal 2009 as compared to the first half of fiscal 2008 was primarily due to the purchase of insurance coverage for workers' compensation claims in the second quarter of 2009.

We use a combination of third-party insurance and self-insurance for our insurable risks. In the second quarter of 2009 we paid \$70 million to purchase insurance coverage for certain of our workers' compensation risks from fiscal 2006 and years prior. The insurance allowed us to limit our risk for these workers' compensation matters, although we are not indemnified from liability for these matters. Accordingly, the payment was recorded as a deposit. This transaction also allowed us to reduce the amount of letters of credit used as collateral for our insurance programs by \$115 million. The premium payment associated with this transaction is reported as cash used in operating activities.

Merchandise inventories at August 1, 2009 were \$9.4 billion, as compared to \$9.8 billion at August 2, 2008. Merchandise payables were \$3.4 billion at August 1, 2009, as compared to \$3.5 billion as of August 2, 2008. Domestic inventory declined from \$8.9 billion at August 2, 2008 to \$8.6 billion at August 1, 2009 reflecting the effectiveness of our efforts to control inventory levels. Sears Canada's inventory levels decreased \$91 million to \$789 million from August 2, 2008 to August 1, 2009 primarily due to the impact of differences in currency exchange rates.

**Investing Activities**

For the first half of fiscal 2009, we used \$122 million of cash for capital expenditures as compared to \$277 million used during the first half of fiscal 2008. We also received \$61 million of cash from investments, which reflects cash received from The Reserve Primary Fund of \$22 million, as well as changes in restricted cash requirements at Sears Canada. During the first half of 2008, we received \$75 million of proceeds from sales of property and investments, which was mainly related to the sale of Sears Canada's Calgary downtown full-line store.

**Financing Activities**

During the 26-week period ended August 1, 2009, we repurchased 2.7 million of our common shares at a total cost of \$134 million under our share repurchase program. As of August 1, 2009, we had \$371 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 August 2, 2008, we repurchased 6.0 million of our common shares at a total cost of \$477 million under our share repurchase program.

Cash provided by financing activities declined in the first half of 2009 as compared to the first half of 2008 mainly due to a decrease in short-term borrowings during the first half of 2009 of \$239 million as compared to the first half in 2008. During the first half of fiscal 2009, we made repayments on long-term debt of \$302 million. We borrowed \$560 million under our Original and Amended Credit Agreement during the first half of 2009 to meet seasonal working capital needs while, at the same time, continuing to invest in our stores, repurchase our

**Table of Contents****SEARS HOLDINGS CORPORATION****13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

stock and make payments on our term debt. As a result, we had \$995 million in secured line of credit borrowings outstanding under the Amended Credit Agreement at August 1, 2009. The entire \$995 million in Amended Credit Agreement borrowings have been classified within short-term borrowings on our Condensed Consolidated Balance Sheet as of August 1, 2009 as we expect to repay the entire amount within the next twelve months.

Our outstanding borrowings as of August 1, 2009, August 2, 2008 and January 31, 2009 were as follows:

<i>millions</i>	<b>August 1, 2009</b>	<b>August 2, 2008</b>	<b>January 31, 2009</b>
Short-term borrowings:			
Unsecured commercial paper	\$ 20	\$ 174	\$ 7
Secured borrowings	995	800	435
Long-term debt, including current portion:			
Notes and debentures outstanding	1,560	1,935	1,813
Capitalized lease obligations	664	705	664
<b>Total borrowings</b>	<b>\$ 3,239</b>	<b>\$ 3,614</b>	<b>\$ 2,919</b>

**Liquidity**

Our primary need for liquidity is to fund seasonal working capital requirements of our retail businesses, capital expenditures and for general corporate purposes. We believe that these needs will be adequately funded by our operating cash flows, credit terms from vendors, current balances in cash and cash equivalents and borrowings under our revolving credit facilities. While we expect to use these facilities as our primary funding source, we may also access the public debt markets on an opportunistic basis. Additionally, we may from time to time consider selective strategic transactions to create value and improve performance, which may include acquisitions, dispositions, restructurings, joint ventures and partnerships. Transactions of these types may result in material proceeds or cash outlays. See our Annual Report on Form 10-K for the fiscal year ended January 31, 2009 for additional information regarding our sources of liquidity.

**Debt Ratings**

The ratings of our domestic debt securities as of August 1, 2009 appear in the table below:

	<b>Moody's Investors Service</b>	<b>Standard &amp; Poor's Ratings Services</b>
Unsecured long-term debt	Ba3	BB-
Unsecured commercial paper	NP	B-2

**Credit Agreement**

During the second quarter, we extended the maturity date of our Original Credit Agreement by entering into an Amended Credit Agreement which has an expiration date of June 22, 2012. The Amended Credit Agreement is a revolving credit facility under which SRAC and Kmart Corporation are the borrowers. Our Original Credit Agreement, which was set to expire on March 24, 2010, provided \$4.0 billion of borrowing capacity, however only approximately \$3.8 billion had been available since September 2008 when an affiliate of Lehman Brothers notified us it would no longer fund its proportionate share of commitments under the Original Agreement. Also during the second quarter of fiscal 2009, we agreed, for a fee, to allow one of the lenders in our Amended Credit Agreement to exit its commitment, which decreased our total borrowing capacity by \$65 million at August 1,





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### **SEARS HOLDINGS CORPORATION**

#### **13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

2009. As a result of the amendment and changes to the facility during the second quarter, our total borrowing capacity increased to \$4.1 billion at August 1, 2009. The fee we received related to the exit of one of our lenders was recorded as a reduction to interest expense during the second quarter of fiscal 2009.

The amended terms and conditions of the asset based credit facility provide for a bifurcation of the \$4.1 billion Amended Credit Agreement into a \$2.4 billion tranche maturing on June 22, 2012 and bearing an interest rate of LIBOR plus 4.00% (the Extended Tranche), with a LIBOR floor of 1.75%, and a \$1.7 billion tranche maturing March 24, 2010, bearing an initial interest rate of LIBOR plus 0.875% (the Existing Tranche). The bifurcation into the Extended Tranche provides Holdings and its subsidiaries more than adequate liquidity for standby letters of credit and working capital needs. The Amended Credit Agreement also gives us the flexibility, subject to certain terms and conditions, to increase the size of the credit facility or add a term loan tranche to the Amended Credit Agreement in an aggregate amount of up to \$1.0 billion. The amendment and extension revises certain terms of the credit agreement to reflect current market conditions. It imposes various requirements, including a requirement that, if availability under the credit facility is beneath a certain threshold, the fixed charge ratio as of the last day of any fiscal quarter be not less than 1.0 to 1.0, a cash dominion requirement if excess availability on the revolver falls below designated levels, and limitations on our ability to make restricted payments, including dividends and share repurchases. In connection with the Amended Credit Agreement, the Company agreed to limit the amount of cash accumulated when borrowings are outstanding under the credit facility. Similar to the Original Credit Agreement, the Amended Credit Agreement has a \$1.5 billion letter of credit sub-limit, 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.

At August 1, 2009, we had \$995 million of borrowings and \$801 million of letters of credit outstanding under the Amended Credit Agreement. Our availability under the agreement, given total outstanding borrowings and letters of credit of \$1.8 billion, was \$2.3 billion at August 1, 2009. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

The foregoing description is qualified in its entirety by reference to the full text of the Amended Credit Agreement.

#### *Orchard Supply Hardware LLC ( OSH LLC ) Credit Agreement*

In November 2005, OSH LLC entered into a five-year, \$130 million senior secured revolving credit facility (the OSH LLC Facility), which includes a \$25 million letter of credit sub-limit. The OSH LLC Facility was subsequently amended in December 2006 to expire in December 2011. The OSH LLC Facility is available for OSH LLC's general corporate purposes and is secured by a first lien on substantially all of OSH LLC's non-real estate assets. Availability under the OSH LLC Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. As of August 1, 2009, there were no borrowings outstanding under the OSH LLC Facility and \$6 million in outstanding letters of credit.

#### *Refunds of Income Taxes Paid*

We file income tax returns in the United States as well as various foreign jurisdictions. Further, the IRS, as well as other state, local and foreign income tax jurisdictions audit the various returns filed by Kmart, Sears and Holdings. As a result of returns filed, as well as resolution of matters under audit, we expect to receive refunds of approximately \$215 million in the second half of 2009 for taxes previously paid to taxing authorities.

#### *Domestic Pension Plan Funding*

In our Annual Report on Form 10-K for the fiscal year ended January 31, 2009 we disclosed that we expected to make contributions to our domestic pension plans of approximately \$170 million in 2009 and \$500 million in

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**SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

2010. The large increase in contributions expected between fiscal 2009 and 2010 at that time was due primarily to the severe decline in capital markets that occurred in the latter part of 2008 and U.S. government legislation regarding pension-funding requirements. Based on new guidance issued by the Treasury Department, we now estimate that the 2010 contribution will be approximately \$325 million, though the ultimate amount of pension contributions could be affected by further changes in the applicable regulation and financial market and investment performance. We expect each remaining quarter of 2009 to contain domestic pension plan expense consistent with first quarter levels.

**Recent Accounting Pronouncements**

See Part I, Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements, Note 14 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, the availability of consumer and commercial credit, changes in consumer confidence, tastes, preferences and spending, and changes in vendor relationship; 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 attract, motivate and retain key executives and other associates; and 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.

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 31, 2009, 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.

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### **SEARS HOLDINGS CORPORATION**

**13 and 26 Weeks Ended August 1, 2009 and August 2, 2008**

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

The nature of market risks faced by us at August 1, 2009 is the same as disclosed in our Annual Report on Form 10-K for the year ended January 31, 2009.

##### *Interest Rate Risk*

We manage interest rate risk through the use of fixed and variable-rate funding and interest rate derivatives. As of August 1, 2009, we had interest rate derivatives with a notional amount of \$120 million, nominal fair value and a weighted average remaining life of 0.4 years. All debt securities and interest-rate derivative instruments are considered non-trading. As of August 1, 2009, 41% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at August 1, 2009, which totaled approximately \$1.3 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by \$13 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*

We, from time to time, enter into foreign currency forward contracts, which have typically been designated and qualify as hedges of the foreign currency exposure of our net investment in Sears Canada. We had no such foreign currency forward contracts outstanding as of August 1, 2009.

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. As of August 1, 2009, these contracts had a notional value of approximately \$305 million and a weighted average remaining life of 0.4 years. The aggregate fair value of the option contracts as of August 1, 2009 was \$15 million. A hypothetical 1% adverse movement in the level of the Canadian exchange rate relative to the U.S. dollar as of August 1, 2009, with all other variables held constant, would have resulted in a fair value for these contracts of approximately \$13 million as of August 1, 2009, a decrease of \$2 million.

##### *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 officer and principal 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 officer and principal 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 principal 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*

See Part I, Item 1, Financial Statements Notes to Condensed Consolidated Financial Statements, Note 7 Claims Resolution and Bankruptcy-Related Settlements, and Note 13 Legal Proceedings, for 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 fiscal 2009. During the 13 weeks ended August 1, 2009, we repurchased 1.7 million of our common shares at a total cost of \$94 million under our common share repurchase program. As of August 1, 2009, we had \$371 million of remaining authorization under the program.

	<b>Total Number of Shares Purchased<sup>(1)</sup></b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program<sup>(2)</sup></b>	<b>Average Price Paid per Share for Publicly Announced Program</b>	<b>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program</b>
May 3, 2009 to May 30, 2009	1,708,742	\$ 54.87	1,708,742	\$ 54.87	
May 31, 2009 to July 4, 2009	111	61.83			
July 5, 2009 to August 1, 2009	535	66.34			
Total	1,709,388	\$ 54.88	1,708,742	\$ 54.87	\$ 371,000,000

<sup>(1)</sup> Includes 646 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 3, 2009 to May 30, 2009	
May 31, 2009 to July 4, 2009	111
July 5, 2009 to August 1, 2009	535
Total	646

<sup>(2)</sup> Our common share repurchase program was initially announced on September 14, 2005 with a total authorization by our Board of Directors of up to \$500 million. Subsequently, we announced that our Board of Directors authorized the repurchase of up to an additional \$500 million of common stock on each of October 14, 2005, April 5, 2006 and September 12, 2006, \$1.0 billion of common stock on July 10, 2007, \$1.5 billion of common stock on August 13, 2007, and \$500 million of common stock on each of May 29, 2008 and December 2, 2008 for a total authorization since inception of the program of \$5.5 billion. The program has no stated expiration date. Our Amended Credit Agreement imposes various requirements, including a requirement that, if availability under the credit facility is beneath a certain threshold, the fixed charge ratio as of the last day of any fiscal quarter be not less than 1.0 to 1.0, a cash dominion requirement if excess availability on the revolver falls below designated levels, and limitations on our ability to make restricted payments, including dividends and share repurchases. In connection with the Amended Credit Agreement, the Company agreed to limit the amount of cash accumulated when borrowings are outstanding under the credit facility.



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**SEARS HOLDINGS CORPORATION**

*Item 4. Submission of Matters to a Vote of Security Holders*

See Part II, Item 4, Submission of Matters to a Vote of Security Holders in our Quarterly Report on Form 10-Q for the quarter ended May 2, 2009 regarding the matters submitted to a vote at our annual meeting of stockholders held on May 4, 2009, which information is incorporated herein by this reference.

*Item 6. Exhibits*

(a) Exhibits.

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

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**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 24, 2009

By

/s/ WILLIAM K. PHELAN  
**William K. Phelan**  
**Senior Vice President and Controller**  
**(Principal Accounting Officer and duly**  
**authorized officer of Registrant)**



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**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 Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000-51217)).
- 10.1 Amended and Restated Credit Agreement, dated as of May 21, 2009, among Sears Holdings Corporation, Sears Roebuck Acceptance Corp., Kmart Corporation, the lenders party thereto, Bank of America, N.A., as Administrative Agent, Co-Collateral Agent and Swingline Lender, Wells Fargo Retail Finance, LLC and General Electric Capital Corporation, as Co-Syndication Agents and Co-Collateral Agents, JPMorgan Chase Bank, N.A. and Barclays Bank plc, as Co-Documentation Agents, and Banc of America Securities LLC, Wells Fargo Retail Finance, LLC and GE Capital Markets, Inc., as Joint Lead Arrangers and Joint Bookrunners (incorporated by reference to Exhibit 10.3 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended May 2, 2009 (File No. 000-51217)).
- 10.2 Amended and Restated Guarantee and Collateral Agreement, dated as of May 21, 2009, among the Registrant and certain other subsidiaries of the Registrant and Bank of America, N.A., Wells Fargo Retail Finance, LLC and General Electric Capital Corporation, as Co-Collateral Agents (incorporated by reference to Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended May 2, 2009 (File No. 000-51217)).
- \*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.

\* Filed herewith