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SEARS HOLDINGS CORP  
Form 10-K  
March 18, 2014

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Fiscal Year Ended February 1, 2014  
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)

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| Delaware<br>(State of Incorporation)   | 20-1920798<br>(I.R.S. Employer Identification No.) |
| 3333 Beverly Road, Hoffman Estates, Illinois<br>(Address of principal executive offices) | 60179<br>(Zip Code)                                |
| Registrant's Telephone Number, Including Area Code:                                      | (847) 286-2500                                     |

Securities registered pursuant to Section 12(b) of the Act:

|  |  |
|--|--|
| Title of each class<br>Common Shares, par value \$0.01 per share | Name of Each Exchange on Which Registered<br>The NASDAQ Stock Market |
|--|--|

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K ( $\$229.405$  of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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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

On March 1, 2014, the registrant had 106,443,237 common shares outstanding. The aggregate market value (based on the closing price of the Registrant's common shares for stocks quoted on the NASDAQ Global Select Market) of the Registrant's common shares owned by non-affiliates (which are assumed, solely for the purpose of this calculation, to be stockholders other than (i) directors and executive officers of the Registrant and (ii) any person known by the Registrant to beneficially own five percent or more of the Registrant's common shares), as of the last business day of the Registrant's most recently completed second fiscal quarter, was approximately \$860 million.

Documents Incorporated By Reference

Part III of this Form 10-K incorporates by reference certain information from the Registrant's definitive proxy statement relating to our Annual Meeting of Stockholders to be held on May 6, 2014 (the "2014 Proxy Statement"), which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Form 10-K relates.

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## PART I

### Item 1. Business

#### General

Sears Holdings Corporation ("Holdings") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings (together with its subsidiaries, "we," "us," "our," or the "Company") was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger") on March 24, 2005. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 1,980 full-line and specialty retail stores in the United States operating through Kmart and Sears and 449 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ("Sears Canada"), a 51%-owned subsidiary. Further, we operate a number of websites under the sears.com and kmart.com banners which offer more than 110 million products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way<sup>SM</sup>, a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way connects all of the ways members shop - in store, at home, online and by phone. The Company is the leading home appliance retailer as well as a leader in tools, lawn and garden, fitness equipment and automotive repair and maintenance. Key proprietary brands include Kenmore<sup>®</sup>, Craftsman<sup>®</sup> and DieHard<sup>®</sup>. We also maintain a broad apparel and home offering including such well-known labels as Lands' End<sup>®</sup>, the Kardashian Kollection, Jaclyn Smith, Joe Boxer, Route 66, Cannon, Sandra Lee and Levi's. Additionally, we launched the Adam Levine and Nicki Minaj collections in 500 Kmart stores and on shopyourway.com/kmart.com. We are the nation's largest provider of home services, with more than 13 million service and installation calls made annually.

The retail industry is changing rapidly. The progression of the Internet, mobile technology, social networking and social media is fundamentally reshaping the way we interact with our core customers and members. As a result, we are transitioning to a member-centric company. Our focus continues to be on our core customers, our members, and finding ways to provide them value and convenience through Integrated Retail and our Shop Your Way membership platform. We have invested significantly in our online ecommerce platforms, our membership program and the technology needed to support these initiatives.

#### Business Segments

During 2013, we operated three reportable segments: Kmart, Sears Domestic and Sears Canada. Financial information, including revenues, operating income (loss), total assets and capital expenditures for each of these business segments is contained in Note 17 of Notes to Consolidated Financial Statements. Information regarding the components of revenue for Holdings is included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as Note 17.

#### Kmart

At February 1, 2014, the Company operated a total of 1,152 Kmart stores across 49 states, Guam, Puerto Rico and the U.S. Virgin Islands. This store count consists of 1,135 discount stores, averaging 94,000 square feet, and 17 Super Centers, averaging 165,000 square feet. Most Kmart stores are one-floor, free-standing units that carry a wide array of products across many merchandise categories, including consumer electronics, seasonal merchandise, outdoor living, toys, lawn and garden equipment, food and consumables and apparel, including products sold under such well-known labels as Jaclyn Smith, Joe Boxer and Alphaline, and certain proprietary Sears brand products (such as Kenmore, Craftsman, and DieHard) and services. We also offer an assortment of major appliances, including Kenmore-branded products, in virtually all of our locations. There are 840 Kmart stores that also operate in-store pharmacies. The Super Centers generally operate 24 hours a day and combine a full-service grocery along with the merchandise selection of a discount store. There are also 16 Sears Auto Centers operating in Kmart stores. Sears Auto Centers offer a variety of professional automotive repair and maintenance services, as well as a full assortment of automotive accessories. Kmart continues to offer its layaway program, which allows members and customers to cost-effectively finance their purchases both in-store and online. In addition, we have expanded the

ways our members and customers can receive their purchases, allowing our members and customers to buy online and pick up in store. This service, powered by MyGofer, is now available in over 1,100 Kmart stores via either mygofer.com or kmart.com. Kmart also sells its products through its kmart.com website and provides members and customers the option of buying through a mobile app or online and picking up their merchandise in one of our Kmart stores.

#### Sears Domestic

At February 1, 2014, Sears Domestic operations consisted of the following:

Full-line Stores—778 stores, of which 768 are Full-line stores located across all 50 states and Puerto Rico. These stores are primarily mall-based locations averaging 136,000 square feet. Full-line stores offer a wide array of products and service offerings across many merchandise categories, including appliances, consumer electronics, tools, sporting goods, outdoor living, lawn and garden equipment, certain automotive services and products, such as tires and batteries, home fashion products, as well as apparel, footwear, jewelry and accessories for the whole family. Our product offerings include our proprietary Kenmore, Craftsman, DieHard, Lands' End, Covington, Apostrophe, and Canyon River Blues brand merchandise, and other brand merchandise such as Alphaline and Roadhandler. In addition, at February 1, 2014, we operated 10 Sears Essentials/Grand stores located in 10 states. These stores are primarily free-standing units averaging 157,000 square feet, offering health and beauty products, pantry goods, household products and toys in addition to the offerings of the typical mall-based store. We also have 696 Sears Auto Centers operating in association with Full-line stores and eight Sears Auto Centers operating out of Sears Essentials/Grand stores. In addition, there are 34 free standing Sears Auto Centers that operate independently of Full-line stores. Sears also extends the availability of its product selection through the use of its sears.com website, which offers an assortment of home, apparel and accessory merchandise and provides members and customers the option of buying through a mobile app or online and picking up their merchandise in one of our Full-line stores. As previously announced, we are considering strategic alternatives for our Sears Auto Center business, subject to board approval and other conditions.

Specialty Stores—50 specialty stores (primarily consisting of the 34 free standing Sears Auto Centers noted above and 13 Lands' End retail stores noted below) located in free-standing, off-mall locations or high-traffic neighborhood shopping centers.

Lands' End—Lands' End, Inc. ("Lands' End") is a leading direct merchant of traditionally styled casual clothing, accessories and footwear for men, women and children, as well as home products and soft luggage. These products are offered through multiple selling channels including landsend.com, one of the leading apparel websites, as well as catalog mailings, and international businesses. Lands' End has 13 retail stores, averaging 9,000 square feet, which offer Lands' End merchandise primarily from catalog and Internet channel overstocks. In addition, Lands' End has 275 "store within a store" departments inside Sears Domestic Full-line locations.

As previously announced, we are pursuing the separation of our Lands' End business through a pro rata distribution to our shareholders, subject to certain conditions.

Commercial Sales—We sell Sears merchandise, parts, and services to commercial customers through our business-to-business Sears Commercial Sales and Appliance Builder/Distributor businesses.

Sears Commercial Sales provides appliances and services to commercial customers in the single-family residential construction/remodel, property management, multi-family new construction, and government/military sectors.

Our Appliance Builder/Distributor business offers premium appliance and plumbing fixtures to architects, designers, and new construction or remodeling customers, and is currently operating in nine markets with 17 facilities.

Home Services—Product Repair Services, the nation's largest product repair service provider, is a key element in our active relationship with more than 41 million households. With approximately 7,500 service technicians making over 13 million service and installation calls annually, this business delivers

a broad range of retail-related residential and commercial services across all 50 states, Puerto Rico, Guam and the Virgin Islands under either the Sears Parts & Repair Services or A&E Factory Service trade names. Commercial and residential customers can obtain parts and repair services for all major brands of products within the appliances, lawn and garden equipment, consumer electronics, floor care products, and heating and cooling systems categories. We also provide repair parts with supporting instructions for "do-it-yourself" members and customers through our searspartsdirect.com website. This business also offers protection agreements, product installation services and Kenmore and Carrier brand residential heating and cooling systems. Home Services also includes home improvement services (primarily siding, windows, cabinet refacing, kitchen remodeling, roofing, carpet and upholstery cleaning, air duct cleaning, and garage door installation and repair) provided through Sears Home Improvement Services and Sears Home & Business Franchises.

#### Sears Canada

Sears Canada, a consolidated, 51%-owned subsidiary of Sears, conducts retail operations in Canada similar to those conducted by Sears Domestic, with a greater emphasis on apparel and other softlines than in the U.S. stores.

As previously announced, we plan to work with the board and management of Sears Canada to increase the value of our investment in Sears Canada.

At February 1, 2014, Sears Canada operated a total of 118 full-line stores, 331 specialty stores (including 48 furniture and appliance stores, 234 hometown dealer stores primarily operated under independent local ownership, four appliance and mattress stores, 34 Corbeil stores, and 11 outlet stores), eight home services showrooms, 1,446 catalog pick-up locations and 97 travel offices. Sears Canada also sells its products through its sears.ca website.

#### Separation of Sears Hometown and Outlet Businesses

On October 11, 2012, we completed the separation of our Sears Hometown and Outlet businesses through a rights offering transaction. Holdings received gross proceeds of \$446.5 million with respect to the transaction, consisting of \$346.5 million for the sale of Sears Hometown and Outlet Stores, Inc. ("SHO") common shares and \$100 million through a dividend from SHO prior to the separation. Prior to the separation, SHO entered into an asset-based senior secured revolving credit facility with a group of financial institutions to provide (subject to availability under a borrowing base) for aggregate maximum borrowings of \$250 million. Borrowings of \$100 million from this revolving credit facility were used to fund the dividend paid to Holdings. We accounted for this separation in accordance with accounting standards applicable to common control transactions as ESL Investments, Inc. (together with its affiliated funds, "ESL") is a majority shareholder of Holdings and became a majority shareholder of SHO as a result of exercising subscription rights pursuant to the rights offering. Accordingly, we classified the difference between the proceeds received and the carrying value of net assets contributed to SHO as a reduction of capital in excess of par value in the Consolidated Statement of Equity for the period ended February 2, 2013.

In connection with the separation, Holdings and certain of its subsidiaries entered into various agreements with SHO under the terms described in Note 15. Because of the various agreements with SHO, the Company has determined that it has significant continuing cash flows with SHO. Accordingly, the operating results for SHO through the date of the separation are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Consolidated Financial Statements. See Note 15 of Notes to Consolidated Financial Statements for further information related to the agreements with SHO.

#### Partial Spin-Off of Interest in Sears Canada

On November 13, 2012, we completed a partial spin-off (the "spin-off") of our interest in Sears Canada. Prior to the spin-off, Holdings beneficially owned approximately 96% of the issued and outstanding common shares of Sears Canada. In connection with the spin-off, we distributed approximately 45 million common shares of Sears Canada held by Holdings on a pro rata basis to holders of Holdings' common stock. Following the spin-off, Holdings was the beneficial holder of approximately 51% of the issued and outstanding common shares of Sears Canada, and as such, Holdings has maintained control of Sears Canada and will continue to consolidate the results of Sears Canada. We accounted for the spin-off as an equity transaction in accordance with accounting standards

applicable to noncontrolling interests. Accordingly, we reclassified a portion of our ownership interest in Sears Canada and accumulated other comprehensive loss to noncontrolling interest in the Consolidated Statement of Equity at February 2, 2013.

At February 1, 2014, February 2, 2013 and January 28, 2012, Holdings was the beneficial holder of approximately 52 million, or 51%, 52 million, or 51%, and 97 million, or 95%, respectively, of the common shares of Sears Canada.

#### Spin-Off of Orchard Supply Hardware Stores Corporation

On December 30, 2011, we completed the spin-off to our shareholders of all the capital stock of Orchard Supply Hardware Stores Corporation ("Orchard") that was owned by Holdings immediately prior to the spin-off, consisting of common stock that represented approximately 80% of the voting power of Orchard's outstanding capital stock and preferred stock that represented 100% of Orchard's outstanding nonvoting capital stock. In connection with the spin-off, Holdings and certain of its subsidiaries entered into various agreements with Orchard, including a distribution agreement, a transition services agreement, an appliance sale and consignment agreement and brand license agreements. In addition, certain tax matters between Holdings and Orchard are governed by a tax sharing agreement entered into in 2005.

#### Real Estate Transactions

In the normal course of business, we consider opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash. In addition, we review leases that will expire in the short term in order to determine the appropriate action to take with respect to them.

Further information concerning our real estate transactions is contained in Note 11 of Notes to Consolidated Financial Statements.

#### Trademarks and Trade Names

The K MART® and SEARS® trade names, service marks and trademarks, used by us both in the United States and internationally, are material to our retail and other related businesses.

We sell proprietary branded merchandise under a number of brand names that are important to our operations. Our KENMORE®, CRAFTSMAN®, DIEHARD® and LANDS' END® brands are among the most recognized proprietary brands in retailing. These marks are the subject of numerous United States and foreign trademark registrations. Other well recognized Company trademarks and service marks include CANYON RIVER BLUES®, COVINGTON®, SHOP YOUR WAY™, SMART SENSE®, STRUCTURE®, THOM MCAN® and TOUGHSKINS®, which also are registered or are the subject of pending registration applications in the United States. Generally, our rights in our trade names and marks continue so long as we use them.

#### Seasonality

The retail business is seasonal in nature, and we generate a high proportion of our revenues, operating income and operating cash flows during the fourth quarter of our year, which includes the holiday season. As a result, our overall profitability is heavily impacted by our fourth quarter operating results. Additionally, in preparation for the fourth quarter holiday season, we significantly increase our merchandise inventory levels, which are financed from operating cash flows, credit terms received from vendors and borrowings under our domestic credit agreement (described in the "Uses and Sources of Liquidity" section below). Fourth quarter reported revenues accounted for approximately 30% of total reported revenues in each of the years 2013, 2012 and 2011. See Note 19 of Notes to Consolidated Financial Statements for further information on revenues earned by quarter in 2013 and 2012.

#### Competition

Our business is subject to highly competitive conditions. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, consumer electronics dealers, auto service

providers, specialty retailers, wholesale clubs, as well as many other retailers operating on a national, regional or local level in the U.S. and Canada. Online and catalog businesses, which handle similar lines of merchandise, also compete with us. Walmart, Target, Kohl's, J.C. Penney, Macy's, The Home Depot, Lowe's, Best Buy and Amazon are some of the national retailers and businesses with which we compete. The Home Depot and Lowe's are major competitors in relation to our home appliance business, which accounted for approximately 13% of our 2013, 15% of our 2012 and 16% of our 2011 reported revenues. Sears Canada competes in Canada with Hudson's Bay Company, other Canadian-based store and online retailers, as well as certain U.S.-based competitors, including some of those mentioned above, that are expanding into Canada. Success in these competitive marketplaces is based on factors such as price, product assortment and quality, service and convenience, including availability of retail-related services such as access to credit, product delivery, repair and installation. Additionally, we are influenced by a number of factors including, but not limited to, the cost of goods, consumer debt availability and buying patterns, economic conditions, customer preferences, inflation, currency exchange fluctuations, weather patterns, and catastrophic events. Item 1A in this report on Form 10-K contains further information regarding risks to our business.

#### Employees

At February 1, 2014, subsidiaries of Holdings had approximately 226,000 employees in the United States and U.S. territories, and approximately 23,000 employees in Canada through Sears Canada. These employee counts include part-time employees.

#### Our Website; Availability of SEC Reports and Other Information

Our corporate website is located at [searsholdings.com](http://searsholdings.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports are available, free of charge, through the "SEC Filings" portion of the Investor Information section of our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC").

The Corporate Governance Guidelines of our Board of Directors, the charters of the Audit, Compensation, Finance and Nominating and Corporate Governance Committees of the Board of Directors, our Code of Conduct and the Board of Directors Code of Conduct are available in the Corporate Governance section of [searsholdings.com](http://searsholdings.com). References to our website address or the website address of Sears Canada do not constitute incorporation by reference of the information contained on such websites, and the information contained on the websites is not part of this document.

#### Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, results of operations and financial condition.

If we fail to offer merchandise and services that our members and customers want, our sales may be limited, which would reduce our revenues and profits.

In order for our business to be successful, we must identify, obtain supplies of, and offer to our members and customers, attractive, innovative and high-quality merchandise on a continuous basis. Our products and services must satisfy the desires of our members and customers, whose preferences may change in the future. If we misjudge either the demand for products and services we sell or our members' and customers' purchasing habits and tastes, we may be faced with excess inventories of some products and missed opportunities for products and services we chose not to offer. In addition, our sales may decline or we may be required to sell the merchandise we have obtained at lower prices. This would have a negative effect on our business and results of operations.

If our integrated retail strategy to transform into a member-centric retailer is not successful, our business and results of operations could be adversely affected.

We are seeking to transform into a member-centric retailer through our integrated retail strategy, which is based on a number of initiatives, including our Shop Your Way program, that depend, among other things, on our ability to respond quickly to ongoing technology developments and implement new ways to understand and rely on the data to interact with our members and customers in order to achieve expected benefits. In addition, one or more of these initiatives may not be accepted by our members and customers, which may result in the Company's sales being less than it anticipates; and no assurance can be given that our strategy and offerings will be successful and will not have a material adverse effect on our reputation, financial condition and operating results.

If we do not successfully manage our inventory levels, our operating results will be adversely affected.

We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory as we seek to minimize out-of-stock levels across all product categories and to maintain in-stock levels. We obtain a significant portion of our inventory from vendors located outside the United States. Some of these vendors often require lengthy advance notice of our requirements in order to be able to supply products in the quantities we request. This usually requires us to order merchandise, and enter into purchase order contracts for the purchase and manufacture of such merchandise, well in advance of the time these products will be offered for sale. As a result, we may experience difficulty in responding to a changing retail environment, which makes us vulnerable to changes in price. If we do not accurately anticipate the future demand for a particular product or the time it will take to obtain new inventory, our inventory levels will not be appropriate and our results of operations may be negatively impacted.

If we are unable to compete effectively in the highly competitive retail industry, our business and results of operations could be materially adversely affected.

The retail industry is highly competitive with few barriers to entry. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, appliances and consumer electronics retailers, auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level in the U.S. and Canada. Some of our competitors are actively engaged in new store expansion. Online and catalog businesses, which handle similar lines of merchandise, and some of which are not required to collect sales taxes on purchases made by their customers, also compete with us. In this competitive marketplace, success is based on factors such as price, product assortment and quality, service and convenience. Our success depends on our ability to differentiate ourselves from our competitors with respect to shopping convenience, a quality assortment of available merchandise and superior customer service. We must also successfully respond to our members' and customers' changing tastes. The performance of our competitors, as well as changes in their pricing policies, marketing activities, new store openings and other business strategies, could have a material adverse effect on our business, financial condition and results of operations.

Our business has been and will continue to be affected by worldwide economic conditions; a failure of the economy to sustain its recovery, a renewed decline in consumer-spending levels and other conditions, including inflation and changing prices of energy, could lead to reduced revenues and gross margins, and negatively impact our liquidity. Many economic and other factors are outside of our control, including consumer and commercial credit availability, consumer confidence and spending levels, including the impact of payroll tax and medical cost increases on U.S. consumers, inflation, employment levels, housing sales and remodels, consumer debt levels, fuel costs and other challenges currently affecting the global economy, the full impact of which on our business, results of operations and financial condition cannot be predicted with certainty. These economic conditions adversely affect the disposable income levels of, and the credit available to, our members and customers, which could lead to reduced demand for our merchandise. Changing fuel and energy costs may have a significant impact on our operations. We require significant quantities of fuel for the vehicles used by technicians in our home services business and we are exposed to the risk associated with variations in the market price for petroleum products. We

could experience a disruption in energy supplies, including our supply of gasoline, as a result of factors that are beyond our control, which could have an adverse effect on our business. Certain of our vendors also could experience increases in the cost of various raw materials, such as cotton, oil-related materials, steel and rubber, which could result in increases in the prices that we pay for merchandise, particularly apparel, appliances and tires. The domestic and international political situation also affects consumer confidence. The threat, outbreak or escalation of terrorism, military conflicts or other hostilities could lead to a decrease in consumer spending. Any of these events and factors could cause us to increase inventory markdowns and promotional expenses, thereby reducing our gross margins and operating results.

The lack of willingness of our vendors to provide acceptable payment terms could negatively impact our liquidity and/or reduce the availability of products or services we seek to procure.

We depend on our vendors to provide us with financing on our purchases of inventory and services. Our vendors could seek to limit the availability of vendor credit to us or other terms under which they sell to us, or both, which could negatively impact our liquidity. In addition, the inability of vendors to access liquidity, or the insolvency of vendors, could lead to their failure to deliver inventory or other services. Certain of our vendors finance their operations and/or reduce the risk associated with collecting accounts receivable from us by selling or “factoring” the receivables or by purchasing credit insurance or other forms of protection from loss associated with our credit risks. The ability of our vendors to do so is subject to the perceived credit quality of the Company. Such vendors could be limited in their ability to factor receivables or obtain credit protection in the future because of our perceived financial position and creditworthiness, which could reduce the availability of products or services we seek to procure.

Certain factors, including changes in market conditions and our credit ratings, may limit our access to capital markets and other financing sources and materially increase our borrowing costs.

In addition to credit terms from vendors, our liquidity needs are funded by our operating cash flows and, to the extent necessary, borrowings under our credit agreements and commercial paper program and access to capital markets. The availability of financing depends on numerous factors, including economic and market conditions, our operating performance, our credit ratings, and lenders' assessments of our prospects and the prospects of the retail industry in general. Changes in these factors may affect our cost of financing, liquidity and our ability to access financing sources, including our commercial paper program and possible second lien indebtedness that is permitted under the domestic revolving credit facility, with respect to each of which we have no lender commitments. Rating agencies revise their ratings for the companies that they follow from time to time and our ratings may be revised or withdrawn in their entirety at any time.

While the Company's domestic revolving credit facility currently provides for up to \$3.275 billion of lender commitments, our ability to borrow funds under this facility is limited by a borrowing base determined relative to the value, from time to time, of eligible inventory, accounts receivable and certain other assets. In addition, our ability to incur possible second lien indebtedness that is otherwise permitted under the domestic revolving credit facility is limited by a borrowing base requirement under the indenture that governs our senior secured notes due 2018. If, through asset sales or other means, the value of these eligible assets is not sufficient to support borrowings of up to the full amount of the commitments under this facility, we will not have full access to the facility, but rather could have access to a lesser amount determined by the borrowing base. Such a decline in the value of eligible assets also could result in our inability to borrow up to the full amount of second lien indebtedness permitted by the domestic credit facility, but rather we could be limited to borrowing a lesser amount determined by the borrowing base as calculated pursuant to the terms of the indenture. The domestic revolving credit facility also effectively limits full access to the facility if our fixed charge ratio at the last day of any quarter is less than 1.0 to 1.0. As of February 1, 2014, our fixed charge ratio was less than 1.0 to 1.0.

The lenders under our credit facilities may not be able to meet their commitments if they experience shortages of capital and liquidity and there can be no assurance that our ability to otherwise access the credit markets will not be adversely affected by changes in the financial markets and the global economy.

We cannot predict whether our plans to generate liquidity will be successful.

We have plans to generate at least \$1.0 billion million of additional liquidity during fiscal year 2014. We currently anticipate generating approximately \$500 million from an exit dividend in connection with the planned separation of our Lands' End, Inc. subsidiary through a pro rata distribution to our stockholders (the "LE Spin-off"), we are working with the board and management of Sears Canada to increase the value of our investment in Sears Canada, and we are evaluating strategic alternatives for our Sears Auto Centers business, subject in each case to certain conditions, including board approval in the case of possible transactions involving Sears Canada and Sears Auto Centers. The achievement of these objectives and outcome of these initiatives are subject to risks and uncertainties with respect to market conditions and other factors that may cause our actual results, performance or achievements to be materially different from our plans, and there can be no assurance that transactions to monetize assets or other actions to generate liquidity will become available on terms that are acceptable to us, on intended timetables or at all. In addition, there can be no assurance that the evaluation and/or completion of any of these potential transactions will not have a negative impact on our other businesses.

Potential liabilities in connection with the separation of Lands' End, Inc. may arise under fraudulent conveyance and transfer laws and legal capital requirements.

With respect to the LE Spin-off, if either Holdings or Lands' End subsequently fails to pay its creditors or enters insolvency proceedings, the transaction may be challenged under U.S. federal, U.S. state and foreign fraudulent conveyance and transfer laws, as well as legal capital requirements governing distributions and similar transactions. If a court were to determine under these laws that, (a) at the time of the LE Spin-off, the entity in question: (1) was insolvent; (2) was rendered insolvent by reason of the LE Spin-off; (3) had remaining assets constituting unreasonably small capital; (4) intended to incur, or believed it would incur, debts beyond its ability to pay these debts as they matured; or (b) the transaction in question failed to satisfy applicable legal capital requirements, the court could determine that the LE Spin-off was voidable, in whole or in part. Subject to various defenses, the court could then require Holdings or Lands' End, or other recipients of value in connection with the LE Spin-off (potentially including Lands' End stockholders as recipients of shares of Lands' End common stock in connection with the spin-off), as the case may be, to turn over value to other entities involved in the LE Spin-off and contemplated transactions for the benefit of unpaid creditors. The measure of insolvency and applicable legal capital requirements will vary depending upon the jurisdiction whose law is being applied.

We rely extensively on computer systems to implement our integrated retail strategy, process transactions, summarize results and otherwise manage our business. Disruptions in these systems could harm our ability to run our business. Given the significance of our online and mobile capabilities, our collection and use of data to create personalized experiences, and the number of individual transactions we have each year, including in our stores, it is critical that we maintain uninterrupted operation of our computer and communications hardware and software systems, some of which are based on end-of-life or legacy technology, operate with minimal or no vendor support and are otherwise difficult to maintain. Our systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees. Operating legacy systems subject us to inherent costs and risks associated with maintaining, upgrading and replacing these systems and retaining sufficiently skilled personnel to maintain and operate the systems, demands on management time, and other risks and costs. Cyber-security risks such as malicious software and attempts to gain unauthorized access to data are rapidly evolving. Techniques or software used to gain unauthorized access, and/or disable, degrade or harm our systems may be difficult to detect or scope for prolonged periods of time, and we may be unable to anticipate these techniques or put in place protective or preventive measures. These attempts to gain unauthorized access could lead to disruptions in our systems, unauthorized release of confidential or otherwise protected information or corruption of data. If individuals are successful in infiltrating, breaking into, disrupting, damaging or otherwise stealing from the computer systems of the Company or its third-party providers, or if our systems are otherwise damaged or cease to function properly, we may have to make a significant investment to fix or replace them, we may suffer interruptions in our operations in the interim, we may face costly litigation, the ability for our members to earn or redeem points in our Shop Your Way program may be impacted or halted, and our reputation with our members and customers may



be harmed. Any material interruption in our computer operations may have a material adverse effect on our business or results of operations, including on our Shop Your Way program and participation in or engagement with that program. In addition, we are pursuing initiatives to transform our information technology processes and systems. These initiatives are highly complex and include replacing legacy systems, upgrading existing systems, and acquiring new systems and hardware with updated functionality. The risk of disruption is increased in periods when such complex and significant systems changes are undertaken.

If we do not maintain the security of our member and customer, associate or company information, we could damage our reputation, incur substantial additional costs and become subject to litigation.

Any significant security compromise, breach of member and customer, associate or company data (either held or maintained by the Company or our third-party providers) or disruption or delay on the ability for our members to earn or redeem points in our Shop Your Way program, could significantly damage our reputation and brands and result in additional costs, lower participation in or engagement with our Shop Your Way program, lost sales, exposure to fraudulent sales, government investigations, government enforcement actions, fines and/or lawsuits. The regulatory environment related to information security and privacy is increasingly rigorous, with new and constantly changing requirements applicable to our business, and compliance with those requirements could result in additional costs or accelerate these costs. There is no guarantee that the procedures that we have implemented to protect against unauthorized access to secured data are adequate to safeguard against all data security breaches. A data security breach could result in a loss of customer or member confidence and negatively impact our business, including our Shop Your Way program, and our results of operations.

Due to the seasonality of our business, our annual operating results would be adversely affected if our business performs poorly in the fourth quarter.

Our business is seasonal, with a high proportion of revenues, operating income and operating cash flows being generated during the fourth quarter of our year, which includes the holiday season. As a result, our fourth quarter operating results significantly impact our annual operating results. Our fourth quarter operating results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions.

Our sales may fluctuate for a variety of reasons, which could adversely affect our results of operations.

Our business is sensitive to customers' spending patterns, which in turn are subject to prevailing economic conditions. Our sales and results of operations have fluctuated in the past, and we expect them to continue to fluctuate in the future. A variety of other factors affect our sales and financial performance, including:

actions by our competitors, including opening of new stores in our existing markets or changes to the way these competitors go to market online,

seasonal fluctuations due to weather conditions,

changes in our merchandise strategy and mix,

changes in population and other demographics, and

timing of our promotional events.

Accordingly, our results for any one quarter are not necessarily indicative of the results to be expected for any other quarter, and comparable store sales for any particular future period may increase or decrease. For more information on our results of operations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this report on Form 10-K.

We rely on foreign sources for significant amounts of our merchandise, and our business may therefore be negatively affected by the risks associated with international trade.

We depend on a large number of products produced in foreign markets. We face risks, including reputational risks, associated with the delivery of merchandise originating outside the United States, including:

potential economic and political instability in countries where our suppliers are located,

increases in shipping costs,  
manufacturing and transportation delays and interruptions,  
supplier compliance with applicable laws, including labor and environmental laws, and with our global compliance program for suppliers and factories,  
adverse fluctuations in currency exchange rates, and  
changes in U.S. and foreign laws affecting the importation and taxation of goods, including duties, tariffs and quotas, or changes in the enforcement of those laws.

We rely on third parties to provide us with services in connection with the administration of certain aspects of our business.

We have entered into agreements with third-party service providers (both domestic and overseas) to provide processing and administrative functions over a broad range of areas, and we may continue to do so in the future. These areas include finance and accounting, information technology, including IT development, call center, human resources and procurement functions. Services provided by third parties as a part of outsourcing initiatives could be interrupted as a result of many factors, such as acts of God or contract disputes, and any failure by third parties to provide us with these services on a timely basis or within our service level expectations and performance standards could result in a disruption of our business. In addition, to the extent we are unable to maintain our outsourcing arrangements; we would incur substantial costs, including costs associated with hiring new employees, in order to return these services in-house. These outsourcing arrangements also carry the risk that the Company will fail to adequately retain the significant internal historical knowledge of our business and systems that is transferred to the service providers as the employment of the Company's personnel who possess such knowledge ends.

We could incur charges due to impairment of goodwill, intangible and long-lived assets.

At February 1, 2014, we had goodwill and intangible asset balances of \$3.2 billion, which are subject to periodic testing for impairment. Our long-lived assets, primarily stores, also are subject to periodic testing for impairment. A significant amount of judgment is involved in the periodic testing. Failure to achieve sufficient levels of cash flow within each of our reporting units, or sales of our branded products or cash flow generated from operations at individual store locations could result in impairment charges for goodwill and intangible assets or fixed asset impairment for long-lived assets, which could have a material adverse effect on our reported results of operations. Impairment charges, if any, resulting from the periodic testing are non-cash. A significant and sustained decline in our stock price could result in goodwill impairment charges. During times of financial market volatility, significant judgment is used to determine the underlying cause of the decline and whether stock price declines are short-term in nature or indicative of an event or change in circumstances. See Notes 12 and 13 of Notes to Consolidated Financial Statements for further information.

The loss of key personnel may disrupt our business and adversely affect our financial results.

We depend on the contributions of key personnel, including Edward S. Lampert, our Chairman and Chief Executive Officer, and other key employees, for our future success. Although certain executives have employment agreements with us, changes in our senior management and any future departures of key employees may disrupt our business and materially adversely affect our results of operations.

Affiliates of our Chairman and Chief Executive Officer, whose interests may be different than your interests, exert substantial influence over our Company.

Affiliates of Edward S. Lampert, our Chairman and Chief Executive Officer, beneficially own approximately 48% of the outstanding shares of our common stock. These affiliates are controlled, directly or indirectly, by Mr. Lampert. Accordingly, these affiliates, and thus Mr. Lampert, have substantial influence over many, if not all, actions to be taken or approved by our stockholders, including the election of directors and any transactions involving a change of control.

The interests of these affiliates, which have investments in other companies, including our former subsidiary, Sears Hometown and Outlet Stores, Inc., may from time to time diverge from the interests of our other stockholders, particularly with regard to new investment opportunities. This substantial influence may have the effect of discouraging offers to acquire our Company because the consummation of any such acquisition would likely require the consent of these affiliates.

We may be unable to protect or preserve the image of our brands and our intellectual property rights, which could have a negative impact on our business.

We regard our copyrights, service marks, trademarks, trade dress, trade secrets, patents and similar intellectual property as critical to our success, particularly those that relate to our private branded merchandise. As such, we rely on trademark and copyright law, patent law, trade secret protection and confidentiality agreements with our associates, consultants, vendors, and others to protect our proprietary rights. Nevertheless, the steps we take to protect our proprietary rights may be inadequate. If we are unable to protect or preserve the value of our trademarks, copyrights, trade secrets, patents or other proprietary rights for any reason, or if we fail to maintain the image of our brands due to merchandise and service quality issues, actual or perceived, adverse publicity, governmental investigations or litigation, or other reasons, our brands and reputation could be damaged and we could lose members and customers. We may be subject to product liability claims if people or properties are harmed by the products we sell or the services we offer.

Some of the products we sell may expose us to product liability claims relating to personal injury, death, or property damage caused by such products, and may require us to take actions such as product recalls. We also provide various services, which could also give rise to such claims. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.

We may be subject to periodic litigation and other regulatory proceedings. These proceedings may be affected by changes in laws and government regulations or changes in the enforcement thereof.

From time to time, we may be involved in lawsuits and regulatory actions relating to our business, certain of which may be in jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants. Some of these actions have the potential for significant statutory penalties, and compensatory, treble or punitive damages. Our pharmacy, home services and grocery businesses, in particular, are subject to numerous federal, state and local regulations, and a significant change in, or noncompliance with, these regulations could have a material adverse effect on our compliance costs and results of operations. We are impacted by trends in litigation, including class-action allegations brought under various consumer protection and employment laws, including wage and hour laws, and investigations and actions that are based on allegations of untimely compliance or noncompliance with applicable regulations or statutes. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition and results of operations. In addition, regardless of the outcome of any litigation or regulatory proceedings, these proceedings could result in substantial costs and may require that we devote substantial resources to defend our Company. Further, changes in governmental regulations both in the United States and in the other countries where we operate could have adverse effects on our business and subject us to additional regulatory actions. For a description of current legal proceedings, see Item 3, "Legal Proceedings," as well as Note 18 of Notes to Consolidated Financial Statements in this report on Form 10-K.

Our pension and postretirement benefit plan obligations are currently underfunded, and we may have to make significant cash payments to some or all of these plans, which would reduce the cash available for our businesses.

We have unfunded obligations under our domestic and foreign pension and postretirement benefit plans. The funded status of our pension plans is dependent upon many factors, including returns on invested assets, the level of

certain market interest rates and the discount rate used to determine pension obligations. Unfavorable returns on the plan assets or unfavorable changes in applicable laws or regulations could materially change the timing and amount of required plan funding, which would reduce the cash available for our businesses. In addition, a decrease in the discount rate used to determine pension obligations could result in an increase in the valuation of pension obligations, which could affect the reported funding status of our pension plans and future contributions, as well as the periodic pension cost in subsequent years. Moreover, unfavorable regulatory action could materially change the timing and amount of required plan funding and negatively impact our business operations and impair our business strategy.

Item 1B. Unresolved Staff Comments

Not applicable.

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**Item 2. Properties**

The following table summarizes the locations of our Kmart and Sears Domestic stores at February 1, 2014:

| State/Territory | Kmart           |               | Sears Domestic        |                                   |                  |
|-----------------|-----------------|---------------|-----------------------|-----------------------------------|------------------|
|                 | Discount Stores | Super Centers | Full-line Mall Stores | Sears Essentials/<br>Grand Stores | Specialty Stores |
| Alabama         | 22              | —             | 10                    | —                                 | —                |
| Alaska          | —               | —             | 3                     | —                                 | —                |
| Arizona         | 15              | —             | 14                    | —                                 | —                |
| Arkansas        | 5               | —             | 7                     | —                                 | 1                |
| California      | 96              | —             | 79                    | 1                                 | 5                |
| Colorado        | 13              | —             | 11                    | 1                                 | 1                |
| Connecticut     | 7               | —             | 8                     | —                                 | —                |
| Delaware        | 6               | —             | 4                     | —                                 | —                |
| Florida         | 62              | —             | 51                    | —                                 | 1                |
| Georgia         | 27              | —             | 19                    | —                                 | —                |
| Hawaii          | 7               | —             | 4                     | —                                 | —                |
| Idaho           | 8               | —             | 5                     | —                                 | —                |
| Illinois        | 42              | 2             | 29                    | 1                                 | 8                |
| Indiana         | 31              | 2             | 17                    | —                                 | 1                |
| Iowa            | 20              | —             | 9                     | —                                 | 2                |
| Kansas          | 9               | —             | 8                     | —                                 | 1                |
| Kentucky        | 27              | —             | 8                     | —                                 | —                |
| Louisiana       | 11              | —             | 13                    | —                                 | 1                |
| Maine           | 6               | —             | 5                     | —                                 | —                |
| Maryland        | 21              | —             | 19                    | —                                 | —                |
| Massachusetts   | 19              | —             | 21                    | —                                 | —                |
| Michigan        | 68              | 5             | 23                    | —                                 | —                |
| Minnesota       | 21              | —             | 11                    | —                                 | 4                |
| Mississippi     | 5               | —             | 4                     | —                                 | —                |
| Missouri        | 26              | —             | 10                    | 1                                 | —                |
| Montana         | 9               | —             | 3                     | —                                 | —                |
| Nebraska        | 8               | —             | 4                     | —                                 | —                |
| Nevada          | 10              | —             | 4                     | 1                                 | 1                |
| New Hampshire   | 5               | —             | 6                     | —                                 | —                |
| New Jersey      | 32              | —             | 20                    | —                                 | 2                |
| New Mexico      | 13              | —             | 7                     | —                                 | —                |
| New York        | 50              | —             | 45                    | —                                 | 7                |
| North Carolina  | 39              | —             | 21                    | —                                 | —                |
| North Dakota    | 6               | —             | 4                     | —                                 | —                |
| Ohio            | 51              | 7             | 37                    | 1                                 | 1                |
| Oklahoma        | 9               | —             | 10                    | —                                 | —                |
| Oregon          | 11              | —             | 7                     | —                                 | 1                |
| Pennsylvania    | 92              | 1             | 42                    | 1                                 | 2                |
| Rhode Island    | 1               | —             | 2                     | —                                 | —                |
| South Carolina  | 22              | —             | 11                    | —                                 | —                |
| South Dakota    | 9               | —             | 2                     | —                                 | —                |
| Tennessee       | 30              | —             | 17                    | —                                 | —                |
| Texas           | 19              | —             | 58                    | 1                                 | 1                |
| Utah            | 14              | —             | 4                     | 1                                 | 1                |

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|                     |       |    |     |    |    |
|---------------------|-------|----|-----|----|----|
| Vermont             | 3     | —  | 2   | —  | —  |
| Virginia            | 36    | —  | 19  | 1  | 1  |
| Washington          | 13    | —  | 19  | —  | 2  |
| West Virginia       | 15    | —  | 7   | —  | —  |
| Wisconsin           | 26    | —  | 14  | —  | 5  |
| Wyoming             | 9     | —  | 2   | —  | —  |
| Puerto Rico         | 24    | —  | 9   | —  | 1  |
| U.S. Virgin Islands | 4     | —  | —   | —  | —  |
| Guam                | 1     | —  | —   | —  | —  |
| Totals              | 1,135 | 17 | 768 | 10 | 50 |

|   | Kmart           |               | Sears Domestic        |                                   |                  | Sears Canada     |                  |     | Total |
|---|-----------------|---------------|-----------------------|-----------------------------------|------------------|------------------|------------------|-----|-------|
|   | Discount Stores | Super Centers | Full-line Mall Stores | Sears Essentials/<br>Grand Stores | Specialty Stores | Full-line Stores | Specialty Stores |     |       |
| Owned                                   | 183             | 12            | 485                   | 7                                 | 25               | 14               | 2                | 728 |       |
| Leased                                  | 952             | 5             | 283                   | 3                                 | 25               | 104              | 104              |     | 1,476 |
| Independently-owned and operated stores | —               | —             | —                     | —                                 | —                | —                | 225              |     | 225   |
| Stores at February 1, 2014              | 1,135           | 17            | 768                   | 10                                | 50               | 118              | 331              |     | 2,429 |

In addition, at February 1, 2014, we had 36 domestic supply chain distribution centers, of which 12 were owned and 24 were leased with remaining lease terms ranging up to six years. Of the total, 10 primarily support Kmart stores, 21 primarily support Sears stores and five support both Sears and Kmart stores. We also had 419 domestic store warehouses, customer call centers and service facilities (including 17 facilities related to our appliance builder/distributor business), most of which are leased for terms ranging generally from three to five years or are part of other facilities included in the above table. Many of our facilities are also used to support our online channels.

Our principal executive offices are located on a 200-acre site owned by us at the Prairie Stone office park in Hoffman Estates, Illinois. The complex consists of six interconnected office buildings totaling approximately two million gross square feet of office space. In addition, we have a campus in Dodgeville, Wisconsin supporting the corporate headquarters, distribution center and customer sales/service operations for Lands' End. We also own an 86,000 square foot office building in Troy, Michigan. We operate numerous buying offices throughout the world that procure product internationally, as well as an information technology center in Pune, India.

At February 1, 2014, Sears Canada operated a total of 118 full-line stores, 331 specialty stores (including 48 furniture and appliance stores, 234 hometown dealer stores operated under independent local ownership, four appliance and mattress stores, 34 Corbeil stores, and 11 outlet stores), eight home services showrooms, 1,446 catalog pick-up locations and 97 travel offices.

A description of our leasing arrangements and commitments appears in Note 14 of Notes to Consolidated Financial Statements.

#### Item 3. Legal Proceedings

Item 103 of SEC Regulation S-K requires that we disclose legal proceedings to which the Company and a governmental authority is a party and that arise under laws dealing with the discharge of materials into the environment or the protection of the environment, if the proceeding reasonably involves potential monetary sanctions of \$100,000 or more. Disclosure also is required as to any such proceedings known by us to be contemplated by governmental authorities. In that connection, we note that Sears received a notice of violation from the California South Coast Air Quality Management District ("SCAQMD") alleging that Sears stores that are located in the SCAQMD jurisdiction sold architectural coating products that exceed the current SCAQMD limitations on volatile organic compounds. The parties entered into a settlement agreement under which the Company paid a \$50,000 penalty.

See Part II, Item 8, "Financial Statements—Notes to Consolidated Financial Statements," Note 18—"Legal Proceedings," for additional information regarding legal proceedings, which information is incorporated herein by this reference.

#### Item 4. Mine Safety Disclosures

Not applicable.

## EXECUTIVE OFFICERS OF THE REGISTRANT

The following table and information sets forth the names of our executive officers, their current positions and offices with the Company, the date they first became executive officers of the Company, their current ages, and their principal employment during the past five years.

| Name                  | Position  | Date First Became an Executive Officer | Age |
|-----------------------|---|--|-----|
| Edward S. Lampert     | Chairman of the Board and Chief Executive Officer   | 2013                                   | 51  |
| Jeffrey A. Balagna    | Executive Vice President, Chief Information Officer   | 2013                                   | 53  |
| Ronald D. Boire       | Executive Vice President, Chief Merchandising Officer and President, Sears Full Line Stores and Kmart Formats | 2012                                   | 52  |
| Imran Jooma           | Executive Vice President and President, Online, Marketing, Pricing and Financial Services                     | 2012                                   | 41  |
| Robert A. Schriesheim | Executive Vice President and Chief Financial Officer  | 2011                                   | 53  |
| Dane A. Drobny        | Senior Vice President, General Counsel and Corporate Secretary  | 2010                                   | 46  |
| Leena Munjal          | Senior Vice President, Customer Experience and Integrated Retail  | 2013                                   | 37  |
| Robert A. Riecker     | Vice President, Controller and Chief Accounting Officer   | 2012                                   | 49  |

Mr. Lampert has served as Chairman of the Company's Board of Directors since 2004 and as our Chief Executive Officer since February 2013. He also is the Chairman and Chief Executive Officer of ESL Investments, Inc., which he founded in April 1988.

Mr. Balagna joined the Company as Executive Vice President and Chief Information Officer in May 2013. Prior to joining the Company, he served as the Senior Vice President and Chief Information Officer of Eli Lilly and Company, a pharmaceutical company, since February 2012. He previously served in senior positions for Carlson Companies, including President and Chief Executive Officer for Carlson Marketing Worldwide, a marketing, travel and hospitality company, which was acquired by Groupe Aeroplan, Inc. in 2009, from 2008 to September 2011, Chief Executive Officer of Carlson's T.G.I. Friday's and Pickup Stix casual restaurant businesses in 2008, and Executive Vice President, Chief Information Officer and Customer Technology Officer for Carlson Companies from 2005 to 2008. He previously served in senior positions for Medtronic, Inc., General Electric Company, and Ford Motor Company.

Mr. Boire joined the Company as Executive Vice President, Chief Merchandising Officer and President, Sears Full Line Stores and Kmart Formats in January 2012. He served from October 2009 until January 2012 as President and Chief Executive Officer of Brookstone, a consumer products company. He served as President, U.S. Toys, North America, for Toys "R" Us, a specialty retailer of toys and juvenile products, from July 2006 until September 2009. He previously served as Executive Vice President, Global Merchandise Manager, of Best Buy Co., Inc., a retailer of consumer electronics and related products, from May 2003 to June 2006. Prior to joining Best Buy Co., Inc., Mr. Boire served for 17 years in a variety of increasingly senior roles at Sony Electronics Inc., a marketer of electronic products and services.

Mr. Jooma joined the Company in June 2007 as Vice President, e-Commerce, and has served in his current position since November 2011. He was elected Executive Vice President in November 2012. From May 2010 until November 2011, he served as the Company's Senior Vice President and President, e-Commerce. From August 2009 until May 2010, he served as Senior Vice President, e-Commerce, of the Company. Prior to joining the Company, he served as Vice President of eCommerce at Circuit City Stores, Inc. and prior thereto as the Divisional Vice President of eCommerce at OfficeMax Incorporated.

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

Mr. Drobny joined us as Senior Vice President, General Counsel and Corporate Secretary in May 2010. Prior to joining the Company, he practiced law with the law firm of Winston & Strawn LLP, most recently as Capital Partner, from September 1993 until May 2010.

Ms. Munjal was appointed to her current position in October 2012. She was appointed as Divisional Vice President, Integrated Retail and Member Experience, in July 2011 and was promoted to Vice President in June 2012. From October 2009 to June 2011, she served as Divisional Vice President, and Chief of Staff, Office of the Chairman, and served as Chief of Staff, Office of the CEO, from November 2007 to November 2009. Ms. Munjal joined Sears as Director, Information Technology, in March 2003.

Mr. Riecker was appointed to his current position in January 2012. He joined the Company as Assistant Controller in October 2005 and served as Vice President and Assistant Controller from May 2007 to October 2011. From October 2011 until his election as Vice President, Controller and Chief Accounting Officer, he served as the Company's Vice President, Internal Audit.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Holdings' common stock is quoted on The NASDAQ Stock Market under the ticker symbol SHLD. There were 13,148 shareholders of record at March 1, 2014. The quarterly high and low sales prices for Holdings' common stock are set forth below.

|                    | Fiscal Year 2013 |                |               |                |
|--------------------|------------------|----------------|---------------|----------------|
|                    | Sears Holdings   |                |               |                |
|                    | First Quarter    | Second Quarter | Third Quarter | Fourth Quarter |
| Common stock price |                  |                |               |                |
| High               | \$54.22          | \$60.74        | \$66.00       | \$67.50        |
| Low                | \$43.72          | \$41.84        | \$38.88       | \$34.21        |

|                    | Fiscal Year 2012 |                |               |                |
|--------------------|------------------|----------------|---------------|----------------|
|                    | Sears Holdings   |                |               |                |
|                    | First Quarter    | Second Quarter | Third Quarter | Fourth Quarter |
| Common stock price |                  |                |               |                |
| High               | \$85.90          | \$65.70        | \$67.20       | \$68.77        |
| Low                | \$41.14          | \$46.28        | \$47.01       | \$38.40        |

Holdings has not paid and does not expect to pay cash dividends in the foreseeable future.

**Equity Compensation Plan Information**

The following table reflects information about securities authorized for issuance under our equity compensation plans at February 1, 2014.

| Plan Category   | (a)<br>Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and<br>rights | (b)<br>Weighted-average<br>exercise price of<br>outstanding<br>options,<br>warrants and<br>rights | (c)<br>Number of securities<br>remaining available for<br>future issuance<br>under equity<br>compensation plans* |
|---|---|---|--|
| Equity compensation plans approved by security<br>holders     | —   | —   | 5,270,385  |
| Equity compensation plans not approved by<br>security holders | —   | —   | —  |
| Total   | —   | —   | 5,270,385  |

\*Represents shares of common stock that may be issued pursuant to our 2006 Stock Plan or our 2013 Stock Plan. Awards under the 2006 Stock Plan may be restricted stock awards, a grant of shares of our common stock in connection with an award made under a long-term incentive plan, or certain other stock-based awards. Awards under the 2013 Stock Plan may be restricted stock, stock unit awards, incentive stock options, nonqualified stock options, stock appreciation rights, or certain other stock-based awards. The 2013 Stock Plan also allows common stock of Holdings to be awarded in settlement of an incentive award under the Sears Holdings Corporation Umbrella Incentive Program (and any incentive program established thereunder). The shares shown consist of 277,583 shares of common stock that are available for future issuance pursuant to our 2006 Stock Plan and 4,992,802 shares of common stock that are available for future issuance pursuant to our 2013 Stock Plan. Excludes shares covered by an outstanding plan award that, subsequent to February 1, 2014, ultimately are not delivered on an unrestricted basis.

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(for example, because the award is forfeited, canceled, settled in cash or used to satisfy tax withholding obligations).

### Stock Performance Graph

#### Comparison of Five-Year Cumulative Stockholder Return

The following graph compares the cumulative total return to stockholders on Holdings' common stock from January 30, 2009 through January 31, 2014, the last trading day before the end of fiscal year 2013, based on the market prices at the last trading day before the end of each fiscal year through and including fiscal year 2013 and assuming reinvestment of the value of shares of Orchard distributed to Holdings' shareholders on December 30, 2011, subscription rights to purchase shares of common stock of SHO distributed to Holdings' shareholders on October 11, 2012 and common shares of Sears Canada distributed to Holdings' shareholders on November 13, 2012, with the return on the S&P 500 Stock Index, the S&P 500 Retailing Index and the S&P 500 Department Stores Index for the same period. The graph assumes an initial investment of \$100 on January 30, 2009 in each of our common stock, the S&P 500 Stock Index, the S&P Retailing Index and the S&P 500 Department Stores Index.

The S&P 500 Retailing Index consists of companies included in the S&P 500 Stock Index in the broadly defined retail sector, which includes competing retailers of softlines (apparel and domestics) and hardlines (appliances, electronics and home improvement products), as well as food and drug retailers. The S&P 500 Department Stores Index consists primarily of department stores that compete with our full-line stores.

|                                 | Jan. 30,<br>2009 | Jan. 29,<br>2010 | Jan. 28,<br>2011 | Jan. 27,<br>2012 | Feb. 1,<br>2013 | Jan. 31,<br>2014 |
|---------------------------------|------------------|------------------|------------------|------------------|-----------------|------------------|
| Sears Holdings                  | \$100.00         | \$227.96         | \$185.92         | \$112.01         | \$134.58        | \$102.94         |
| S&P 500 Stock Index             | \$100.00         | \$133.12         | \$154.54         | \$159.38         | \$183.22        | \$215.84         |
| S&P 500 Retailing Index         | \$100.00         | \$155.54         | \$191.89         | \$214.72         | \$269.46        | \$333.86         |
| S&P 500 Department Stores Index | \$100.00         | \$167.17         | \$187.76         | \$208.69         | \$210.82        | \$239.53         |

### Purchase of Equity Securities

During the quarter ended February 1, 2014, we did not repurchase any shares of our common stock under our common share repurchase program. At February 1, 2014, we had approximately \$504 million of remaining authorization under the program.

|                                       | Total Number of Shares Purchased <sup>(1)</sup> | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program <sup>(2)</sup> | Average Price Paid per Share for Publicly Announced Program | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|---------------------------------------|---|------------------------------|---|---|--|
| November 3, 2013 to November 30, 2013 | 1,090   | \$59.93                      | —   | \$—   |  |
| December 1, 2013 to January 4, 2014   | 4,077   | 59.07                        | —   | —   |  |
| January 5, 2014 to February 1, 2014   | 16,470  | 39.98                        | —   | —   |  |
| <b>Total</b>                          | <b>21,637</b>                                   | <b>\$44.58</b>               | <b>—</b>  | <b>\$—</b>  | <b>\$ 504,000,000</b>  |

<sup>(1)</sup> Consists entirely of 21,637 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock.

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

The domestic credit agreement (described in the “Uses and Sources of Liquidity” section below) limits our ability to make restricted payments, including dividends and share repurchases, subject to specified exceptions that are available if, in each case, no event of default under the credit facility exists immediately before or after giving effect to the restricted payment. These include exceptions that require that projected availability under the credit facility, as defined, is at least 15% and an exception that requires that the restricted payment is funded from cash on hand and not from borrowings under the credit facility. The Domestic Credit Agreement also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

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**Item 6. Selected Financial Data**

The table below summarizes our recent financial information. The data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 and our Consolidated Financial Statements and notes thereto in Item 8.

| dollars in millions, except per share<br>and store data  | Fiscal     |           |            |          |          |
|--|------------|-----------|------------|----------|----------|
|  | 2013       | 2012      | 2011       | 2010     | 2009     |
| <b>Summary of Operations</b>   |            |           |            |          |          |
| Revenues <sup>(1)</sup>  | \$36,188   | \$39,854  | \$41,567   | \$42,664 | \$43,360 |
| Domestic comparable store sales %  | (3.8 )%    | (2.5 )%   | (2.2 )%    | (1.3 )%  | (4.7 )%  |
| Net income (loss) from continuing<br>operations attributable to Holdings'<br>shareholders <sup>(2)</sup> | (1,365 )   | (930 )    | (3,113 )   | 122      | 218      |
| <b>Per Common Share</b>  |            |           |            |          |          |
| Basic:   |            |           |            |          |          |
| Net income (loss) from continuing<br>operations attributable to Holdings'<br>shareholders                | \$(12.87 ) | \$(8.78 ) | \$(29.15 ) | \$1.09   | \$1.85   |
| Diluted:   |            |           |            |          |          |
| Net income (loss) from continuing<br>operations attributable to Holdings'<br>shareholders                | \$(12.87 ) | \$(8.78 ) | \$(29.15 ) | \$1.09   | \$1.85   |
| Holdings' book value per common<br>share   | \$16.34    | \$25.89   | \$40.26    | \$78.19  | \$79.21  |
| <b>Financial Data</b>  |            |           |            |          |          |
| Total assets   | \$18,261   | \$19,340  | \$21,381   | \$24,360 | \$24,901 |
| Long-term debt   | 2,559      | 1,579     | 1,693      | 1,872    | 949      |
| Long-term capital lease obligations  | 275        | 364       | 395        | 472      | 510      |
| Capital expenditures   | 329        | 378       | 432        | 426      | 350      |
| Adjusted EBITDA  | (337 )     | 536       | 196        | 1,291    | 1,635    |
| Number of stores   | 2,429      | 2,548     | 4,010      | 3,949    | 3,862    |

<sup>(1)</sup> We follow a retail-based financial reporting calendar. Accordingly, the fiscal year ended February 2, 2013 contained 53 weeks, while all other years presented contained 52 weeks.

The periods presented were impacted by certain significant items, which affected the comparability of amounts reflected in the above selected financial data. For 2013, 2012 and 2011, these significant items are discussed within Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." 2010 results include the impact of domestic pension expense of \$96 million, a \$30 million charge related to store closings and severance, a gain on the sale of real estate of \$28 million, mark-to-market losses of \$4 million on Sears Canada

<sup>(2)</sup> hedge transactions, a tax impact of \$9 million related to a dividend received from Sears Canada and a tax benefit of \$13 million related to the resolution of certain income tax matters. 2009 results include the impact of domestic pension expense of \$170 million, a \$131 million charge related to store closings and severance, a gain on the sale of Sears Canada Headquarters of \$44 million, a gain of \$32 million recorded in connection with the settlement of Visa/MasterCard antitrust litigation, mark-to-market losses of \$33 million on Sears Canada hedge transactions and a tax benefit of \$41 million related to the resolution of certain income tax matters.



Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

We have divided our "Management's Discussion and Analysis of Financial Condition and Results of Operations" into the following six sections:

**Overview of Holdings**

**Results of Operations:**

Fiscal Year

Holdings' Consolidated Results

Business Segment Results

**Analysis of Consolidated Financial Condition**

**Contractual Obligations and Off-Balance Sheet Arrangements**

**Application of Critical Accounting Policies and Estimates**

**Cautionary Statement Regarding Forward-Looking Information**

The discussion that follows should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8.

**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 an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 1,980 full-line and specialty retail stores in the United States, operating through Kmart and Sears, and 449 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ("Sears Canada"), a 51%-owned subsidiary. Further, we operate a number of websites under the Sears.com and Kmart.com banners which offer more than 110 million products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way<sup>SM</sup>, a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way connects all of the ways members shop - in store, at home, online and by phone.

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 Item 1 in this report on Form 10-K. Our business segments have been determined in accordance with accounting standards regarding the determination, and reporting, of business segments.

Our focus in 2013 revolved around continuing our transformation into a member-centric retailer leveraging Shop Your Way and Integrated Retail, which we believe will position us for enhanced growth and profitability to create long-term shareholder value. The investments we made throughout 2013 are enabling us to learn more about how our members want to shop so that we can develop deeper relationships with them and provide them with access to the widest possible assortment of products and services. Looking ahead, we intend to continue to enhance our financial flexibility to support and drive our transformation. While transformations of this size are challenging, we believe that the changes we are making through Shop Your Way and Integrated Retail will benefit us in the changing retail landscape.

Our transformation is guided by these five key pillars:

- Create lasting relationships with members by empowering them to manage their lives
- Attain best in class productivity and efficiency
- Build our brands
- Reinvent the Company continuously through technology and innovation
- Reinforce "The SHC Way" by living our values every day

We seek to achieve the execution of the transformation to drive profitability and position ourselves in the changing environment by the following:

- Leveraging Shop Your Way and Integrated Retail as the foundation of our member-centric business model
- Realignment of our businesses to become a more focused company
- Enhancing our financial flexibility to support and fund our transformation
- Allowing shareholders to participate in value creation actions

#### Leveraging Shop Your Way and Integrated Retail

We seek to proactively transform our business to benefit from the changing retail landscape. At the core of our transformation is transitioning to a member-centric integrated retailer leveraging our Shop Your Way platform. Shop Your Way is unique in that it is a program that rewards members, enhances interaction with members and delivers useful information to our Company. As a result, we are able to be more strategic in how we invest in capabilities to enable our members to access the widest possible assortment of products and services.

#### Realignment Of Our Businesses

We are accelerating our pace of change to position ourselves in the changing environment. We are proactively learning more each day about how our members want to shop and what resonates with them. We are utilizing this feedback as we continue our transition and invest in two primary areas: Our member-based platform Shop Your Way and Integrated Retail. These two key elements represent a different way of doing business at Sears Holdings and are the foundations of our other programs and initiatives. Within these two key areas, we are making substantial investments in engaging members with personalized, relevant content, offering more capabilities to our members, continually enhancing member engagement, and building out our platform technology. To enable this change, we have been strategically realigning our portfolio of businesses to focus on our core strengths, simplify Sears Holdings and become a more focused company that is more efficient to manage and easier to understand - all while seeking to enable us to better optimize our allocation of capital and attract the best talent.

We are investing in capabilities that are intended to enable our members to access the widest possible assortment of products and services. In addition, we are using data and analytics on member trends to make targeted offers and decisions delivered in real-time. We are expanding our reach through Sears Marketplace, our innovative community that allows third-party merchants to advertise or sell their products on the Sears Holdings' family of websites, where we now offer over 100 million items, and multiple delivery options. We are also developing digital and social relationships with our members as we aspire to do more than simply transact. We are working to build valued, trusted relationships with our members by providing differentiated products and services that will be difficult for others to replicate.

#### Enhancing Our Financial Flexibility

As we previously stated, we are reconfiguring our asset base as we accelerate our transformation. In 2012, we separated our Sears Hometown and Outlet Stores business through a rights offering transaction. We consider this transaction to be successful as it:

generated approximately \$450 million of gross proceeds for Sears Holdings;  
did not reduce our overall scale, as our products and services are sold through their locations; and  
allowed existing shareholders the right to participate in value creation generated by Sears Hometown and Outlet Stores.

We recently announced that we intend to separate Lands' End and are exploring strategic alternatives for our Sears Auto Centers business. We believe that these strategic actions are beneficial for a number of reasons:

First, Sears Holdings becomes a more focused company that is more efficient to manage and easier to understand;

• Second, the management of these separated businesses are better able to pursue their own strategic opportunities, optimize their capital structures, attract talent, and allocate capital in a more focused manner;

• Third, they provide multiple opportunities for our shareholders to participate in the value creation generated by these businesses; and

Finally, they potentially enhance Sears Holdings' and the separated entities' financial flexibility.

We believe that we can readily generate liquidity from our asset base. In fact, in 2013 we generated \$2.0 billion of liquidity consisting of \$1.0 billion through real estate transactions in the United States and Canada and another \$1.0 billion, as we executed a five-year secured term loan in October 2013. We expect to continue with these types of activities during 2014. We currently anticipate generating about \$500 million from an exit dividend in connection with the previously announced separation of Lands' End through a pro rata distribution to our shareholders, with the separation being subject to certain conditions. We currently expect that the combination of (1) the Lands' End transaction, (2) our continuing to work with the board and management of Sears Canada to increase the value of our investment, which has a market value as of March 14, 2014 of about \$760 million, and realize significant cash proceeds and (3) our evaluation of opportunities with respect to a potential separation of our Sears Auto Centers when taken together will result in cash proceeds to the Company in excess of \$1.0 billion in 2014, which will help fund our transformation and create value.

## RESULTS OF OPERATIONS

### Fiscal Year

Our fiscal year end is the Saturday closest to January 31 each year. Fiscal years 2013 and 2011 consisted of 52 weeks while fiscal year 2012 consisted of 53 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years. The following fiscal periods are presented in this report.

| Fiscal year | Ended            | Weeks |
|-------------|------------------|-------|
| 2013        | February 1, 2014 | 52    |
| 2012        | February 2, 2013 | 53    |
| 2011        | January 28, 2012 | 52    |

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**Holdings' Consolidated Results**

Holdings' consolidated results of operations for 2013, 2012 and 2011 are summarized as follows:

| millions, except per share data   | 2013             | 2012           | 2011             |
|---|------------------|----------------|------------------|
| <b>REVENUES</b>   |                  |                |                  |
| Merchandise sales and services  | \$36,188         | \$39,854       | \$41,567         |
| <b>COSTS AND EXPENSES</b>   |                  |                |                  |
| Cost of sales, buying and occupancy                                     | 27,433           | 29,340         | 30,966           |
| Gross margin dollars  | 8,755            | 10,514         | 10,601           |
| Gross margin rate   | 24.2 %           | 26.4 %         | 25.5 %           |
| Selling and administrative  | 9,384            | 10,660         | 10,664           |
| Selling and administrative expense as a percentage of revenues          | 25.9 %           | 26.7 %         | 25.7 %           |
| Depreciation and amortization   | 732              | 830            | 853              |
| Impairment charges  | 233              | 330            | 649              |
| Gain on sales of assets   | (667 )           | (468 )         | (64 )            |
| Total costs and expenses  | 37,115           | 40,692         | 43,068           |
| Operating loss  | (927 )           | (838 )         | (1,501 )         |
| Interest expense  | (254 )           | (267 )         | (289 )           |
| Interest and investment income  | 207              | 94             | 41               |
| Other income (loss)   | 2                | 1              | (2 )             |
| Loss from continuing operations before income taxes                     | (972 )           | (1,010 )       | (1,751 )         |
| Income tax expense  | (144 )           | (44 )          | (1,369 )         |
| Loss from continuing operations   | (1,116 )         | (1,054 )       | (3,120 )         |
| Loss from discontinued operations, net of tax                           | —                | —              | (27 )            |
| Net loss  | (1,116 )         | (1,054 )       | (3,147 )         |
| (Income) loss attributable to noncontrolling interests                  | (249 )           | 124            | 7                |
| <b>NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b>                  | <b>\$1,365 )</b> | <b>\$930 )</b> | <b>\$3,140 )</b> |
| Amounts attributable to Holdings' shareholders:                         |                  |                |                  |
| Loss from continuing operations, net of tax                             | \$1,365 )        | \$930 )        | \$3,113 )        |
| Loss from discontinued operations, net of tax                           | —                | —              | (27 )            |
| Net loss  | \$1,365 )        | \$930 )        | \$3,140 )        |
| <b>NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b> |                  |                |                  |
| Diluted loss per share from continuing operations                       | \$12.87 )        | \$8.78 )       | \$29.15 )        |
| Diluted loss per share from discontinued operations                     | —                | —              | (0.25 )          |
|   | \$12.87 )        | \$8.78 )       | \$29.40 )        |
| Diluted weighted average common shares outstanding                      | 106.1            | 105.9          | 106.8            |

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 stores that have undergone format changes. Domestic comparable store sales amounts include sales from sears.com and kmart.com shipped directly to customers. These online sales resulted in a benefit of approximately 60 basis points and 30 basis points, respectively, for 2013 and 2012. In addition, domestic comparable store sales have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period, which resulted in a positive impact of approximately 10 basis points for 2013 and no impact in 2012.

As previously noted, fiscal 2013 was comprised of the 52-week period ended February 1, 2014, while fiscal 2012 was comprised of the 53-week period ended February 2, 2013. This one week shift had no impact on the domestic comparable store sales results reported herein due to the fact that for purposes of reporting domestic comparable store sales results for 2013, weeks one through 52 for fiscal 2013 have been compared to weeks two through 53 for fiscal year 2012, thereby eliminating the impact of the one week shift. Domestic comparable store sales results for 2012 were calculated based on the 52-week period ended January 26, 2013 as compared to the comparable 52-week period in the prior year.

#### 2013 Compared to 2012

##### Net Loss Attributable to Holdings' Shareholders

We recorded a net loss attributable to Holdings' shareholders of \$1.4 billion (\$12.87 loss per diluted share) and \$930 million (\$8.78 loss per diluted share) for 2013 and 2012, respectively. Our results for 2013 and 2012 were affected by a number of significant items. Our net loss as adjusted for these significant items was \$700 million (\$6.60 loss per diluted share) for 2013 and \$266 million (\$2.51 loss per diluted share) for 2012. The increase in net loss for the year reflected a decline in gross margin, which resulted from both a decline in revenues as well as a decline in gross margin rate of 220 basis points, partially offset by a decrease in selling and administrative expenses.

In addition to our net loss from continuing operations determined in accordance with GAAP, for purposes of evaluating operating performance, we use an Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA") measurement as well as Adjusted Earnings per Share ("Adjusted EPS").

Adjusted EBITDA is computed as net loss attributable to Sears Holdings Corporation appearing on the Statements of Operations excluding income (loss) attributable to noncontrolling interests, income tax expense, interest expense, interest and investment income, other income (loss), depreciation and amortization and gain on sales of assets. In addition, it is adjusted to exclude certain significant items as set forth below. Our management uses Adjusted EBITDA to evaluate the operating performance of our businesses, as well as executive compensation metrics, for comparable periods. Adjusted EBITDA should not be used by investors or other third parties as the sole basis for formulating investment decisions as it excludes a number of important cash and non-cash recurring items.

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

- EBITDA excludes the effects of financings and investing activities by eliminating the effects of interest and depreciation costs;
- Management considers gains/(losses) on the sale of assets to result from investing decisions rather than ongoing operations; and

Other significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, which affects comparability of results. Adjustments to EBITDA include impairment charges related to fixed assets and intangible assets, pension settlements, closed store and severance charges, domestic pension expense, transaction costs, hurricane losses and the SHO separation. We have adjusted our results for these items to make our statements more comparable and therefore more useful to investors as the items are not representative of our ongoing operations and reflect past investment decisions.

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Adjusted EBITDA was determined as follows:

|  | 2013       | 2012     | 2011       |
|--|------------|----------|------------|
| millions   |            |          |            |
| Net loss attributable to SHC per statement of operations | \$(1,365 ) | \$(930 ) | \$(3,140 ) |
| Income (loss) attributable to noncontrolling interests   | 249        | (124 )   | (7 )       |
| Loss from discontinued operations, net of tax            | —          | —        | 27         |
| Income tax expense                                       | 144        | 44       | 1,369      |
| Interest expense   | 254        | 267      | 289        |
| Interest and investment income                           | (207 )     | (94 )    | (41 )      |
| Other (income) loss                                      | (2 )       | (1 )     | 2          |
| Operating loss   | (927 )     | (838 )   | (1,501 )   |
| Depreciation and amortization                            | 732        | 830      | 853        |
| Gain on sales of assets                                  | (667 )     | (468 )   | (64 )      |
| Before excluded items                                    | (862 )     | (476 )   | (712 )     |
| Impairment charges                                       | 233        | 330      | 649        |
| Domestic pension expense                                 | 162        | 165      | 74         |
| Closed store reserve, severance and other                | 130        | 140      | 254        |
| Pension settlements                                      | —          | 455      | —          |
| Transaction costs  | —          | 12       | —          |
| Hurricane losses   | —          | —        | 12         |
| Adjusted EBITDA  | (337 )     | 626      | 277        |
| SHO Separation   | —          | (90 )    | (81 )      |
| Adjusted EBITDA as defined                               | \$ (337 )  | \$ 536   | \$ 196     |
| % to revenues  | (0.9 )%    | 1.4 %    | 0.5 %      |

Adjusted EBITDA for our segments was as follows:

|                                    | 2013    | 2012              | 2011            |                   |       |                   |                 |                   |         |                   |                 |                   |
|------------------------------------|---------|-------------------|-----------------|-------------------|-------|-------------------|-----------------|-------------------|---------|-------------------|-----------------|-------------------|
| millions                           | Kmart   | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings | Kmart | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings | Kmart   | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| Operating income                   |         |                   |                 |                   |       |                   |                 |                   |         |                   |                 |                   |
| (loss) per statement of operations | \$(351) | \$(940)           | \$ 364          | \$(927)           | \$ 5  | \$(656)           | \$(187)         | \$(838)           | \$(34 ) | \$(1,447)         | \$(20 )         | \$(1,501)         |
| Depreciation and amortization      | 129     | 511               | 92              | 732               | 147   | 578               | 105             | 830               | 149     | 601               | 103             | 853               |
| Gain on sales of assets            | (66 )   | (63 )             | (538 )          | (667 )            | (37 ) | (261 )            | (170 )          | (468 )            | (34 )   | (30 )             | —               | (64 )             |
| Before excluded items              | (288 )  | (492 )            | (82 )           | (862 )            | 115   | (339 )            | (252 )          | (476 )            | 81      | (876 )            | 83              | (712 )            |
| Impairment charges                 | 70      | 150               | 13              | 233               | 10    | 25                | 295             | 330               | 15      | 634               | —               | 649               |
| Domestic pension expense           | —       | 162               | —               | 162               | —     | 165               | —               | 165               | —       | 74                | —               | 74                |
| Closed store reserve,              | 89      | (31 )             | 72              | 130               | 76    | 44                | 20              | 140               | 76      | 160               | 18              | 254               |

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|             |          |          |       |          |        |        |       |        |        |          |        |        |
|-------------|----------|----------|-------|----------|--------|--------|-------|--------|--------|----------|--------|--------|
| severance   |          |          |       |          |        |        |       |        |        |          |        |        |
| and other   |          |          |       |          |        |        |       |        |        |          |        |        |
| Pension     |          |          |       |          |        |        |       |        |        |          |        |        |
| settlements | —        | —        | —     | —        | —      | 452    | 3     | 455    | —      | —        | —      | —      |
| Transaction |          |          |       |          |        | 9      | 3     | 12     | —      | —        | —      | —      |
| costs       |          |          |       |          |        |        |       |        |        |          |        |        |
| Hurricane   |          |          |       |          |        | —      | —     | —      | —      | 12       | —      | 12     |
| losses      |          |          |       |          |        |        |       |        |        |          |        |        |
| Adjusted    | (129 )   | (211 )   | 3     | (337 )   | 201    | 356    | 69    | 626    | 172    | 4        | 101    | 277    |
| EBITDA      |          |          |       |          |        |        |       |        |        |          |        |        |
| SHO         |          |          |       |          |        |        |       |        |        |          |        |        |
| Separation  | —        | —        | —     | —        | —      | (90 )  | —     | (90 )  | —      | (81 )    | —      | (81 )  |
| Adjusted    |          |          |       |          |        |        |       |        |        |          |        |        |
| EBITDA as   | \$ (129) | \$ (211) | \$ 3  | \$ (337) | \$ 201 | \$ 266 | \$ 69 | \$ 536 | \$ 172 | \$ (77 ) | \$ 101 | \$ 196 |
| defined     |          |          |       |          |        |        |       |        |        |          |        |        |
| % to        | (1.0 )%  | (1.1 )%  | 0.1 % | (0.9 )%  | 1.4 %  | 1.4 %  | 1.6 % | 1.4 %  | 1.1 %  | (0.4 )%  | 2.2 %  | 0.5 %  |
| revenues    |          |          |       |          |        |        |       |        |        |          |        |        |

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These other significant items included in Adjusted EBITDA are further explained as follows:

**Impairment charges –** Accounting standards require the Company to evaluate the carrying value of fixed assets, goodwill and intangible assets for impairment. As a result of the Company's analysis, we have recorded impairment charges related to certain fixed asset and goodwill balances.

**Pension settlements –** The Company amended its domestic pension plan and offered a one-time voluntary lump sum payment option in an effort to reduce its long-term pension obligations and ongoing annual pension expense. The pension settlements were funded from existing pension plan assets. In connection with this transaction, the Company incurred a charge to operations as a result of the requirement to expense the unrealized actuarial losses. The charge had no effect on equity because the unrealized actuarial losses are already recognized in accumulated other comprehensive income/(loss). Accordingly, the effect on retained earnings was offset by a corresponding reduction in accumulated other comprehensive loss.

**Closed store reserve and severance –** We are transforming our Company to a less asset-intensive business model. Throughout this transformation, we continue to make choices related to our stores, which could result in sales, closures, lease terminations or a variety of other decisions.

**Domestic pension expense –** Contributions to our pension plans remain a significant use of our cash on an annual basis. Cash contributions to our pension and postretirement plans are separately disclosed on the cash flow statement. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, we have a legacy pension obligation for past service performed by Kmart and Sears associates. The annual pension expense included in our statement of operations related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, our domestic pension expense was \$162 million in 2013, \$165 million in 2012 and \$74 million in 2011. Pension expense is comprised of interest cost, expected return on plan assets and amortization of experience losses. This adjustment eliminates the entire pension expense from the statement of operations to improve comparability. Pension expense is included in the determination of Net Income. The components of the adjustments to EBITDA related to domestic pension expense were as follows:

| millions                                   | 2013         | 2012         | 2011        |
|--|--------------|--------------|-------------|
| <b>Components of net periodic expense:</b> |              |              |             |
| Interest cost                              | \$219        | \$291        | \$313       |
| Expected return on plan assets             | (224)        | ) (291       | ) (302      |
| Amortization of experience losses          | 167          | 165          | 63          |
| <b>Net periodic expense</b>                | <b>\$162</b> | <b>\$165</b> | <b>\$74</b> |

In accordance with U.S. GAAP, we recognize on the balance sheet actuarial gains and losses for defined benefit pension plans annually in the fourth quarter of each fiscal year and whenever a plan is determined to qualify for a remeasurement during a fiscal year. For income statement purposes, these actuarial gains and losses are recognized throughout the year through an amortization process. The Company recognizes in its results of operations, as a corridor adjustment, any unrecognized actuarial net gains or losses that exceed 10% of the larger of projected benefit obligations or plan assets. Accumulated gains/losses that are inside the 10% corridor are not recognized, while accumulated actuarial gains/losses that are outside the 10% corridor are amortized over the "average future service" of the population and are included in the amortization of experience losses line item above.

Actuarial gains and losses occur when actual experience differs from the estimates used to allocate the change in value of pension plans to expense throughout the year or when assumptions change, as they may each year. Significant factors that can contribute to the recognition of actuarial gains and losses include changes in discount rates used to remeasure pension obligations on an annual basis or upon a qualifying remeasurement, differences between actual and expected returns on plan assets and other changes in actuarial assumptions. Management believes these actuarial gains and losses are primarily financing activities that are more reflective of changes in current conditions in global financial markets

(and in particular interest rates) that are not directly related to the underlying business and that do not have an immediate, corresponding impact on the benefits provided to eligible retirees. For further information on the actuarial assumptions and plan assets referenced above, see Management's Discussion & Analysis - Application of Critical Accounting Policies and Estimates - Defined Benefit Pension Plans, and Note 7 of Notes to Consolidated Financial Statements.

- SHO separation – The results of the Sears Hometown and Outlet businesses that were included in our results of operations prior to the separation.

The following tables set forth results of operations on a GAAP and "As Adjusted" basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Consolidated Statements of Operations during the years 2013, 2012 and 2011.

Year Ended February 1, 2014

| millions, except per share data                        | GAAP      | Domestic<br>Pension<br>Expense | Closed Store<br>Reserve,<br>Store<br>Impairments,<br>Severance<br>and Other | Gain on<br>Sales of<br>Assets | Gain on<br>Sale of<br>Canadian<br>Joint<br>Venture | Tax<br>Matters | As<br>Adjusted |   |
|--|-----------|--------------------------------|---|-------------------------------|--|----------------|----------------|---|
| Gross margin impact                                    | \$8,755   | \$—                            | \$57  | \$—                           | \$—  | \$—            | \$8,812        |   |
| Selling and administrative impact                      | 9,384     | (162)                          | )(73  | )—                            | —  | —              | 9,149          |   |
| Depreciation and amortization impact                   | 732       | —                              | (11   | )—                            | —  | —              | 721            |   |
| Impairment charges impact                              | 233       | —                              | (233  | )—                            | —  | —              | —              |   |
| Gain on sales of assets impact                         | (667      | )—                             | —   | 604                           | —  | —              | (63            | ) |
| Operating loss impact                                  | (927      | )162                           | 374   | (604                          | )—   | —              | (995           | ) |
| Interest and investment income impact                  | 207       | —                              | —   | —                             | (163   | )—             | 44             |   |
| Income tax expense impact                              | (144      | )(60                           | )(141   | )228                          | 61   | 507            | 451            |   |
| Income attributable to noncontrolling interests impact | (249      | )—                             | (42   | )263                          | 80   | —              | 52             |   |
| After tax and noncontrolling interests impact          | (1,365    | )102                           | 191   | (113                          | )(22   | )507           | (700           | ) |
| Diluted loss per share impact                          | \$(12.87) | \$0.96                         | \$ 1.80   | \$(1.06                       | )\$(0.21   | )\$4.78        | \$(6.60        | ) |

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| Year Ended February 2, 2013                                      |            |  |                            |                               |                      |                         |                        |   |                |                                   |   |                |
|--|------------|--|----------------------------|-------------------------------|----------------------|-------------------------|------------------------|---|----------------|-----------------------------------|---|----------------|
| millions,<br>except per<br>share data                            | GAAP       | Closed Store<br>Reserve,<br>Domestic<br>Pension<br>Expense<br>and<br>Impairments<br>and<br>Severance | Gain on<br>Store<br>Assets | Gain on<br>Sales of<br>Assets | Transaction<br>Costs | Goodwill<br>Impairments | Pension<br>Settlements | Sale of<br>Canadian<br>Joint<br>Venture | Tax<br>Matters | As<br>Adjusted<br>SHO<br>Reported | As<br>Separation<br>Adjusted <sup>(1)</sup> | As<br>Reported |
| Gross margin<br>impact   | \$ 10,514  | \$—  | \$ 35                      | \$—                           | \$—                  | \$—                     | \$—                    | \$—                                     | \$—            | \$ 10,549                         | \$(432 )                                    | \$ 10,117      |
| Selling and<br>administrative<br>impact                          | 10,660     | (165 )   | (105 )                     | —                             | (12 )                | —                       | (455 )                 | —                                       | —              | 9,923                             | (343 )                                      | 9,580          |
| Depreciation<br>and<br>amortization<br>impact                    | 830        | —  | (22 )                      | —                             | —                    | —                       | —                      | —                                       | —              | 808                               | (6 )  | 802            |
| Impairment<br>charges impact                                     | 330        | —  | (35 )                      | —                             | —                    | (295 )                  | —                      | —                                       | —              | —                                 | —   | —              |
| Gain on sales<br>of assets<br>impact                             | (468 )     | —  | —                          | 419                           | —                    | —                       | —                      | —                                       | —              | (49 )                             | —   | (49 )          |
| Operating loss<br>impact   | (838 )     | 165  | 197                        | (419 )                        | 12                   | 295                     | 455                    | —                                       | —              | (133 )                            | (83 )                                       | (216 )         |
| Interest and<br>investment<br>income impact                      | 94         | —  | —                          | —                             | —                    | —                       | (25 )                  | —                                       | 69             | —                                 | —   | 69             |
| Income tax<br>expense impact                                     | (44 )      | (62 )  | (74 )                      | 157                           | (5 )                 | —                       | —                      | 9                                       | 143            | 124                               | 33  | 157            |
| Loss<br>attributable to<br>noncontrolling<br>interests<br>impact | 124        | —  | (7 )                       | 8                             | —                    | (145 )                  | (1 )                   | 12                                      | —              | (9 )                              | —   | (9 )           |
| After tax and<br>noncontrolling<br>interests<br>impact           | (930 )     | (103 )   | 116                        | (254 )                        | 7                    | 150                     | 454                    | (4 )                                    | 143            | (215 )                            | (51 )                                       | (266 )         |
| Diluted loss<br>per share<br>impact                              | \$ (8.78 ) | \$ 0.97  | \$ 1.09                    | \$ (2.40)                     | \$ 0.07              | \$ 1.42                 | \$ 4.29                | \$ (0.04 )                              | \$ 1.35        | \$ (2.03 )                        | \$(0.48 )                                   | \$(2.51 )      |

<sup>(1)</sup> Adjusted to reflect the results of the Sears Hometown and Outlet businesses that were included in our results of operations prior to the separation.

| Year Ended January 28, 2012           |           |  |                          |                                |                    |                         |                |                            |                          |                                   |   |                |
|---------------------------------------|-----------|--|--------------------------|--------------------------------|--------------------|-------------------------|----------------|----------------------------|--------------------------|-----------------------------------|---|----------------|
| millions,<br>except<br>per share data | GAAP      | Closed Store<br>Reserve,<br>Domestic<br>Pension<br>Expense<br>and<br>Impairments<br>and<br>Severance | Mark-to-Market<br>Losses | Gain on<br>Hurricane<br>Losses | Sales of<br>Assets | Goodwill<br>Impairments | Tax<br>Matters | Discontinued<br>Operations | Adjusted SHO<br>Reported | As<br>Adjusted<br>SHO<br>Reported | As<br>Separation<br>Adjusted <sup>(1)</sup> | As<br>Reported |
| Gross margin<br>impact                | \$ 10,601 | \$—  | \$ 130                   | \$—                            | \$—                | \$—                     | \$—            | \$—                        | \$—                      | \$ 10,731                         | \$(524 )                                    | \$ 10,207      |

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|  |            |         |         |         |           |         |         |          |         |           |           |           |
|--|------------|---------|---------|---------|-----------|---------|---------|----------|---------|-----------|-----------|-----------|
| Selling and administrative impact                    | 10,664     | (74)    | (124)   | —       | —         | (12)    | —       | —        | —       | 10,454    | (459)     | 9,995     |
| Depreciation and amortization impact                 | 853        | —       | (8)     | —       | —         | —       | —       | —        | —       | 845       | (10)      | 835       |
| Impairment charges impact                            | 649        | —       | (98)    | —       | —         | —       | (551)   | —        | —       | —         | —         | —         |
| Gain on sales of assets impact                       | (64)       | —       | —       | —       | 33        | —       | —       | —        | —       | (31)      | —         | (31)      |
| Operating loss impact                                | (1,501)    | 74      | 360     | —       | (33)      | 12      | 551     | —        | —       | (537)     | (55)      | (592)     |
| Other loss impact                                    | (2)        | —       | —       | 6       | —         | —       | —       | —        | —       | 4         | —         | 4         |
| Income tax expense impact                            | (1,369)    | (28)    | (134)   | (2)     | 13        | (5)     | —       | 1,819    | —       | 294       | 22        | 316       |
| Loss from discontinued operations, net of tax impact | (27)       | —       | —       | —       | —         | —       | —       | —        | 27      | —         | —         | —         |
| Loss attributable to noncontrolling interest impact  | 7          | —       | (1)     | (1)     | —         | —       | —       | —        | —       | 5         | —         | 5         |
| After tax and noncontrolling interest impact         | (3,140)    | 46      | 225     | 3       | (20)      | 7       | 551     | 1,819    | 27      | (482)     | (33)      | (515)     |
| Diluted loss per share impact                        | \$ (29.40) | \$ 0.43 | \$ 2.10 | \$ 0.03 | \$ (0.19) | \$ 0.07 | \$ 5.16 | \$ 17.03 | \$ 0.25 | \$ (4.52) | \$ (0.31) | \$ (4.83) |

<sup>(1)</sup> Adjusted to reflect the results of the Sears Hometown and Outlet businesses that were included in our results of operations prior to the separation.

We also believe that our use of Adjusted EPS provides an appropriate measure for investors to use in assessing our performance across periods, given that this measure provides an adjustment for certain significant items which may vary significantly from period to period, improving the comparability of year-to-year results and is therefore representative of our ongoing performance. Therefore, we have adjusted our results for them to make our statements more useful and comparable. However, we do not, and do not recommend that you, solely use Adjusted EPS to assess our financial and earnings performance. We also use, and recommend that you use, diluted earnings per share in addition to Adjusted EPS in assessing our earnings performance.

In addition to the significant items included in the Adjusted EBITDA calculation, Adjusted EPS includes the following other significant items which, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, and affects comparability of results.

Gains on sales of assets - We have recorded significant gains on sales of assets which were primarily attributable to several real estate transactions. Management considers these gains on sale of assets to result from investing decisions rather than ongoing operations.

Tax Matters - In 2011, and again in 2013, we recorded a non-cash charge to establish a valuation allowance against substantially all of our domestic deferred tax assets. Accounting rules generally require that a valuation reserve be established when income has not been generated over a three-year cumulative period to support the deferred tax asset. While an accounting loss was recorded, we believe no economic loss has occurred as these net operating losses and tax benefits remain available to reduce future taxes as income is generated in subsequent periods. As this valuation allowance has a significant impact on the effective tax rate, we have adjusted our results to reflect a standard effective tax rate for the Company beginning in fiscal 2011 when the valuation allowance was first established.

#### Revenues and Comparable Store Sales

Revenues decreased \$3.7 billion, or 9.2%, to \$36.2 billion in 2013, as compared to revenues of \$39.9 billion in 2012. The revenue decrease was primarily due to the effect of having fewer Kmart and Sears Full-line stores in operation, which accounted for approximately \$1.1 billion of the decline, as well as lower domestic comparable store sales, which accounted for approximately \$1.0 billion of the decline. Revenues for the year were also impacted by approximately \$490 million attributable to the separation of SHO, which occurred in the third quarter of 2012. The prior year first nine months, which included the separation of SHO, included revenues of approximately \$1.7 billion related to SHO merchandise sales to its customers, as well as \$70 million for merchandise sold to SHO for resale which occurred after the separation. The first nine months of 2013, included revenues from SHO of approximately \$1.3 billion, primarily related to merchandise sold to SHO for resale. Fiscal 2012 also benefited from approximately \$500 million of revenue attributable to the 53rd week. Sears Canada had a 2.7% decline in comparable store sales during 2013, which accounted for approximately \$85 million of the decline. In addition, Sears Canada revenues experienced declines in 2013 of approximately \$150 million as a result of a new licensing arrangement related to the Sears Home Improvements Product Services ("SHIPS"), and approximately \$70 million due to the closure of four Full-line stores in Sears Canada that occurred in 2012. Finally, Sears Canada revenues in 2013 included a decrease of \$157 million due to foreign currency exchange rates.

Domestic comparable store sales declined 3.8%, comprised of decreases of 3.6% at Kmart and 4.1% at Sears Domestic. The decline at Kmart reflects declines in a majority of categories, most notably grocery & household, consumer electronics, drugstore and toys. The decline at Sears Domestic reflects decreases in most categories including the home appliances, consumer electronics, tools and lawn & garden categories, as well as declines at Sears Auto Centers, partially offset by increases in the home and footwear categories.

#### Gross Margin

Gross margin declined \$1.8 billion to \$8.8 billion in 2013 from \$10.5 billion in 2012 due to the above noted decline in revenues, as well as a decline in gross margin rate. Gross margin included expenses of \$57 million and \$35 million in 2013 and 2012, respectively, related to store closings, while 2012 also included gross margin of \$432 million from SHO. Excluding these items, gross margin decreased \$1.3 billion. In addition, Sears Canada's gross margin for 2013 included a decrease of \$42 million related to the impact of foreign currency exchange rates.

The gross margin rate for both Kmart and Sears Domestic for the year were impacted by transactions that offer both traditional promotional marketing discounts and Shop Your Way points. As compared to the prior year, Kmart's gross margin rate for 2013 declined 170 basis points, with decreases experienced in a majority of categories, particularly apparel and grocery & household. Sears Domestic's gross margin rate declined 260 basis points in 2013 due to selling merchandise to SHO at cost pursuant to the terms of the separation as expected and previously disclosed, which accounted for approximately 120 basis points of the decline. Sears Domestic experienced margin decreases in the home appliances and apparel categories. Sears Canada's gross margin rate declined 190 basis points in 2013 due to an increase in inventory reserve requirements.



#### Selling and Administrative Expenses

Selling and administrative expenses decreased \$1.3 billion to \$9.4 billion in 2013 from \$10.7 billion in 2012 and included expenses related to pension plans, store closings and severance of \$235 million and \$725 million in 2013 and 2012, respectively. The prior year also included selling and administrative expense of \$343 million related to SHO and \$12 million of transaction costs associated with strategic initiatives. Excluding these items, selling and administrative expenses declined \$431 million primarily due to a decrease in payroll expense. Selling and administrative expenses at Sears Canada for 2013 included a decrease of \$45 million related to the impact of foreign currency exchange rates.

Selling and administrative expenses as a percentage of revenues ("selling and administrative expense rate") were 25.9% and 26.7% for 2013 and 2012, respectively, and decreased primarily as the decrease in overall selling and administrative expenses were partially offset by lower expense leverage due to the above noted decline in revenues.

#### Depreciation and Amortization

Depreciation and amortization expense decreased by \$98 million during 2013 to \$732 million and included charges of \$11 million and \$22 million in 2013 and 2012, respectively, taken in connection with store closings. The prior year also included depreciation and amortization expense of \$6 million related to SHO. The decrease in 2013 is primarily due to having fewer assets available for depreciation.

#### Impairment Charges

We recorded impairment charges of \$233 million and \$35 million in 2013 and 2012, respectively, related to the impairment of long-lived assets. During 2012, we also recorded impairment charges of \$295 million related to the impairment of goodwill. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

#### Gain on Sales of Assets

We recorded total gains on sales of assets of \$667 million in 2013 and \$468 million in 2012, which were primarily attributable to several real estate transactions.

The gain on sales of assets in 2013 included a gain of \$180 million recognized on the amendment and early termination of the leases on two properties operated by Sears Canada, for which Sears Canada received \$184 million (\$191 million Canadian) in cash proceeds. We also recorded a gain on sales of assets of \$357 million in 2013 recognized on the surrender and early termination of the leases of five properties operated by Sears Canada, for which Sears Canada received \$381 million (\$400 million Canadian) in cash proceeds. Finally, gain on sales of assets in 2013 also included a gain of \$67 million related to the sale of a store previously operated under The Great Indoors format, two Sears Full-line stores and two Kmart stores for which the Company received \$98 million in cash proceeds.

The gain on sales of assets in 2012 included a gain of \$223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for \$270 million in cash proceeds, and a gain of \$163 million recognized on the surrender and early termination of the leases on three properties operated by Sears Canada, under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received \$171 million (\$170 million Canadian) in cash proceeds. Gain on sales of assets recorded in 2012 also included a gain of \$33 million related to the sale of a store operated under The Great Indoors format, one Sears Full-line store and one Kmart store.

#### Operating Loss

We recorded an operating loss of \$927 million and \$838 million in 2013 and 2012, respectively. Operating loss for 2013 included non-cash charges related to domestic pension plans, store closings, store impairments and severance, as well as the gains on sales of assets which aggregated to operating income of \$68 million. Operating loss for 2012 included non-cash charges related to pension settlements and the impairment of Sears Canada goodwill balances, expenses related to domestic pension plans, store closings, store impairments, severance and transaction

costs, as well as the gains on sales of assets and operating income from SHO, which all aggregated to an operating loss of \$622 million. Excluding these items, operating loss increased \$779 million in 2013 compared to 2012 primarily due to the above noted declines in revenues and gross margin rate, which were partially offset by a decline in selling and administrative expenses.

#### Interest Expense

We incurred \$254 million and \$267 million in interest expense during 2013 and 2012, respectively. The decrease is due to a lower average interest rate on outstanding borrowings in 2013.

#### Interest and Investment Income

We recorded interest and investment income of \$207 million and \$94 million during 2013 and 2012, respectively. During 2013, investment income included a gain of \$163 million related to the sale of 50% joint venture interests in eight properties Sears Canada owned with The Westcliff Group of Companies, for which Sears Canada received \$270 million (\$297 million Canadian) in cash proceeds.

#### Income Taxes

Our effective tax rate for 2013 was 14.8% compared to 4.4% in 2012. Our tax rate in 2013 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic jurisdictions where it is not more likely than not that such benefits would be realized. The 2013 rate was impacted unfavorably by an additional valuation allowance on state separate entity deferred tax assets and favorably for the lower tax on the Sears Canada gain on sales of assets, federal and state tax audit settlements and statute expirations. In addition, the 2013 rate included a partial tax benefit on the loss from continuing operations, which was exactly offset by income tax expense on other comprehensive income.

#### 2012 Compared to 2011

##### Net Loss from Continuing Operations Attributable to Holdings' Shareholders

We recorded a net loss from continuing operations attributable to Holdings' shareholders of \$930 million (\$8.78 loss per diluted share from continuing operations) and \$3.1 billion (\$29.15 loss per diluted share from continuing operations) for 2012 and 2011, respectively. Our results for 2012 and 2011 were affected by a number of significant items, including non-cash charges related to pension settlements and the impairment of goodwill balances and a \$1.8 billion non-cash charge to establish a valuation allowance against our domestic deferred tax assets in 2011. Our net loss from continuing operations as adjusted for these significant items was \$215 million (\$2.03 loss per diluted share from continuing operations) for 2012 and \$482 million (\$4.52 loss per diluted share from continuing operations) for 2011. The improvement in net loss for the year reflected an improvement in gross margin rate of 90 basis points and a decrease in selling and administrative expenses, which were partially offset by a decline in gross margin dollars, given lower sales.

#### Revenues and Comparable Store Sales

Revenues decreased \$1.7 billion, or 4.1%, to \$39.9 billion, as compared to revenues of \$41.6 billion in 2011. The decline in revenue was primarily the result of having fewer Kmart and Sears Full-line stores in operation, which accounted for approximately \$930 million of the decline, a decrease in domestic comparable store sales of 2.5%, which accounted for approximately \$740 million of the decline, and the separation of the Sears Hometown and Outlet businesses, partially offset by the inclusion of an additional week of revenues in 2012. The Company recorded approximately \$500 million of revenues during the 53rd week of 2012. The separation of the Sears Hometown and Outlet businesses resulted in a net decrease in revenues of approximately \$100 million. Additionally, Sears Canada had a 5.6% decline in comparable store sales, which accounted for approximately \$185 million of the decline, and revenues for the year included a decrease of \$37 million due to changes in foreign currency exchange rates.

Domestic comparable store sales declined 2.5% with declines of 1.4% at Sears Domestic and 3.7% at Kmart.

Excluding the consumer electronics category, total domestic comparable store sales decreased 1.4% with Sears Domestic decreasing only 0.1% and Kmart decreasing 2.8%.

The decline in comparable store sales of 1.4% at Sears Domestic was driven by decreases in consumer electronics, lawn and garden and home appliances as well as at Sears Auto Centers. These decreases were partially offset by increases in apparel and home. The Kmart decline in comparable store sales of 3.7% reflects decreases in a majority of its categories, most notably the consumer electronics, pharmacy, grocery and household and drug store categories.

#### Gross Margin

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Gross margin declined \$87 million to \$10.5 billion in 2012 from \$10.6 billion in 2011 and included charges of \$35 million and \$130 million related to store closures for 2012 and 2011, respectively. Excluding these items, gross margin declined \$182 million as the above noted decline in revenues was only partially offset by an improvement in gross margin rate. In addition, Sears Canada's gross margin included a decrease of \$11 million related to the impact of foreign currency exchange rates.

Sears Domestic's gross margin rate improved 120 basis points in 2012 primarily due to improved margins in the apparel, home appliance and footwear categories, which were partially offset by declines in the consumer electronics category and the Lands' End customer direct business. Kmart's gross margin rate improved 70 basis points in 2012 due to the improvement in the apparel, pharmacy and toys categories, which were partially offset by a decline in the consumer electronics category. Sears Canada's gross margin rate decreased 10 basis points in 2012 due to declines in the fitness and recreation, children's wear, jewelry, accessories and luggage and footwear categories.

#### Selling and Administrative Expenses

Selling and administrative expenses for 2012 were flat with the prior year and included expenses related to pension plans, store closings and severance of \$725 million in 2012 and \$198 million in 2011. The current year also included \$12 million of transaction costs associated with strategic initiatives while 2011 included expense of \$12 million related to hurricane losses in 2011. Excluding these items, selling and administrative expenses declined \$531 million due to reductions in advertising, supplies and payroll expenses. Selling and administrative expenses at Sears Canada for 2012 included a decrease of \$10 million related to the impact of foreign currency exchange rates.

Selling and administrative expense rate was 26.7% and 25.7% for 2012 and 2011, respectively, and increased primarily as a result of the above noted charges.

#### Depreciation and Amortization

Depreciation and amortization expense decreased by \$23 million during 2012 to \$830 million and included charges of \$22 million and \$8 million in 2012 and 2011, respectively, taken in connection with store closings. The decrease is primarily due to having fewer assets available for depreciation.

#### Impairment Charges

During 2012, we recorded impairment charges of \$295 million and \$35 million related to the impairment of goodwill and long-lived assets, respectively. We also recorded impairment charges during 2011 of \$551 million and \$98 million related to the impairment of goodwill and long-lived assets, respectively. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

#### Gain on Sales of Assets

We recorded total gains on sales of assets of \$468 million in 2012 and \$64 million in 2011, which were primarily attributable to several real estate transactions. The gain on sale of assets in 2012 included a gain of \$223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for \$270 million in cash proceeds, and a gain of \$163 million recognized on the surrender and early termination of the leases on three properties operated by Sears Canada, under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received \$171 million (\$170 million Canadian) in cash proceeds. Gain on sales of assets recorded in 2012 also included a gain of \$33 million related to the sale of a store operated under The Great Indoors format, one Sears Full-line store and one Kmart store. During 2011, the gain on sales of assets included a gain of \$21 million recognized on the sale of two stores operated under The Great Indoors format and \$12 million recognized on the sale of a store operated under the Kmart format.

#### Operating Loss

We recorded an operating loss of \$838 million and \$1.5 billion in 2012 and 2011, respectively. Operating loss for 2012 included non-cash charges related to pension settlements and the impairment of Sears Canada goodwill balances, expenses related to domestic pension plans, store closings and store impairments and severance and transaction costs, as well as the gains on sales of assets which aggregated to an operating loss of \$705 million. Operating loss for 2011 included a non-cash charge of \$551 million related to goodwill balances of certain reporting units, expenses related to domestic pension plans, store closings, severance and hurricane losses and a net gain on the sales of assets which aggregated to an operating loss of \$964 million. Excluding these items, operating loss improved \$404 million primarily due to the improvement in gross margin rate and a decrease in selling and administrative expenses, which were partially offset by a decline in gross margin dollars, given lower sales.

#### Interest Expense

We incurred \$267 million and \$289 million in interest expense during 2012 and 2011, respectively. The decrease is due to lower average outstanding borrowings.

### Income Taxes

Our income tax effective rate was 4.4% in 2012 and 78.2% in 2011. The 2012 tax rate continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic jurisdictions where it is not more likely than not that such benefits will be realized. The prior year tax rate is the result of significant tax matters in 2011 which included a non-cash charge of \$1.8 billion to establish a valuation allowance against certain deferred income tax assets.

### Business Segment Results

#### Kmart

Kmart results and key statistics were as follows:

|  | 2013     | 2012     | 2011     |  |
|--|----------|----------|----------|--|
| millions, except number of stores                              |          |          |          |  |
| Merchandise sales and services                                 | \$13,194 | \$14,567 | \$15,285 |  |
| Comparable store sales %                                       | (3.6 )%  | (3.7 )%  | (1.4 )%  |  |
| Cost of sales, buying and occupancy                            | 10,329   | 11,158   | 11,818   |  |
| Gross margin dollars   | 2,865    | 3,409    | 3,467    |  |
| Gross margin rate  | 21.7 %   | 23.4 %   | 22.7 %   |  |
| Selling and administrative                                     | 3,083    | 3,284    | 3,371    |  |
| Selling and administrative expense as a percentage of revenues | 23.4 %   | 22.5 %   | 22.1 %   |  |
| Depreciation and amortization                                  | 129      | 147      | 149      |  |
| Impairment charges   | 70       | 10       | 15       |  |
| Gain on sales of assets  | (66 )    | (37 )    | (34 )    |  |
| Total costs and expenses                                       | 13,545   | 14,562   | 15,319   |  |
| Operating income (loss)  | \$(351 ) | \$5      | \$(34 )  |  |
| Adjusted EBITDA  | \$(129 ) | \$201    | \$172    |  |
| Total Kmart stores   | 1,152    | 1,221    | 1,305    |  |

## 2013 Compared to 2012

### Revenues and Comparable Store Sales

Kmart's revenues decreased by \$1.4 billion to \$13.2 billion in 2013 due to the effect of having fewer stores in operation in 2013, which accounted for approximately \$625 million of the decline. Revenues were also impacted by a decrease in comparable store sales of 3.6%, which accounted for approximately \$525 million of the decline. In addition, the prior year benefited from the inclusion of approximately \$190 million of revenues recorded in the 53rd week.

The decline in comparable store sales of 3.6% reflects declines in a majority of categories, most notably grocery & household, consumer electronics, drugstore and toys.

### Gross Margin

Kmart generated \$2.9 billion in gross margin in 2013 and \$3.4 billion in 2012. The decrease in Kmart's gross margin is due to the above noted decrease in sales, as well as a decline in gross margin rate. Gross margin included \$45 million and \$21 million for markdowns recorded in connection with store closings during 2013 and 2012, respectively.

Excluding these items, gross margin decreased \$520 million.

Kmart's gross margin rate declined 170 basis points to 21.7% in 2013 from 23.4% in 2012, and was impacted by transactions that offer both traditional promotional marketing discounts and Shop Your Way Points. The gross margin rate reflects decreases experienced in a majority of categories, particularly apparel and grocery & household.

### Selling and Administrative Expenses

Kmart's selling and administrative expenses decreased \$201 million in 2013. The decrease primarily reflects decreases in payroll expense. Selling and administrative expenses for 2013 and 2012 were impacted by expenses of \$44 million and \$55 million, respectively, related to store closings and severance.

Kmart's selling and administrative expense rate was 23.4% in 2013 and 22.5% in 2012 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

### Depreciation and Amortization

Depreciation and amortization expense decreased \$18 million in 2013 to \$129 million and included charges of \$9 million in both 2013 and 2012, respectively, taken in connection with store closings. The decrease is primarily due to having fewer assets to depreciate.

### Impairment charges

Kmart recorded impairment charges of \$70 million and \$10 million in 2013 and 2012, respectively, related to impairment of long-lived assets. Impairment charges recorded during 2013 and 2012 are further described in Note 13 of Notes to Consolidated Financial Statements.

### Gain on Sales of Assets

Kmart recorded total gains on sales of assets of \$66 million and \$37 million in 2013 and 2012, respectively. The gain on sales of assets in 2013 included gains of \$24 million related to the sale of two stores for which the Company received \$24 million in cash proceeds. The gains on sales of assets in 2012 included a gain of \$11 million recognized on the sale of one store.

### Operating Income (Loss)

Kmart recorded an operating loss of \$351 million in 2013 as compared to operating income of \$5 million in 2012. Operating loss in 2013 included expenses related to store closings, store impairments and severance, as well as gains on the sales of assets which aggregated to an operating loss of \$144 million. Operating income in 2012 also included expenses related to store closings, store impairments and severance, as well as gains on sales of assets which aggregated to an operating loss of \$84 million. Excluding these items, Kmart would have reported an operating loss of \$207 million in 2013 as compared to operating income of \$89 million in 2012. This decline in operating performance was primarily the result of the above noted declines in sales and gross margin, partially offset by a decrease in selling and administrative expenses.

### 2012 Compared to 2011

#### Revenues and Comparable Store Sales

Kmart's revenues decreased by \$718 million to \$14.6 billion as comparable store sales decreased 3.7% in 2012, which accounted for approximately \$540 million of the decline. The decrease in revenue was also due to the impact of Kmart having fewer stores in operation during 2012, which accounted for approximately \$400 million of the decline. These declines were partially offset by the inclusion of approximately \$190 million of revenues recorded in the 53rd week of 2012.

The decrease in comparable store sales of 3.7% reflects decreases in a majority of its categories, most notably in the consumer electronics, pharmacy, grocery and household, and drug store categories. Excluding the consumer electronics category, Kmart comparable store sales decreased 2.8%. The decrease in consumer electronics sales continue to be negatively impacted by price compression as well as market shifts such as moves to smartphone technology and away from digital cameras, GPS devices, MP3 players and camcorders in addition to transitions to online gaming and applications while the decrease in pharmacy sales was driven by the conversion of brand name drugs to equivalent generic drugs. The decrease in the grocery and household category was primarily attributable to competitive pressures in this category.

#### Gross Margin

Kmart generated \$3.4 billion in gross margin in 2012 and \$3.5 billion in 2011. The decrease in Kmart's gross margin is due to the above noted decrease in sales which was partially offset an improvement in gross margin rate and included \$21 million and \$46 million for markdowns recorded in connection with store closings during 2012 and 2011, respectively.

Kmart's gross margin rate increased 70 basis points to 23.4% in 2012 from 22.7% in 2011 mainly due to improvements in the apparel, pharmacy and toys categories which were partially offset by a decline in the consumer electronics category.

#### Selling and Administrative Expenses

Kmart's selling and administrative expenses decreased \$87 million in 2012. The decrease primarily reflects decreases in payroll and advertising expenses. Selling and administrative expenses for 2012 and 2011 were impacted by expenses of \$55 million and \$30 million, respectively, related to store closings and severance.

Kmart's selling and administrative expense rate was 22.5% in 2012 and 22.1% in 2011 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

#### Depreciation and Amortization

Depreciation and amortization expense decreased \$2 million in 2012 to \$147 million and included \$9 million of charges taken in connection with store closings. The decrease is primarily due to having fewer assets to depreciate.

#### Impairment charges

We recorded impairment charges of \$10 million and \$15 million in 2012 and 2011, respectively, related to impairment of long-lived assets. Impairment charges recorded during 2012 and 2011 are further described in Note 13 of Notes to Consolidated Financial Statements.

#### Gain on Sales of Assets

Kmart recorded a total net gain on sales of assets of \$37 million and \$34 million in 2012 and 2011, respectively. The gains on sales of assets in 2012 included a gain of \$11 million recognized on the sale of one store while 2011 included a gain of \$12 million recognized on the sale of one store.

#### Operating Income (Loss)

Kmart recorded operating income of \$5 million in 2012 as compared to an operating loss of \$34 million in 2011. This improvement was primarily driven by the improvement in gross margin rate and a decrease in selling and administrative expenses which more than offset the above noted decrease in revenues. Operating income in 2012 included expenses related to store closing and severance costs of \$85 million and store impairments of \$10 million as well as a gain of \$11 million related to the sale of one store. Kmart's operating loss for 2011 included expenses related to store impairments of \$15 million, store closing and severance costs of \$76 million as well as a gain of \$12 million related to the sale of one store.

## Sears Domestic

Sears Domestic results and key statistics were as follows:

|  | 2013     | 2012     | 2011       |  |
|--|----------|----------|------------|--|
| millions, except number of stores                              | \$19,198 | \$20,977 | \$21,649   |  |
| Merchandise sales and services                                 |          |          |            |  |
| Comparable store sales %                                       | (4.1 )%  | (1.4 )%  | (3.0 )%    |  |
| Cost of sales, buying and occupancy                            | 14,324   | 15,107   | 15,849     |  |
| Gross margin dollars   | 4,874    | 5,870    | 5,800      |  |
| Gross margin rate  | 25.4 %   | 28.0 %   | 26.8 %     |  |
| Selling and administrative                                     | 5,216    | 6,184    | 6,042      |  |
| Selling and administrative expense as a percentage of revenues | 27.2 %   | 29.5 %   | 27.9 %     |  |
| Depreciation and amortization                                  | 511      | 578      | 601        |  |
| Impairment charges   | 150      | 25       | 634        |  |
| Gain on sales of assets  | (63 )    | (261 )   | (30 )      |  |
| Total costs and expenses                                       | 20,138   | 21,633   | 23,096     |  |
| Operating loss   | \$(940 ) | \$(656 ) | \$(1,447 ) |  |
| Adjusted EBITDA  | \$(211 ) | \$356    | \$4        |  |
| SHO separation   | —        | (90 )    | (81 )      |  |
| Adjusted EBITDA as defined <sup>(1)</sup>                      | \$(211 ) | \$266    | \$(77 )    |  |
| Number of:   |          |          |            |  |
| Full-line stores <sup>(2)</sup>                                | 778      | 798      | 867        |  |
| Specialty stores <sup>(3)</sup>                                | 50       | 54       | 1,338      |  |
| Total Domestic Sears Stores                                    | 828      | 852      | 2,205      |  |

<sup>(1)</sup> Adjusted to reflect the results of the Sears Hometown and Outlet businesses that were included in our results of operations prior to the separation.

<sup>(2)</sup> 2013 included 768 Full-line stores and 10 Sears Essentials/Grand stores; 2012 included 788 Full-line stores and 10 Sears Essentials/Grand stores; 2011 included 834 Full-line stores and 33 Sears Essentials/Grand stores

<sup>(3)</sup> 2011 included 1,273 stores of Sears Hometown and Outlet Stores, Inc.

2013 Compared to 2012

## Revenues and Comparable Store Sales

Sears Domestic's revenues decreased by \$1.8 billion to \$19.2 billion in 2013. The decline in revenue was due to lower comparable store sales, which accounted for approximately \$515 million of the decline, and the effect of having fewer stores in operation, which accounted for approximately \$470 million of the decline. Revenues for the year were also impacted by approximately \$490 million attributable to the separation of SHO, which occurred in the third quarter of 2012. The prior year first nine months, which included the separation of SHO, included revenues of approximately \$1.7 billion related to SHO merchandise sales to its customers, as well as \$70 million for merchandise sold to SHO for resale which occurred after the separation. The first nine months of 2013, included revenues from SHO of approximately \$1.3 billion, primarily related to merchandise sold to SHO for resale. Fiscal 2012 also benefited from \$275 million of revenue attributable to the 53rd week.

Sears Domestic comparable store sales declined 4.1%, which reflects decreases in most categories including the home appliances, consumer electronics, tools and lawn & garden categories, as well as declines at Sears Auto Centers, partially offset by increases in the home and footwear categories.

### Gross Margin

Sears Domestic generated gross margin dollars of \$4.9 billion and \$5.9 billion in 2013 and 2012, respectively. Gross margin for 2013 and 2012 included charges related to store closures of \$11 million and \$14 million, respectively. The prior year also included gross margin of \$432 million from SHO. Excluding these items, gross margin decreased \$567 million.

Sears Domestic's gross margin rate was 25.4% in 2013 and 28.0% in 2012. The decrease of 260 basis points in 2013 was due to selling merchandise to SHO at cost pursuant to the terms of the separation as expected and previously disclosed, which accounted for approximately 120 basis points of the decline. Gross margin rate was also impacted by transactions that offer both traditional promotional marketing discounts and Shop Your Way Points. Sears Domestic experienced margin decreases in the home appliances and apparel categories.

### Selling and Administrative Expenses

Sears Domestic's selling and administrative expenses decreased \$968 million in 2013 as compared to 2012. Selling and administrative expenses were impacted by expenses related to domestic pension plans, store closings and severance of \$120 million and \$647 million in 2013 and 2012, respectively. The prior year also included expenses of \$343 million related to SHO and \$9 million of transaction costs associated with strategic initiatives. Excluding these items, selling and administrative expenses decreased by \$89 million primarily due to a decline in payroll expenses.

Sears Domestic's selling and administrative expense rate was 27.2% in 2013 and 29.5% in 2012 and decreased as a result of the above noted significant items.

### Depreciation and Amortization

Depreciation and amortization expense decreased \$67 million in 2013 to \$511 million and included charges of \$2 million and \$13 million in 2013 and 2012, respectively, taken in connection with store closings. The decrease is primarily attributable to having fewer assets available for depreciation.

### Impairment Charges

Sears Domestic recorded impairment charges of \$150 million and \$25 million in 2013 and 2012, respectively, related to the impairment of long-lived assets. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

### Gain on Sales of Assets

Sears Domestic recorded total gains on sales of assets of \$63 million in 2013 and \$261 million in 2012 which were primarily attributable to several real estate transactions. The gain on sales of assets in 2013 included a gain of \$43 million related to the sale of a store previously operated under The Great Indoors format and two Sears Full-line stores for which the Company received \$74 million in proceeds. The gain on sales of assets in 2012 included a gain of \$223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for \$270 million in cash proceeds. Gain on sales of assets recorded in 2012 also included a gain of \$22 million related to the sale of a store operated under The Great Indoors format and one Sears Full-line store.

### Operating Loss

Sears Domestic reported an operating loss of \$940 million in 2013 compared to \$656 million in 2012. Sears Domestic's operating loss in 2013 included expenses related to domestic pension plans, store closings, store impairments and severance, as well as gains on the sales of assets which aggregated to an operating loss of \$240 million. Operating loss in 2012 included expenses related to domestic pension plans, store closings, store impairments, severance and transaction costs, as well as gains on the sales of assets and operating income from SHO which aggregated to an operating loss \$380 million. Excluding these items, Sears Domestic would have reported an operating loss of \$700 million and \$276 million in 2013 and 2012 respectively. The increase in operating loss in

2013 was driven by the above noted decline in sales and gross margin, partially offset by a decrease in selling and administrative expenses.

## 2012 Compared to 2011

### Revenues and Comparable Store Sales

Sears Domestic's revenues decreased by \$672 million as comparable store sales decreased 1.4%, which accounted for approximately \$200 million of the decline. The decline in revenue is mainly due to the impact of having fewer Sears Full-line stores in operation, which accounted for approximately \$530 million, the decline in comparable store sales and the separation of the Sears Hometown and Outlet businesses, partially offset by the inclusion of approximately \$275 million of revenues recorded in the 53rd week of 2012. The separation of the Sears Hometown and Outlet businesses resulted in a net decrease in revenues of approximately \$100 million.

The decrease of 1.4% in comparable store sales was driven by decreases in the consumer electronics, lawn and garden and home appliances categories, as well as at Sears Auto Centers. These decreases were partially offset by increases in apparel and home. Consumer electronics continues to be negatively impacted by price compression, as well as market shifts such as moves to smartphone technology and away from digital cameras, GPS devices, MP3 Players and camcorders in addition to transitions to online gaming and applications. Excluding the consumer electronics category, Sears Domestic comparable stores sales decreased only 0.1%.

### Gross Margin

Sears Domestic generated gross margin dollars of \$5.9 billion in 2012 and \$5.8 billion in 2011 as the decline in revenues in 2012 noted above was offset by an improvement in gross margin rate. Gross margin for 2012 and 2011 included charges of \$14 million and \$84 million, respectively, for markdowns recorded in connection with store closings.

Sears Domestic's gross margin rate was 28.0% in 2012 and 26.8% in 2011. The increase of 120 basis points was mainly due to improvements in the apparel, home appliance and footwear categories, which were partially offset by declines in the consumer electronics category and our Lands' End customer direct business.

### Selling and Administrative Expenses

Sears Domestic's selling and administrative expenses increased \$142 million in 2012 as compared to 2011. Selling and administrative expenses for 2012 were impacted by expenses of \$617 million related to pension plans and \$30 million related to store closings and severance, while 2011 was impacted by expenses of \$74 million related to pension plans and \$76 million related to store closings and severance. Selling and administrative expenses for 2012 also included \$9 million of transaction costs associated with strategic initiatives while 2011 included expense of \$12 million related to hurricane losses. Excluding these items, selling and administrative expenses decreased \$352 million due to declines in advertising and payroll expenses.

Sears Domestic's selling and administrative expense rate was 29.5% in 2012 and 27.9% in 2011 and increased as a result of the above noted increase in significant items.

### Depreciation and Amortization

Depreciation and amortization expense decreased \$23 million to \$578 million during 2012 and included charges of \$13 million and \$8 million in 2012 and 2011, respectively, taken in connection with store closings. The decrease is primarily attributable to having fewer assets available for depreciation.

### Impairment Charges

During 2012, we recorded impairment charges of \$25 million related to the impairment of long-lived assets. We also recorded impairment charges during 2011 of \$551 million and \$98 million related to the impairment of goodwill and long-lived assets, respectively. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

### Gain on Sales of Assets

We recorded total gains on sales of assets of \$261 million in 2012 and \$30 million in 2011 which were primarily attributable to several real estate transactions. The gain on sale of assets in 2012 included a gain of \$223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for \$270 million in cash proceeds. Gain on sales of assets recorded in 2012 also included a gain of \$22

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million related to the sale of a store operated under The Great Indoors format and one Sears Full-line store. The gain on sales of assets in 2011 included a gain of \$21 million recognized on the sale of two stores operated under the Great Indoors format.

### Operating Loss

Sears Domestic reported an operating loss of \$656 million in 2012 compared to \$1.4 billion in 2011. Sears Domestic's operating loss improved as the increase in selling and administrative expenses noted above was more than offset by lower impairment charges, an increase in the gains on sales of assets and an increase in gross margin dollars. Sears Domestic's operating loss included expenses related to domestic pension plans and store closings and severance of \$674 million and \$242 million in 2012 and 2011, respectively, impairments of \$25 million and \$634 million in 2012 and 2011 respectively, \$9 million of transaction costs associated with strategic initiatives in 2012 and hurricane losses of \$12 million in 2011, as well as a gains of \$245 million and \$21 million in 2012 and 2011, respectively, related to the sale of real estate assets.

### Sears Canada

Sears Canada, a consolidated, 51%-owned subsidiary of Sears, conducts similar retail operations as Sears Domestic.

Sears Canada results and key statistics were as follows:

| millions, except number of stores                              | 2013    | 2012     | 2011      |  |
|--|---------|----------|-----------|--|
| Merchandise sales and services                                 | \$3,796 | \$4,310  | \$4,633   |  |
| Comparable store sales %                                       | (2.7 )% | (5.6 )%  | (7.7 )%   |  |
| Cost of sales, buying and occupancy                            | 2,780   | 3,075    | 3,299     |  |
| Gross margin dollars   | 1,016   | 1,235    | 1,334     |  |
| Gross margin rate  | 26.8 %  | 28.7 %   | 28.8 %    |  |
| Selling and administrative                                     | 1,085   | 1,192    | 1,251     |  |
| Selling and administrative expense as a percentage of revenues | 28.6 %  | 27.7 %   | 27.0 %    |  |
| Depreciation and amortization                                  | 92      | 105      | 103       |  |
| Impairment charges   | 13      | 295      | —         |  |
| Gain on sales of assets  | (538 )  | (170 )   | —         |  |
| Total costs and expenses                                       | 3,432   | 4,497    | 4,653     |  |
| Operating income (loss)  | \$364   | \$(187 ) | ) \$(20 ) |  |
| Adjusted EBITDA  | \$3     | \$69     | \$101     |  |
| Number of:   |         |          |           |  |
| Full-line stores   | 118     | 118      | 122       |  |
| Specialty stores   | 331     | 357      | 378       |  |
| Total Sears Canada Stores                                      | 449     | 475      | 500       |  |

## 2013 Compared to 2012

### Revenues and Comparable Store Sales

Sears Canada's revenues decreased \$514 million for 2013 as compared to the same period last year and included a \$157 million decrease due to the impact of exchange rates during the year. On a Canadian dollar basis, revenues decreased by \$357 million. Revenues primarily decreased as a result of a new licensing arrangement related to the SHIPS business, which accounted for approximately \$150 million of the decline. Revenues also decreased as a result of lower comparable store sales, which accounted for approximately \$85 million of the decline, and the closure of four Full-line stores, which accounted for approximately \$70 million of the decline. Comparable store sales declined 2.7%, which was primarily driven by declines in home furnishings, fitness, home decor, electronics, home appliances and apparel and accessories. Fiscal 2012 also benefited from revenues of approximately \$35 million due to the 53rd week.

### Gross Margin

Gross margin dollars decreased \$219 million in 2013 to \$1.0 billion and included a \$42 million decrease due to the impact of exchange rates. Gross margin decreased \$177 million on a Canadian dollar basis, and included charges of \$1 million for markdowns recorded in connection with store closings announced during 2013. Sears Canada's gross margin rate decreased 190 basis points to 26.8%, in 2013 from 28.7% in 2012, due to an increase in inventory reserve requirements.

### Selling and Administrative Expenses

For 2013, Sears Canada's selling and administrative expenses decreased \$107 million, and included a decrease of \$45 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses decreased by \$62 million primarily due to decreases in advertising and payroll expenses. Selling and administrative expenses for 2013 included expenses of \$71 million related to store closings and severance. Selling and administrative expenses for 2012 included expenses of \$20 million related to store closings and severance, \$3 million related to pension settlements and \$3 million of transaction costs associated with strategic initiatives.

Sears Canada's selling and administrative expense rate was 28.6% in 2013 and 27.7% in 2012 and increased primarily due to decreased leverage as a result of the above noted decline in revenues.

### Impairment Charges

We recorded impairment charges of \$13 million in 2013 related to long-lived assets and \$295 million in 2012 related to goodwill. Impairment charges recorded are further described in Notes 12 and 13 of Notes to Consolidated Financial Statements.

### Gain on Sales of Assets

We recorded total gains on sales of assets of \$538 million in 2013 and \$170 million in 2012. During 2013, we recorded gains on sales of assets of \$357 million recognized on the surrender and early termination of the leases of five properties operated by Sears Canada, for which Sears Canada received \$381 million (\$400 million Canadian) in cash proceeds, and \$180 million recognized on the amendment and early termination of the leases on two properties operated by Sears Canada for which Sears Canada received \$184 million (\$191 million Canadian) in cash proceeds. During 2012, we recorded a gain of \$163 million recognized on the surrender and early termination of the leases on three properties under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received \$171 million (\$170 million Canadian) in cash proceeds.

### Operating Income (Loss)

Sears Canada recorded operating income of \$364 million and an operating loss of \$187 million in 2013 and 2012, respectively. Operating income in 2013 included expenses related to store closings, severance and impairment charges, as well as gains on sales of assets which aggregated to operating income of \$452 million. Operating loss in 2012 included expenses related to store closings, severance and pension settlements, transaction costs associated with strategic initiatives and goodwill impairment charges, as well as a gain on sales of assets which aggregated to an operating loss of \$158 million. Excluding these items, Sears Canada would have recorded an operating loss of \$88 million in 2013 compared to an operating loss of \$29 million in 2012. Operating loss increased in 2013 due to the decline in margin, partially offset by a decline in selling and administrative expenses.

### 2012 Compared to 2011

#### Revenues and Comparable Store Sales

Sears Canada's revenues decreased \$323 million for 2012 as compared to the same period last year and included a \$37 million decrease due to the impact of exchange rates during the year. On a Canadian dollar basis, revenues decreased by \$286 million predominately due to a 5.6%, or approximately \$185 million, decrease in comparable store sales primarily due to sales decreases in the tools, lawn and garden, electronics, bed and bath, women's apparel and menswear categories, partially offset by an increase in major appliances. These declines were partially offset by the inclusion of approximately \$35 million of revenues recorded in the 53rd week of 2012.

#### Gross Margin

Gross margin dollars decreased \$99 million in 2012 to \$1.2 billion and included an \$11 million decrease due to the impact of exchange rates. Gross margin decreased \$88 million on a Canadian dollar basis. Sears Canada's gross margin rate decreased 10 basis points to 28.7%, in 2012 from 28.8% in 2011, due to decreases in the fitness and recreation, children's wear, jewelry, accessories and luggage and footwear categories.

#### Selling and Administrative Expenses

For 2012, Sears Canada's selling and administrative expenses decreased \$59 million, and included a decrease of \$10 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses decreased by \$49 million primarily due to decreases in advertising. Selling and administrative expenses for 2012 included expenses of \$20 million related to store closings and severance, \$3 million related to pension settlements and \$3 million of transaction costs associated with strategic initiatives. Selling and administrative expenses for 2011 included severance expenses of \$18 million.

Sears Canada's selling and administrative expense rate was 27.7% in 2012 and 27.0% in 2011 and increased primarily due to the above noted decline in revenues.

#### Impairment Charges

We recorded impairment charges of \$295 million in 2012 related to goodwill. We did not record any such impairments in 2011. Impairment charges recorded are further described in Note 12 of Notes to Consolidated Financial Statements.

#### Gain on Sales of Assets

We recorded a total gain on sales of assets of \$170 million in 2012 which included a gain of \$163 million recognized on the surrender and early termination of the leases on three properties under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received \$171 million (\$170 million Canadian) in cash proceeds.

**Operating Loss**

Sears Canada recorded an operating loss of \$187 million and \$20 million in 2012 and 2011, respectively. Operating loss in 2012 included expenses of \$20 million related to store closings and severance, \$3 million related to pension settlements and \$3 million of transaction costs associated with strategic initiatives, as well as an impairment charge of \$295 million and a gain on sales of assets of \$163 million in 2012. Operating loss in 2011 included expenses related to store closings and severance of \$18 million. The increase in operating loss was primarily due to the decline in sales, partially offset by the gain on sales of assets noted above as well as the decrease in selling and administrative expenses.

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

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. Our cash balances as of February 1, 2014 and February 2, 2013 are detailed in the following table.

| millions                                 | February 1,<br>2014 | February 2,<br>2013 |
|--|---------------------|---------------------|
| <b>Domestic</b>                          |                     |                     |
| Cash and equivalents                     | \$428               | \$227               |
| Cash posted as collateral                | 18                  | 20                  |
| Credit card deposits in transit          | 131                 | 133                 |
| Total domestic cash and cash equivalents | 577                 | 380                 |
| <b>Sears Canada</b>                      |                     |                     |
| Total cash and cash equivalents          | 451                 | 229                 |
| Restricted cash                          | 1,028               | 609                 |
| Total cash balances                      | 10                  | 9                   |
|  | <b>\$1,038</b>      | <b>\$618</b>        |

We had total cash balances of \$1.0 billion at February 1, 2014 and \$618 million at February 2, 2013. The increase in cash during 2013 primarily reflects cash proceeds of approximately \$1.0 billion from the sales of properties and investments, which were partially offset by operating losses. Significant uses of our cash during 2013 included contributions to our pension and postretirement benefit plans of \$426 million, capital expenditures of \$329 million, interest of \$206 million and taxes of \$21 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.

Our invested cash may include, from time to time, investments in, but not limited to, commercial paper, federal, state and municipal government securities, floating-rate notes, repurchase agreements and money market funds. Cash amounts held in these short-term investments are 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 cash related to Sears Canada's balances, which have been pledged as collateral for letters of credit obligations issued under its offshore merchandise purchasing program.

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash balances when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit were \$97 million and \$114 million as of February 1, 2014 and February 2, 2013, respectively.

#### Investment of Available Capital

Since the Merger, we have continued to invest in our businesses to transform the customer experience as the retail industry evolves and provide the opportunity for attractive returns. Our Board of Directors has delegated authority to direct investment of our surplus cash to our Chairman and Chief Executive Officer, Edward S. Lampert, subject to various limitations that have been or may be from time to time adopted by the Board of Directors and/or Finance Committee of the Board of Directors.

#### Operating Activities and Cash Flows

The Company used \$1.1 billion of cash in its continuing operations during 2013 and \$303 million during 2012. 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. The increase in cash used in operations in 2013 was driven primarily by increased operating losses.

The Company used \$303 million in cash flows in its continuing operations during 2012 and \$307 million during 2011 as the decrease in our net loss in 2012 compared to the prior year was offset by increases in contributions to our pension and postretirement benefit plans.

Merchandise inventories were \$7.0 billion at February 1, 2014 and \$7.6 billion at February 2, 2013. Merchandise payables were \$2.5 billion at February 1, 2014 and \$2.8 billion at February 2, 2013. Our Domestic inventory balances decreased approximately \$355 million from \$6.8 billion at February 2, 2013 to \$6.4 billion at February 1, 2014 driven by both improved productivity and store closures. Sears Domestic inventory decreased in a majority of categories, with the most notable decreases in the apparel and jewelry categories. Kmart inventory decreased in a majority of categories with the most notable decreases in the consumer electronics, grocery & household, jewelry and toys categories. Sears Canada's inventory levels decreased approximately \$169 million from \$791 million at February 2, 2013 to \$622 million at February 1, 2014, primarily due to the timing of merchandise receipts and was also impacted by changes in foreign currency exchange rates.

#### Investing Activities and Cash Flows

We generated net cash flows from investing activities from continuing operations of \$664 million in 2013 and \$191 million in 2012, compared to net cash flows used in investing activities from continuing operations of \$352 million in 2011.

For 2013, net cash flows generated from investing activities included cash proceeds from the sales of properties and investments of \$995 million, which were partially offset by cash used for capital expenditures of \$329 million. For 2012, net cash flows generated from investing activities included cash proceeds from the sales of properties of \$532 million and \$37 million from changes in investments and restricted cash, which were partially offset by cash used for capital expenditures of \$378 million. Net cash flows used in investing activities from continuing operations in 2011 was primarily used for purchases of property and equipment.

We spent \$329 million, \$378 million, and \$432 million during 2013, 2012 and 2011, respectively, for capital expenditures. Capital expenditures during both 2013 and 2012 primarily included investments in online and mobile shopping capabilities, enhancements to the Shop Your Way platform, information technology infrastructure and store maintenance. Capital expenditures in 2011 included investments in online initiatives, information technology infrastructure, in-home consultative sales technology, and maintenance for stores and distribution centers.

We anticipate 2014 capital expenditure levels to be similar to 2013 levels. It should be noted that in the normal course of business, we consider opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash and cause our capital expenditure levels to vary from period to period. In addition, we review leases that will expire in the short term in order to determine the appropriate action to take with respect to them.

#### Financing Activities and Cash Flows

During 2013, the Company generated net cash from financing activities from continuing operations of \$902 million, primarily due to proceeds from debt issuances of \$994 million, as well as an increase in short-term

borrowings of \$238 million, which were partially offset by Sears Canada dividends paid to noncontrolling interests of \$233 million. On October 2, 2013, the Company completed a new senior secured term loan facility of \$1.0 billion under the Company's existing Second Amended and Restated Credit agreement. The proceeds from the new term loan facility were used to pay down existing revolver borrowings. During 2013, Sears Canada declared a cash dividend of \$5 Canadian per common share, or approximately \$509 million Canadian (\$476 million U.S.), which was paid on December 6, 2013. Accordingly, the minority shareholders in Sears Canada received dividends of \$233 million. For further information, see Note 2 of Notes to Consolidated Financial Statements.

During 2012, the Company reported net cash used in financing activities from continuing operations of \$27 million which included gross cash proceeds of \$446.5 million as a result of the separation of SHO, which consisted of \$346.5 million in cash proceeds received for the sale of SHO common shares and \$100 million received through a dividend from SHO prior to the separation. The proceeds received were used to fund repayments on our domestic revolving credit facility. Repayments of long-term debt in 2012 were \$335 million in 2012.

During 2011, the Company generated net cash from financing activities from continuing operations of \$47 million, which reflects an increase in debt to fund operations, and common share repurchase activity. Repayments of long-term debt were \$611 million in 2011, and were offset by an increase of \$815 million in total short-term borrowings and proceeds of \$104 million from Sears Canada's credit facility,

During 2013 and 2012, we did not repurchase any of our common shares under our share repurchase program. We repurchased \$183 million of our common stock pursuant to our common share repurchase program in 2011. The common share repurchase program was initially announced in 2005 and had a total authorization since inception of the program of \$6.5 billion. At February 1, 2014, we had approximately \$504 million of remaining authorization under the program. The common share repurchase program 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.

#### Uses and Source of Liquidity

Our primary need for liquidity is to fund working capital requirements of our businesses, capital expenditures and for general corporate purposes, including debt repayment and pension plan contributions. We consider ourselves to be an asset-rich enterprise with substantial liquidity and financial flexibility benefiting from multiple funding resources such as our \$3.275 billion domestic revolving credit facility through April 2016, an \$800 million Canadian revolving credit facility through September 2015, which is subject to potential reserves. Our \$1.24 billion of senior secured notes are due in 2018. In addition, as discussed in Note 3 of the Notes to Consolidated Financial Statements, the Company completed a new senior secured term loan facility \$1.0 billion under the Company's existing Second Amended and Restated Credit agreement in the third quarter of 2013. Further, there is approximately \$327 million of remaining Sears debt from the Merger. These funding resources and obligations are described in more detail below. In addition, at February 1, 2014, we had cash balances of \$1.0 billion and \$4.5 billion of inventory, net of payables.

The domestic revolving credit facility and senior secured notes are firmly in place and are supported by an asset base which includes \$6.4 billion of domestic inventory, owned and leased real estate assets, market leading proprietary brands such as Kenmore, Craftsman and DieHard, and well-established stand-alone businesses such as Lands' End and Sears Canada. This asset base provides us flexibility as we continue to transform our business.

During 2013, we demonstrated our ability to monetize assets as we redeploy our capital in support of our transformation to a member-centric model leveraging our Integrated Retail and Shop Your Way platforms. More specifically, we generated approximately \$2.0 billion of liquidity in 2013 as compared to our previously stated objective of \$500 million announced in November 2012, through the following actions:

- completed a new senior secured term loan facility of \$1.0 billion under the Company's existing Second Amended and Restated Credit Agreement;

- Sears Canada's termination of its leases with respect to five stores for a total consideration of approximately \$0.4 billion;

• Sears Canada's sale of its 50% joint venture interests in eight properties it owned with The Westcliff Group of Companies for consideration of approximately \$0.3 billion; and  
 proceeds of approximately \$0.3 billion generated for other real estate transactions completed throughout the year. We believe that we are executing on a clear plan to increase financial flexibility, further de-risk our balance sheet and create shareholder value. We expect to continue with these types of activities during 2014. We currently anticipate generating approximately \$500 million from an exit dividend in connection with the previously announced separation of Lands' End through a pro rata distribution to our shareholders, with the separation being subject to certain conditions. We currently expect that the combination of (1) the Lands' End transaction, (2) our continuing to work with the board and management of Sears Canada to increase the value of our investment, which has a market value as of March 14, 2014 of about \$760 million, and realize significant cash proceeds and (3) our evaluation of opportunities with respect to a potential separation of our Sears Auto Centers when taken together will result in cash proceeds to the Company in excess of \$1.0 billion in 2014, which will help fund our transformation and create value. We also continue to reduce unprofitable stores as leases expire and, in some cases, accelerate closings when circumstances dictate.

Our outstanding borrowings at February 1, 2014 and February 2, 2013 were as follows:

| millions  | February 1,<br>2014 | February 2,<br>2013 |
|---|---------------------|---------------------|
| <b>Short-term borrowings:</b>                     |                     |                     |
| Unsecured commercial paper                        | \$9                 | \$345               |
| Secured borrowings                                | 1,323               | 749                 |
| <b>Long-term debt, including current portion:</b> |                     |                     |
| Notes, term loan and debentures outstanding       | 2,571               | 1,593               |
| Capitalized lease obligations                     | 346                 | 433                 |
| <b>Total borrowings</b>                           | <b>\$4,249</b>      | <b>\$3,120</b>      |

We fund our peak sales season working capital needs through our domestic revolving credit facility and commercial paper markets.

| millions   | 2013    | 2012    |
|--|---------|---------|
| <b>Secured borrowings:</b>                       |         |         |
| Maximum daily amount outstanding during the year | \$2,029 | \$1,862 |
| Average amount outstanding during the year       | 1,276   | 972     |
| Amount outstanding at year-end                   | 1,323   | 749     |
| Weighted average interest rate                   | 2.8     | % 2.9   |

|  |       |       |
|--|-------|-------|
| <b>Unsecured commercial paper:</b>               |       |       |
| Maximum daily amount outstanding during the year | \$384 | \$377 |
| Average amount outstanding during the year       | 225   | 302   |
| Amount outstanding at year-end                   | 9     | 345   |
| Weighted average interest rate                   | 2.6   | % 2.2 |

#### Domestic Credit Agreement

During the first quarter of 2011, Sears Roebuck Acceptance Corp. ("SRAC"), Kmart Corporation (together with SRAC, the "Borrowers") and Holdings entered into an amended credit agreement (the "Domestic Credit Agreement"). The Domestic Credit Agreement provides for a \$3.275 billion asset-based revolving credit facility (the "Revolving Facility") with a \$1.5 billion letter of credit sub-limit. On October 2, 2013, Holdings and the Borrowers entered into a First Amendment (the "Amendment") to the Domestic Credit Agreement with a syndicate of lenders.

Pursuant to the Amendment, the Borrowers borrowed \$1.0 billion under a new senior secured term loan facility (the "Term Loan").

Advances under the Domestic Credit Agreement bear interest at a rate equal to, at the election of the Borrowers, either the London Interbank Offered Rate ("LIBOR") or a base rate, in either case plus an applicable margin. The Domestic Credit Agreement's interest rates for LIBOR-based borrowings vary based on leverage in the range of LIBOR plus 2.0% to 2.5%. Interest rates for base rate-based borrowings vary based on leverage in the range of the applicable base rate plus 1.0% to 1.5%. Commitment fees are in a range of 0.375% to 0.625% based on usage. The Revolving Facility is in place as a funding source for general corporate purposes and is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and is subject to a borrowing base formula to determine availability. The Revolving Facility permits aggregate second lien indebtedness of up to \$2.0 billion, of which \$1.2 billion in second lien notes were outstanding at February 1, 2014, resulting in \$760 million of permitted second lien indebtedness, subject to limitations imposed by a borrowing base requirement under the indenture that governs our 6 5/8% senior secured notes due 2018. The Revolving Facility is expected to expire in April 2016.

The Term Loan bears interest at a rate equal to, at the election of the Borrowers, either (1) LIBOR (subject to a 1.00% LIBOR floor) or (2) the highest of (x) the prime rate of the bank acting as agent of the syndicate of lenders (y) the federal funds rate plus 0.50% and (z) the one-month LIBOR rate plus 1.00% (the highest of (x), (y) and (z), the "Base Rate"), plus an applicable margin for LIBOR loans of 4.50% and for Base Rate loans of 3.50%. Beginning February 2, 2014, the Borrowers are required to repay the Term Loan in quarterly installments of \$2.5 million, with the remainder of the Term Loan maturing June 30, 2018. Beginning with the fiscal year ending January 2015, the Borrowers are also required to make certain mandatory repayments of the Term Loan from excess cash flow (as defined in the Domestic Credit Agreement). The Term Loan may be prepaid in whole or part without penalty, other than a 1.00% prepayment premium if the Borrowers enter into certain repricing transactions with respect to the Term Loan within one year. The Term Loan is secured by the same collateral as the Revolving Facility on a pari passu basis with the Revolving Facility, and is guaranteed by the same subsidiaries of the Company that guarantee the Revolving Facility.

The Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, subject to specified exceptions that are available if, in each case, no event of default under the credit facility exists immediately before or after giving effect to the restricted payment. These include exceptions that require that projected availability under the credit facility, as defined, is at least 15% and an exception that requires that the restricted payment is funded from cash on hand and not from borrowings under the credit facility. The Domestic Credit Agreement also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

At February 1, 2014 and February 2, 2013, we had \$1.3 billion and \$749 million respectively, of Revolving Facility borrowings and \$661 million and \$754 million, respectively, of letters of credit outstanding under the Revolving Facility. The increase in Revolving Facility borrowings in 2013 is due to lower commercial paper borrowings and increased domestic cash balances. At February 1, 2014, the amount available to borrow under the Revolving Facility was \$549 million, which reflects the effect of the springing fixed charge coverage ratio covenant and the borrowing base limitation. At February 2, 2013, the amount available to borrow was \$1.4 billion, which reflects the effect of the springing fixed charge coverage ratio covenant, while the borrowing base requirement had no effect on availability. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs. At February 1, 2014, we had \$1.0 billion of borrowings under the Term Loan.

#### Senior Secured Notes

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



net proceeds of this offering to repay borrowings outstanding under a previous domestic credit agreement on the settlement date and to fund the working capital requirements of our retail businesses, capital expenditures and for general corporate purposes. The indenture under which the Notes were issued contains restrictive covenants that, among other things, (1) limit the ability of the Company and certain of its domestic subsidiaries to create liens and enter into sale and leaseback transactions and (2) limit the ability of the Company to consolidate with or merge into, or sell other than for cash or lease all or substantially all of its assets to, another person. The indenture also provides for certain events of default, which, if any were to occur, would permit or require the principal and accrued and unpaid interest on all the then outstanding notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Notes at a purchase price equal to 101% of the principal amount if the borrowing base (as calculated pursuant to the indenture) falls below the principal value of the notes plus any other indebtedness for borrowed money that is secured by liens on the Collateral for two consecutive quarters or upon the occurrence of certain change of control triggering events. The Company may call the Notes at a premium based on the “Treasury Rate” as defined in the indenture, plus 50 basis points. On September 6, 2011, we completed our offer to exchange the Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

#### Sears Canada Credit Agreement

In September 2010, Sears Canada entered into a five-year, \$800 million Canadian senior secured revolving credit facility (the “Sears Canada Facility”). The Sears Canada Facility is available for Sears Canada’s general corporate purposes and is secured by a first lien on inventory and credit card receivables. Availability under the Sears Canada Facility is determined pursuant to a borrowing base formula based on inventory and credit card receivables, subject to certain limitations. At February 1, 2014 and February 2, 2013 we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$336 million (\$374 million Canadian) and \$503 million (\$502 million Canadian), respectively, at February 1, 2014 and February 2, 2013. The current availability may be reduced by reserves currently estimated by the Company to be approximately \$177 million, which may be applied by the lenders at their discretion pursuant to the Credit Facility agreement. As a result of judicial developments relating to the priorities of pension liability relative to certain secured obligations, Sears Canada has executed an amendment to the Sears Canada Credit Facility which would provide additional security to lenders, with respect to the Company’s unfunded pension liability by pledging certain real estate assets as collateral thereby partially reducing the potential reserve amounts by up to \$135 million the lenders could apply. The potential additional reserve amount may increase or decrease in the future based on estimated net pension liabilities.

#### Debt Repurchase Authorization

In 2005, our Finance Committee of the Board of Directors authorized the repurchase, subject to market conditions and other factors, of up to \$500 million of our outstanding indebtedness in open market or privately negotiated transactions. Our wholly owned finance subsidiary, Sears Roebuck Acceptance Corp. (“SRAC”), has repurchased \$215 million of its outstanding notes. In 2011, Sears Holdings repurchased \$10 million of senior secured notes, recognizing a gain of \$2 million. The unused balance of this authorization is \$275 million

#### Unsecured Commercial Paper

We borrow through the commercial paper markets. At February 1, 2014 and February 2, 2013, we had outstanding commercial paper borrowings of \$9 million and \$345 million, respectively. ESL held none of our commercial paper at February 1, 2014, including any held by Edward S. Lampert. ESL held \$285 million of our commercial paper at February 2, 2013, including \$169 million held by Edward S. Lampert. See Note 15 of Notes to Consolidated Financial Statements for further discussion of these borrowings.

## Debt Ratings

Our corporate family debt ratings at February 1, 2014 appear in the table below:

| Moody's<br>Investors Service<br>Caa1 | Standard & Poor's<br>Ratings Services<br>CCC+ | Fitch Ratings<br>CCC |
|--------------------------------------|---|----------------------|
|--------------------------------------|---|----------------------|

## Domestic Pension Plan Funding

Contributions to our pension plans remain a significant use of our cash on an annual basis. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, the Company has a legacy pension obligation for past service performed by Kmart and Sears associates. During 2013, we contributed \$361 million to our domestic pension plans. We estimate that the domestic pension contribution will be \$487 million in 2014 and approximately \$310 million in 2015, though the ultimate amount of pension contributions could be affected by changes in the applicable regulations as well as financial market and investment performance.

In 2012, federal legislation was signed into law which allowed pension plan sponsors to use higher interest rate assumptions in valuing plan liabilities and determining funding obligations. As a result of this legislation, the Company's domestic pension plan was within \$203 million of being 80% funded under applicable law. In order to reduce the risks of gross pension obligations, the Company elected to contribute an additional \$203 million to its domestic pension plan on September 14, 2012, after which its domestic pension plan was 80% funded under applicable law.

Effective September 17, 2012, the Company amended its domestic pension plan, primarily related to lump sum benefit eligibility, and began notifying certain former employees of the Company of its offer to pay those employees' pension benefit in a lump sum. These amendments did not have a significant impact on our plan. Former employees eligible for the voluntary lump sum payment option are generally those who are vested traditional formula participants of the Plan who terminated employment prior to January 1, 2012 and who have not yet started receiving monthly payments of their pension benefits.

The Company offered the one-time voluntary lump sum window in an effort to reduce its long-term pension obligations and ongoing annual pension expense. This voluntary offer was made to approximately 86,000 eligible terminated vested participants, representing approximately \$2.0 billion of the Company's total qualified pension plan liabilities. Eligible participants had until November 19, 2012 to make their election. The Company made payments of approximately \$1.5 billion to employees who made the election in December 2012 and funded the payments from existing pension plan assets. In connection with this transaction, the Company incurred a non-cash charge to operations of approximately \$452 million pre-tax in the fourth quarter of 2012 as a result of the requirement to expense the unrealized actuarial losses. The charge had no effect on equity because the unrealized actuarial losses are already recognized in accumulated other comprehensive income/(loss). Accordingly, the effect on retained earnings was offset by a corresponding reduction in accumulated other comprehensive loss.

## Wholly owned Insurance Subsidiary and Intercompany Securities

We have numerous types of insurable risks, including workers' compensation, product and general liability, automobile, warranty, asbestos and environmental claims and the extended service contracts we sell to our customers. In addition, we provide credit insurance to third party creditors of the Company to mitigate their credit risk with the Company. The associated risks are managed through Holdings' wholly owned insurance subsidiary, Sears Reinsurance Company Ltd. ("Sears Re"), a Bermuda Class 3 insurer.

In accordance with applicable insurance regulations, Sears Re holds marketable securities to support the insurance coverage it provides. Sears has utilized two securitization structures to issue specific securities in which Sears Re has invested its capital to fund its insurance obligations. In November 2003, Sears formed a Real Estate Mortgage Investment Conduit, or REMIC. The real estate associated with 125 Full-line stores was contributed to indirect wholly owned subsidiaries of Sears, and then leased back to Sears. The contributed stores were mortgaged and the REMIC issued to wholly owned subsidiaries of Sears (including Sears Re) \$1.3 billion (par value) of securities (the "REMIC Securities") that are secured by the mortgages and collateral assignments of the store leases.



Payments to the holders on the REMIC Securities are funded by the lease payments. In May 2006, a subsidiary of Holdings contributed the rights to use the Kenmore, Craftsman and DieHard trademarks in the U.S. and its possessions and territories to KCD IP, LLC, an indirect wholly owned subsidiary of Holdings. KCD IP, LLC has licensed the use of the trademarks to subsidiaries of Holdings, including Sears and Kmart. Asset-backed securities with a par value of \$1.8 billion (the "KCD Securities") were issued by KCD IP, LLC and subsequently purchased by Sears Re, the collateral for which includes the trademark rights and royalty income. Payments to the holders on the KCD Securities are funded by the royalty payments. The issuers of the REMIC Securities and KCD Securities and the owners of these real estate and trademark assets are bankruptcy remote, special purpose entities that are indirect wholly owned subsidiaries of Holdings. Cash flows received from rental streams and licensing fee streams paid by Sears, Kmart, other affiliates and third parties, are used for the payment of fees and interest on these securities. In the fourth quarter of fiscal 2013, Holdings contributed all of the outstanding capital stock of Sears Re to SRe Holding Corporation, a direct wholly owned subsidiary of Holdings. Sears Re thereafter reduced its excess statutory capital through the distribution of all REMIC Securities held by it to SRe Holding Corporation. Since the inception of the REMIC and KCD IP, LLC, the REMIC Securities and the KCD Securities have been entirely held by our wholly owned consolidated subsidiaries. At February 1, 2014 and February 2, 2013, the net book value of the securitized trademark rights was approximately \$1.0 billion. The net book value of the securitized real estate assets was approximately \$0.7 billion at February 1, 2014 and \$0.8 billion at February 2, 2013.

### Contractual Obligations and Off-Balance Sheet Arrangements

Information concerning our obligations and commitments to make future payments under contracts such as debt and lease agreements, and under contingent commitments, is aggregated in the following tables.

| Contractual Obligations  | Total           | Payments Due by Period |                |                |                |              |
|--|-----------------|------------------------|----------------|----------------|----------------|--------------|
|  |                 | Within 1 Year          | 1-3 Years      | 4-5 Years      | After 5 Years  | Other        |
| <b>millions</b>  |                 |                        |                |                |                |              |
| Operating leases   | \$3,774         | \$684                  | \$1,104        | \$672          | \$1,314        | \$—          |
| Short-term debt  | 1,332           | 1,332                  | —              | —              | —              | —            |
| Capital lease obligations  | 479             | 102                    | 163            | 83             | 131            | —            |
| Royalty license fees <sup>(1)</sup>                                      | 120             | 56                     | 50             | 14             | —              | —            |
| Purchase obligations   | 90              | 22                     | 45             | 23             | —              | —            |
| Pension funding obligations  | 1,621           | 487                    | 636            | 495            | 3              | —            |
| Long-term debt including current portion and interest                    | 3,261           | 95                     | 180            | 2,393          | 593            | —            |
| Liability and interest related to uncertain tax positions <sup>(2)</sup> | 203             | —                      | —              | —              | —              | 203          |
| <b>Total contractual obligations</b>                                     | <b>\$10,880</b> | <b>\$2,778</b>         | <b>\$2,178</b> | <b>\$3,680</b> | <b>\$2,041</b> | <b>\$203</b> |

We pay royalties under various merchandise license agreements, which are generally based on sales of products covered under these agreements. We currently have license agreements for which we pay royalties, including those to use American Greetings and Joe Boxer. Royalty license fees represent the minimum the Company is obligated to pay, regardless of sales, as guaranteed royalties under these license agreements.

At February 1, 2014, our uncertain tax position liability and gross interest payable were \$150 million and \$53 million, respectively. We are unable to reasonably estimate the timing of liabilities and interest payments arising from uncertain tax positions in individual years due to the uncertainties in the timing of the effective settlement of tax positions.

### Other Commercial Commitments

We issue various types of guarantees in the normal course of business. We had the following guarantees outstanding at February 1, 2014:

| millions  | Bank Issued | SRAC Issued | Other | Total |
|---|-------------|-------------|-------|-------|
| Standby letters of credit                             | \$683       | \$16        | \$—   | \$699 |
| Commercial letters of credit                          | 13          | 105         | —     | 118   |
| Secondary lease obligations and performance guarantee | —           | —           | 55    | 55    |

The secondary lease obligations relate to certain store leases of previously divested Sears businesses. We remain secondarily liable if the primary obligor defaults.

#### Application of Critical Accounting Policies and Estimates

In preparing the financial statements, certain accounting policies require considerable judgment to select the appropriate assumptions to calculate financial estimates. These estimates are complex and subject to an inherent degree of uncertainty. We base our estimates on historical experience, terms of existing contracts, evaluation of trends and other assumptions that we believe to be reasonable under the circumstances. We continually evaluate the information used to make these estimates as our business and the economic environment change. Although the use of estimates is pervasive throughout the financial statements, we consider an accounting estimate to be critical if: it requires assumptions to be made about matters that were highly uncertain at the time the estimate was made, and changes in the estimate that are reasonably likely to occur from period to period or different estimates that could have been selected would have a material effect on our financial condition, cash flows or results of operations.

Management believes the current assumptions and other considerations used to estimate amounts reflected in the financial statements are appropriate. However, if actual experience differs from the assumptions and the considerations used in estimating amounts, the resulting changes could have a material adverse effect on our consolidated results of operations, and in certain situations, could have a material adverse effect on our financial condition.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the disclosure presented below relating to the selection of these estimates.

The following is a summary of our most critical policies and estimates. See Note 1 of Notes to Consolidated Financial Statements for a listing of our other significant accounting policies.

#### Valuation of Inventory

Our inventory is valued at the lower of cost or market determined primarily using the retail inventory method (“RIM”). RIM is an averaging method that is commonly used in the retail industry. To determine inventory cost under RIM, inventory at its retail selling value is segregated into groupings of merchandise having similar characteristics, which are then converted to a cost basis by applying specific average cost factors for each grouping of merchandise. Cost factors represent the average cost-to-retail ratio for each merchandise group based upon the year purchasing activity for each store location. Accordingly, a significant assumption under the retail method is that inventory in each group is similar in terms of its cost-to-retail relationship and has similar turnover rates. Management monitors the content of merchandise in these groupings to prevent distortions that would have a material effect on inventory valuation.

RIM inherently requires management judgment and certain estimates that may significantly affect the ending inventory valuation, as well as gross margin. Among others, two significant estimates used in inventory valuation are the level and timing of permanent markdowns (clearance markdowns used to clear unproductive or slow-moving inventory) and shrinkage. Amounts are charged to cost of sales, buying and occupancy at the time the retail value of inventory is reduced through the use of permanent markdowns.

Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise, fashion trends and weather conditions. In addition, inventory is also evaluated against corporate pre-determined historical markdown cadences. When a decision is made to permanently markdown merchandise, the resulting gross margin reduction is recognized in the period the markdown is recorded. The timing of the decision, particularly surrounding the balance sheet date, can have a significant effect on the results of operations. Shrinkage is estimated as a percentage of sales for the period from the date of the last physical inventory to the end of the year. Physical inventories are taken annually for all stores and inventory records are adjusted accordingly. The shrinkage rate from the most recent physical inventory, in combination with historical experience, is used as the basis for the shrinkage accrual following the physical inventory.

### Self Insurance Reserves

We use a combination of third-party insurance and/or self-insurance for a number of risks including workers' compensation, asbestos and environmental, automobile, warranty, product and general liability claims. General liability costs relate primarily to litigation that arises from store operations. Self-insurance reserves include actuarial estimates of both claims filed and carried at their expected ultimate settlement value and claims incurred but not yet reported. Our estimated claim amounts are discounted using a rate with a duration that approximates the duration of our self-insurance reserve portfolio. Our liability reflected on the Consolidated Balance Sheets represents an estimate of the ultimate cost of claims incurred at the balance sheet date. In estimating this liability, we utilize loss development factors based on Company-specific data to project the future development of incurred losses. Loss estimates are adjusted based upon actual claims settlements and reported claims. These projections are subject to a high degree of variability based upon future inflation rates, litigation trends, legal interpretations, benefit level changes and claim settlement patterns. Although we do not expect the amounts ultimately paid to differ significantly from our estimates, self-insurance reserves could be affected if future claim experience differs significantly from the historical trends and the actuarial assumptions.

### Defined Benefit Pension Plans

The fundamental components of accounting for defined benefit pension plans consist of the compensation cost of the benefits earned, the interest cost from deferring payment of those benefits into the future and the results of investing any assets set aside to fund the obligation. Such retirement benefits were earned by associates ratably over their service careers. Therefore, the amounts reported in the income statement for these retirement plans have historically followed the same pattern. Accordingly, changes in the obligations or the value of assets to fund them have been recognized systematically and gradually over the associate's estimated period of service. The largest drivers of losses or charges in recent years have been the discount rate used to determine the present value of the obligation and the actual return on pension assets. We recognize the changes by amortizing experience gains/losses in excess of the 10% corridor into expense over the associated service period.

The Company's actuarial valuations utilize key assumptions including discount rates and expected returns on plan assets. We are required to consider current market conditions, including changes in interest rates and plan asset investment returns, in determining these assumptions. The determination of our obligations and expense for pension benefits is dependent upon certain assumptions used in calculating such amounts. Key assumptions used in the actuarial valuations include the discount rate and expected long-term rate of return on plan assets. To determine the discount rate used in the development of the benefit obligation and net periodic benefit cost, a cash flow matching analysis of the expected future benefit payments is performed. In addition to considering the results that cash flow matching produces, the Company gives consideration to changes in industry benchmark yield curve rates. Actuarial assumptions may differ materially from actual results due to changing market and economic conditions, changes in investment strategies, higher or lower withdrawal rates, and longer or shorter life spans of participants.

The actual and expected return on plan assets for 2013, 2012 and 2011 were as follows:

|                                | 2013  | 2012   | 2011   |   |
|--------------------------------|-------|--------|--------|---|
| Actual return on plan assets   | 10.54 | % 9.75 | % 0.11 | % |
| Expected return on plan assets | 7.00  | % 7.25 | % 7.50 | % |

The Sears Holdings Corporation Investment Committee is responsible for the investment of the assets of Holdings' domestic pension plan. The Investment Committee, made up primarily of select members of senior management, has appointed a non-affiliated third party professional to advise the Investment Committee with respect to the SHC domestic pension plan assets. The plan's overall investment objective is to provide a long-term return that, along with Company contributions, is expected to meet future benefit payment requirements. A long-term horizon has been adopted in establishing investment policy such that the likelihood and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets. The plan's investment policy requires investments to be diversified across individual securities, industries, market capitalization and valuation characteristics. In addition, various techniques are utilized to monitor, measure and manage risk.

For purposes of determining the periodic expense of our defined benefit plan, we use the fair value of plan assets as the market related value. A one-percentage-point change in the assumed discount rate would have the following effects on the pension liability:

| millions                             | 1 percentage-point<br>Increase | 1 percentage-point<br>Decrease |   |
|--------------------------------------|--------------------------------|--------------------------------|---|
| Effect on interest cost component    | \$28                           | \$(36)                         | ) |
| Effect on pension benefit obligation | \$(596)                        | ) \$713                        |   |

For 2014 and beyond, the domestic weighted-average health care cost trend rates used in measuring the postretirement benefit expense are a 8.0% trend rate in 2014 to an ultimate trend rate of 6.0% in 2018. A one-percentage-point change in the assumed health care cost trend rate would have the following effects on the postretirement liability:

| millions   | 1 percentage-point<br>Increase | 1 percentage-point<br>Decrease |   |
|--|--------------------------------|--------------------------------|---|
| Effect on total service and interest cost components | \$1                            | \$(1)                          | ) |
| Effect on postretirement benefit obligation          | \$17                           | \$(15)                         | ) |

#### Income Taxes

We account for income taxes according to accounting standards for such taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the book basis and tax basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If future utilization of deferred tax assets is uncertain, the Company may record a valuation allowance against certain deferred tax assets. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results adjusted for the results of discontinued operations and changes in accounting policies and incorporate assumptions including the amount of future state, federal and foreign pre-tax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. In evaluating the objective evidence that historical results provide, we consider cumulative operating income (loss) over the past several years. These assumptions require significant judgment about the forecasts of future taxable income. After consideration of evidence regarding the ability to realize our deferred tax assets, we established a valuation allowance against certain deferred income tax assets in 2013, 2012 and 2011. In 2013, the Company increased its valuation allowance by \$623 million. Included in this \$623 million valuation allowance increase was \$138 million for state separate entity deferred tax assets as Kmart Corporation incurred a three-year cumulative loss in 2013. The Company continues to monitor its operating performance and evaluate the likelihood of the future realization of these deferred tax assets.

Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income ("OCI"). An exception is provided in the authoritative accounting guidance when there is income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expense recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from other sources, including gain from pension and other postretirement benefits recorded as a component of OCI, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. As a result, for the year ended February 1, 2014, the Company recorded a tax expense of \$97 million in OCI related to the gain on pension and other postretirement benefits, and recorded a corresponding tax benefit of \$97 million in continuing operations.

In accordance with accounting standards for uncertain tax positions, we record unrecognized tax benefits for positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Further, we record the largest amount of the unrecognized tax benefit that is greater than 50% likely of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine whether the recognition threshold has been met and, if so, the appropriate amount of unrecognized tax benefits to be recorded in the Consolidated Financial Statements. Management reevaluates tax positions each period in which new information about recognition or measurement becomes available.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and the valuation allowance recorded against our net deferred tax assets, if any. As further described above, management considers estimates of the amount and character of future taxable income in assessing the likelihood of realization of deferred tax assets. Our actual effective tax rate and income tax expense could vary from estimated amounts due to the future impacts of various items, including changes in income tax laws, tax planning and the Company's forecasted financial condition and results of operations in future periods. Although management believes current estimates are reasonable, actual results could differ from these estimates.

Domestic and foreign tax authorities periodically audit our income tax returns. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposures associated with our various tax filing positions, we record reserves in accordance with accounting standards for uncertain tax positions. A number of years may elapse before a particular matter, for which we have established a reserve, is audited and fully resolved. Management's estimates at the date of the financial statements reflect our best judgment, giving consideration to all currently available facts and circumstances. As such, these estimates may require adjustment in the future, as additional facts become known or as circumstances change. For further information, see Note 10 of Notes to Consolidated Financial Statements.

#### Goodwill and Intangible Asset Impairment Assessments

At both February 1, 2014 and February 2, 2013, we had goodwill balances of \$379 million and intangible asset balances of \$2.9 billion. The Company evaluates the carrying value of goodwill and intangible assets for possible impairment under accounting standards governing goodwill and other intangible assets. The majority of our goodwill and intangible assets relate to Kmart's acquisition of Sears in March 2005. We allocated goodwill, which is defined as the total purchase price less the fair value of all assets and liabilities acquired, to reporting units at the acquisition date. As required by accounting standards, we perform annual goodwill and intangible impairment tests in the fourth quarter and update the tests between annual tests if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and the testing for recoverability of a significant asset group within a reporting unit. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements.

#### Goodwill Impairment Assessments

Our goodwill resides in multiple reporting units. The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. We estimate fair value using the best information available, using both a market approach, as well as a discounted cash flow model, commonly referred to as the income approach. The market approach determines the value of a reporting unit by deriving market multiples for reporting units based on assumptions potential market participants would use in establishing a bid price for the unit. This approach therefore assumes strategic initiatives will result in improvements in operational

performance in the event of purchase, and includes the application of a discount rate based on market participant assumptions with respect to capital structure and access to capital markets. The income approach uses a reporting unit's projection of estimated operating results and cash flows that is discounted using a weighted-average cost of capital that reflects current market conditions appropriate to each of our reporting units. The projection uses management's best estimates of economic and market conditions over the projected period, including growth rates in sales, costs, estimates of future expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, future estimates of capital expenditures and changes in future working capital requirements. Our final estimate of fair value of reporting units is developed by weighting the fair values determined through both the market participant and income approaches, where comparable market participant information is available.

If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. The amount of impairment is determined by comparing the implied fair value of reporting unit goodwill to the carrying value of the goodwill in the same manner as if the reporting unit was being acquired in a business combination. Specifically, we allocate the fair value to all of the assets and liabilities of the reporting unit, including any unrecognized intangible assets, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we record an impairment charge for the difference.

After performing the first step of the process, we determined goodwill recorded at reporting units within the Sears Canada and Sears Domestic segments in 2012 and 2011, respectively, was potentially impaired. The impairment determination was primarily driven by the combination of lower sales and continued margin pressure coupled with expense increases which led to a decline in our operating profit. After performing the second step of the process, we determined that the total amount of goodwill recorded at these reporting units was impaired and recorded charges of \$295 million and \$551 million in 2012 and 2011, respectively. We did not record any goodwill impairment charges in 2013.

The use of different assumptions, estimates or judgments in either step of the goodwill impairment testing process, such as the estimated future cash flows of our reporting units, the discount rate used to discount such cash flows, or the estimated fair value of the reporting units' tangible and intangible assets and liabilities, could significantly increase or decrease the estimated fair value of a reporting unit or its net assets, and therefore, impact the related impairment charge. At the 2013 annual impairment test date, the conclusion that no indication of goodwill impairment existed for the remaining reporting units would not have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of our reporting units to their net present value in determining their estimated fair values and/or (2) a 100 basis point decrease in the estimated sales growth rate and/or terminal period growth rate.

Based on our sensitivity analysis, we do not believe that the remaining recorded goodwill balance is at risk of impairment at any reporting unit at the end of the year because the fair value is in excess of the carrying value and not at risk of failing step one. However, goodwill impairment charges may be recognized in future periods in one or more of the reporting units to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry or in the equity markets, which includes the market value of our common shares, deterioration in our performance or our future projections, or changes in our plans for one or more reporting units.

#### Intangible Asset Impairment Assessments

We review indefinite-lived intangible assets, primarily trade names, for impairment by comparing the carrying amount of each asset to the sum of undiscounted cash flows expected to be generated by the asset. We consider the income approach when testing intangible assets with indefinite lives for impairment on an annual basis. We determined that the income approach, specifically the Relief from Royalty Method, was most appropriate for analyzing our indefinite-lived assets. This method is based on the assumption that, in lieu of ownership, a firm would be willing to pay a royalty in order to exploit the related benefits of this asset class. The Relief from Royalty Method involves two steps: (1) estimation of reasonable royalty rates for the assets and (2) the application of these royalty rates to a net sales stream and discounting the resulting cash flows to determine a value. We multiplied the selected royalty rate by the forecasted net sales stream to calculate the cost savings (relief from royalty payment) associated with the assets.

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The cash flows are then discounted to present value by the selected discount rate and

compared to the carrying value of the assets. We did not record any intangible asset impairment charges in 2013, 2012 or 2011.

The use of different assumptions, estimates or judgments in our intangible asset impairment testing process, such as the estimated future cash flows of assets and the discount rate used to discount such cash flows, could significantly increase or decrease the estimated fair value of an asset, and therefore, impact the related impairment charge. At the 2013 annual impairment test date, the above-noted conclusion that no indication of intangible asset impairment existed at the test date would have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of our assets to their net present value in determining their estimated fair values (without any change in the aggregate estimated cash flows of our intangibles), (2) a 100 basis point decrease in the terminal period growth rate without a change in the discount rate of each intangible, or (3) a 10 basis point decrease in the royalty rate applied to the forecasted net sales stream of our assets and would have resulted in a potential impairment of approximately \$70 million under any of those scenarios.

Based on our analysis, we do not believe that the indefinite-lived intangible balance is at risk of impairment at the end of the year because the fair values are substantially in excess of the carrying values. However, indefinite-lived intangible impairment charges may be recognized in future periods to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry, deterioration in our performance or our future projections, or changes in our plans for one or more indefinite-lived intangible asset.

#### Impairment of Long-Lived Assets

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses, current cash flows that may be insufficient to recover the investment in the property over the remaining useful life, or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques.

As a result of this impairment testing, the Company recorded impairment charges of \$220 million, \$35 million and \$16 million during 2013, 2012 and 2011, respectively. Our impairment testing includes uncertainty because it requires management to make assumptions and to apply judgment to estimate future cash flows and asset fair values. If actual results are not consistent with our estimates and assumptions used in estimating future cash flows and asset fair values, we may be exposed to additional impairment charges in the future, which could be material to our results of operations.

#### New Accounting Pronouncements

See Note 1 of Notes to Consolidated Financial Statements for information regarding new accounting pronouncements.

#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements made in this Annual Report on Form 10-K 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 of future or conditional verbs such as "will," "may" and "could" are generally

forward-looking in nature and not historical facts. Such statements are based upon the current beliefs and expectations of the Company's 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 our integrated retail strategy to transform our business; our ability to successfully manage our inventory levels; initiatives to improve our liquidity through inventory management and other actions; competitive conditions in the retail and related services industries; worldwide economic conditions and business uncertainty, including the availability of consumer and commercial credit, changes in consumer confidence and spending, the impact of rising fuel prices, and changes in vendor relationships; vendors' lack of willingness to provide acceptable payment terms or otherwise restricting financing to purchase inventory or services; possible limits on our access to our domestic credit facility, which is subject to a borrowing base limitation and a springing fixed charge coverage ratio covenant, capital markets and other financing sources, including additional second lien financings, with respect to which we do not have commitments from lenders; our ability to successfully achieve our plans to generate liquidity through potential transactions or otherwise; potential liabilities in connection with the separation of Lands' End, Inc.; our extensive reliance on computer systems, including legacy systems, to implement our integrated retail strategy, process transactions, summarize results, maintain customer, member, associate and Company data, and otherwise manage our business, which may be subject to disruptions or security breaches; 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 reliance on third parties to provide us with services in connection with the administration of certain aspects of our business and the transfer of significant internal historical knowledge to such parties; 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; our ability to protect or preserve the image of our brands; the outcome of pending and/or future legal proceedings, including product liability and qui tam claims and proceedings with respect to which the parties have reached a preliminary settlement; and the timing and amount of required pension plan funding.

Certain of these and other factors are discussed in more detail in Part I, Item 1A of this Annual Report on Form 10-K. While we believe that our forecasts and assumptions are reasonable, we caution that actual results may differ materially. We intend the forward-looking statements to speak only as of the time made and do not undertake to update or revise them as more information becomes available.

#### Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

##### Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding. All debt securities are considered non-trading. At February 1, 2014, 55% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at February 1, 2014, which totaled approximately \$2.3 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by \$23 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

##### Foreign Currency Risk

At February 1, 2014, we had a foreign currency forward contract outstanding, totaling \$43 million Canadian notional value and with a remaining life of 0.1 years, designed to hedge our net investment in Sears Canada against adverse changes in exchange rates. The aggregate fair value of the forward contract at February 1, 2014 was \$2 million. A hypothetical 1% adverse movement in the level of the Canadian exchange rate relative to the U.S. dollar at February 1, 2014, with all other variables held constant, would have resulted in a fair value of this contract of approximately \$1 million at February 1, 2014, a decrease of \$1 million. Certain of our currency forward contracts require collateral be posted in the event our liability under such contracts reaches a predetermined threshold. Cash collateral posted under these contracts is recorded as part of our accounts receivable balance. We had no cash collateral posted under our contracts at February 1, 2014.

Sears Canada reduces its foreign exchange risk with respect to U.S. dollar denominated assets and liabilities and purchases of goods or services by entering into foreign exchange forward contracts. At February 1, 2014, these contracts had a notional value of \$90 million. The fair value of the forward contracts at February 1, 2014 was approximately \$6 million. A hypothetical 1% adverse movement in the level of the Canadian exchange rate relative to the U.S. dollar at February 1, 2014, with all other variables held constant, would have resulted in a fair value for these contracts of approximately \$5 million at February 1, 2014, a decrease of \$1 million.

##### 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 investment grade credit ratings or better at February 1, 2014. We had no derivative instruments at February 2, 2013.

Item 8. Financial Statements and Supplementary Data

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**SEARS HOLDINGS CORPORATION****Consolidated Statements of Operations  
millions, except per share data****REVENUES**Merchandise sales and services<sup>(1)</sup>

|   | 2013     | 2012     | 2011     |
|---|----------|----------|----------|
| Merchandise sales and services <sup>(1)</sup> | \$36,188 | \$39,854 | \$41,567 |

**COSTS AND EXPENSES**

Cost of sales, buying and occupancy

|                                     |        |        |        |
|-------------------------------------|--------|--------|--------|
| Cost of sales, buying and occupancy | 27,433 | 29,340 | 30,966 |
|-------------------------------------|--------|--------|--------|

Selling and administrative

|                            |       |        |        |
|----------------------------|-------|--------|--------|
| Selling and administrative | 9,384 | 10,660 | 10,664 |
|----------------------------|-------|--------|--------|

Depreciation and amortization

|                               |     |     |     |
|-------------------------------|-----|-----|-----|
| Depreciation and amortization | 732 | 830 | 853 |
|-------------------------------|-----|-----|-----|

Impairment charges

|                    |     |     |     |
|--------------------|-----|-----|-----|
| Impairment charges | 233 | 330 | 649 |
|--------------------|-----|-----|-----|

Gain on sales of assets

|                         |      |        |       |   |
|-------------------------|------|--------|-------|---|
| Gain on sales of assets | (667 | ) (468 | ) (64 | ) |
|-------------------------|------|--------|-------|---|

Total costs and expenses

|                          |        |        |        |
|--------------------------|--------|--------|--------|
| Total costs and expenses | 37,115 | 40,692 | 43,068 |
|--------------------------|--------|--------|--------|

Operating loss

|                |      |        |          |   |
|----------------|------|--------|----------|---|
| Operating loss | (927 | ) (838 | ) (1,501 | ) |
|----------------|------|--------|----------|---|

Interest expense

|                  |      |        |        |   |
|------------------|------|--------|--------|---|
| Interest expense | (254 | ) (267 | ) (289 | ) |
|------------------|------|--------|--------|---|

Interest and investment income

|                                |     |    |    |
|--------------------------------|-----|----|----|
| Interest and investment income | 207 | 94 | 41 |
|--------------------------------|-----|----|----|

Other income (loss)

|                     |   |   |    |   |
|---------------------|---|---|----|---|
| Other income (loss) | 2 | 1 | (2 | ) |
|---------------------|---|---|----|---|

Loss from continuing operations before income taxes

|   |      |          |          |   |
|---|------|----------|----------|---|
| Loss from continuing operations before income taxes | (972 | ) (1,010 | ) (1,751 | ) |
|---|------|----------|----------|---|

Income tax expense

|                    |      |       |          |   |
|--------------------|------|-------|----------|---|
| Income tax expense | (144 | ) (44 | ) (1,369 | ) |
|--------------------|------|-------|----------|---|

Loss from continuing operations

|                                 |        |          |          |   |
|---------------------------------|--------|----------|----------|---|
| Loss from continuing operations | (1,116 | ) (1,054 | ) (3,120 | ) |
|---------------------------------|--------|----------|----------|---|

Loss from discontinued operations, net of tax

|   |   |   |     |   |
|---|---|---|-----|---|
| Loss from discontinued operations, net of tax | — | — | (27 | ) |
|---|---|---|-----|---|

Net loss

|          |        |          |          |   |
|----------|--------|----------|----------|---|
| Net loss | (1,116 | ) (1,054 | ) (3,147 | ) |
|----------|--------|----------|----------|---|

(Income) loss attributable to noncontrolling interests

|  |      |       |   |
|--|------|-------|---|
| (Income) loss attributable to noncontrolling interests | (249 | ) 124 | 7 |
|--|------|-------|---|

**NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS \$(1,365**

|   |                |                  |          |
|---|----------------|------------------|----------|
| <b>NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS \$(1,365</b> | <b>) \$930</b> | <b>) \$3,140</b> | <b>)</b> |
|---|----------------|------------------|----------|

Amounts attributable to Holdings' shareholders:

Loss from continuing operations, net of tax

|   |          |          |            |   |
|---|----------|----------|------------|---|
| Loss from continuing operations, net of tax | \$(1,365 | ) \$(930 | ) \$(3,113 | ) |
|---|----------|----------|------------|---|

Loss from discontinued operations, net of tax

|   |   |   |     |   |
|---|---|---|-----|---|
| Loss from discontinued operations, net of tax | — | — | (27 | ) |
|---|---|---|-----|---|

Net loss

|          |          |          |            |   |
|----------|----------|----------|------------|---|
| Net loss | \$(1,365 | ) \$(930 | ) \$(3,140 | ) |
|----------|----------|----------|------------|---|

**NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS****Basic:**

Continuing operations

|                       |          |           |            |   |
|-----------------------|----------|-----------|------------|---|
| Continuing operations | \$(12.87 | ) \$(8.78 | ) \$(29.15 | ) |
|-----------------------|----------|-----------|------------|---|

Discontinued operations

|                         |   |   |       |   |
|-------------------------|---|---|-------|---|
| Discontinued operations | — | — | (0.25 | ) |
|-------------------------|---|---|-------|---|

|  |          |           |            |   |
|--|----------|-----------|------------|---|
|  | \$(12.87 | ) \$(8.78 | ) \$(29.40 | ) |
|--|----------|-----------|------------|---|

**Diluted:**

Continuing operations

|                       |          |           |            |   |
|-----------------------|----------|-----------|------------|---|
| Continuing operations | \$(12.87 | ) \$(8.78 | ) \$(29.15 | ) |
|-----------------------|----------|-----------|------------|---|

Discontinued operations

|                         |   |   |       |   |
|-------------------------|---|---|-------|---|
| Discontinued operations | — | — | (0.25 | ) |
|-------------------------|---|---|-------|---|

|  |          |           |            |   |
|--|----------|-----------|------------|---|
|  | \$(12.87 | ) \$(8.78 | ) \$(29.40 | ) |
|--|----------|-----------|------------|---|

Basic weighted average common shares outstanding

|  |       |       |       |
|--|-------|-------|-------|
| Basic weighted average common shares outstanding | 106.1 | 105.9 | 106.8 |
|--|-------|-------|-------|

Diluted weighted average common shares outstanding

|  |       |       |       |
|--|-------|-------|-------|
| Diluted weighted average common shares outstanding | 106.1 | 105.9 | 106.8 |
|--|-------|-------|-------|

<sup>(1)</sup> Includes merchandise sales from Sears Hometown and Outlet Stores, Inc. ("SHO") of \$1.5 billion and \$437 million in 2013 and 2012, respectively. Pursuant to the terms of the separation, merchandise is sold to SHO at cost.

See accompanying Notes to Consolidated Financial Statements.

**SEARS HOLDINGS CORPORATION**  
**Consolidated Statements of Comprehensive Income (Loss)**

| millions   | 2013      | 2012      | 2011        |
|--|-----------|-----------|-------------|
| Net loss   | \$(1,116) | \$(1,054) | \$(3,147)   |
| Other comprehensive income (loss)                                    |           |           |             |
| Pension and postretirement adjustments, net of tax                   | 422       | 74        | (789)       |
| Deferred gain (loss) on derivatives, net of tax                      | 2         | 5         | (6)         |
| Currency translation adjustments, net of tax                         | (71)      | ) 5       | (38)        |
| Total other comprehensive income (loss)                              | 353       | 84        | (833)       |
| Comprehensive loss   | (763)     | ) (970)   | ) (3,980)   |
| Comprehensive (income) loss attributable to noncontrolling interests | (260)     | ) 124     | 12          |
| Comprehensive loss attributable to Holdings' shareholders            | \$(1,023) | ) \$(846) | ) \$(3,968) |

See accompanying Notes to Consolidated Financial Statements.

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**SEARS HOLDINGS CORPORATION**

**Consolidated Balance Sheets**

|  | February 1,<br>2014 | February 2,<br>2013 |
|--|---------------------|---------------------|
| millions   |                     |                     |
| <b>ASSETS</b>  |                     |                     |
| Current assets   |                     |                     |
| Cash and cash equivalents  | \$ 1,028            | \$ 609              |
| Restricted cash  | 10                  | 9                   |
| Accounts receivable <sup>(1)</sup>   | 553                 | 635                 |
| Merchandise inventories  | 7,034               | 7,558               |
| Prepaid expenses and other current assets  | 334                 | 454                 |
| Total current assets   | 8,959               | 9,265               |
| Property and equipment   |                     |                     |
| Land   | 1,850               | 1,875               |
| Buildings and improvements   | 5,405               | 6,072               |
| Furniture, fixtures and equipment  | 2,587               | 2,950               |
| Capital leases   | 267                 | 347                 |
| Gross property and equipment   | 10,109              | 11,244              |
| Less accumulated depreciation and amortization   | (4,715 )            | ( 5,191 )           |
| Total property and equipment, net  | 5,394               | 6,053               |
| Goodwill   | 379                 | 379                 |
| Trade names and other intangible assets  | 2,850               | 2,881               |
| Other assets   | 679                 | 762                 |
| <b>TOTAL ASSETS</b>  | <b>\$ 18,261</b>    | <b>\$ 19,340</b>    |
| <b>LIABILITIES</b>   |                     |                     |
| Current liabilities  |                     |                     |
| Short-term borrowings <sup>(2)</sup>   | \$ 1,332            | \$ 1,094            |
| Current portion of long-term debt and capitalized lease obligations                                | 83                  | 83                  |
| Merchandise payables   | 2,496               | 2,761               |
| Other current liabilities  | 2,527               | 2,683               |
| Unearned revenues  | 900                 | 931                 |
| Other taxes  | 460                 | 480                 |
| Short-term deferred tax liabilities  | 387                 | 382                 |
| Total current liabilities  | 8,185               | 8,414               |
| Long-term debt and capitalized lease obligations <sup>(3)</sup>                                    | 2,834               | 1,943               |
| Pension and postretirement benefits  | 1,942               | 2,730               |
| Other long-term liabilities  | 2,008               | 2,126               |
| Long-term deferred tax liabilities   | 1,109               | 955                 |
| <b>Total Liabilities</b>   | <b>16,078</b>       | <b>16,168</b>       |
| Commitments and contingencies  |                     |                     |
| <b>EQUITY</b>  |                     |                     |
| Sears Holdings Corporation equity  |                     |                     |
| Preferred stock, 20 shares authorized; no shares outstanding                                       | —                   | —                   |
| Common stock \$0.01 par value; 500 shares authorized; 106 and 106 shares outstanding, respectively | 1                   | 1                   |
| Treasury stock—at cost   | (5,963 )            | ( 5,970 )           |
| Capital in excess of par value   | 9,298               | 9,298               |

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|   |                 |                 |
|---|-----------------|-----------------|
| Retained earnings (deficit)             | (480            | ) 885           |
| Accumulated other comprehensive loss    | (1,117          | ) (1,459 )      |
| Total Sears Holdings Corporation equity | 1,739           | 2,755           |
| Noncontrolling interest                 | 444             | 417             |
| Total Equity                            | 2,183           | 3,172           |
| <b>TOTAL LIABILITIES AND EQUITY</b>     | <b>\$18,261</b> | <b>\$19,340</b> |

- (1) Includes \$68 million and \$79 million at February 1, 2014 and February 2, 2013, respectively, of net amounts receivable from SHO.
- (2) Includes \$285 million of unsecured commercial paper held by ESL and its affiliates at February 2, 2013. ESL and its affiliates held none of our commercial paper at February 1, 2014.
- (3) Includes \$95 million of senior secured notes and \$3 million of subsidiary notes held by ESL and its affiliates at both February 1, 2014 and February 2, 2013.

See accompanying Notes to Consolidated Financial Statements.

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**SEARS HOLDINGS CORPORATION**

**Consolidated Statements of Cash Flows**

millions

|  | 2013      | 2012      | 2011      |
|--|-----------|-----------|-----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |           |           |           |
| Net loss   | \$(1,116) | \$(1,054) | \$(3,147) |
| Income from discontinued operations, net of tax                                    | —         | —         | 27        |
| Loss from continuing operations  | (1,116)   | (1,054)   | (3,120)   |
| Adjustments to reconcile net loss to net cash used in operating activities:        |           |           |           |
| Deferred tax valuation allowance   | 720       | 237       | 1,798     |
| Tax benefit resulting from Other Comprehensive Income allocation                   | (97)      | —         | —         |
| Depreciation and amortization  | 732       | 830       | 853       |
| Impairment charges   | 233       | 330       | 649       |
| Gain on sales of assets  | (667)     | (468)     | (64)      |
| Gain on sales of investments   | (169)     | (28)      | —         |
| Pension and postretirement plan contributions                                      | (426)     | (593)     | (390)     |
| Pension and postretirement plan settlements  | —         | 455       | —         |
| Settlement of Canadian dollar hedges   | 9         | 6         | —         |
| Change in operating assets and liabilities (net of acquisitions and dispositions): |           |           |           |
| Deferred income taxes  | (441)     | (206)     | (533)     |
| Merchandise inventories  | 446       | 427       | 545       |
| Merchandise payables   | (230)     | (117)     | (134)     |
| Income and other taxes   | 63        | (63)      | (50)      |
| Mark-to-market adjustments and settlements on Sears Canada derivative instruments  | (6)       | 1         | 2         |
| Other operating assets   | 43        | (100)     | (67)      |
| Other operating liabilities  | (203)     | 40        | 70        |
| Net cash used in operating activities—continuing operations                        | (1,109)   | (303)     | (307)     |
| Net cash provided by operating activities—discontinued operations                  | —         | —         | 32        |
| Net cash used in operating activities  | (1,109)   | (303)     | (275)     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |           |           |           |
| Proceeds from sales of property and investments                                    | 995       | 532       | 72        |
| Net (increase) decrease in investments and restricted cash                         | (2)       | 37        | 8         |
| Purchases of property and equipment  | (329)     | (378)     | (432)     |
| Net cash provided by (used in) investing activities—continuing operations          | 664       | 191       | (352)     |
| Net cash provided by investing activities—discontinued operations                  | —         | —         | 43        |
| Net cash provided by (used in) investing activities                                | 664       | 191       | (309)     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |           |           |           |
| Proceeds from debt issuances   | 994       | 5         | 104       |
| Repayments of long-term debt   | (83)      | (335)     | (611)     |
| Increase (decrease) in short-term borrowings, primarily 90 days or less            | 238       | (81)      | 815       |
| Sears Hometown and Outlet Stores, Inc. pre-separation funding                      | —         | 100       | —         |
| Proceeds from the sale of Sears Hometown and Outlet Stores, Inc.                   | —         | 347       | —         |
| Debt issuance costs  | (14)      | (3)       | (35)      |
| Purchase of Sears Canada shares  | —         | (10)      | (43)      |
| Sears Canada dividends paid to noncontrolling interests                            | (233)     | (50)      | —         |
| Purchase of treasury stock   | —         | —         | (183)     |
| Net cash provided by (used in) financing activities—continuing operations          | 902       | (27)      | 47        |
| Net cash used in financing activities—discontinued operations                      | —         | —         | (75)      |

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|  |         |       |        |   |
|--|---------|-------|--------|---|
| Net cash provided by (used in) financing activities          | 902     | (27)  | ) (28  | ) |
| Effect of exchange rate changes on cash and cash equivalents | (38     | ) 1   | —      | ) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS         | 419     | (138  | ) (612 | ) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR                 | 609     | 747   | 1,359  |   |
| CASH AND CASH EQUIVALENTS, END OF YEAR                       | \$1,028 | \$609 | \$747  |   |

**SUPPLEMENTAL INFORMATION:**

|  |      |      |       |   |
|--|------|------|-------|---|
| Capital lease obligation incurred                          | \$31 | \$61 | \$3   |   |
| <b>Supplemental Cash Flow Data:</b>                        |      |      |       |   |
| Income taxes paid, net of refunds                          | \$21 | \$40 | \$94  |   |
| Cash interest paid   | 206  | 199  | 223   |   |
| Unpaid liability to acquire equipment and software         | 41   | 30   | 52    |   |
| Non-cash dividend in connection with Spin-Off transactions | —    | (542 | ) (74 | ) |

See accompanying Notes to Consolidated Financial Statements.

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**SEARS HOLDINGS CORPORATION**

**Consolidated Statements of Equity**

| <b>Equity Attributable to Holdings' Shareholders</b>  |                        |                 |                   |                                      |                                   |           | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Noncontrolling<br>Interests | Total   |
|---|------------------------|-----------------|-------------------|--------------------------------------|-----------------------------------|-----------|--|-----------------------------|---------|
| dollars and shares in<br>millions   | Number<br>of<br>Shares | Common<br>Stock | Treasury<br>Stock | Capital in<br>Excess of<br>Par Value | Retained<br>Earnings<br>(Deficit) |           |  |                             |         |
| Balance at January 29, 2011   | 109                    | \$1             | \$(5,826)         | \$10,185                             | \$4,930                           |           | \$(779)  | \$103                       | \$8,614 |
| Comprehensive loss  |                        |                 |                   |                                      |                                   |           |  |                             |         |
| Net loss  | —                      | —               | —                 | —                                    | (3,140)                           | )—        | (7)  | (3,147)                     |         |
| Pension and postretirement<br>adjustments,<br>net of tax  | —                      | —               | —                 | —                                    | —                                 | (789)     | )—   | (789)                       |         |
| Deferred loss on derivatives,<br>net of tax   | —                      | —               | —                 | —                                    | —                                 | (6)       | )—   | (6)                         |         |
| Currency translation<br>adjustments, net of tax   | —                      | —               | —                 | —                                    | —                                 | (33)      | (5)  | (38)                        |         |
| Total Comprehensive Loss  |                        |                 |                   |                                      |                                   |           |  |                             | (3,980) |
| Stock awards  | —                      | —               | 23                | (19)                                 | )—                                | —         | —  | —                           | 4       |
| Purchase of Sears Canada<br>shares  | —                      | —               | —                 | (24)                                 | )—                                | (2)       | (17)   | (43)                        |         |
| Shares repurchased  | (3)                    | )—              | (183)             | )—                                   | —                                 | —         | —  | —                           | (183)   |
| Associate stock purchase  | —                      | —               | 5                 | —                                    | —                                 | —         | —  | —                           | 5       |
| Non-cash dividend issued in<br>connection with Spin-Off   | —                      | —               | —                 | (137)                                | )75                               | —         | (12)   | (74)                        |         |
| Other   | —                      | —               | —                 | —                                    | —                                 | —         | (2)  | (2)                         |         |
| Balance at January 28, 2012   | 106                    | \$1             | \$(5,981)         | \$10,005                             | \$1,865                           | \$(1,609) | )\$60  | \$4,341                     |         |
| Comprehensive loss  |                        |                 |                   |                                      |                                   |           |  |                             |         |
| Net loss  | —                      | —               | —                 | —                                    | (930)                             | )—        | (124)  | (1,054)                     |         |
| Pension and postretirement<br>adjustments, net of tax   | —                      | —               | —                 | —                                    | —                                 | 74        | —  | 74                          |         |
| Deferred gain on<br>derivatives, net of tax   | —                      | —               | —                 | —                                    | —                                 | 5         | —  | 5                           |         |
| Currency translation<br>adjustments, net of tax   | —                      | —               | —                 | —                                    | —                                 | 5         | —  | 5                           |         |
| Total Comprehensive Loss  |                        |                 |                   |                                      |                                   |           |  |                             | (970)   |
| Stock awards  | —                      | —               | 7                 | (1)                                  | )—                                | —         | —  | —                           | 6       |
| Purchase of Sears Canada<br>shares  | —                      | —               | —                 | (3)                                  | )—                                | (1)       | (6)  | (10)                        |         |
| Associate stock purchase  | —                      | —               | 4                 | —                                    | —                                 | —         | —  | —                           | 4       |
| Separation of Sears<br>Hometown and Outlet<br>Stores, Inc.  | —                      | —               | —                 | (149)                                | )—                                | —         | —  | —                           | (149)   |
| Sears Canada dividend paid<br>to noncontrolling interests   | —                      | —               | —                 | —                                    | (50)                              | )—        | —  | —                           | (50)    |
| Non-cash dividend issued in<br>connection with spin-off of<br>45 million common shares<br>of Sears Canada | —                      | —               | —                 | (554)                                | )—                                | 67        | 487  | —                           |         |
| Balance at February 2, 2013   | 106                    | \$1             | \$(5,970)         | \$9,298                              | \$885                             | \$(1,459) | )\$417   | \$3,172                     |         |

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|   |     |      |            |          |           |            |          |          |
|---|-----|------|------------|----------|-----------|------------|----------|----------|
| Comprehensive loss  |     |      |            |          |           |            |          |          |
| Net income (loss)   | —   | —    | —          | —        | (1,365 )  | —          | 249      | (1,116 ) |
| Pension and postretirement<br>adjustments, net of tax     | —   | —    | —          | —        | —         | 372        | 50       | 422      |
| Deferred gain on<br>derivatives, net of tax               | —   | —    | —          | —        | —         | 2          | —        | 2        |
| Currency translation<br>adjustments, net of tax           | —   | —    | —          | —        | —         | (32 )      | (39 )    | (71 )    |
| Total Comprehensive Loss                                  |     |      |            |          |           |            |          | (763 )   |
| Stock awards  | —   | —    | 3          | —        | —         | —          | —        | 3        |
| Associate stock purchase                                  | —   | —    | 4          | —        | —         | —          | —        | 4        |
| Sears Canada dividend paid<br>to noncontrolling interests | —   | —    | —          | —        | —         | —          | (233 )   | (233 )   |
| Balance at February 1, 2014                               | 106 | \$ 1 | \$(5,963 ) | \$ 9,298 | \$ (480 ) | \$(1,117 ) | ) \$ 444 | \$ 2,183 |

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION  
Notes to Consolidated Financial Statements

**NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations, Consolidation and Basis of Presentation

Sears Holdings Corporation (“Holdings”) is the parent company of Kmart Holding Corporation (“Kmart”) and Sears, Roebuck and Co. (“Sears”). Holdings (together with its subsidiaries, “we,” “us,” “our,” or the “Company”) was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the “Merger”), on March 24, 2005. We are an integrated retailer with 1,980 full-line and specialty retail stores in the United States, operating through Kmart and Sears, and 449 full-line and specialty retail stores in Canada operating through Sears Canada Inc. (“Sears Canada”), a 51%-owned subsidiary. We have three reportable segments: Kmart, Sears Domestic and Sears Canada.

The consolidated financial statements include all majority-owned subsidiaries in which Holdings exercises control. Investments in companies in which Holdings exercises significant influence, but which we do not control (generally 20% to 50% ownership interest), are accounted for under the equity method of accounting. Investments in companies in which we have less than a 20% ownership interest and do not exercise significant influence are accounted for at cost. All intercompany transactions and balances have been eliminated.

Separation of Sears Hometown and Outlet Businesses

On October 11, 2012, we completed the separation of our Sears Hometown and Outlet businesses through a rights offering transaction. Holdings received gross proceeds of \$446.5 million with respect to the transaction, consisting of \$346.5 million for the sale of Sears Hometown and Outlet Stores, Inc. ("SHO") common shares and \$100 million through a dividend from SHO prior to the separation. Prior to the separation, SHO entered into an asset-based senior secured revolving credit facility with a group of financial institutions to provide (subject to availability under a borrowing base) for aggregate maximum borrowings of \$250 million. Borrowings of \$100 million from this revolving credit facility were used to fund the dividend paid to Holdings. We accounted for this separation in accordance with accounting standards applicable to common control transactions as ESL Investments, Inc. (together with its affiliated fund, "ESL") is a majority shareholder of Holdings and became a majority shareholder of SHO as a result of exercising subscription rights pursuant to the rights offering. Accordingly, we classified the difference between the proceeds received and the carrying value of net assets contributed to SHO as a reduction of capital in excess of par value in the Consolidated Statement of Equity for the period ended February 2, 2013.

In connection with the separation, Holdings and certain of its subsidiaries entered into various agreements with SHO under the terms described in Note 15. Because of the various agreements with SHO, the Company has determined that it has significant continuing cash flows with SHO. Accordingly, the operating results for SHO through the date of the separation are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Consolidated Financial Statements. See Note 15 to the Consolidated Financial Statements for further information related to the agreements with SHO.

Spin-Off of Orchard Supply Hardware Stores Corporation

On December 30, 2011, we completed the spin-off to our shareholders of all the capital stock of Orchard Supply Hardware Stores Corporation (“Orchard”) that was owned by Holdings immediately prior to the spin-off, consisting of common stock that represented approximately 80% of the voting power of Orchard's outstanding capital stock and preferred stock that represented 100% of Orchard's outstanding nonvoting capital stock. In connection with the spin-off, Holdings and certain of its subsidiaries entered into various agreements with Orchard, including a distribution agreement, a transition services agreement, an appliance sale and consignment agreement and brand license agreements. In addition, certain tax matters between Holdings and Orchard are governed by a tax sharing agreement entered into in 2005.

Holdings has no significant continuing involvement in the operations of Orchard. Accordingly, the operating results for Orchard are presented as discontinued operations in the accompanying Consolidated Statement of Operations for the year ended January 28, 2012. In addition, the cash flows from operating, investing and financing activities for Orchard have been separately stated as discontinued operations in the accompanying Consolidated



**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

Statement of Cash Flows for the year ended January 28, 2012. The Notes to Consolidated Financial Statements exclude the impact of Orchard for all periods presented. Prior to completion of the spin-off, Orchard's results of operations, financial position and cash flows were presented within the Sears Domestic segment.

**Fiscal Year**

Our fiscal year ends on the Saturday closest to January 31 each year. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years. The following fiscal periods are presented in this report.

**Fiscal Year**

|      | Ended            | Weeks |
|------|------------------|-------|
| 2013 | February 1, 2014 | 52    |
| 2012 | February 2, 2013 | 53    |
| 2011 | January 28, 2012 | 52    |

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events. The estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances. Adjustments to estimates and assumptions are made when facts and circumstances dictate. As future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying consolidated financial statements. Significant estimates and assumptions are required as part of determining inventory and accounts receivable valuation, estimating depreciation, amortization and recoverability of long-lived assets, establishing self-insurance, warranty, legal and other reserves, performing goodwill, intangible and long-lived asset impairment analyses, and in establishing valuation allowances on deferred income tax assets and reserves for tax examination exposures, and calculating retirement benefits.

**Cash and Cash Equivalents**

Cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. We also include deposits in-transit from banks for payments related to third-party credit card and debit card transactions within cash equivalents. The deposits in-transit balances included within cash equivalents were \$144 million and \$148 million at February 1, 2014 and February 2, 2013, respectively.

We classify cash balances which have been pledged as collateral, and for which we do not have the ability to substitute letters of credit, as restricted cash on our Consolidated Balance Sheet.

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash and cash equivalents when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit included in other current liabilities were \$97 million and \$114 million at February 1, 2014 and February 2, 2013, respectively.

**Allowance for Doubtful Accounts**

We provide an allowance for doubtful accounts based on both historical experience and a specific identification basis. Allowances for doubtful accounts on accounts receivable balances were \$28 million and \$26 million at February 1, 2014 and February 2, 2013, respectively. Our accounts receivable balance on our Consolidated Balance Sheet is presented net of our allowance for doubtful accounts and is comprised of various vendor-related and customer-related accounts receivable, including receivables related to our pharmacy operations.

## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

#### Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market. For Kmart and Sears Domestic, cost is primarily determined using the retail inventory method (“RIM”). Kmart merchandise inventories are valued under the RIM using primarily a first-in, first-out (“FIFO”) cost flow assumption. Sears Domestic merchandise inventories are valued under the RIM using primarily a last-in, first-out (“LIFO”) cost flow assumption. For Sears Canada, cost is determined using the average cost method based on individual items.

Inherent in the RIM calculation are certain significant management judgments and estimates including, among others, merchandise markups, markdowns and shrinkage, which significantly impact the ending inventory valuation at cost, as well as resulting gross margins. The methodologies utilized by us in our application of the RIM are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogenous classes of merchandise, the development of shrinkage and obsolescence reserves, the accounting for price changes and the computations inherent in the LIFO adjustment (where applicable). Management believes that the RIM provides an inventory valuation that reasonably approximates cost and results in carrying inventory at the lower of cost or market.

Approximately 47% of consolidated merchandise inventories are valued using LIFO. To estimate the effects of inflation on inventories, we utilize external price indices determined by an outside source, the Bureau of Labor Statistics. If the FIFO method of inventory valuation had been used instead of the LIFO method, merchandise inventories would have been \$70 million higher at February 1, 2014 and \$72 million higher at February 2, 2013.

#### Vendor Rebates and Allowances

We receive rebates and allowances from certain vendors through a variety of programs and arrangements intended to offset our costs of promoting and selling certain vendor products. These vendor payments are recognized and recorded as a reduction to the cost of merchandise inventories when earned and, thereafter, as a reduction of cost of sales, buying and occupancy as the merchandise is sold. Upfront consideration received from vendors linked to purchases or other commitments is initially deferred and amortized ratably to cost of sales, buying and occupancy over the life of the contract or as performance of the activities specified by the vendor to earn the fee is completed.

#### Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Additions and substantial improvements are capitalized and include expenditures that materially extend the useful lives of existing facilities and equipment. Maintenance and repairs that do not materially improve or extend the lives of the respective assets are expensed as incurred.

Depreciation expense, which includes depreciation on assets under capital leases, is recorded over the estimated useful lives of the respective assets using the straight-line method for financial statement purposes, and accelerated methods for tax purposes. The range of lives are generally 20 to 50 years for buildings, 3 to 10 years for furniture, fixtures and equipment, and 3 to 5 years for computer systems and computer equipment. Leasehold improvements are depreciated over the shorter of the associated lease term or the estimated useful life of the asset. Depreciation expense included within depreciation and amortization expense reported on the Consolidated Statements of Operations was \$703 million, \$778 million, and \$798 million for the years ended February 1, 2014, February 2, 2013 and January 28, 2012, respectively.

Primarily as a result of store closing actions, certain property and equipment are considered held for sale. The value of assets held for sale was \$39 million and \$57 million at February 1, 2014 and February 2, 2013, respectively. These assets were included in prepaid expenses and other current assets in the Consolidated Balance Sheets at February 1, 2014 and February 2, 2013 at the lower of their historical net book value or their estimated fair value, less estimated costs to sell. We expect to sell the properties within a year and we continually remarket them. Substantially all assets held for sale are held within the Sears Domestic segment.

#### Impairment of Long-Lived Assets and Costs Associated with Exit Activities

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In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is

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**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses, current cash flows that may be insufficient to recover the investment in the property over the remaining useful life, or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques. See Note 13 for further information regarding long-lived asset impairment charges recorded during 2013. We account for costs associated with location closings in accordance with accounting standards pertaining to accounting for costs associated with exit or disposal activities. As such, we record a liability for costs associated with location closings, which includes employee severance, inventory markdowns and other liquidation fees when management makes the decision to exit a location. We record a liability for future lease costs (net of estimated sublease income) when we cease to use the location.

**Goodwill, Trade Names, Other Intangible Assets and Related Impairments**

Trade names acquired as part of the Merger account for the majority of our intangible assets recognized in the Consolidated Balance Sheet. The majority of these trade name assets, such as Kenmore, Craftsman and Lands' End, are expected to generate cash flows indefinitely, do not have estimable or finite useful lives and, therefore, are accounted for as indefinite-lived assets not subject to amortization. Certain intangible assets, including favorable lease rights, contractual arrangements and customer lists, have estimable, finite useful lives, which are used as the basis for their amortization. The estimated useful lives of such assets are determined using a number of factors, including the demand for the asset, competition and the level of expenditure required to maintain the cash flows associated with the asset.

Our goodwill results from the Merger. We perform annual goodwill and indefinite-lived intangible asset impairment tests at the last day of our November accounting period each year and assess the need to update the tests between annual tests if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit or indefinite-lived intangible asset below its carrying amount. A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and the testing for recoverability of a significant asset group within a reporting unit. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements.

**Goodwill Impairment Assessments**

Our goodwill resides in multiple reporting units. The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. We estimate fair value using the best information available, using both a market approach, as well as a discounted cash flow model, commonly referred to as the income approach. The market approach determines the value of a reporting unit by deriving market multiples for reporting units based on assumptions potential market participants would use in establishing a bid price for the unit. This approach therefore assumes strategic initiatives will result in improvements in operational performance in the event of purchase, and includes the application of a discount rate based on market participant assumptions with respect to capital structure and access to capital markets. The income approach uses a reporting unit's projection of estimated operating results and cash flows that is discounted using a weighted-average cost of capital that reflects current market conditions appropriate for the reporting unit. The projection uses management's best estimates of economic and market conditions over the projected period, including growth rates in sales, costs, estimates of future

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expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, future estimates of capital expenditures and changes in future

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## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

working capital requirements. Our final estimate of fair value of reporting units is developed by weighting the fair values determined through both the market and income approaches.

If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss, if any. The amount of impairment is determined by comparing the implied fair value of reporting unit goodwill to the carrying value of the goodwill in the same manner as if the reporting unit was being acquired in a business combination. See Note 12 for further information regarding goodwill and related impairment charges recorded during 2012 and 2011.

#### Intangible Asset Impairment Assessments

We consider the income approach when testing intangible assets with indefinite lives for impairment on an annual basis. We utilize the income approach, specifically the relief from royalty method, for analyzing our indefinite-lived assets. This method is based on the assumption that, in lieu of ownership, a firm would be willing to pay a royalty in order to exploit the related benefits of this asset class. The relief from royalty method involves two steps:

(1) estimation of reasonable royalty rates for the assets and (2) the application of these royalty rates to a net sales stream and discounting the resulting cash flows to determine a value. We multiplied the selected royalty rate by the forecasted net sales stream to calculate the cost savings (relief from royalty payment) associated with the assets. The cash flows are then discounted to present value by the selected discount rate and compared to the carrying value of the assets.

#### Financial Instruments and Hedging Activities

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. We primarily use foreign currency forward contracts to hedge the foreign currency exposure of our net investment in Sears Canada against adverse changes in exchange rates and to hedge against foreign currency exposure arising from Sears Canada's inventory purchase contracts denominated in U.S. dollars.

#### Hedges of Net Investment in Sears Canada

When applying hedge accounting treatment to our derivative transactions, we formally document our hedge relationships, including identification of the hedging instruments and the hedged items, as well as our risk management objectives and strategies for undertaking the hedge transaction. We also formally assess, both at inception and at least quarterly thereafter, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in either the fair value or cash flows of the hedged item. If it is determined that a derivative ceases to be a highly effective hedge, we discontinue hedge accounting.

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

#### Sears Canada Hedges of Merchandise Purchases

Sears Canada mitigates the risk of currency fluctuations on offshore merchandise purchases denominated in U.S. currency by purchasing foreign exchange forward contracts for a portion of its expected requirements. Since the Company's 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. Changes in the fair value of these contracts are recorded in the Consolidated Statements of Operations as a component of other income (loss) each period.

## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

#### Hedges of Foreign Currency

The foreign currency forward contracts are recorded on the Consolidated Balance Sheet at fair value and, to the extent they have been designated and qualify for hedge accounting treatment, an offsetting amount is recorded as a component of other comprehensive income (loss), net of income tax effects. Changes in the fair value of those forward contracts for which hedge accounting is not applied are recorded in the Consolidated Statements of Operations as a component of other income (loss). Certain of our currency forward contracts require collateral to be posted in the event our liability under such contracts reaches a predetermined threshold. Cash collateral posted under these contracts is recorded as part of our restricted cash balance.

#### 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 investment grade credit ratings or better at February 1, 2014.

#### Fair Value of Financial Instruments

We determine the fair value of financial instruments in accordance with standards pertaining to fair value measurements. Such standards define fair value and establish a framework for measuring fair value in GAAP. Under fair value measurement accounting standards, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. We report the fair value of financial assets and liabilities based on the fair value hierarchy prescribed by accounting standards for fair value measurements, which prioritizes the inputs to valuation techniques used to measure fair value into three levels. See Note 4 for further information regarding our derivative positions.

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of temporary cash investments, accounts receivable and derivative financial instruments. We place our cash and cash equivalents in investment-grade, short-term instruments with high quality financial institutions and, by policy, limit the amount of credit exposure in any one financial instrument. We use high credit quality counterparties to transact our derivative transactions.

Cash and cash equivalents, accounts receivable, merchandise payables, credit facility borrowings and accrued liabilities are reflected in the 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 3.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Self-insurance Reserves

We are self-insured for certain costs related to workers' compensation, asbestos and environmental, automobile, warranty, product and general liability claims. We obtain third-party insurance coverage to limit our exposure to certain of these self-insured risks. A portion of these self-insured risks is managed through a wholly-owned insurance subsidiary. Our liability reflected on the Consolidated Balance Sheet, classified within other liabilities (current and long-term), represents an estimate of the ultimate cost of claims incurred at the balance sheet date. In estimating this liability, we utilize loss development factors based on Company-specific data to project the future development of incurred losses. Loss estimates are adjusted based upon actual claims settlements and reported claims. The liabilities for self-insured risks are discounted to their net present values using an interest rate which is based upon the expected duration of the liabilities. Expected payments as of February 1, 2014 were as follows:

millions

|                               |        |
|-------------------------------|--------|
| 2014                          | \$ 251 |
| 2015                          | 153    |
| 2016                          | 115    |
| 2017                          | 86     |
| 2018                          | 63     |
| Later years                   | 365    |
| Total undiscounted obligation | 1,033  |
| Less—discount                 | (97 )  |
| Net obligation                | \$ 936 |

## Loss Contingencies

We account for contingent losses in accordance with accounting standards pertaining to loss contingencies. Under accounting standards, loss contingency provisions are recorded for probable losses at management's best estimate of a loss, or when a best estimate cannot be made, a minimum loss contingency amount is recorded. These estimates are often initially developed substantially earlier than the ultimate loss is known, and the estimates are refined each accounting period, as additional information is known.

## Revenue Recognition

Revenues include sales of merchandise, services and extended service contracts, net commissions earned from leased departments in retail stores, delivery and handling revenues related to merchandise sold, and fees earned from co-branded credit card programs. We recognize revenues from retail operations at the later of the point of sale or the delivery of goods to the customer. Direct to customer revenues are recognized when the merchandise is delivered to the customer. Revenues from product installation and repair services are recognized at the time the services are provided. Revenues from the sale of service contracts and the related direct acquisition costs are deferred and amortized over the lives of the associated contracts, while the associated service costs are expensed as incurred.

We earn revenues through arrangements with third-party financial institutions that manage and directly extend credit relative to our co-branded credit card programs. The third-party financial institutions pay us for generating new accounts and sales activity on co-branded cards, as well as for selling other financial products to cardholders. We recognize these revenues in the period earned, which is when our related performance obligations have been met. We sell gift cards to customers at our retail stores and through our direct to customer operations. The gift cards generally do not have expiration dates. Revenues from gift cards are recognized when (i) the gift card is redeemed by the customer, or (ii) the likelihood of the gift card being redeemed by the customer is remote (gift card breakage) based on historical redemption patterns and we determine that we do not have a legal obligation to remit the value of the unredeemed gift cards to the relevant jurisdictions.

Revenues from merchandise sales and services are reported net of estimated returns and allowances and exclude sales taxes. The reserve for returns and allowances is calculated as a percentage of sales based on historical



## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

return percentages. Estimated returns are recorded as a reduction of sales and cost of sales. We defer the recognition of layaway sales and profit until the period in which the customer takes possession of the merchandise.

#### Cost of Sales, Buying and Occupancy Costs

Cost of sales, buying and occupancy are comprised principally of the costs of merchandise, buying, warehousing and distribution (including receiving and store delivery costs), retail store occupancy costs, product repair, and home service and installation costs, customer shipping and handling costs, vendor allowances, markdowns and physical inventory losses.

The Company has a Shop Your Way program in which customers earn points on purchases which may be redeemed to pay for future purchases. The expense for customer points earned is recognized as customers earn them and recorded in cost of sales.

#### Selling and Administrative Expenses

Selling and administrative expenses are comprised principally of payroll and benefits costs for retail and corporate employees, occupancy costs of corporate facilities, advertising, pre-opening costs and other administrative expenses.

#### Pre-Opening Costs

Pre-opening and start-up activity costs are expensed in the period in which they occur.

#### Advertising Costs

Advertising costs are expensed as incurred, generally the first time the advertising occurs, and amounted to \$1.5 billion, \$1.6 billion and \$1.9 billion for 2013, 2012 and 2011, respectively. These costs are included within selling and administrative expenses in the accompanying Consolidated Statements of Operations.

#### Income Taxes

We account for income taxes in accordance with accounting standards pertaining to such taxes. Accordingly, we provide deferred income tax assets and liabilities based on the estimated future tax effects of differences between the financial and tax basis of assets and liabilities based on currently enacted tax laws in effect for the year in which the differences are expected to reverse. The tax balances and income tax expense recognized by us are based on management's interpretation of the tax laws of multiple jurisdictions. Income tax expense also reflects our best estimates and assumptions regarding, among other things, the level of future taxable income, tax planning, and any valuation allowance. Future changes in tax laws, changes in projected levels of taxable income, tax planning, and adoption and implementation of new accounting standards could impact the effective tax rate and tax balances recorded by us. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results adjusted for the results of discontinued operations and changes in accounting policies and incorporate assumptions including the amount of future state, federal and foreign pre-tax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. In evaluating the objective evidence that historical results provide, we consider cumulative operating income (loss) over the past three years. These assumptions require significant judgment about the forecasts of future taxable income. Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income ("OCI"). An exception is provided in the authoritative accounting guidance when there is income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expense recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from

## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

other sources, including gain from pension and other postretirement benefits recorded as a component of OCI, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets.

#### Stock-based Compensation

We account for stock-based compensation arrangements in accordance with accounting standards pertaining to share-based payment transactions, which requires us to both recognize as expense the fair value of all stock-based compensation awards (which includes stock options, although there were no options outstanding in 2013) and to classify excess tax benefits associated with share-based compensation deductions as cash from financing activities rather than cash from operating activities. We recognize compensation expense as awards vest on a straight-line basis over the requisite service period of the award.

#### Earnings Per Common Share

Basic earnings per common share is calculated by dividing net income attributable to Holdings' shareholders by the weighted average number of common shares outstanding for each period. Diluted earnings per common share also includes the dilutive effect of potential common shares, exercise of stock options and the effect of restricted stock when dilutive.

#### New Accounting Pronouncements

##### Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the Financial Accounting Standards Board ("FASB") issued an accounting standards update which requires an unrecognized tax benefit to be presented as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward that the entity intends to use and is available for settlement at the reporting date. The update will be effective for the Company in the first quarter of 2014 and is not expected to have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

##### Disclosures about Reclassification Adjustments out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued an accounting standards update which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. The update requires entities to disclose additional information about reclassification adjustments, including changes in accumulated other comprehensive income balances by component and significant items reclassified out of accumulated other comprehensive income. The update was effective and adopted by the Company in the first quarter of 2013 and impacted the Company's disclosures, but otherwise did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

##### Testing Indefinite-Lived Intangible Assets for Impairment

In July 2012, the FASB issued an accounting standards update which provides, subject to certain conditions, the option to perform a qualitative, rather than quantitative, assessment to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. This update was effective and adopted by the Company in the first quarter of 2013 and did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

##### Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB issued an accounting standards update which requires disclosures of gross and net information about financial derivative instruments eligible for offset in the statement of financial position or subject to a master netting agreement. In January 2013, the FASB issued an accounting standards update which narrows the scope of the disclosure requirements to derivatives, securities borrowings, and securities lending transactions that are either offset or subject to a master netting arrangement. This update was effective for and adopted by the

## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

Company in the first quarter of 2013 and impacted the Company's disclosures, but otherwise did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

#### NOTE 2—SEARS CANADA

##### Sears Holdings Ownership of Sears Canada

At February 1, 2014 and February 2, 2013, Sears Holdings was the beneficial holder of approximately 52 million, or 51% of the common shares of Sears Canada.

##### Partial Spin-Off

On November 13, 2012, we completed a partial spin-off (the “spin-off”) of our interest in Sears Canada. Prior to the spin-off, Holdings beneficially owned approximately 96% of the issued and outstanding common shares of Sears Canada. In connection with the spin-off, we distributed approximately 45 million common shares of Sears Canada held by Holdings on a pro rata basis to holders of Holdings' common stock. Following the spin-off, Holdings was the beneficial holder of approximately 51% of the issued and outstanding common shares of Sears Canada, and as such, Holdings has maintained control of Sears Canada and will continue to consolidate the results of Sears Canada. We accounted for the spin-off as an equity transaction in accordance with accounting standards applicable to noncontrolling interests. Accordingly, we reclassified a portion of our ownership interest in Sears Canada and accumulated other comprehensive loss to noncontrolling interest in the Consolidated Statement of Equity for the period ended February 2, 2013.

##### Sears Canada Share Repurchases

During the second quarter of 2013, Sears Canada renewed its Normal Course Issuer Bid with the Toronto Stock Exchange that permits it to purchase for cancellation up to 5% of its issued and outstanding common shares, representing approximately 5.1 million common shares. The purchase authorization expires on May 23, 2014, or on such earlier date as Sears Canada may complete its purchases pursuant to the Normal Course Issuer bid. There were no share purchases during 2013. As part of a Normal Course Issuer bid in place for the period from May 25, 2011 to May 24, 2012, and then canceled, Sears Canada purchased and canceled approximately 0.9 million common shares for \$10 million and approximately 2.7 million common shares for \$43 million during 2012 and 2011, respectively.

##### Dividends

On November 19, 2013, Sears Canada announced that its Board of Directors declared a cash dividend of \$5 Canadian per common share, or approximately \$509 million Canadian (\$476 million U.S.), which was paid on December 6, 2013 to shareholders of record at the close of business on December 2, 2013. Accordingly, the Company received dividends of \$243 million and minority shareholders in Sears Canada received dividends of \$233 million during the fourth quarter of 2013.

On December 12, 2012, Sears Canada announced that its Board of Directors declared a cash dividend of \$1 Canadian per common share, or approximately \$102 million Canadian (\$102 million U.S.) which was paid on December 31, 2012 to shareholders of record at the close of business on December 24, 2012. Accordingly, the Company received dividends of \$52 million and minority shareholders in Sears Canada received dividends of \$50 million during the fourth quarter of 2012.

#### NOTE 3—BORROWINGS

Total borrowings outstanding at February 1, 2014 and February 2, 2013 were \$4.2 billion and \$3.1 billion, respectively. At February 1, 2014, total short-term borrowings were \$1.3 billion, consisting of \$1.3 billion secured borrowings and \$9 million of unsecured commercial paper. At February 2, 2013, total short-term borrowings were \$1.1 billion, consisting of \$749 million secured borrowings and \$345 million of unsecured commercial paper. The weighted-average annual interest rate paid on short-term debt was 2.8% in 2013 and 2.7% in 2012.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

Long-term debt was as follows:

| ISSUE   | February 1,<br>2014 | February 2,<br>2013 |
|---|---------------------|---------------------|
| <b>millions</b>   |                     |                     |
| <b>SEARS ROEBUCK ACCEPTANCE CORP.</b>                   |                     |                     |
| 6.50% to 7.50% Notes, due 2017 to 2043                  | \$327               | \$327               |
| 7.05% to 7.50% Medium-Term Notes, due 2013              | —                   | 11                  |
| Term Loan (Credit Facility), due 2018                   | 991                 | —                   |
| <b>SEARS HOLDINGS CORP.</b>                             |                     |                     |
| 6.625% Senior Secured Notes, due 2018                   | 1,238               | 1,237               |
| <b>CAPITALIZED LEASE OBLIGATIONS</b>                    | 346                 | 433                 |
| <b>OTHER NOTES AND MORTGAGES</b>                        | 15                  | 18                  |
| Total long-term borrowings                              | 2,917               | 2,026               |
| Current maturities                                      | (83 )               | (83 )               |
| Long-term debt and capitalized lease obligations        | \$2,834             | \$1,943             |
| Weighted-average annual interest rate on long-term debt | 6.4 %               | 6.7 %               |

The fair value of long-term debt, excluding capitalized lease obligations, was \$2.3 billion at February 1, 2014 and \$1.4 billion at February 2, 2013. 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. Our long-term debt instruments are valued using Level 2 measurements as defined in Note 5.

At February 1, 2014, long-term debt maturities for the next five years and thereafter were as follows:

|                 |  |         |
|-----------------|--|---------|
| <b>millions</b> |  |         |
| 2014            |  | \$83    |
| 2015            |  | 75      |
| 2016            |  | 65      |
| 2017            |  | 104     |
| 2018            |  | 2,224   |
| Thereafter      |  | 366     |
|                 |  | \$2,917 |

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**Interest**

Interest expense for years 2013, 2012 and 2011 was as follows:

|   | 2013  | 2012  | 2011  |
|---|-------|-------|-------|
| <b>COMPONENTS OF INTEREST EXPENSE</b>               |       |       |       |
| Interest expense                                    | \$217 | \$232 | \$248 |
| Accretion of lease obligations at net present value | 16    | 17    | 20    |
| Amortization of debt issuance costs                 | 21    | 18    | 21    |
| Interest expense                                    | \$254 | \$267 | \$289 |

**Debt Repurchase Authorization**

In 2005, our Finance Committee of the Board of Directors authorized the repurchase, subject to market conditions and other factors, of up to \$500 million of our outstanding indebtedness in open market or privately negotiated transactions. Our wholly owned finance subsidiary, Sears Roebuck Acceptance Corp. ("SRAC"), has repurchased \$215 million of its outstanding notes. In 2011, Sears Holdings repurchased \$10 million of senior secured notes, recognizing a gain of \$2 million. The unused balance of this authorization is \$275 million.

**Unsecured Commercial Paper**

We borrow through the commercial paper markets. At February 1, 2014 and February 2, 2013, we had outstanding commercial paper borrowings of \$9 million and \$345 million, respectively. ESL held none of our commercial paper at February 1, 2014, including any held by Edward S. Lampert. ESL held \$285 million of our commercial paper at February 2, 2013, including \$169 million held by Edward S. Lampert. See Note 15 for further discussion of these borrowings.

**Domestic Credit Agreement**

During the first quarter of 2011, Sears Roebuck Acceptance Corp. ("SRAC"), Kmart Corporation (together with SRAC, the "Borrowers") and Holdings entered into an amended credit agreement (the "Domestic Credit Agreement"). The Domestic Credit Agreement provides for a \$3.275 billion asset-based revolving credit facility (the "Revolving Facility") with a \$1.5 billion letter of credit sub-limit. On October 2, 2013, Holdings and the Borrowers entered into a First Amendment (the "Amendment") to the Domestic Credit Agreement with a syndicate of lenders. Pursuant to the Amendment, the Borrowers borrowed \$1.0 billion under a new senior secured term loan facility (the "Term Loan"). Advances under the Domestic Credit Agreement bear interest at a rate equal to, at the election of the Borrowers, either the London Interbank Offered Rate ("LIBOR") or a base rate, in either case plus an applicable margin. The Domestic Credit Agreement's interest rates for LIBOR-based borrowings vary based on leverage in the range of LIBOR plus 2.0% to 2.5%. Interest rates for base rate-based borrowings vary based on leverage in the range of the applicable base rate plus 1.0% to 1.5%. Commitment fees are in a range of 0.375% to 0.625% based on usage. The Revolving Facility is in place as a funding source for general corporate purposes and is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and is subject to a borrowing base formula to determine availability. The Revolving Facility permits aggregate second lien indebtedness of up to \$2.0 billion, of which \$1.2 billion in second lien notes were outstanding at February 1, 2014, resulting in \$760 million of permitted second lien indebtedness, subject to limitations imposed by a borrowing base requirement under the indenture that governs our 6 5/8% senior secured notes due 2018. The Revolving Facility is expected to expire in April 2016.

The Term Loan bears interest at a rate equal to, at the election of the Borrowers, either (1) LIBOR (subject to a 1.00% LIBOR floor) or (2) the highest of (x) the prime rate of the bank acting as agent of the syndicate of lenders, (y) the federal funds rate plus 0.50% and (z) the one-month LIBOR rate plus 1.00% (the highest of (x), (y) and (z), the "Base Rate"), plus an applicable margin for LIBOR loans of 4.50% and for Base Rate loans of 3.50%. Beginning February 2, 2014, the Borrowers are required to repay the Term Loan in quarterly installments of \$2.5 million, with

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

the remainder of the Term Loan maturing June 30, 2018. Beginning with the fiscal year ending January 2015, the Borrowers are also required to make certain mandatory repayments of the Term Loan from excess cash flow (as defined in the Domestic Credit Agreement). The Term Loan may be prepaid in whole or part without penalty, other than a 1.00% prepayment premium if the Borrowers enter into certain repricing transactions with respect to the Term Loan within one year. The Term Loan is secured by the same collateral as the Revolving Facility on a pari passu basis with the Revolving Facility, and is guaranteed by the same subsidiaries of the Company that guarantee the Revolving Facility.

The Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, subject to specified exceptions that are available if, in each case, no event of default under the credit facility exists immediately before or after giving effect to the restricted payment. These include exceptions that require that projected availability under the credit facility, as defined, is at least 15% and an exception that requires that the restricted payment is funded from cash on hand and not from borrowings under the credit facility. The Domestic Credit Agreement also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

At February 1, 2014 and February 2, 2013, we had \$1.3 billion and \$749 million respectively, of Revolving Facility borrowings and \$661 million and \$754 million, respectively, of letters of credit outstanding under the Revolving Facility. At February 1, 2014, the amount available to borrow under the Revolving Facility was \$549 million, which reflects the effect of the springing fixed charge coverage ratio covenant and the borrowing base limitation. At February 2, 2013, the amount available to borrow was \$1.4 billion, which reflects the effect of the springing fixed charge coverage ratio covenant, while the borrowing base requirement had no effect on availability. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs. At February 1, 2014, we had \$1.0 billion of borrowings under the Term Loan.

## Senior Secured Notes

In October 2010, we sold \$1 billion aggregate principal amount of senior secured notes (the “Notes”), which bear interest at 6 5/8% per annum and mature on October 15, 2018. Concurrent with the closing of the sale of the Notes, the Company sold \$250 million aggregate principal amount of Notes to the Company’s domestic pension plan in a private placement. The Notes are guaranteed by certain subsidiaries of the Company and are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables (the “Collateral”). The lien that secures the Notes is junior in priority to the lien on such assets that secures obligations under the Domestic Credit Agreement, as well as certain other first priority lien obligations. The Company used the net proceeds of this offering to repay borrowings outstanding under a previous domestic credit agreement on the settlement date and to fund the working capital requirements of our retail businesses, capital expenditures and for general corporate purposes. The indenture under which the Notes were issued contains restrictive covenants that, among other things, (1) limit the ability of the Company and certain of its domestic subsidiaries to create liens and enter into sale and leaseback transactions and (2) limit the ability of the Company to consolidate with or merge into, or sell other than for cash or lease all or substantially all of its assets to, another person. The indenture also provides for certain events of default, which, if any were to occur, would permit or require the principal and accrued and unpaid interest on all the then outstanding notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Notes at a purchase price equal to 101% of the principal amount if the borrowing base (as calculated pursuant to the indenture) falls below the principal value of the notes plus any other indebtedness for borrowed money that is secured by liens on the Collateral for two consecutive quarters or upon the occurrence of certain change of control triggering events. The Company may call the Notes at a premium based on the “Treasury Rate” as defined in the indenture, plus 50 basis points. On September 6, 2011, we completed our offer to exchange the Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

Sears Canada Credit Agreement

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In September 2010, Sears Canada entered into a five-year, \$800 million Canadian senior secured revolving credit facility (the “Sears Canada Facility”). The Sears Canada Facility is available for Sears Canada’s general corporate purposes and is secured by a first lien on inventory and credit card receivables. Availability under the

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

Sears Canada Facility is determined pursuant to a borrowing base formula based on inventory and credit card receivables, subject to certain limitations. At February 1, 2014 and February 2, 2013 we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$336 million (\$374 million Canadian) and \$503 million (\$502 million Canadian), respectively, at February 1, 2014 and February 2, 2013. The current availability may be reduced by reserves currently estimated by the Company to be approximately \$177 million, which may be applied by the lenders at their discretion pursuant to the Credit Facility agreement. As a result of judicial developments relating to the priorities of pension liability relative to certain secured obligations, Sears Canada has executed an amendment to the Sears Canada Credit Facility which would provide additional security to lenders, with respect to the Company's unfunded pension liability by pledging certain real estate assets as collateral thereby partially reducing the potential reserve amounts by up to \$135 million the lenders could apply. The potential additional reserve amount may increase or decrease in the future based on estimated net pension liabilities.

**Cash Collateral**

We post cash collateral for certain self-insurance programs. We continue to classify the cash collateral posted for self-insurance programs as cash and cash equivalents due to our ability to substitute letters of credit for the cash at any time at our discretion. At February 1, 2014 and February 2, 2013, \$18 million and \$19 million of cash, respectively, was posted as collateral for self-insurance programs.

**Wholly owned Insurance Subsidiary and Intercompany Securities**

We have numerous types of insurable risks, including workers' compensation, product and general liability, automobile, warranty, asbestos and environmental claims and the extended service contracts we sell to our customers. In addition, we provide credit insurance to third party creditors of the Company to mitigate their credit risk with the Company. The associated risks are managed through Holdings' wholly owned insurance subsidiary, Sears Reinsurance Company Ltd. ("Sears Re"), a Bermuda Class 3 insurer.

In accordance with applicable insurance regulations, Sears Re holds marketable securities to support the insurance coverage it provides. Sears has utilized two securitization structures to issue specific securities in which Sears Re has invested its capital to fund its insurance obligations. In November 2003, Sears formed a Real Estate Mortgage Investment Conduit, or REMIC. The real estate associated with 125 Full-line stores was contributed to indirect wholly owned subsidiaries of Sears, and then leased back to Sears. The contributed stores were mortgaged and the REMIC issued to wholly owned subsidiaries of Sears (including Sears Re) \$1.3 billion (par value) of securities (the "REMIC Securities") that are secured by the mortgages and collateral assignments of the store leases. Payments to the holders on the REMIC Securities are funded by the lease payments. In May 2006, a subsidiary of Holdings contributed the rights to use the Kenmore, Craftsman and DieHard trademarks in the U.S. and its possessions and territories to KCD IP, LLC, an indirect wholly owned subsidiary of Holdings. KCD IP, LLC has licensed the use of the trademarks to subsidiaries of Holdings, including Sears and Kmart. Asset-backed securities with a par value of \$1.8 billion (the "KCD Securities") were issued by KCD IP, LLC and subsequently purchased by Sears Re, the collateral for which includes the trademark rights and royalty income. Payments to the holders on the KCD Securities are funded by the royalty payments. The issuers of the REMIC Securities and KCD Securities and the owners of these real estate and trademark assets are bankruptcy remote, special purpose entities that are indirect wholly owned subsidiaries of Holdings. Cash flows received from rental streams and licensing fee streams paid by Sears, Kmart, other affiliates and third parties, are used for the payment of fees and interest on these securities. In the fourth quarter of fiscal 2013, Holdings contributed all of the outstanding capital stock of Sears Re to SRe Holding Corporation, a direct wholly owned subsidiary of Holdings. Sears Re thereafter reduced its excess statutory capital through the distribution of all REMIC Securities held by it to SRe Holding Corporation. Since the inception of the REMIC and KCD IP, LLC, the REMIC Securities and the KCD Securities have been entirely held by our wholly owned consolidated subsidiaries. At February 1, 2014 and February 2, 2013, the net book value of the securitized trademark rights was approximately \$1.0 billion. The net book value of the securitized real estate assets was approximately \$0.7 billion at February 1, 2014 and \$0.8 billion at February 2, 2013.



## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

#### Trade Creditor Matters

We have ongoing discussions concerning our liquidity and financial position with the vendor community and third parties that offer various credit protection services to our vendors. The topics discussed have included such areas as pricing, payment terms and ongoing business arrangements. As of the date of this report, we have not experienced any significant disruption in our access to merchandise or our operations.

#### NOTE 4—DERIVATIVE FINANCIAL INSTRUMENTS AND FINANCIAL GUARANTEES

We primarily use derivatives as a risk management tool to decrease our exposure to fluctuations in the foreign currency market, and do not use derivative financial instruments for trading or speculative purposes. 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. The recorded amounts and corresponding gains on the hedging activity were not material as of February 1, 2014 and February 2, 2013 or for fiscal years 2013, 2012 and 2011.

#### Hedges of Net Investment in Sears Canada

During the fourth quarter of 2013, we entered into a foreign currency forward contract with a total Canadian notional value of \$43 million, and with a remaining life of 0.1 years at February 1, 2014. This contract was designated and qualified as a hedge of the foreign currency exposure of our net investment in Sears Canada.

For derivatives that are designated as hedges of our net investment in Sears Canada, we assess effectiveness based on changes in forward currency exchange rates. Changes in forward rates on the derivatives are recorded in the currency translation adjustments line in accumulated other comprehensive loss and will remain there until we substantially liquidate or sell our holdings in Sears Canada.

We settled foreign currency forward contracts during 2013 and 2012 and received net amounts of \$9 million and \$6 million, respectively, relative to these contract settlements. As hedge accounting was applied to these contracts, an offsetting amount was recorded as a component of other comprehensive loss.

#### Sears Canada Hedges of Merchandise Purchases

At February 1, 2014, Sears Canada had \$90 million notional amount of foreign exchange forward contracts. Sears Canada had no outstanding foreign currency forward contracts at February 2, 2013. These forward contracts are used to reduce the foreign exchange risk with respect to U.S. dollar denominated assets and liabilities and purchases of goods or services.

Sears Canada has merchandise purchase contracts denominated in U.S. currency. The merchandise purchase contracts are considered embedded derivatives under relevant accounting rules.

We record mark-to-market adjustments for the fair value of forward contracts and embedded derivatives at the end of each period. 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 foreign currency exchange rates by entering into foreign exchange forward contracts. Since the Company's functional currency is the U.S. dollar, we are not directly exposed to the risk of exchange rate changes due to Sears Canada's contracts, and therefore we do not account for these instruments as a hedge of our foreign currency exposure risk.

#### 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 investment grade credit ratings or better at February 1, 2014 and February 2, 2013.

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**Financial Guarantees**

We issue various types of guarantees in the normal course of business. We had the following guarantees outstanding at February 1, 2014:

| millions                     | Bank<br>Issued | SRAC<br>Issued | Other | Total |
|------------------------------|----------------|----------------|-------|-------|
| Standby letters of credit    | \$683          | \$16           | \$—   | \$699 |
| Commercial letters of credit | 13             | 105            | —     | 118   |
| Secondary lease obligations  | —              | —              | 55    | 55    |

The secondary lease obligations related to certain store leases of previously divested Sears businesses. We remain secondarily liable if the primary obligor defaults.

**NOTE 5—FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES**

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

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

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

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

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

Accounts receivable, merchandise payables, short-term borrowings, accrued liabilities and domestic cash and cash equivalents are reflected in the Consolidated Balance Sheets at cost, which approximates fair value due to the short-term nature of these instruments. The fair value of our debt is disclosed in Note 3 to the Consolidated Financial Statements. The fair value of pension and other postretirement benefit plan assets is disclosed in Note 7 to the Consolidated Financial Statements. The following tables provide the fair value measurement amounts for other financial assets recorded in our Consolidated Balance Sheets at fair value at February 1, 2014 and February 2, 2013:

| millions  | Total Fair Value    |         |         |         |
|---|---------------------|---------|---------|---------|
|   | Amounts at          |         |         |         |
|   | February 1,<br>2014 | Level 1 | Level 2 | Level 3 |
| Cash equivalents <sup>(1)</sup>                   | \$346               | \$346   | \$—     | \$—     |
| Restricted cash <sup>(2)</sup>                    | 10                  | 10      | —       | —       |
| Foreign currency derivative assets <sup>(3)</sup> | 8                   | —       | 8       | —       |
| Total   | \$364               | \$356   | \$8     | \$—     |

  

| millions                        | Total Fair Value    |         |         |         |
|---------------------------------|---------------------|---------|---------|---------|
|                                 | Amounts at          |         |         |         |
|                                 | February 2,<br>2013 | Level 1 | Level 2 | Level 3 |
| Cash equivalents <sup>(1)</sup> | \$181               | \$181   | \$—     | \$—     |
| Restricted cash <sup>(2)</sup>  | 9                   | 9       | —       | —       |
| Total                           | \$190               | \$190   | \$—     | \$—     |

<sup>(1)</sup> Included within Cash and cash equivalents on the Consolidated Balance Sheets.

<sup>(2)</sup> Included within Restricted cash on the Consolidated Balance Sheets.

<sup>(3)</sup> Included within Prepaid expenses and other current assets on the Consolidated Balance Sheets.

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

## Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible fixed assets, goodwill and other intangible assets, which are remeasured when the derived fair value is below carrying value on our Consolidated Balance Sheets. For these assets, we do not periodically adjust carrying value to fair value except in the event of impairment. When we determine that impairment has occurred, we measure the impairment and adjust the carrying value as discussed in Note 1. With the exception of the goodwill and fixed asset impairments described in Note 12 and Note 13, respectively, we had no significant remeasurements of such assets or liabilities to fair value during 2013 and 2012.

All of the fair value remeasurements were based on significant unobservable inputs (Level 3). Fixed asset fair values were derived based on discussions with real estate brokers, review of comparable properties, if available, and internal expertise related to the current marketplace conditions. Inputs for the goodwill included discounted cash flow analyses, comparable marketplace fair value data, as well as management's assumptions in valuing significant tangible and intangible assets, as described in Note 1, Summary of Significant Accounting Policies.

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**NOTE 6—INTEREST AND INVESTMENT INCOME**

The following table sets forth the components of interest and investment income as reported in our Consolidated Statements of Operations:

| millions                                     | 2013         | 2012        | 2011        |
|--|--------------|-------------|-------------|
| Interest income on cash and cash equivalents | \$4          | \$7         | \$4         |
| Other investment income                      | 203          | 87          | 37          |
| <b>Total</b>                                 | <b>\$207</b> | <b>\$94</b> | <b>\$41</b> |

**Interest Income on Cash and Cash Equivalents**

We recorded interest income of \$4 million in 2013, \$7 million in 2012, and \$4 million in 2011, primarily related to interest earned on cash and cash equivalents. These cash and cash equivalents consist of highly liquid investments with original maturities of three months or less at the date of purchase. Our invested cash may include, from time to time, investments in, but not limited to, commercial paper, federal, state and municipal government securities, floating-rate notes, repurchase agreements and money market funds. All invested cash amounts are readily available to us.

**Other Investment Income**

Other investment income primarily includes income generated by (and sales of investments in) certain real estate joint ventures and other equity investments in which we do not have a controlling interest. Investment income from equity investments was \$185 million, \$47 million and \$27 million in 2013, 2012 and 2011, respectively. During 2013, the investment income from equity investments included gains of \$163 million related to the sale of 50% joint venture interests in eight properties Sears Canada owned with The Westcliff Group of Companies, for which Sears Canada received \$270 million (\$297 million Canadian) in cash proceeds. In connection with this transaction, we determined that because we have surrendered substantially all of our rights and obligations and have transferred substantially all of the risks and rewards of ownership related to the eight properties, immediate gain recognition is appropriate.

During 2012, the investment income from equity investments included gains of \$25 million related to sales of real estate joint ventures held by Sears Canada. Other investment income also included a \$6 million, \$30 million and \$4 million dividend received on our cost method investment in Sears Mexico for 2013, 2012 and 2011, respectively.

**NOTE 7—BENEFIT PLANS**

We sponsor a number of pension and postretirement benefit plans. Expenses for retirement and savings-related benefit plans were as follows:

| millions                        | 2013         | 2012         | 2011         |
|---------------------------------|--------------|--------------|--------------|
| Retirement/401(k) Savings Plans | \$8          | \$10         | \$11         |
| Pension plans                   | 176          | 630          | 78           |
| Postretirement benefits         | 18           | 24           | 24           |
| <b>Total</b>                    | <b>\$202</b> | <b>\$664</b> | <b>\$113</b> |

**Retirement Savings Plans**

Sears Holdings sponsors retirement savings plans for employees meeting service eligibility requirements. The Company does not match employee contributions.

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**Other Benefit Plans**

Certain domestic full-time and part-time employees of Sears are eligible to participate in noncontributory defined benefit plans after meeting age and service requirements. Effective January 1, 2006, the Sears domestic pension plan was frozen and domestic associates no longer earn additional benefits under the plan.

Substantially all full-time Canadian employees, as well as some part-time employees, are eligible to participate in contributory defined benefit plans. Effective July 1, 2008, the Sears Canada defined pension plan was amended and a defined contribution component was added. The defined benefit service accrual ceased and all plan members earn pensionable service under the defined contribution component of the Sears Canada Inc. Registered Retirement Plan. Pension benefits are based on length of service, compensation and, in certain plans, social security or other benefits. Funding for the various plans is determined using various actuarial cost methods.

In addition to providing pension benefits, Sears provides domestic and Canadian employees and retirees certain medical benefits. These benefits provide access to medical plans, with Company subsidies for certain eligible retirees. Certain domestic Sears retirees are also provided life insurance benefits. To the extent we share the cost of the retiree medical benefits with retirees, such cost sharing is based on years of service and year of retirement. Sears' postretirement benefit plans are not funded. We have the right to modify or terminate these plans.

**Pension Plans**

| millions                                       | 2013            | 2012            |            |                 |                 |            |
|--|-----------------|-----------------|------------|-----------------|-----------------|------------|
|  | SHC<br>Domestic | Sears<br>Canada | Total      | SHC<br>Domestic | Sears<br>Canada | Total      |
| <b>Change in projected benefit obligation:</b> |                 |                 |            |                 |                 |            |
| Beginning balance                              | \$5,311         | \$1,438         | \$6,749    | \$6,109         | \$1,426         | \$7,535    |
| Interest cost                                  | 219             | 56              | 275        | 291             | 65              | 356        |
| Actuarial (gain) loss                          | (124 )          | 43              | (81 )      | 639             | 64              | 703        |
| Benefits paid                                  | (424 )          | (112 )          | (536 )     | (323 )          | (122 )          | (445 )     |
| Settlements                                    | (1 )            | —               | (1 )       | (1,405 )        | —               | (1,405 )   |
| Foreign currency exchange impact and other     | —               | (141 )          | (141 )     | —               | 5               | 5          |
| Balance at the measurement date                | \$4,981         | \$1,284         | \$6,265    | \$5,311         | \$1,438         | \$6,749    |
| <b>Change in assets at fair value:</b>         |                 |                 |            |                 |                 |            |
| Beginning balance                              | \$3,221         | \$1,272         | \$4,493    | \$4,051         | \$1,227         | \$5,278    |
| Actual return on plan assets                   | 333             | 161             | 494        | 382             | 130             | 512        |
| Company contributions                          | 361             | 39              | 400        | 516             | 33              | 549        |
| Benefits paid                                  | (424 )          | (112 )          | (536 )     | (323 )          | (122 )          | (445 )     |
| Settlements                                    | (1 )            | —               | (1 )       | (1,405 )        | —               | (1,405 )   |
| Foreign currency exchange impact               | —               | (136 )          | (136 )     | —               | 4               | 4          |
| Balance at the measurement date                | \$3,490         | \$1,224         | \$4,714    | \$3,221         | \$1,272         | \$4,493    |
| Net amount recognized                          | \$(1,491 )      | \$(60 )         | \$(1,551 ) | \$(2,090 )      | \$(166 )        | \$(2,256 ) |

The accumulated benefit obligation for the SHC Domestic pension plan was \$5.0 billion at February 1, 2014 and \$5.3 billion at February 2, 2013. The accumulated benefit obligation for the Sears Canada pension plan was \$1.3 billion at February 1, 2014 and \$1.4 billion at February 2, 2013.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Postretirement Obligations

| millions  | 2013                                 |                                      |                                      | 2012                                 |                                      |                                      |
|---|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
|   | SHC<br>Domestic                      | Sears<br>Canada                      | Total                                | SHC<br>Domestic                      | Sears<br>Canada                      | Total                                |
| <b>Change in accumulated postretirement benefit obligation:</b> |                                      |                                      |                                      |                                      |                                      |                                      |
| Beginning balance   | \$247                                | \$295                                | \$542                                | \$253                                | \$321                                | \$574                                |
| Interest cost   | 8                                    | 12                                   | 20                                   | 10                                   | 14                                   | 24                                   |
| Plan participants' contributions                                | 31                                   | —                                    | 31                                   | 42                                   | —                                    | 42                                   |
| Actuarial (gain) loss   | (15 )                                | (2 )                                 | (17 )                                | 9                                    | 16                                   | 25                                   |
| Settlement gain   | —                                    | —                                    | —                                    | —                                    | (22 )                                | (22 )                                |
| Benefits paid   | (56 )                                | (15 )                                | (71 )                                | (67 )                                | (17 )                                | (84 )                                |
| Benefits paid - settlements                                     | —                                    | —                                    | —                                    | —                                    | (18 )                                | (18 )                                |
| Plan amendment  | —                                    | (46 )                                | (46 )                                | —                                    | —                                    | —                                    |
| Foreign currency exchange rate impact and other                 | —                                    | (28 )                                | (28 )                                | —                                    | 1                                    | 1                                    |
| Balance at the measurement date                                 | <b>\$215</b>                         | <b>\$216</b>                         | <b>\$431</b>                         | <b>\$247</b>                         | <b>\$295</b>                         | <b>\$542</b>                         |
| <b>Change in plan assets at fair value:</b>                     |                                      |                                      |                                      |                                      |                                      |                                      |
| Beginning of year balance                                       | \$—                                  | \$45                                 | \$45                                 | \$—                                  | \$69                                 | \$69                                 |
| Actual return on plan assets                                    | —                                    | 1                                    | 1                                    | —                                    | —                                    | —                                    |
| Company contributions   | 25                                   | 1                                    | 26                                   | 25                                   | 19                                   | 44                                   |
| Plan participants' contributions                                | 31                                   | —                                    | 31                                   | 42                                   | —                                    | 42                                   |
| Benefits paid   | (56 )                                | (15 )                                | (71 )                                | (67 )                                | (17 )                                | (84 )                                |
| Benefits paid - settlements                                     | —                                    | —                                    | —                                    | —                                    | (18 )                                | (18 )                                |
| Foreign currency exchange rate impact and other                 | —                                    | (12 )                                | (12 )                                | —                                    | (8 )                                 | (8 )                                 |
| Balance at the measurement date                                 | <b>\$—</b>                           | <b>\$20</b>                          | <b>\$20</b>                          | <b>\$—</b>                           | <b>\$45</b>                          | <b>\$45</b>                          |
| Funded status   | <b><u><math>(\\$215 )</math></u></b> | <b><u><math>(\\$196 )</math></u></b> | <b><u><math>(\\$411 )</math></u></b> | <b><u><math>(\\$247 )</math></u></b> | <b><u><math>(\\$250 )</math></u></b> | <b><u><math>(\\$497 )</math></u></b> |

The current portion of our liability for postretirement obligations is \$25 million, which we expect to pay during fiscal 2014.

Weighted-average assumptions used to determine plan obligations were as follows:

|                                 | 2013            |                 | 2012            |                 | 2011            |                 |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                 | SHC<br>Domestic | Sears<br>Canada | SHC<br>Domestic | Sears<br>Canada | SHC<br>Domestic | Sears<br>Canada |
| <b>Pension benefits:</b>        |                 |                 |                 |                 |                 |                 |
| Discount Rate                   | 4.60%           | 4.20%           | 4.25%           | 4.20%           | 4.90%           | 4.70%           |
| Rate of compensation increases  | N/A             | 3.50%           | N/A             | 3.50%           | N/A             | 3.50%           |
| <b>Postretirement benefits:</b> |                 |                 |                 |                 |                 |                 |
| Discount Rate                   | 4.00%           | 4.20%           | 3.55%           | 4.20%           | 4.20%           | 4.60%           |
| Rate of compensation increases  | N/A             | 3.50%           | N/A             | 3.50%           | N/A             | 3.50%           |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Net Periodic Benefit Cost

The components of net periodic benefit cost were as follows:

| millions                        | 2013            |                 |        | 2012            |                 |        | 2011            |                 |        | Total |
|---------------------------------|-----------------|-----------------|--------|-----------------|-----------------|--------|-----------------|-----------------|--------|-------|
|                                 | SHC<br>Domestic | Sears<br>Canada | Total  | SHC<br>Domestic | Sears<br>Canada | Total  | SHC<br>Domestic | Sears<br>Canada |        |       |
| <b>Pension benefits:</b>        |                 |                 |        |                 |                 |        |                 |                 |        |       |
| Interest cost                   | \$219           | \$56            | \$275  | \$291           | \$65            | \$356  | \$314           | \$74            | \$388  |       |
| Expected return on plan assets  | (224 )          | (76 )           | (300 ) | (291 )          | (76 )           | (367 ) | (302 )          | (80 )           | (382 ) |       |
| Cost of settlements             | —               | —               | —      | 452             | —               | 452    | —               | —               | —      |       |
| Recognized net loss and other   | 167             | 34              | 201    | 165             | 24              | 189    | 63              | 9               | 72     |       |
| Net periodic benefit cost       | \$162           | \$14            | \$176  | \$617           | \$13            | \$630  | \$75            | \$3             | \$78   |       |
| <b>Postretirement benefits:</b> |                 |                 |        |                 |                 |        |                 |                 |        |       |
| Interest cost                   | \$8             | \$12            | \$20   | \$10            | \$14            | \$24   | \$13            | \$16            | \$29   |       |
| Expected return on assets       | —               | (2 )            | (2 )   | —               | (3 )            | (3 )   | —               | (5 )            | (5 )   |       |
| Cost of settlements             | —               | —               | —      | —               | 3               | 3      | —               | —               | —      |       |
| Net periodic benefit cost       | \$8             | \$10            | \$18   | \$10            | \$14            | \$24   | \$13            | \$11            | \$24   |       |

Weighted-average assumptions used to determine net cost were as follows:

|                                 | 2013            |                 | 2012            |                 | 2011            |                 |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                 | SHC<br>Domestic | Sears<br>Canada | SHC<br>Domestic | Sears<br>Canada | SHC<br>Domestic | Sears<br>Canada |
| <b>Pension benefits:</b>        |                 |                 |                 |                 |                 |                 |
| Discount Rate                   | 4.25%           | 4.20%           | 4.90%           | 4.70%           | 5.75%           | 5.40%           |
| Return of plan assets           | 7.00%           | 6.50%           | 7.25%           | 6.50%           | 7.50%           | 6.50%           |
| Rate of compensation increases  | N/A             | 3.50%           | N/A             | 3.50%           | N/A             | 3.50%           |
| <b>Postretirement benefits:</b> |                 |                 |                 |                 |                 |                 |
| Discount Rate                   | 3.55%           | 4.20%           | 4.20%           | 4.60%           | 5.00%           | 5.40%           |
| Return of plan assets           | N/A             | 3.75%           | N/A             | 3.75%           | N/A             | 6.50%           |
| Rate of compensation increases  | N/A             | 3.50%           | N/A             | 3.50%           | N/A             | 3.50%           |

For purposes of determining the periodic expense of our defined benefit plans, we use the fair value of plan assets as the market related value. A one-percentage-point change in the assumed discount rate would have the following effects on the pension liability:

| millions                             | 1 percentage-point<br>Increase | 1 percentage-point<br>Decrease |
|--------------------------------------|--------------------------------|--------------------------------|
| Effect on interest cost component    | \$28                           | \$(36 )                        |
| Effect on pension benefit obligation | \$(596 )                       | \$713                          |

For 2014 and beyond, the domestic weighted-average health care cost trend rates used in measuring the postretirement benefit expense are an 8.0% trend rate in 2014 to an ultimate trend rate of 6.0% in 2018. A one-

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

percentage-point change in the assumed health care cost trend rate would have the following effects on the postretirement liability:

| millions   | 1 percentage-point<br>Increase | 1 percentage-point<br>Decrease |
|--|--------------------------------|--------------------------------|
| Effect on total service and interest cost components | \$1                            | \$(1 )                         |
| Effect on postretirement benefit obligation          | \$17                           | \$(15 )                        |

\$123 million of the unrecognized net losses in accumulated other comprehensive income are expected to be amortized as a component of net periodic benefit cost during 2014.

**Investment Strategy**

The Investment Committee, made up of select members of senior management, has appointed a non-affiliated third party professional to advise the Committee with respect to the SHC domestic pension plan assets. The plan's overall investment objective is to provide a long-term return that, along with Company contributions, is expected to meet future benefit payment requirements. A long-term horizon has been adopted in establishing investment policy such that the likelihood and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets. The plan's investment policy requires investments to be diversified across individual securities, industries, market capitalization and valuation characteristics. In addition, various techniques are utilized to monitor, measure and manage risk.

Domestic plan assets were invested in the following classes of securities:

|  | Plan Assets at      |   |                     |   |
|--|---------------------|---|---------------------|---|
|  | February 1,<br>2014 | % | February 2,<br>2013 | % |
| Equity securities                      | 36                  | % | 31                  | % |
| Fixed income and other debt securities | 59                  | % | 64                  | % |
| Other                                  | 5                   | % | 5                   | % |
| Total                                  | 100                 | % | 100                 | % |

The domestic plan's target allocation is determined by taking into consideration the amounts and timing of projected liabilities, our funding policies and expected returns on various asset classes. At February 1, 2014, the plan's target asset allocation was 35% equity and 65% fixed income. To develop the expected long-term rate of return on assets assumption, we considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

Sears Canada plan assets were invested in the following classes of securities (none of which were securities of the Company):

|  | Plan Assets at      |   |                     |   |
|--|---------------------|---|---------------------|---|
|  | February 1,<br>2014 | % | February 2,<br>2013 | % |
| Equity securities                      | 26                  | % | 26                  | % |
| Fixed income and other debt securities | 74                  | % | 74                  | % |
| Total                                  | 100                 | % | 100                 | % |

The Sears Canada plans' target allocation is determined by taking into consideration the amounts and timing of projected liabilities, our funding policies and expected returns on various asset classes. At February 1, 2014, the plan's target asset allocation was 55% to 75% fixed income and 25% to 45% equity. To develop the expected long-term rate of return on assets assumption, we considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**Future Cash Flows of Benefit Plans**

Information regarding expected future cash flows for our benefit plans is as follows:

|  | SHC<br>Domestic | Sears<br>Canada | Total |
|--|-----------------|-----------------|-------|
| <b>Pension benefits:</b>                             |                 |                 |       |
| Employer contributions:                              |                 |                 |       |
| 2014 (expected)                                      | \$487           | \$—             | \$487 |
| Expected benefit payments:                           |                 |                 |       |
| 2014   | \$339           | \$79            | \$418 |
| 2015   | 342             | 80              | 422   |
| 2016   | 344             | 80              | 424   |
| 2017   | 344             | 80              | 424   |
| 2018   | 345             | 80              | 425   |
| 2019-2023  | 1,709           | 395             | 2,104 |
| <b>Postretirement benefits:</b>                      |                 |                 |       |
| Employer contributions:                              |                 |                 |       |
| 2014 (expected)                                      | \$25            | \$1             | \$26  |
| Expected employer contribution for benefit payments: |                 |                 |       |
| 2014   | \$25            | \$16            | \$41  |
| 2015   | 24              | 16              | 40    |
| 2016   | 23              | 15              | 38    |
| 2017   | 21              | 15              | 36    |
| 2018   | 20              | 15              | 35    |
| 2019-2023  | 80              | 71              | 151   |

**Domestic Pension Plan Funding**

Contributions to our pension plans remain a significant use of our cash on an annual basis. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, the Company has a legacy pension obligation for past service performed by Kmart and Sears associates. During 2013, we contributed \$361 million to our domestic pension plans. We estimate that the domestic pension contribution will be \$487 million in 2014 and approximately \$310 million in 2015, though the ultimate amount of pension contributions could be affected by changes in the applicable regulations, as well as financial market and investment performance.

In 2012, federal legislation was signed into law which allowed pension plan sponsors to use higher interest rate assumptions in valuing plan liabilities and determining funding obligations. As a result of this legislation, the Company's domestic pension plan was within \$203 million of being 80% funded under applicable law. In order to reduce the risks of gross pension obligations, the Company elected to contribute an additional \$203 million to its domestic pension plan on September 14, 2012, after which its domestic pension plan was 80% funded under applicable law.

Effective September 17, 2012, the Company amended its domestic pension plan, primarily related to lump sum benefit eligibility, and began notifying certain former employees of the Company of its offer to pay those employees' pension benefit in a lump sum. These amendments did not have a significant impact on our plan. Former employees eligible for the voluntary lump sum payment option are generally those who are vested traditional formula participants of the Plan who terminated employment prior to January 1, 2012 and who have not yet started receiving monthly payments of their pension benefits.

The Company offered the one-time voluntary lump sum window in an effort to reduce its long-term pension obligations and ongoing annual pension expense. This voluntary offer was made to approximately 86,000 eligible



## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

terminated vested participants, representing approximately \$2.0 billion of the Company's total qualified pension plan liabilities. Eligible participants had until November 19, 2012 to make their election. The Company made payments of approximately \$1.5 billion to employees who made the election in December 2012 and funded the payments from existing pension plan assets. In connection with this transaction, the Company incurred a non-cash charge to operations of approximately \$452 million pre-tax in the fourth quarter of 2012 as a result of the requirement to expense the unrealized actuarial losses. The charge had no effect on equity because the unrealized actuarial losses are already recognized in accumulated other comprehensive income/(loss). Accordingly, the effect on retained earnings was offset by a corresponding reduction in accumulated other comprehensive loss.

## Fair Value of Pension and Postretirement Benefit Plan Assets

The following table presents our plan assets using the fair value hierarchy at February 1, 2014 and February 2, 2013:

| SHC Domestic<br>millions                        | Investment Assets at Fair Value at<br>February 1, 2014 |         |         |         |
|---|--|---------|---------|---------|
|   | Total  | Level 1 | Level 2 | Level 3 |
| Cash equivalents and short-term investments     | \$274  | \$—     | \$274   | \$—     |
| Equity securities:                              |  |         |         |         |
| U.S. companies                                  | 1,026  | 1,026   | —       | —       |
| International companies                         | 163  | 163     | —       | —       |
| Fixed income securities:                        |  |         |         |         |
| Corporate bonds and notes                       | 1,888  | —       | 1,888   | —       |
| Sears Holdings Corporation senior secured notes | 99   | —       | 99      | —       |
| Mortgage-backed and asset-backed                | 3  | —       | 3       | —       |
| Ventures and partnerships                       | 6  | —       | —       | 6       |
| Total investment assets at fair value           | \$3,459  | \$1,189 | \$2,264 | \$6     |
| Cash  | 3  |         |         |         |
| Accounts receivable                             | 57   |         |         |         |
| Accounts payable                                | (29 )  |         |         |         |
| Net assets available for plan benefits          | \$3,490  |         |         |         |

**SEARS HOLDINGS CORPORATION**  
 Notes to Consolidated Financial Statements—(Continued)

| Investment Assets at Fair Value at<br>February 2, 2013 |         |         |         |         |
|--|---------|---------|---------|---------|
|  | Total   | Level 1 | Level 2 | Level 3 |
| SHC Domestic   | \$187   | \$—     | \$187   | \$—     |
| millions   |         |         |         |         |
| Cash equivalents and short-term investments            |         |         |         |         |
| Equity securities:                                     |         |         |         |         |
| U.S. companies   | 848     | 848     | —       | —       |
| International companies                                | 138     | 138     | —       | —       |
| Registered investment companies                        | 1       | 1       | —       | —       |
| Fixed income securities:                               |         |         |         |         |
| Corporate bonds and notes                              | 1,840   | —       | 1,840   | —       |
| Sears Holdings Corporation senior secured notes        | 176     | —       | 176     | —       |
| U.S. government and agencies                           | 1       | —       | 1       | —       |
| Mortgage-backed and asset-backed                       | 6       | —       | 6       | —       |
| Ventures and partnerships                              | 12      | —       | —       | 12      |
| Total investment assets at fair value                  | \$3,209 | \$987   | \$2,210 | \$12    |
| Accounts receivable                                    | 44      |         |         |         |
| Accounts payable                                       | (32 )   |         |         |         |
| Net assets available for plan benefits                 | \$3,221 |         |         |         |
| Investment Assets at Fair Value at<br>February 1, 2014 |         |         |         |         |
|  | Total   | Level 1 | Level 2 | Level 3 |
| Sears Canada   | \$107   | \$—     | \$107   | \$—     |
| millions   |         |         |         |         |
| Cash equivalents and short-term investments            |         |         |         |         |
| Equity securities:                                     |         |         |         |         |
| U.S. companies   | 152     | 152     | —       | —       |
| International companies                                | 3       | 3       | —       | —       |
| Common collective trusts                               | 264     | —       | 264     | —       |
| Fixed income securities:                               |         |         |         |         |
| Corporate bonds and notes                              | 617     | —       | 554     | 63      |
| Mortgage-backed and asset-backed                       | 54      | —       | 6       | 48      |
| Municipal and foreign government                       | 14      | —       | 14      | —       |
| Hedge and pooled equity funds                          | 2       | —       | —       | 2       |
| Total investment assets at fair value                  | \$1,213 | \$155   | \$945   | \$113   |
| Cash   | 31      |         |         |         |
| Refundable deposits                                    | 22      |         |         |         |
| Accounts receivable                                    | 347     |         |         |         |
| Accounts payable                                       | (369 )  |         |         |         |
| Net assets available for plan benefits                 | \$1,244 |         |         |         |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

| Sears Canada<br>millions                    | Investment Assets at Fair Value at<br>February 2, 2013 |         |         |         |
|---|--|---------|---------|---------|
|   | Total  | Level 1 | Level 2 | Level 3 |
| Cash equivalents and short-term investments | \$67   | \$—     | \$67    | \$—     |
| Equity securities:                          |  |         |         |         |
| U.S. companies                              | 177  | 177     | —       | —       |
| International companies                     | 5  | 5       | —       | —       |
| Common collective trusts                    | 277  | —       | 277     | —       |
| Fixed income securities:                    |  |         |         |         |
| Corporate bonds and notes                   | 613  | —       | 612     | 1       |
| U.S. government and agencies                | 1  | —       | 1       | —       |
| Mortgage-backed and asset-backed            | 66   | —       | 7       | 59      |
| Municipal and foreign government            | 34   | —       | 34      | —       |
| Hedge and pooled equity funds               | 3  | —       | —       | 3       |
| Total investment assets at fair value       | \$1,243  | \$182   | \$998   | \$63    |
| Cash  | 42   |         |         |         |
| Refundable deposits                         | 25   |         |         |         |
| Accounts receivable                         | 567  |         |         |         |
| Accounts payable                            | (560 )   |         |         |         |
| Net assets available for plan benefits      | \$1,317  |         |         |         |

Equity securities, which include common and preferred stocks and registered investment companies (mutual funds), are actively traded and valued at the closing price reported in the active market in which the security is traded and are assigned to Level 1.

Common collective trusts are portfolios of underlying investments held by investment managers and are valued at the unit value reported by the investment managers as of the end of each period presented. Collective short-term investment funds are stated at net asset value (NAV) as determined by the investment managers. Investment managers value the underlying investments of the funds at amortized cost, which approximates fair value, and have assigned a Level 2 to the valuation of those investments. Fixed income securities are assigned to Level 2 as they are primarily valued by institutional bid evaluation, which determines the estimated price a dealer would pay for a security and which is developed using proprietary models established by the pricing vendors for this purpose.

Certain corporate and mortgage-backed debt securities are assigned to Level 3 based on the relatively low position in the preferred hierarchy of the pricing source. Valuation of the Plan's non-public limited partnerships requires significant judgment by the general partners due to the absence of quoted market value, inherent lack of liquidity, and the long-term nature of the assets, and may result in fair value measurements that are not indicative of ultimate realizable value. Hedge funds consist of fund-of-funds investments and direct hedge funds and are assigned to Level 3. The fund-of-funds investments are primarily valued using a market approach based on the NAVs calculated by the fund and are not publicly available. Direct hedge funds are primarily valued by each fund's third party administrator based on the valuation of the underlying type of security held and are not publicly available. All hedge fund investments are in the process of being redeemed.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

A rollforward of our Level 3 assets each year is as follows:

|                                     | February 2,<br>2013<br>Balance | Net Realized and<br>Unrealized<br>Losses | Purchases | Sales and<br>Settlements | Net Transfers<br>Into/(Out of)<br>Level 3 | February 1,<br>2014<br>Balance |
|-------------------------------------|--------------------------------|--|-----------|--------------------------|---|--------------------------------|
| <b>SHC Domestic</b>                 |                                |  |           |                          |   |                                |
| <b>millions</b>                     |                                |  |           |                          |   |                                |
| Fixed income securities:            |                                |  |           |                          |   |                                |
| Venture and partnerships            | \$12                           | \$(3 )                                   | \$—       | \$(3 )                   | \$—                                       | \$6                            |
| Total Level 3 investments           | \$12                           | \$(3 )                                   | \$—       | \$(3 )                   | \$—                                       | \$6                            |
| <b>SHC Domestic</b>                 |                                |  |           |                          |   |                                |
| <b>millions</b>                     |                                |  |           |                          |   |                                |
| Fixed income securities:            |                                |  |           |                          |   |                                |
| Corporate bonds and notes           | \$2                            | \$(2 )                                   | \$—       | \$—                      | \$—                                       | \$—                            |
| Venture and partnerships            | 15                             | 1  | —         | (4 )                     | —   | 12                             |
| Total Level 3 investments           | \$17                           | \$(1 )                                   | \$—       | \$(4 )                   | \$—                                       | \$12                           |
| <b>Sears Canada</b>                 |                                |  |           |                          |   |                                |
| <b>millions</b>                     |                                |  |           |                          |   |                                |
| Fixed income securities:            |                                |  |           |                          |   |                                |
| Corporate bonds and notes           | \$1                            | \$—                                      | \$63      | \$(1 )                   | \$—                                       | \$63                           |
| Mortgage-backed and<br>asset-backed | 59                             | (2 )                                     | —         | (9 )                     | —   | 48                             |
| Hedge and pooled equity funds       | 3                              | —  | —         | (1 )                     | —   | 2                              |
| Total Level 3 investments           | \$63                           | \$(2 )                                   | \$63      | \$(11 )                  | \$—                                       | \$113                          |
| <b>Sears Canada</b>                 |                                |  |           |                          |   |                                |
| <b>millions</b>                     |                                |  |           |                          |   |                                |
| Fixed income securities:            |                                |  |           |                          |   |                                |
| Corporate bonds and notes           | \$—                            | \$—                                      | \$1       | \$—                      | \$—                                       | \$1                            |
| Mortgage backed-and<br>asset-backed | 64                             | 5  | —         | (10 )                    | —   | 59                             |
| Hedge and pooled equity funds       | 16                             | —  | —         | (13 )                    | —   | 3                              |
| Total Level 3 investments           | \$80                           | \$5                                      | \$1       | \$(23 )                  | \$—                                       | \$63                           |

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

**NOTE 8—EARNINGS PER SHARE**

The following tables set forth the components used to calculate basic and diluted loss per share from continuing operations attributable to Holdings' shareholders. Restricted stock awards for 2013 and 2012 were not included in the computation of diluted loss per share from continuing operations attributable to Holdings' shareholders because the effect of their inclusion would have been antililutive.

|   | 2013        | 2012       | 2011        |
|---|-------------|------------|-------------|
| millions, except earnings per share   |             |            |             |
| Basic weighted average shares   | 106.1       | 105.9      | 106.8       |
| Dilutive effect of restricted stock and stock options                             | —           | —          | —           |
| Diluted weighted average shares   | 106.1       | 105.9      | 106.8       |
| Net loss from continuing operations attributable to Holdings' shareholders        | \$ (1,365 ) | \$ (930 )  | \$ (3,113 ) |
| Loss per share from continuing operations attributable to Holdings' shareholders: |             |            |             |
| Basic   | \$ (12.87 ) | \$ (8.78 ) | \$ (29.15 ) |
| Diluted   | \$ (12.87 ) | \$ (8.78 ) | \$ (29.15 ) |

**NOTE 9—EQUITY****Stock-based Compensation**

We account for stock-based compensation using the fair value method in accordance with accounting standards regarding share-based payment transactions. We recorded \$12 million, \$15 million and \$14 million in total compensation expense relative to stock-based compensation arrangements during 2013, 2012, and 2011, respectively. At February 1, 2014, we had \$3 million in total compensation cost related to nonvested awards, which is expected to be recognized over approximately the next three years.

We do not currently have an employee stock option plan and at February 1, 2014, there are no outstanding options. We granted restricted stock awards to certain associates. These restricted stock awards typically vest in zero to three years from the date of grant, provided the grantee remains employed by us at the vesting date. The fair value of these awards is equal to the market price of our common stock on the date of grant. We do not currently have a broad-based program that provides for restricted stock awards on an annual basis. Changes in restricted stock awards for 2013, 2012, and 2011 were as follows:

| (Shares in thousands)     | 2013   |                             | 2012   |                             | 2011   |                             |
|---------------------------|--------|-----------------------------|--------|-----------------------------|--------|-----------------------------|
|                           | Shares | Weighted-Average            | Shares | Weighted-Average            | Shares | Weighted-Average            |
|                           |        | Fair Value on Date of Grant |        | Fair Value on Date of Grant |        | Fair Value on Date of Grant |
| Beginning of year balance | 424    | \$57.72                     | 496    | \$65.02                     | 313    | \$74.09                     |
| Granted                   | 135    | 49.19                       | 175    | 49.20                       | 386    | 59.60                       |
| Vested                    | (281 ) | 57.71                       | (172 ) | 60.89                       | (72 )  | 81.55                       |
| Forfeited                 | (73 )  | 68.47                       | (75 )  | 78.59                       | (131 ) | 61.62                       |
| End of year balance       | 205    | \$48.24                     | 424    | \$57.72                     | 496    | \$65.02                     |

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

| millions   | 2013 | 2012 | 2011 |
|--|------|------|------|
| Aggregate fair value of shares granted based on weighted average fair value at date of grant | \$7  | \$9  | \$23 |
| Aggregate fair value of shares vesting during period   | 14   | 10   | 5    |
| Aggregate fair value of shares forfeited during period                                       | 4    | 4    | 8    |

Approximately 124,000 shares of the 205,000 shares of unvested restricted stock outstanding at February 1, 2014 are scheduled to vest during 2014, subject to satisfaction of applicable vesting conditions.

**Common Share Repurchase Program**

From time to time, we repurchase shares of our common stock under a common share repurchase program authorized by our Board of Directors. The common share repurchase program was initially announced in 2005 with a total authorization since inception of the program of \$6.5 billion. During 2013 and 2012, we repurchased no shares of our common stock under our common share repurchase program. During 2011, we repurchased approximately 2.8 million of our common shares at a total cost of approximately \$183 million, or an average price of \$65.66 per share. At February 1, 2014, we had approximately \$504 million of remaining authorization under our common share repurchase program.

The share repurchase program has no stated expiration date and share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods.

**Accumulated Other Comprehensive Loss**

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

| millions  | February 1,<br>2014 | February 2,<br>2013 | January 28,<br>2012 |
|---|---------------------|---------------------|---------------------|
| Pension and postretirement adjustments (net of tax of \$(328), \$(443) and \$(492), respectively) | \$(1,036 )          | \$(1,408 )          | \$(1,575 )          |
| Cumulative unrealized derivative gain (loss) (net of tax of \$0, \$0 and \$0, respectively)       | 2                   | —                   | (5 )                |
| Currency translation adjustments (net of tax of \$(38), \$(39) and \$(26), respectively)          | (83 )               | (51 )               | (29 )               |
| Accumulated other comprehensive loss  | \$(1,117 )          | \$(1,459 )          | \$(1,609 )          |

Pension and postretirement adjustments relate to the net actuarial gain on our pension and postretirement plans recognized as a component of accumulated other comprehensive loss.

Accumulated other comprehensive loss attributable to noncontrolling interests at February 1, 2014, February 2, 2013, and January 28, 2012 was \$53 million, \$64 million and \$9 million, respectively.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Income Tax Expense Allocated to Each Component of Other Comprehensive Income

Income tax expense allocated to each component of other comprehensive income was as follows:

| millions   | 2013                    | Before<br>Tax<br>Amount     | Tax<br>Expense           | Net of<br>Tax<br>Amount |
|--|-------------------------|-----------------------------|--------------------------|-------------------------|
| Other comprehensive income   |                         |                             |                          |                         |
| Pension and postretirement adjustments                                       |                         |                             |                          |                         |
| Experience gain  | \$362                   | \$(126 )                    | \$236                    |                         |
| Less: amortization of prior service cost included in net period pension cost | 193                     | (7 )                        | 186                      |                         |
| Pension and postretirement adjustments, net of tax                           | 555                     | (133 )                      | 422                      |                         |
| Deferred gain on derivatives   | 2                       | —                           | 2                        |                         |
| Currency translation adjustments   | (70 )                   | (1 )                        | (71 )                    |                         |
| Total other comprehensive income   | \$487                   | \$(134 )                    | \$353                    |                         |
| millions   | 2012                    |                             |                          |                         |
| Before<br>Tax<br>Amount  | Before<br>Tax<br>Amount | Tax<br>(Expense)<br>Benefit | Net of<br>Tax<br>Benefit | Net of<br>Tax<br>Amount |
| Other comprehensive income   |                         |                             |                          |                         |
| Pension and postretirement adjustments                                       |                         |                             |                          |                         |
| Experience loss  | \$(564 )                | \$1                         | \$(563 )                 |                         |
| Less: cost of settlements  | 454                     | —                           | 454                      |                         |
| Less: amortization of prior service cost included in net period pension cost | 189                     | (6 )                        | 183                      |                         |
| Pension and postretirement adjustments, net of tax                           | 79                      | (5 )                        | 74                       |                         |
| Deferred gain on derivatives   | 5                       | —                           | 5                        |                         |
| Currency translation adjustments   | (8 )                    | 13                          | 5                        |                         |
| Total other comprehensive income   | \$76                    | \$8                         | \$84                     |                         |
| millions   | 2011                    |                             |                          |                         |
| Before<br>Tax<br>Amount  | Before<br>Tax<br>Amount | Tax<br>(Expense)<br>Benefit | Net of<br>Tax<br>Benefit | Net of<br>Tax<br>Amount |
| Other comprehensive loss   |                         |                             |                          |                         |
| Pension and postretirement adjustments                                       |                         |                             |                          |                         |
| Experience loss  | \$(872 )                | \$14                        | \$(858 )                 |                         |
| Less: amortization of prior service cost included in net period pension cost | 72                      | (3 )                        | 69                       |                         |
| Pension and postretirement adjustments, net of tax                           | (800 )                  | 11                          | (789 )                   |                         |
| Deferred loss on derivatives   | (6 )                    | —                           | (6 )                     |                         |
| Currency translation adjustments   | (57 )                   | 19                          | (38 )                    |                         |
| Total other comprehensive loss   | \$(863 )                | \$30                        | \$(833 )                 |                         |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## NOTE 10—INCOME TAXES

|  | 2013        | 2012        | 2011        |
|--|-------------|-------------|-------------|
| millions   |             |             |             |
| Income (loss) before income taxes:                               |             |             |             |
| U.S.   | \$ (1,610 ) | \$ (1,226 ) | \$ (1,809 ) |
| Foreign  | 638         | 216         | 58          |
| Total  | \$ (972 )   | \$ (1,010 ) | \$ (1,751 ) |
| Income tax expense (benefit):                                    |             |             |             |
| Current:   |             |             |             |
| Federal  | \$ 2        | \$ 17       | \$ 19       |
| State and local  | (6 )        | 15          | —           |
| Foreign  | 47          | 27          | 2           |
| Total current  | 43          | 59          | 21          |
| Deferred:  |             |             |             |
| Federal  | 96          | 8           | 1,357       |
| State and local  | (42 )       | (41 )       | (35 )       |
| Foreign  | 47          | 18          | 26          |
| Total deferred   | 101         | (15 )       | 1,348       |
| Total  | \$ 144      | \$ 44       | \$ 1,369    |
|  | 2013        | 2012        | 2011        |
| Effective tax rate reconciliation:                               |             |             |             |
| Federal income tax rate (benefit rate)                           | (35.0 ) %   | (35.0 ) %   | (35.0 ) %   |
| State and local tax (benefit) net of federal tax benefit         | (3.5 )      | (3.0 )      | (1.3 )      |
| Federal and state valuation allowance                            | 74.0        | 23.5        | 104.1       |
| Tax on separation of Sears Hometown and Outlet Stores, Inc.      | —           | 10.3        | —           |
| Nondeductible goodwill impairment                                | —           | 10.2        | 11.4        |
| Tax on partial spin-off of Sears Canada                          | —           | 3.9         | —           |
| Adjust foreign statutory rates                                   | (15.7 )     | (3.2 )      | —           |
| Tax benefit resulting from Other Comprehensive Income allocation | (9.9 )      | —           | —           |
| Tax credits  | (1.3 )      | (1.0 )      | (1.5 )      |
| Long life land and intangibles                                   | 0.6         | (0.8 )      | —           |
| Resolution of income tax matters                                 | (1.4 )      | (0.5 )      | 0.7         |
| Canadian repatriation cost on Sears Canada dividend received     | 6.1         | 0.5         | —           |
| Other  | 0.9         | (0.5 )      | (0.2 )      |
|  | 14.8 %      | 4.4 %       | 78.2 %      |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

| millions                                    | February 1,<br>2014 | February 2,<br>2013 |
|---|---------------------|---------------------|
| <b>Deferred tax assets and liabilities:</b> |                     |                     |
| <b>Deferred tax assets:</b>                 |                     |                     |
| Federal benefit for state and foreign taxes | \$ 147              | \$ 151              |
| Accruals and other liabilities              | 144                 | 179                 |
| Capital leases                              | 96                  | 114                 |
| NOL carryforwards                           | 1,187               | 722                 |
| Postretirement benefit plans                | 74                  | 78                  |
| Pension                                     | 961                 | 1,208               |
| Deferred revenue                            | 171                 | 202                 |
| Credit carryforwards                        | 721                 | 605                 |
| Other                                       | 149                 | 163                 |
| Total deferred tax assets                   | 3,650               | 3,422               |
| Valuation allowance                         | (3,366 )            | (2,743 )            |
| Net deferred tax assets                     | 284                 | 679                 |
| <b>Deferred tax liabilities:</b>            |                     |                     |
| Trade names/Intangibles                     | 1,059               | 1,071               |
| Property and equipment                      | —                   | 156                 |
| Inventory                                   | 421                 | 453                 |
| Other                                       | 126                 | 117                 |
| Total deferred tax liabilities              | 1,606               | 1,797               |
| Net deferred tax liability                  | \$(1,322 )          | \$(1,118 )          |

Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income ("OCI"). An exception is provided in the authoritative accounting guidance when there is income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expense recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from other sources, including gain from pension and other postretirement benefits recorded as a component of OCI, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. As a result, for the year ended February 1, 2014, the Company recorded a tax expense of \$97 million in OCI related to the gain on pension and other postretirement benefits, and recorded a corresponding tax benefit of \$97 million in continuing operations.

We account for income taxes in accordance with accounting standards for such taxes, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the financial reporting and tax bases of recorded assets and liabilities. Accounting standards also require that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion of or all of the deferred tax asset will not be realized.

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three-year periods ended February 1, 2014, February 2, 2013 and January 28, 2012. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.



**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

On the basis of this analysis and the significant negative objective evidence, for the year ended January 28, 2012, a valuation allowance of \$2.1 billion was added to record only the portion of the deferred tax asset that more likely than not will be realized. Of the total valuation allowance recorded, \$317 million was recorded through other comprehensive income. For the year ended February 2, 2013, \$213 million of the valuation allowance increase was recorded through other comprehensive income. For the year ended February 1, 2014, the valuation allowance increased by \$623 million, but none of the increase was recorded through other comprehensive income. Included in the \$623 million valuation allowance increase was \$138 million for state separate entity deferred tax assets, as Kmart Corporation incurred a three-year cumulative loss in 2013.

At February 1, 2014 and February 2, 2013, we had a valuation allowance of \$3.4 billion and \$2.7 billion, respectively, to record only the portion of the deferred tax asset that more likely than not will be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted in the future if estimates of future taxable income during the carryforward period are reduced or increased, or if the objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth. We will continue to evaluate our valuation allowance in future years for any change in circumstances that causes a change in judgment about the realizability of the deferred tax asset.

At the end of 2013 and 2012, we had a federal and state net operating loss (“NOL”) deferred tax asset of \$1.2 billion and \$722 million, respectively, which will expire predominately between 2019 and 2034. We have credit carryforwards of \$721 million, which will expire between 2015 and 2034.

In connection with Sears Canada’s sale of real estate during 2013, Sears Canada declared an extraordinary dividend of \$5 Canadian per share on November 19, 2013. The Company received a taxable dividend of \$260 million Canadian or \$243 million resulting in a taxable income inclusion of \$280 million, which includes a Section 78 Gross-up of \$37 million. The amount of taxes otherwise payable resulting from the taxable dividend was reduced by the utilization of \$59 million of net deferred tax assets, primarily NOL carryforwards. As the Company had previously recorded a valuation allowance against these NOL carryforwards, \$59 million of the related valuation allowance was released upon their utilization.

In connection with the separation of SHO in 2012, the Company incurred a taxable gain of \$266 million. The gain primarily related to the determination that the fair value of the consideration received exceeded the tax basis of the net assets of SHO at the date of the separation. The amount of taxes otherwise payable resulting from the gain was reduced by utilization of \$105 million of deferred tax assets, primarily NOL carryforwards. As the Company had previously recorded a valuation allowance against these NOL carryforwards, \$105 million of the related valuation allowance was released upon their utilization.

In connection with the taxable spin of approximately 45 percent of the Company's common shares in Sears Canada Inc. in 2012, the Company incurred a taxable gain of \$367 million. The gain primarily relates to the determination that the fair market value of the common shares distributed to the public shareholders exceeded the tax basis of the shares distributed. The amount of taxes otherwise payable resulting from the gain was reduced by utilization of \$40 million of net deferred tax assets, primarily NOL carryforwards. As the Company had previously recorded a valuation allowance against these NOL carryforwards, \$40 million of the related valuation allowance was released upon their utilization.

#### **Accounting for Uncertainties in Income Taxes**

We account for uncertainties in income taxes according to accounting standards for uncertain tax positions. We are present in a large number of taxable jurisdictions, and at any point in time, can have audits underway at various stages of completion in any of these jurisdictions. We evaluate our tax positions and establish liabilities for uncertain tax positions that may be challenged by federal, foreign and/or local authorities and may not be fully sustained, despite our belief that the underlying tax positions are fully supportable. Unrecognized tax benefits are reviewed on an ongoing basis and are adjusted in light of changing facts and circumstances, including progress of tax audits,

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developments in case law, and closing of statute of limitations. Such adjustments are reflected in the tax provision as appropriate. We are generally not able to reliably estimate the ultimate settlement amounts until the close of the audit. While we do not expect material changes, it is possible that the amount of unrecognized benefit with respect to our uncertain tax positions will significantly increase or decrease within the next 12 months related to the audits

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

described above. At this time, we are not able to make a reasonable estimate of the range of impact on the balance of unrecognized tax benefits or the impact on the effective tax rate related to these items. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits (“UTB”) is as follows:

| millions                                     | Federal, State, and Foreign Tax |                     |                     |
|--|---------------------------------|---------------------|---------------------|
|  | February 1,<br>2014             | February 2,<br>2013 | January 28,<br>2012 |
| Gross UTB Balance at Beginning of Period     | \$161                           | \$192               | \$192               |
| Tax positions related to the current period: |                                 |                     |                     |
| Gross increases                              | 15                              | 21                  | 22                  |
| Gross decreases                              | —                               | (8 )                | (8 )                |
| Tax positions related to prior periods:      |                                 |                     |                     |
| Gross increases                              | —                               | —                   | 20                  |
| Gross decreases                              | (17 )                           | (33 )               | (19 )               |
| Settlements                                  | (1 )                            | (1 )                | (4 )                |
| Lapse of statute of limitations              | (6 )                            | (10 )               | (10 )               |
| Exchange rate fluctuations                   | (2 )                            | —                   | (1 )                |
| Gross UTB Balance at End of Period           | \$150                           | \$161               | \$192               |

At the end of 2013, we had gross unrecognized tax benefits of \$150 million. Of this amount, \$91 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. We expect that our unrecognized tax benefits could decrease up to \$21 million over the next 12 months for tax audit settlements and the expiration of the statute of limitations for certain jurisdictions.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. At February 1, 2014, the total amount of interest and penalties recognized within the related tax liability in our Consolidated Balance Sheet was \$53 million (\$36 million net of federal benefit). The total amount of net interest expense recognized in our Consolidated Statement of Operations for 2013 was \$2 million.

We file income tax returns in both the United States and various foreign jurisdictions. The U.S. Internal Revenue Service (“IRS”) has completed its examination of Holdings' 2008 through 2009 federal income tax returns, and we are currently working with the IRS appeals division to resolve a single issue arising from these exams. We have resolved all matters arising from prior IRS exams. In addition, Holdings and Sears are under examination by various state, local and foreign income tax jurisdictions for the years 2002 through 2012, and Kmart is under examination by such jurisdictions for the years 2003 through 2012.

**NOTE 11—REAL ESTATE TRANSACTIONS****Gain on Sales of Assets**

We recognized \$667 million, \$468 million, and \$64 million in gains on sales of assets during 2013, 2012 and 2011, respectively. These gains were primarily a function of several large real estate transactions.

During 2013, we recorded gains on sales of assets of \$180 million recognized on the amendment and early termination of the leases on two properties operated by Sears Canada for which Sears Canada received \$184 million (\$191 million Canadian) in cash proceeds. Additionally, in 2013, we recorded gains on sales of assets of \$357 million recognized on the surrender and early termination of the leases of five properties operated by Sears Canada, for which Sears Canada received \$381 million (\$400 million Canadian) in cash proceeds. Gains on sales of assets recorded during 2013 also include gains of \$67 million related to the sale of one store previously operated under The Great Indoors format, two Sears Full-line stores and two Kmart stores for which we received \$98 million in cash proceeds.



**SEARS HOLDINGS CORPORATION**

Notes to Consolidated Financial Statements—(Continued)

During 2012, the gain on sales of assets included gains of \$386 million recognized in connection with real estate transactions which included a gain of \$223 million recognized on the sale of 11 (six owned and five leased) Sears Full-line store locations to General Growth Properties for \$270 million in cash proceeds, and a gain of \$163 million recognized on the surrender and early termination of the leases on three properties operated by Sears Canada, under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received \$171 million (\$170 million Canadian) in cash proceeds. The gain on sales of assets recorded during 2012 also included a gain of \$33 million related to the sale of one store operated under The Great Indoors format, one Sears Full-line store, and one Kmart store.

During 2011, the gain on sales of assets included a gain of \$33 million recognized on the sale of two stores operated under The Great Indoors format and one Kmart store.

One of the gains recognized in 2013 was for the surrender and early termination of one lease operated by Sears Canada. We surrendered all of our rights and obligations under our preexisting lease agreement related to certain floors, and agreed to surrender these premises by March 2014. Sears Canada will continue to lease floors currently used as office space under terms consistent with the existing lease. We determined that there is no continuing involvement related to the floors surrendered as we have transferred all of the risks and rewards of ownership to the landlord, and therefore immediate gain recognition is appropriate.

In connection with the other transactions, we surrendered substantially all of our rights and obligations under our preexisting lease agreements and agreed to surrender each of the premises in periods ranging up to 23 months from the date of closing to facilitate an orderly wind down of operations.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## NOTE 12—GOODWILL AND INTANGIBLE ASSETS

The following summarizes our intangible assets at February 1, 2014 and February 2, 2013, respectively, the amortization expenses recorded for the years then ended, as well as our estimated amortization expense for the next five years and thereafter.

|   | Weighted<br>Average Life<br>millions | February 1, 2014<br>Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | February 2, 2013<br>Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|---|--------------------------------------|---|-----------------------------|---|-----------------------------|
| <b>Amortizing intangible assets:</b>        |                                      |   |                             |   |                             |
| Favorable lease rights                      | 30                                   | \$273   | \$141                       | \$293   | \$148                       |
| Contractual arrangements and customer lists | 9                                    | 217   | 202                         | 218   | 188                         |
| Trade names                                 | 7                                    | 74  | 74                          | 74  | 71                          |
|   |                                      | 564   | 417                         | 585   | 407                         |
| <b>Non-amortizing intangible assets:</b>    |                                      |   |                             |   |                             |
| Trade names                                 |                                      | 2,703   | —                           | 2,703   | —                           |
| Total                                       |                                      | \$3,267   | \$417                       | \$3,288   | \$407                       |

## Annual Amortization Expense

|      |      |
|------|------|
| 2013 | \$28 |
| 2012 | 56   |
| 2011 | 56   |

## Estimated Amortization

|            |      |
|------------|------|
| 2014       | \$22 |
| 2015       | 10   |
| 2016       | 7    |
| 2017       | 7    |
| 2018       | 6    |
| Thereafter | 93   |

Goodwill is the excess of the purchase price over the fair value of the net assets acquired in business combinations accounted for under the purchase method. We recorded \$1.7 billion in goodwill in connection with the Merger. We recorded \$12 million in connection with our acquisition of an additional 3% interest in Sears Canada during 2008.

Changes in the carrying amount of goodwill by segment during years 2012 and 2013 were as follows:

|  | Sears<br>Domestic | Sears<br>Canada | Total  |
|--|-------------------|-----------------|--------|
| Balance, January 28, 2012:                           |                   |                 |        |
| Goodwill   | \$546             | \$295           | \$841  |
| 2012 activity:                                       |                   |                 |        |
| Separation of Sears Hometown and Outlet Stores, Inc. | (167 )            | —               | (167 ) |
| Impairment charges                                   | —                 | (295 )          | (295 ) |
| Balance, February 2, 2013 and February 1, 2014       | \$379             | \$—             | \$379  |

**SEARS HOLDINGS CORPORATION**

Notes to Consolidated Financial Statements—(Continued)

In accordance with accounting standards for goodwill and other intangible assets, goodwill is not amortized but requires testing for potential impairment, at a minimum on an annual basis, or when indications of potential impairment exist. The impairment test for goodwill utilizes a fair value approach. The impairment test for identifiable intangible assets not subject to amortization is also performed annually or when impairment indications exist, and consist of a comparison of the fair value of the intangible asset with its carrying amount. Identifiable intangible assets that are subject to amortization are evaluated for impairment using a process similar to that used to evaluate other long-lived assets. Our annual impairment analysis is performed at the last day of our November accounting period each year.

We perform our annual goodwill and intangible impairment test required under accounting standards at the last day of our November accounting period each year, or when an indication of potential impairment exists. The goodwill impairment test involves a two-step process as described in the “Summary of Significant Accounting Policies” in Note 1. The first step is a comparison of each reporting unit's fair value to its carrying value. If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss.

After performing the first step of the process, we determined goodwill recorded at reporting units within the Sears Canada segment in 2012 and the Sears Domestic segment in 2011 were potentially impaired. The impairment charge was primarily driven by the combination of lower sales and continued margin pressure coupled with expense increases which led to a decline in our operating profit. After performing the second step of the process, we determined that the total amount of goodwill recorded at these reporting units was impaired and recorded charges of \$295 million and \$551 million in 2012 and 2011, respectively.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred at a date other than the annual impairment test date. Such indicators may include, among others: a significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; the testing for recoverability of a significant asset group within a reporting unit; and slower growth rates.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## NOTE 13—STORE CLOSING CHARGES, SEVERANCE COSTS AND IMPAIRMENTS

## Store Closings and Severance

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which we no longer intend to receive any economic benefit are accrued for when we cease to use the leased space and have been reduced for any income that we believe can be realized through sub-leasing the leased space. During 2013, 2012 and 2011, respectively, we closed 70, 92 and 18 stores in our Kmart segment and 23, 147 and 47 stores in our Sears Domestic segment we previously announced would close. We recorded charges for the related lease obligations of \$16 million, \$34 million and \$1 million for 14, 61 and 6 of these stores at Kmart during 2013, 2012 and 2011, respectively, and of \$34 million and \$4 million for 50 and 8 of these stores at Sears Domestic during 2012 and 2011, respectively.

We do not expect additional charges recorded during 2014 related to stores we made the decision to close in 2013 to be material.

We made the decision to close 113, 48 and 74 stores in our Kmart segment and 32, 12 and 173 stores in our Sears Domestic segment during 2013, 2012 and 2011, respectively.

Store closing costs and severance recorded for 2013, 2012 and 2011 were as follows:

| millions         | Markdowns <sup>(1)</sup> | Severance Costs <sup>(2)</sup> | Lease Termination Costs <sup>(2)</sup> | Other Charges <sup>(2)</sup> | Impairment and Accelerated Depreciation <sup>(3)</sup> | Total Store Closing Costs |
|------------------|--------------------------|--------------------------------|--|------------------------------|--|---------------------------|
| Kmart            | \$45                     | \$10                           | \$16                                   | \$18                         | \$12   | \$101                     |
| Sears Domestic   | 11                       | (3 )                           | (39 )                                  | —                            | 12   | (19 )                     |
| Sears Canada     | 1                        | 52                             | —                                      | 2                            | —  | 55                        |
| Total 2013 costs | \$57                     | \$59                           | \$ (23 )                               | \$20                         | \$24   | \$137                     |
|                  |                          |                                |  |                              |  |                           |
| Kmart            | \$21                     | \$13                           | \$34                                   | \$8                          | \$9  | \$85                      |
| Sears Domestic   | 14                       | 2                              | 34                                     | (6 )                         | 13   | 57                        |
| Sears Canada     | —                        | 16                             | (1 )                                   | 5                            | —  | 20                        |
| Total 2012 costs | \$35                     | \$31                           | \$67                                   | \$7                          | \$22   | \$162                     |
|                  |                          |                                |  |                              |  |                           |
| Kmart            | \$46                     | \$14                           | \$1                                    | \$15                         | \$5  | \$81                      |
| Sears Domestic   | 84                       | 41                             | 4                                      | 31                           | 85   | 245                       |
| Sears Canada     | —                        | 18                             | —                                      | —                            | —  | 18                        |
| Total 2011 costs | \$130                    | \$73                           | \$5                                    | \$46                         | \$90   | \$344                     |

<sup>(1)</sup> Recorded within Cost of sales, buying and occupancy on the Consolidated Statements of Operations.

Recorded within Selling and administrative on the Consolidated Statements of Operations. Lease termination costs

<sup>(2)</sup> are net of estimated sublease income, and include the reversal of closed store reserves for which the lease agreement has been terminated and the reversal of deferred rent balances related to closed stores.

2013 costs include \$13 million recorded within impairment charges and \$11 million recorded within Depreciation and amortization on the Consolidated Statements of Operations. 2011 costs include \$82 million recorded within

<sup>(3)</sup> impairment charges and \$8 million recorded within Depreciation and amortization on the Consolidated Statements of Operations. 2012 costs are recorded within Depreciation and amortization on the Consolidated Statements of Operations.



**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

Store closing cost accruals of \$199 million and \$193 million at February 1, 2014 and February 2, 2013, respectively, were as follows:

| millions                                | Severance<br>Costs | Lease<br>Termination<br>Costs | Other<br>Charges | Total |
|---|--------------------|-------------------------------|------------------|-------|
| Balance at January 28, 2012             | \$59               | \$64                          | \$36             | \$159 |
| Store closing costs                     | 31                 | 86                            | 7                | 124   |
| Store closing capital lease obligations | —                  | 9                             | —                | 9     |
| Payments/utilizations                   | (49                | ) (21                         | ) (29            | ) (99 |
| Balance at February 2, 2013             | 41                 | 138                           | 14               | 193   |
| Store closing costs                     | 59                 | 3                             | 20               | 82    |
| Store closing capital lease obligations | —                  | 2                             | —                | 2     |
| Payments/utilizations                   | (37                | ) (24                         | ) (17            | ) (78 |
| Balance at February 1, 2014             | \$63               | \$119                         | \$17             | \$199 |

**Goodwill**

See Note 12 for further information regarding our goodwill impairment charges recorded in 2012 and 2011.

**Long-Lived Assets**

In accordance with accounting standards governing the impairment or disposal of long-lived assets, we performed an impairment test of certain of our long-lived assets (principally the value of buildings and other fixed assets associated with our stores) due to events and changes in circumstances during 2013, 2012 and 2011 that indicated an impairment might have occurred. The impairment review was triggered by establishing a valuation allowance against certain deferred income tax assets, as well as a decline in operating performance at certain locations. As a result of this impairment testing, the Company recorded impairment charges of \$220 million, \$35 million and \$16 million during 2013, 2012 and 2011, respectively. The impairment charges recorded during 2013 included a \$67 million charge at Kmart, a \$140 million charge at Sears Domestic, and a \$13 million charge at Sears Canada. The impairment charges recorded during 2012 included a \$10 million charge at Kmart and a \$25 million charge at Sears Domestic. The impairment charges recorded during 2011 included a \$10 million charge at Kmart and a \$6 million charge at Sears Domestic.

**NOTE 14—LEASES**

We lease certain stores, office facilities, warehouses, computers and transportation equipment.

Operating and capital lease obligations are based upon contractual minimum rents and, for certain stores, amounts in excess of these minimum rents are payable based upon specified percentages of sales. Contingent rent is accrued over the lease term, provided that the achievement of the specified sales level that triggers the contingent rental is probable. Certain leases include renewal or purchase options.

Rental expense for operating leases was as follows:

| millions              | 2013  | 2012  | 2011  |
|-----------------------|-------|-------|-------|
| Minimum rentals       | \$762 | \$824 | \$837 |
| Percentage rentals    | 15    | 17    | 19    |
| Less-Sublease rentals | (56   | ) (47 | ) (30 |
| Total                 | \$721 | \$794 | \$826 |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

Minimum lease obligations, excluding taxes, insurance and other expenses payable directly by us, for leases in effect at February 1, 2014, were as follows:

|   | Minimum Lease Commitments |           |
|---|---------------------------|-----------|
| millions  | Capital                   | Operating |
| 2014  | \$102                     | \$684     |
| 2015  | 90                        | 605       |
| 2016  | 73                        | 499       |
| 2017  | 51                        | 383       |
| 2018  | 32                        | 289       |
| Later years                                       | 131                       | 1,314     |
| Total minimum lease payments <sup>(1)</sup>       | 479                       | 3,774     |
| Less-minimum sublease income                      |                           | (128 )    |
| Net minimum lease payments                        |                           | \$3,646   |
| Less:   |                           |           |
| Estimated executory costs                         | (41 )                     |           |
| Interest at a weighted average rate of 6.4%       | (92 )                     |           |
| Capital lease obligations                         | 346                       |           |
| Less current portion of capital lease obligations | (70 )                     |           |
| Long-term capital lease obligations               | \$276                     |           |

<sup>(1)</sup> Sears Canada: Total operating minimum lease payments of \$379 million.

## NOTE 15—RELATED PARTY DISCLOSURE

## Investment of Surplus Cash

Our Board has delegated authority to direct investment of our surplus cash to Edward S. Lampert, subject to various limitations that have been or may be from time to time adopted by the Board of Directors and/or the Finance Committee of the Board of Directors. Mr. Lampert is Chairman of our Board of Directors and its Finance Committee and is the Chairman and Chief Executive Officer of ESL. Additionally, on February 1, 2013, Mr. Lampert became our Chief Executive Officer, in addition to his role as Chairman of the Board. Neither Mr. Lampert nor ESL will receive compensation for any such investment activities undertaken on our behalf, other than Mr. Lampert's compensation as our Chief Executive Officer. ESL beneficially owned approximately 48% of our outstanding common stock at December 3, 2013.

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



## SEARS HOLDINGS CORPORATION

### Notes to Consolidated Financial Statements—(Continued)

#### Unsecured Commercial Paper

During 2013 and 2012, ESL and its affiliates purchased unsecured commercial paper issued by Sears Roebuck Acceptance Corp. (“SRAC”), an indirect wholly owned subsidiary of Holdings. For the commercial paper outstanding to ESL, the weighted average of each of maturity, annual interest rate, and principal amount outstanding for this commercial paper was 28.9 days, 2.76% and \$184 million and 31.6 days, 2.38% and \$202 million, respectively, in 2013 and 2012. The largest aggregate amount of principal outstanding to ESL at any time since the beginning of 2013 was \$305 million and the aggregate amount of interest paid by SRAC to ESL during 2013 was \$6 million. ESL held none of our commercial paper at February 1, 2014, including any held by Mr. Lampert. ESL held \$285 million in principal amount of our commercial paper at February 2, 2013, which included \$169 million held by Mr. Lampert. The commercial paper purchases were made in the ordinary course of business on substantially the same terms, including interest rates, as terms prevailing for comparable transactions with other persons, and did not present features unfavorable to the Company.

#### Senior Secured Notes

In 2011, Mr. Lampert and ESL purchased an aggregate of \$95 million of principal amount of the Company’s 6 5/8% Senior Secured Notes due 2018 (the “6 5/8% Notes”) and \$10 million of principal amount of unsecured notes issued by SRAC and another indirect wholly owned subsidiary of Sears Holdings, Sears DC Corp. (the “Subsidiary Notes”). The Subsidiary Notes issued by Sears DC Corp. matured in 2012. At both February 1, 2014 and February 2, 2013, Mr. Lampert and ESL held an aggregate of \$95 million of principal amount of 6 5/8% Notes and \$3 million of principal amount of Subsidiary Notes.

#### Trade Receivable Put Agreements

On January 26, 2012, ESL entered into an agreement with a financial institution to acquire from the financial institution an undivided participating interest in a certain percentage of its rights and obligations under trade receivable put agreements that were entered into with certain vendors of the Company. These agreements generally provide that, in the event of a bankruptcy filing by the Company, the financial institution will purchase such vendors’ accounts receivable arising from the sale of goods or services to the Company. ESL may from time to time choose to purchase an 80% undivided participating interest in the rights and obligations primarily arising under future trade receivable put agreements that the financial institution enters into with our vendors during the term of its agreement. The Company is neither a party nor will it become a party to any of these agreements. At February 1, 2014 and February 2, 2013, ESL held a participation interest totaling \$80 million and \$234 million, respectively, in the financial institution’s agreements relating to the Company.

#### Sears Canada

ESL owns approximately 28% of the outstanding common shares of Sears Canada.

#### SHO

Holdings, and certain of its subsidiaries, engage in transactions with SHO pursuant to various agreements with SHO which, among other things, (1) govern the principal transactions relating to the rights offering and certain aspects of our relationship with SHO following the separation, (2) establish terms under which Holdings and certain of its subsidiaries will provide SHO with services, and (3) establish terms pursuant to which Holdings and certain of its subsidiaries will obtain merchandise for SHO. ESL owns approximately 48% of the outstanding common stock of SHO (based on publicly available information as of June 12, 2013).

These agreements were made in the context of a parent-subsidiary relationship and were negotiated in the overall context of the separation. The Company believes that the methods by which costs are allocated are reasonable and are based on prorated estimates of costs expected to be incurred by the Company. A summary of the nature of related party transactions involving SHO is as follows:

SHO obtains a significant amount of its merchandise from the Company. We have also entered into certain agreements with SHO to provide logistics, handling, warehouse and transportation services. SHO also pays a royalty related to the sale of Kenmore, Craftsman and DieHard products and fees for participation in the Shop Your Way

program.

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**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

SHO receives commissions from the Company for the sale of merchandise made through www.sears.com, extended service agreements, delivery and handling services and credit revenues.

The Company provides SHO with shared corporate services. These services include accounting and finance, legal, human resources, information technology and real estate.

Amounts due to or from SHO are non-interest bearing, settled on a net basis, and have payment terms of 10 days after the invoice date. The Company invoices SHO on a weekly basis. At February 1, 2014 and February 2, 2013, Holdings reported a net amount receivable from SHO of \$68 million and \$79 million, respectively, in the Accounts receivable line of the Consolidated Balance Sheet. Amounts related to the sale of inventory and related services, royalties, and corporate shared services were \$1.7 billion during 2013 and \$513 million during the period following the separation of SHO from October 12, 2012 through February 2, 2013. The net amounts SHO earned related to commissions were \$89 million during 2013 and \$60 million during the period following the separation of SHO from October 12, 2012 through February 2, 2013. Additionally, the Company has guaranteed lease obligations for certain SHO store leases that were assigned as a result of the separation. See Note 4 for further information related to these guarantees.

Also in connection with the separation, the Company entered into an agreement with SHO and the agent under SHO's secured credit facility, whereby the Company committed to continue to provide services to SHO in connection with a realization on the lender's collateral after default under the secured credit facility, notwithstanding SHO's default under the underlying agreement with us, and to provide certain notices and services to the agent, for so long as any obligations remain outstanding under the secured credit facility.

**NOTE 16—SUPPLEMENTAL FINANCIAL INFORMATION**

Other long-term liabilities at February 1, 2014 and February 2, 2013 consisted of the following:

| millions                | February 1,<br>2014 | February 2,<br>2013 |
|-------------------------|---------------------|---------------------|
| Unearned revenues       | \$836               | \$843               |
| Self-insurance reserves | 686                 | 714                 |
| Other                   | 486                 | 569                 |
| Total                   | \$2,008             | \$2,126             |

**NOTE 17—SUMMARY OF SEGMENT DATA**

These reportable segment classifications are based on our business formats, as described in Note 1. The Kmart and Sears Canada formats each represent both an operating and reportable segment. The Sears Domestic reportable segment consists of the aggregation of several business formats. These formats are evaluated by our Chief Operating Decision Maker ("CODM") to make decisions about resource allocation and to assess performance.

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

Each of these segments derives its revenues from the sale of merchandise and related services to customers, primarily in the United States and Canada. The merchandise and service categories are as follows:

- (i) Hardlines—consists of appliances, consumer electronics, lawn & garden, tools & hardware, automotive parts, household goods, toys, housewares and sporting goods;
- (ii) Apparel and Soft Home—includes women's, men's, kids', footwear, jewelry, accessories and soft home;
- (iii) Food and Drug—consists of grocery & household, pharmacy and drugstore; and
- (iv) Service—includes repair, installation and automotive service and extended contract revenue;
- (v) Other—includes revenues earned in connection with our agreements with SHO, as well as credit revenues and licensed business revenues.

|  | 2013     |                   |                 |                   |
|--|----------|-------------------|-----------------|-------------------|
| millions                               | Kmart    | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| <b>Merchandise sales and services:</b> |          |                   |                 |                   |
| Hardlines                              | \$4,037  | \$9,355           | \$1,866         | \$15,258          |
| Apparel and Soft Home                  | 4,298    | 5,197             | 1,742           | 11,237            |
| Food and Drug                          | 4,772    | 16                | —               | 4,788             |
| Service                                | —        | 2,502             | 131             | 2,633             |
| Other                                  | 87       | 2,128             | 57              | 2,272             |
| Total merchandise sales and services   | 13,194   | 19,198            | 3,796           | 36,188            |
| <b>Costs and expenses:</b>             |          |                   |                 |                   |
| Cost of sales, buying and occupancy    | 10,329   | 14,324            | 2,780           | 27,433            |
| Selling and administrative             | 3,083    | 5,216             | 1,085           | 9,384             |
| Depreciation and amortization          | 129      | 511               | 92              | 732               |
| Impairment charges                     | 70       | 150               | 13              | 233               |
| Gain on sales of assets                | (66 )    | (63 )             | (538 )          | (667 )            |
| Total costs and expenses               | 13,545   | 20,138            | 3,432           | 37,115            |
| Operating income (loss)                | \$(351 ) | \$(940 )          | \$364           | \$(927 )          |
| Total assets                           | \$3,902  | \$12,206          | \$2,153         | \$18,261          |
| Capital expenditures                   | \$63     | \$196             | \$70            | \$329             |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

|                                      | 2012    |                   |                 |                   |
|--------------------------------------|---------|-------------------|-----------------|-------------------|
| millions                             | Kmart   | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| Merchandise sales and services:      |         |                   |                 |                   |
| Hardlines                            | \$4,486 | \$11,870          | \$2,246         | \$18,602          |
| Apparel and Soft Home                | 4,588   | 5,434             | 1,856           | 11,878            |
| Food and Drug                        | 5,398   | 38                | —               | 5,436             |
| Service                              | —       | 2,604             | 151             | 2,755             |
| Other                                | 95      | 1,031             | 57              | 1,183             |
| Total merchandise sales and services | 14,567  | 20,977            | 4,310           | 39,854            |
| Costs and expenses:                  |         |                   |                 |                   |
| Cost of sales, buying and occupancy  | 11,158  | 15,107            | 3,075           | 29,340            |
| Selling and administrative           | 3,284   | 6,184             | 1,192           | 10,660            |
| Depreciation and amortization        | 147     | 578               | 105             | 830               |
| Impairment charges                   | 10      | 25                | 295             | 330               |
| Gain on sales of assets              | (37 )   | (261 )            | (170 )          | (468 )            |
| Total costs and expenses             | 14,562  | 21,633            | 4,497           | 40,692            |
| Operating income (loss)              | \$5     | \$(656 )          | \$(187 )        | \$(838 )          |
| Total assets                         | \$4,304 | \$12,648          | \$2,388         | \$19,340          |
| Capital expenditures                 | \$122   | \$171             | \$85            | \$378             |
|                                      | 2011    |                   |                 |                   |
| millions                             | Kmart   | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| Merchandise sales and services:      |         |                   |                 |                   |
| Hardlines                            | \$4,765 | \$13,022          | \$2,377         | \$20,164          |
| Apparel and Soft Home                | 4,723   | 5,471             | 2,011           | 12,205            |
| Food and Drug                        | 5,705   | 41                | —               | 5,746             |
| Service                              | —       | 2,657             | 184             | 2,841             |
| Other                                | 92      | 458               | 61              | 611               |
| Total merchandise sales and services | 15,285  | 21,649            | 4,633           | 41,567            |
| Costs and expenses:                  |         |                   |                 |                   |
| Cost of sales, buying and occupancy  | 11,818  | 15,849            | 3,299           | 30,966            |
| Selling and administrative           | 3,371   | 6,042             | 1,251           | 10,664            |
| Depreciation and amortization        | 149     | 601               | 103             | 853               |
| Impairment charges                   | 15      | 634               | —               | 649               |
| Gain on sales of assets              | (34 )   | (30 )             | —               | (64 )             |
| Total costs and expenses             | 15,319  | 23,096            | 4,653           | 43,068            |
| Operating loss                       | \$(34 ) | \$(1,447 )        | \$(20 )         | \$(1,501 )        |
| Total assets                         | \$4,548 | \$13,913          | \$2,920         | \$21,381          |
| Capital expenditures                 | \$118   | \$225             | \$89            | \$432             |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## NOTE 18—LEGAL PROCEEDINGS

We are a defendant in several lawsuits containing class or collective action allegations in which the plaintiffs are current and former hourly and salaried associates who allege violations of various wage and hour laws, rules and regulations pertaining to alleged misclassification of certain of our employees and the failure to pay overtime and/or the failure to pay for missed meal and rest periods. The complaints generally seek unspecified monetary damages, injunctive relief, or both. Further, certain of these proceedings are in jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants. We also are a defendant in several putative or certified class action lawsuits in California relating to alleged failure to comply with California laws pertaining to certain operational, marketing and payroll practices. The California laws alleged to have been violated in each of these lawsuits provide the potential for significant statutory penalties. At this time, the Company is not able to either predict the outcome of these lawsuits or reasonably estimate a potential range of loss with respect to the lawsuits.

We are subject to various other legal and governmental proceedings and investigations, including some involving the practices and procedures in our more highly regulated businesses and many involving litigation incidental to those and other businesses. Some matters contain class action allegations, environmental and asbestos exposure allegations and other consumer-based, regulatory or qui tam claims, each of which may seek compensatory, punitive or treble damage claims (potentially in large amounts), as well as other types of relief. Additionally, some of these claims or actions, such as the qui-tam claims, have the potential for significant statutory penalties.

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

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

## NOTE 19—QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

|   | 2013          |                |               |                |
|---|---------------|----------------|---------------|----------------|
| millions, except per share data                                   | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Revenues  | \$8,452       | \$8,871        | \$8,272       | \$10,593       |
| Cost of sales, buying and occupancy                               | 6,296         | 6,685          | 6,341         | 8,111          |
| Selling and administrative  | 2,218         | 2,291          | 2,262         | 2,613          |
| Net loss attributable to Holdings' shareholders                   | (279 )        | (194 )         | (534 )        | (358 )         |
| Basic net loss per share attributable to Holdings' shareholders   | (2.63 )       | (1.83 )        | (5.03 )       | (3.37 )        |
| Diluted net loss per share attributable to Holdings' shareholders | (2.63 )       | (1.83 )        | (5.03 )       | (3.37 )        |



## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

|  | 2012          |                |               |                |
|--|---------------|----------------|---------------|----------------|
|  | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| millions, except per share data  |               |                |               |                |
| Revenues   | \$9,270       | \$9,467        | \$8,857       | \$12,260       |
| Cost of sales, buying and occupancy  | 6,703         | 6,936          | 6,604         | 9,097          |
| Selling and administrative   | 2,445         | 2,437          | 2,496         | 3,282          |
| Net income (loss) attributable to Holdings' shareholders                   | 189           | (132 )         | (498 )        | (489 )         |
| Basic net income (loss) per share attributable to Holdings' shareholders   | 1.78          | (1.25 )        | (4.70 )       | (4.61 )        |
| Diluted net income (loss) per share attributable to Holdings' shareholders | 1.78          | (1.25 )        | (4.70 )       | (4.61 )        |

Per share amounts for each quarter are required to be computed independently and may not equal the amount computed for the total year.

## NOTE 20—GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION

At February 1, 2014, the principal amount outstanding of the Company's 65/8% senior secured notes due 2018 was \$1.24 billion. These notes were issued in 2010 by Sears Holdings Corporation ("Parent"). The 58% Notes are guaranteed by certain of our 100% owned domestic subsidiaries that own the collateral for the notes, as well as by Sears Holdings Management Corporation and SRAC (the "guarantor subsidiaries"). The following condensed consolidated financial information presents the Condensed Consolidating Balance Sheets at February 1, 2014 and February 2, 2013, and the Condensed Consolidating Statements of Operations, the Consolidating Statements of Comprehensive Income (Loss) and the Condensed Consolidating Statements of Cash flows for 2013, 2012 and 2011 of (i) Parent; (ii) the guarantor subsidiaries; (iii) the non-guarantor subsidiaries; (iv) eliminations and (v) the Company on a consolidated basis.

Merchandise sales and services included revenues of \$1.7 billion and \$2.3 billion from SHO for 2012 and 2011, respectively. Net income (loss) attributable to Holdings' shareholders included net income of approximately \$51 million and \$33 million from SHO for 2012 and 2011, respectively. The financial information for SHO is reflected within the guarantor subsidiaries balances for these periods. The condensed consolidated financial information as of and for the periods ended February 1, 2014 and February 2, 2013 reflects the effects of the separation of SHO.

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

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Balance Sheet

February 1, 2014

| millions  | Parent          | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations       | Consolidated    |
|---|-----------------|------------------------|----------------------------|--------------------|-----------------|
| <b>Current assets</b>   |                 |                        |                            |                    |                 |
| Cash and cash equivalents   | \$—             | \$537                  | \$491                      | \$—                | \$1,028         |
| Intercompany receivables  | —               | —                      | 25,884                     | (25,884 )          | —               |
| Accounts receivable   | —               | 425                    | 128                        | —                  | 553             |
| Merchandise inventories   | —               | 6,356                  | 678                        | —                  | 7,034           |
| Prepaid expenses and other current assets                           | 44              | 873                    | 375                        | (948 )             | 344             |
| Total current assets  | 44              | 8,191                  | 27,556                     | (26,832 )          | 8,959           |
| Total property and equipment, net                                   | —               | 3,906                  | 1,488                      | —                  | 5,394           |
| Goodwill and intangible assets                                      | —               | 944                    | 2,285                      | —                  | 3,229           |
| Other assets  | 13              | 240                    | 2,603                      | (2,177 )           | 679             |
| Investment in subsidiaries  | 14,743          | 25,303                 | —                          | (40,046 )          | —               |
| <b>TOTAL ASSETS</b>   | <b>\$14,800</b> | <b>\$38,584</b>        | <b>\$33,932</b>            | <b>\$(69,055 )</b> | <b>\$18,261</b> |
| <b>Current liabilities</b>  |                 |                        |                            |                    |                 |
| Short-term borrowings   | \$—             | \$1,332                | \$—                        | \$—                | \$1,332         |
| Current portion of long-term debt and capitalized lease obligations | —               | 70                     | 13                         | —                  | 83              |
| Merchandise payables  | —               | 2,213                  | 283                        | —                  | 2,496           |
| Intercompany payables   | 12,103          | 13,781                 | —                          | (25,884 )          | —               |
| Short-term deferred tax liabilities                                 | 2               | 408                    | —                          | (23 )              | 387             |
| Other current liabilities   | 26              | 2,412                  | 2,374                      | (925 )             | 3,887           |
| Total current liabilities   | 12,131          | 20,216                 | 2,670                      | (26,832 )          | 8,185           |
| Long-term debt and capitalized lease obligations                    | 1,238           | 3,781                  | 76                         | (2,261 )           | 2,834           |
| Pension and postretirement benefits                                 | —               | 1,681                  | 261                        | —                  | 1,942           |
| Long-term deferred tax liabilities                                  | —               | 128                    | 955                        | 26                 | 1,109           |
| Other long-term liabilities   | —               | 805                    | 1,453                      | (250 )             | 2,008           |
| Total Liabilities   | 13,369          | 26,611                 | 5,415                      | (29,317 )          | 16,078          |
| <b>EQUITY</b>   |                 |                        |                            |                    |                 |
| Shareholder's equity  | 1,431           | 11,973                 | 28,517                     | (40,182 )          | 1,739           |
| Noncontrolling interest   | —               | —                      | —                          | 444                | 444             |
| Total Equity  | 1,431           | 11,973                 | 28,517                     | (39,738 )          | 2,183           |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                 | <b>\$14,800</b> | <b>\$38,584</b>        | <b>\$33,932</b>            | <b>\$(69,055 )</b> | <b>\$18,261</b> |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Balance Sheet

February 2, 2013

| millions  | Parent          | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations       | Consolidated    |
|---|-----------------|------------------------|----------------------------|--------------------|-----------------|
| <b>Current assets</b>   |                 |                        |                            |                    |                 |
| Cash and cash equivalents   | \$—             | \$320                  | \$289                      | \$—                | \$609           |
| Intercompany receivables  | —               | —                      | 25,553                     | (25,553 )          | —               |
| Accounts receivable   | —               | 506                    | 129                        | —                  | 635             |
| Merchandise inventories   | —               | 6,709                  | 849                        | —                  | 7,558           |
| Prepaid expenses and other current assets                           | 92              | 970                    | 461                        | (1,060 )           | 463             |
| Total current assets  | 92              | 8,505                  | 27,281                     | (26,613 )          | 9,265           |
| Total property and equipment, net                                   | —               | 4,412                  | 1,641                      | —                  | 6,053           |
| Goodwill and intangible assets                                      | —               | 968                    | 2,292                      | —                  | 3,260           |
| Other assets  | 17              | 223                    | 3,147                      | (2,625 )           | 762             |
| Investment in subsidiaries  | 16,413          | 24,988                 | —                          | (41,401 )          | —               |
| <b>TOTAL ASSETS</b>   | <b>\$16,522</b> | <b>\$39,096</b>        | <b>\$34,361</b>            | <b>(\$70,639 )</b> | <b>\$19,340</b> |
| <b>Current liabilities</b>  |                 |                        |                            |                    |                 |
| Short-term borrowings   | \$—             | \$1,094                | \$—                        | \$—                | \$1,094         |
| Current portion of long-term debt and capitalized lease obligations | —               | 66                     | 17                         | —                  | 83              |
| Merchandise payables  | —               | 2,392                  | 369                        | —                  | 2,761           |
| Intercompany payables   | 12,594          | 12,959                 | —                          | (25,553 )          | —               |
| Short-term deferred tax liabilities                                 | 3               | 412                    | —                          | (33 )              | 382             |
| Other current liabilities   | 26              | 2,640                  | 2,455                      | (1,027 )           | 4,094           |
| Total current liabilities   | 12,623          | 19,563                 | 2,841                      | (26,613 )          | 8,414           |
| Long-term debt and capitalized lease obligations                    | 1,237           | 3,081                  | 135                        | (2,510 )           | 1,943           |
| Pension and postretirement benefits                                 | —               | 2,310                  | 420                        | —                  | 2,730           |
| Long-term deferred tax liabilities                                  | —               | —                      | 914                        | 41                 | 955             |
| Other long-term liabilities   | —               | 861                    | 1,513                      | (248 )             | 2,126           |
| Total Liabilities   | 13,860          | 25,815                 | 5,823                      | (29,330 )          | 16,168          |
| <b>EQUITY</b>   |                 |                        |                            |                    |                 |
| Shareholder's equity  | 2,662           | 13,281                 | 28,538                     | (41,726 )          | 2,755           |
| Noncontrolling interest   | —               | —                      | —                          | 417                | 417             |
| Total Equity  | 2,662           | 13,281                 | 28,538                     | (41,309 )          | 3,172           |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                 | <b>\$16,522</b> | <b>\$39,096</b>        | <b>\$34,361</b>            | <b>(\$70,639 )</b> | <b>\$19,340</b> |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Operations

For the Year Ended February 1, 2014

| millions  | Parent   | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated  |
|---|----------|------------------------|----------------------------|--------------|---------------|
| Merchandise sales and services                              | \$—      | \$32,391               | \$7,202                    | \$ (3,405 )  | \$36,188      |
| Cost of sales, buying and occupancy                         | —        | 25,035                 | 4,128                      | (1,730 )     | 27,433        |
| Selling and administrative                                  | 2        | 8,865                  | 2,192                      | (1,675 )     | 9,384         |
| Depreciation and amortization                               | —        | 557                    | 175                        | —            | 732           |
| Impairment charges  | —        | 220                    | 13                         | —            | 233           |
| Gain on sales of assets                                     | —        | (129 )                 | (538 )                     | —            | (667 )        |
| Total costs and expenses                                    | 2        | 34,548                 | 5,970                      | (3,405 )     | 37,115        |
| Operating income (loss)                                     | (2 )     | (2,157 )               | ) 1,232                    | —            | (927 )        |
| Interest expense  | (217 )   | (394 )                 | (85 )                      | ) 442        | (254 )        |
| Interest and investment income                              | —        | 43                     | 606                        | (442 )       | ) 207         |
| Other income  | —        | —                      | 2                          | —            | 2             |
| Income (loss) before income taxes                           | (219 )   | (2,508 )               | ) 1,755                    | —            | (972 )        |
| Income tax (expense) benefit                                | 37       | 469                    | (650 )                     | —            | (144 )        |
| Equity (deficit) in earnings in subsidiaries                | (934 )   | 894                    | —                          | 40           | —             |
| Net income (loss)   | (1,116 ) | (1,145 )               | ) 1,105                    | 40           | (1,116 )      |
| Income attributable to noncontrolling interests             | —        | —                      | —                          | (249 )       | (249 )        |
| NET INCOME (LOSS) ATTRIBUTABLE TO<br>HOLDINGS' SHAREHOLDERS |          | \$ (1,116 )            | \$ (1,145 )                | ) \$ 1,105   | \$ (209 )     |
|   |          |                        |                            |              | ) \$ (1,365 ) |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Operations

For the Year Ended February 2, 2013

| millions  | Parent      | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-------------|------------------------|----------------------------|--------------|--------------|
| Merchandise sales and services                              | \$—         | \$35,417               | \$8,032                    | \$ (3,595 )  | \$39,854     |
| Cost of sales, buying and occupancy                         | —           | 26,531                 | 4,619                      | (1,810 )     | 29,340       |
| Selling and administrative                                  | 2           | 10,054                 | 2,389                      | (1,785 )     | 10,660       |
| Depreciation and amortization                               | —           | 634                    | 196                        | —            | 830          |
| Impairment charges  | —           | 35                     | 295                        | —            | 330          |
| Gain on sales of assets                                     | —           | (298 )                 | (170 )                     | —            | (468 )       |
| Total costs and expenses                                    | 2           | 36,956                 | 7,329                      | (3,595 )     | 40,692       |
| Operating income (loss)                                     | (2 )        | (1,539 )               | 703                        | —            | (838 )       |
| Interest expense  | (227 )      | (391 )                 | (107 )                     | 458          | (267 )       |
| Interest and investment income                              | —           | 43                     | 509                        | (458 )       | 94           |
| Other income  | —           | —                      | 1                          | —            | 1            |
| Income (loss) before income taxes                           | (229 )      | (1,887 )               | 1,106                      | —            | (1,010 )     |
| Income tax (expense) benefit                                | 89          | 527                    | (660 )                     | —            | (44 )        |
| Equity (deficit) in earnings in subsidiaries                | (914 )      | 65                     | —                          | 849          | —            |
| Net income (loss)   | (1,054 )    | (1,295 )               | 446                        | 849          | (1,054 )     |
| Loss attributable to noncontrolling interests               | —           | —                      | —                          | 124          | 124          |
| NET INCOME (LOSS) ATTRIBUTABLE<br>TO HOLDINGS' SHAREHOLDERS | \$ (1,054 ) | \$ (1,295 )            | \$ 446                     | \$ 973       | \$ (930 )    |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Operations

For the Year Ended January 28, 2012

| millions  | Parent            | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations   | Consolidated      |
|---|-------------------|------------------------|----------------------------|----------------|-------------------|
| Merchandise sales and services                                  | \$—               | \$36,714               | \$8,354                    | \$ (3,501 )    | \$41,567          |
| Cost of sales, buying and occupancy                             | —                 | 27,850                 | 4,862                      | (1,746 )       | 30,966            |
| Selling and administrative                                      | 2                 | 9,926                  | 2,491                      | (1,755 )       | 10,664            |
| Depreciation and amortization                                   | —                 | 680                    | 173                        | —              | 853               |
| Impairment charges  | —                 | 649                    | —                          | —              | 649               |
| Gain on sales of assets   | —                 | (63 )                  | (1 )                       | —              | (64 )             |
| Total costs and expenses  | 2                 | 39,042                 | 7,525                      | (3,501 )       | 43,068            |
| Operating income (loss)   | (2 )              | (2,328 )               | 829                        | —              | (1,501 )          |
| Interest expense  | (224 )            | (388 )                 | (112 )                     | 435            | (289 )            |
| Interest and investment income                                  | —                 | 41                     | 435                        | (435 )         | 41                |
| Other loss  | —                 | —                      | (2 )                       | —              | (2 )              |
| Income (loss) from continuing operations before income taxes    | (226 )            | (2,675 )               | 1,150                      | —              | (1,751 )          |
| Income tax (expense) benefit                                    | 43                | (785 )                 | (627 )                     | —              | (1,369 )          |
| Equity (deficit) in earnings in subsidiaries                    | (2,964 )          | 151                    | —                          | 2,813          | —                 |
| Income (loss) from continuing operations                        | (3,147 )          | (3,309 )               | 523                        | 2,813          | (3,120 )          |
| Loss from discontinued operations, net of tax                   | —                 | —                      | (27 )                      | —              | (27 )             |
| Net income (loss)   | (3,147 )          | (3,309 )               | 496                        | 2,813          | (3,147 )          |
| Loss attributable to noncontrolling interests                   | —                 | —                      | —                          | 7              | 7                 |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b> | <b>\$(3,147 )</b> | <b>\$(3,309 )</b>      | <b>) \$496</b>             | <b>\$2,820</b> | <b>\$(3,140 )</b> |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Consolidating Statement of Comprehensive Income (Loss)

For the Year Ended February 1, 2014

| millions   | Parent     | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|------------------------|----------------------------|--------------|--------------|
| Net income (loss)  | \$(1,116 ) | \$(1,145 )             | \$1,105                    | \$40         | \$(1,116 )   |
| <b>Other comprehensive income (loss):</b>                          |            |                        |                            |              |              |
| Pension and postretirement adjustments, net of tax                 | —          | 320                    | 102                        | —            | 422          |
| Deferred gain on derivatives, net of tax                           | 2          | —                      | —                          | —            | 2            |
| Currency translation adjustments, net of tax                       | 9          | —                      | (80 )                      | —            | (71 )        |
| Unrealized net loss, net of tax                                    | —          | (2 )                   | (213 )                     | 215          | —            |
| Total other comprehensive income (loss)                            | 11         | 318                    | (191 )                     | 215          | 353          |
| Comprehensive income (loss)  | (1,105 )   | (827 )                 | 914                        | 255          | (763 )       |
| Comprehensive income attributable to noncontrolling interest       | —          | —                      | —                          | (260 )       | (260 )       |
| Comprehensive income (loss) attributable to Holdings' shareholders | \$(1,105 ) | \$(827 )               | \$914                      | \$(5 )       | \$(1,023 )   |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Consolidating Statement of Comprehensive Income (Loss)

For the Year Ended February 2, 2013

| millions   | Parent     | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|------------------------|----------------------------|--------------|--------------|
| Net income (loss)  | \$(1,054 ) | \$(1,295 )             | \$446                      | \$849        | \$(1,054 )   |
| Other comprehensive income (loss):                                 |            |                        |                            |              |              |
| Pension and postretirement adjustments, net of tax                 | —          | 60                     | 14                         | —            | 74           |
| Deferred gain on derivatives, net of tax                           | 5          | —                      | —                          | —            | 5            |
| Currency translation adjustments, net of tax                       | 6          | —                      | (1 )                       | —            | 5            |
| Unrealized net gain (loss), net of tax                             | —          | (270 )                 | 177                        | 93           | —            |
| Total other comprehensive income (loss)                            | 11         | (210 )                 | 190                        | 93           | 84           |
| Comprehensive income (loss)  | (1,043 )   | (1,505 )               | 636                        | 942          | (970 )       |
| Comprehensive loss attributable to noncontrolling interest         | —          | —                      | —                          | 124          | 124          |
| Comprehensive income (loss) attributable to Holdings' shareholders | \$(1,043 ) | \$(1,505 )             | \$636                      | \$1,066      | \$(846 )     |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Consolidating Statement of Comprehensive Income (Loss)

For the Year Ended January 28, 2012

| millions   | Parent     | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|------------|---------------------------|-----------------------------------|--------------|--------------|
| Net income (loss)  | \$(3,147 ) | \$(3,309 )                | \$496                             | \$2,813      | \$(3,147 )   |
| Other comprehensive loss:  |            |                           |                                   |              |              |
| Pension and postretirement adjustments, net of tax                 | —          | (750 )                    | (39 )                             | —            | (789 )       |
| Deferred loss on derivatives, net of tax                           | (6 )       | —                         | —                                 | —            | (6 )         |
| Currency translation adjustments, net of tax                       | —          | —                         | (38 )                             | —            | (38 )        |
| Unrealized net gain (loss), net of tax                             | —          | 320                       | (320 )                            | —            | —            |
| Total other comprehensive loss                                     | (6 )       | (430 )                    | (397 )                            | —            | (833 )       |
| Comprehensive income (loss)  | (3,153 )   | (3,739 )                  | 99                                | 2,813        | (3,980 )     |
| Comprehensive loss attributable to noncontrolling interest         | —          | —                         | —                                 | 12           | 12           |
| Comprehensive income (loss) attributable to Holdings' shareholders | \$(3,153 ) | \$(3,739 )                | \$99                              | \$2,825      | \$(3,968 )   |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Cash Flows

For the Year Ended February 1, 2014

| millions   | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|--------|------------------------|----------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities          | \$—    | \$(2,344 )             | \$1,235                    | \$—          | \$(1,109 )   |
| Proceeds from sales of property and investments              | —      | 155                    | 840                        | —            | 995          |
| Net increase in investments and restricted cash              | —      | —                      | (2 )                       | —            | (2 )         |
| Purchases of property and equipment                          | —      | (258 )                 | (71 )                      | —            | (329 )       |
| Net investing with Affiliates                                | —      | —                      | 245                        | (245 )       | —            |
| Net cash provided by (used in) investing activities          | —      | (103 )                 | 1,012                      | (245 )       | 664          |
| Proceeds from debt issuances                                 | —      | 990                    | 4                          | —            | 994          |
| Repayments of long-term debt                                 | —      | (65 )                  | (18 )                      | —            | (83 )        |
| Increase in short-term borrowings, primarily 90 days or less | —      | 238                    | —                          | —            | 238          |
| Debt issuance costs  | —      | (14 )                  | —                          | —            | (14 )        |
| Sears Canada dividend paid to noncontrolling shareholders    | —      | 243                    | (476 )                     | —            | (233 )       |
| Intercompany dividend  | 604    | 92                     | (696 )                     | —            | —            |
| Net borrowing with Affiliates                                | (604 ) | 1,180                  | (821 )                     | 245          | —            |
| Net cash provided by (used in) financing activities          | —      | 2,664                  | (2,007 )                   | 245          | 902          |
| Effect of exchange rate changes on cash and cash equivalents | —      | —                      | (38 )                      | —            | (38 )        |
| NET DECREASE IN CASH AND CASH EQUIVALENTS                    | —      | 217                    | 202                        | —            | 419          |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR                 | —      | 320                    | 289                        | —            | 609          |
| CASH AND CASH EQUIVALENTS, END OF YEAR                       | \$—    | \$537                  | \$491                      | \$—          | \$1,028      |

**SEARS HOLDINGS CORPORATION**

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Cash Flows

For the Year Ended February 2, 2013

| millions   | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|--------|------------------------|----------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities              | \$—    | \$(1,356 )             | \$1,053                    | \$—          | \$(303 )     |
| Proceeds from sales of property and investments                  | —      | 353                    | 179                        | —            | 532          |
| Net decrease in investments and restricted cash                  | —      | —                      | 37                         | —            | 37           |
| Purchases of property and equipment                              | —      | (293 )                 | (85 )                      | —            | (378 )       |
| Net investing with Affiliates                                    | —      | —                      | (236 )                     | 236          | —            |
| Net cash provided by (used in) investing activities              | —      | 60                     | (105 )                     | 236          | 191          |
| Proceeds from debt issuances                                     | —      | —                      | 5                          | —            | 5            |
| Repayments of long-term debt                                     | —      | (214 )                 | (121 )                     | —            | (335 )       |
| Decrease in short-term borrowings, primarily 90 days or less     | —      | (81 )                  | —                          | —            | (81 )        |
| Sears Hometown and Outlet Stores, Inc. pre-separation funding    | —      | 100                    | —                          | —            | 100          |
| Intercompany dividend  | 100    | (100 )                 | —                          | —            | —            |
| Proceeds from the sale of Sears Hometown and Outlet Stores, Inc. | 347    | —                      | —                          | —            | 347          |
| Debt issuance costs  | —      | (3 )                   | —                          | —            | (3 )         |
| Purchase of Sears Canada shares                                  | —      | —                      | (10 )                      | —            | (10 )        |
| Sears Canada dividend paid to minority shareholders              | —      | 52                     | (102 )                     | —            | (50 )        |
| Net borrowing with Affiliates                                    | (447 ) | 1,526                  | (843 )                     | (236 )       | —            |
| Net cash provided by (used in) financing activities              | —      | 1,280                  | (1,071 )                   | (236 )       | (27 )        |
| Effect of exchange rate changes on cash and cash equivalents     | —      | —                      | 1                          | —            | 1            |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                 | —      | (16 )                  | (122 )                     | —            | (138 )       |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>              | —      | 336                    | 411                        | —            | 747          |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>                    | \$—    | \$320                  | \$289                      | \$—          | \$609        |

## SEARS HOLDINGS CORPORATION

## Notes to Consolidated Financial Statements—(Continued)

## Condensed Consolidating Statement of Cash Flows

For the Year Ended January 28, 2012

| millions  | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|--------|------------------------|----------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities – continuing operations   | \$—    | \$(1,506 )             | \$1,199                    | \$—          | \$(307 )     |
| Net cash provided by operating activities – discontinued operations           | —      | —                      | 32                         | —            | 32           |
| Net cash provided by (used in) operating activities                           | —      | (1,506 )               | 1,231                      | —            | (275 )       |
| Proceeds from sales of property and investments                               | —      | 72                     | —                          | —            | 72           |
| Net increase in investments and restricted cash                               | —      | —                      | 8                          | —            | 8            |
| Purchases of property and equipment   | —      | (342 )                 | (90 )                      | —            | (432 )       |
| Net investing with Affiliates   | —      | —                      | (275 )                     | 275          | —            |
| Net cash used in investing activities – continuing operations                 | —      | (270 )                 | (357 )                     | 275          | (352 )       |
| Net cash provided by investing activities – discontinued operations           | —      | —                      | 43                         | —            | 43           |
| Net cash used in investing activities   | —      | (270 )                 | (314 )                     | 275          | (309 )       |
| Proceeds from debt issuances  | —      | —                      | 104                        | —            | 104          |
| Repayments of long-term debt  | —      | (481 )                 | (130 )                     | —            | (611 )       |
| Increase in short-term borrowings, primarily 90 days or less                  | —      | 815                    | —                          | —            | 815          |
| Debt issuance costs   | —      | (35 )                  | —                          | —            | (35 )        |
| Purchase of Sears Canada shares   | —      | —                      | (43 )                      | —            | (43 )        |
| Purchase of treasury stock  | —      | (183 )                 | —                          | —            | (183 )       |
| Net borrowing with Affiliates   | (140 ) | 1,190                  | (775 )                     | (275 )       | —            |
| Net cash provided by (used in) financing activities – continuing operations   | (140 ) | 1,306                  | (844 )                     | (275 )       | 47           |
| Net cash provided by (used in) financing activities – discontinued operations | —      | 28                     | (103 )                     | —            | (75 )        |
| Net cash provided by (used in) financing activities                           | (140 ) | 1,334                  | (947 )                     | (275 )       | (28 )        |
| NET DECREASE IN CASH AND CASH EQUIVALENTS                                     | (140 ) | (442 )                 | (30 )                      | —            | (612 )       |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR                                  | 140    | 778                    | 441                        | —            | 1,359        |
| CASH AND CASH EQUIVALENTS, END OF YEAR  | \$—    | \$336                  | \$411                      | \$—          | \$747        |

**SEARS HOLDINGS CORPORATION**

Notes to Consolidated Financial Statements—(Continued)

**NOTE 21—SUBSEQUENT EVENT**

On March 14, 2014, the Company announced that its board of directors approved the previously announced separation of its Lands' End business by means of a spin-off transaction. To effect the spin-off, Sears Holdings will distribute all of the outstanding shares of common stock of Lands' End, Inc. on a pro rata basis to holders of Sears Holdings common stock, except that holders of Sears Holdings' restricted stock that is unvested as of the record date will receive cash awards in lieu of Lands' End shares. The cash awards granted to holders of Sears Holdings restricted stock will be subject to the same vesting requirements as the related restricted stock.

In connection with the spin-off, we expect Lands' End to enter into a \$515 million term loan and \$175 million revolving credit facility. The Company will receive a \$500 million dividend from Lands' End immediately prior to consummation of the spin-off. The transaction is expected to be completed in the first quarter of 2014 and we currently expect that the transaction will receive tax-free spin-off treatment.

Sears Holdings Corporation  
 Schedule II-Valuation and Qualifying Accounts  
 Years 2013, 2012 and 2011

| millions  | Balance at<br>beginning<br>of period | Additions<br>charged to<br>costs and<br>expenses | (Deductions) | Balance at<br>end of period |
|---|--------------------------------------|--|--------------|-----------------------------|
| <b>Allowance for Doubtful Accounts<sup>(1)</sup>:</b>   |                                      |  |              |                             |
| 2013  | \$28                                 | \$6  | \$(2 )       | \$32                        |
| 2012  | 28                                   | 5  | (5 )         | 28                          |
| 2011  | 35                                   | 1  | (8 )         | 28                          |
| <b>Allowance for Deferred Tax Assets<sup>(2)</sup>:</b> |                                      |  |              |                             |
| 2013  | 2,743                                | 726  | (103 )       | 3,366                       |
| 2012  | 2,268                                | 531  | (56 )        | 2,743                       |
| 2011  | 153                                  | 2,118  | (3 )         | 2,268                       |

<sup>(1)</sup> Charges to the account are for the purposes for which the reserves were created.

At the end of 2012 we had a federal and state net operating loss (“NOL”) deferred tax asset of \$722 million and a valuation allowance of \$2.7 billion. In 2013, there was a net increase to the federal and state NOL deferred tax asset of \$465 million, bringing the ending balance to \$1.2 billion. The increase in NOLs resulted from additional federal and state losses incurred during 2013, netted against state NOL expirations. The valuation allowance increased by \$623 million to \$3.4 billion at the end of 2013. Additional valuation allowances for federal and state were created against NOLs, Kmart state separate entity deferred tax assets, and other deferred tax assets, and were netted against state valuation allowance reversals due to expiring state NOLs.

## MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Sears Holdings Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting at February 1, 2014. In making its assessment, management used the criteria set forth in the Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The assessment included the documentation and understanding of the Company's internal control over financial reporting.

Management evaluated the design effectiveness and tested the operating effectiveness of internal controls over financial reporting to form its conclusion.

Based on this evaluation, management concluded that, at February 1, 2014, the Company's internal control over financial reporting is effective to provide reasonable assurance that the Company's financial statements are fairly presented in conformity with generally accepted accounting principles.

Deloitte & Touche LLP, independent registered public accounting firm, has reported on the effectiveness of the Company's internal control over financial reporting at February 1, 2014, as stated in their report included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
To the Board of Directors and Shareholders of Sears Holdings Corporation  
Hoffman Estates, Illinois

We have audited the accompanying consolidated balance sheets of Sears Holdings Corporation and subsidiaries (the "Company") as of February 1, 2014 and February 2, 2013, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for each of the three years in the period ended February 1, 2014. Our audits also included the consolidated financial statement schedule listed in the Index at Item 8. We also have audited the Company's internal control over financial reporting as of February 1, 2014, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and financial statement schedule and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Sears Holdings Corporation and subsidiaries as of February 1, 2014 and February 2, 2013, and the results of their operations and their cash flows for each of the three years in the period ended February 1, 2014, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting.



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as of February 1, 2014, based on the criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As disclosed in Note 1 to the Consolidated Financial Statements, the Company completed the spin-off of Orchard Supply Hardware Stores Corporation during 2011.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Chicago, Illinois

March 18, 2014

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SEARS HOLDINGS CORPORATION

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

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

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

Item 9B. Other Information

Not applicable.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

Information required by Item 10 with respect to directors, the audit committee, audit committee financial experts and Section 16(a) beneficial ownership reporting compliance is included under the headings “Item 1. Election of Directors,” “Committees of the Board of Directors,” “Director Independence” and “Section 16(a) Beneficial Ownership Reporting Compliance” of our definitive proxy statement for our annual meeting of stockholders to be held on May 6, 2014 (the “2014 Proxy Statement.”) and is incorporated herein by reference.

The information required by this Item 10 regarding the Company's executive officers is set forth under the heading “Executive Officers of the Registrant” in Part I of this Form 10-K and is incorporated herein by reference.

Holdings has adopted a Code of Conduct, which applies to all employees, including our principal executive officer, principal financial officer and principal accounting officer, and a Code of Conduct for its Board of Directors.

Directors who are also officers of Holdings are subject to both codes of conduct. Each code of conduct is a code of ethics as defined in Item 406 of SEC Regulation S-K. The codes of conduct are available on the Corporate Governance section of our website at [www.searsholdings.com](http://www.searsholdings.com). Any amendment to, or waiver from, a provision of the codes of conduct will be posted to the above-referenced website.

There were no changes to the process by which stockholders may recommend nominees to the Board of Directors during the last year.

### Item 11. Executive Compensation

Information regarding executive and director compensation is incorporated by reference to the material under the headings “Executive Compensation,” “Compensation of Directors,” and “Compensation Committee Report” of the 2014 Proxy Statement.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the material under the heading “Amount and Nature of Beneficial Ownership” of the 2014 Proxy Statement.

See also “Equity Compensation Plan Information” in Item 5 of this Report for a discussion of securities authorized for issuance under equity compensation plans.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions and director independence is incorporated herein by reference to the material under the headings “Certain Relationships and Transactions,” “Review and Approval of Transactions with Related Persons” and “Corporate Governance” of the 2014 Proxy Statement.

### Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services is incorporated herein by reference to the material under the heading “Independent Registered Public Accounting Firm Fees” of the 2014 Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)The following documents are filed as part of this report:

1.Financial Statements

Financial statements filed as part of this Form 10-K are listed under Item 8.

2.Financial Statement Schedule

The financial statement schedule filed as part of this Form 10-K is listed under Item 8.

The separate financial statements and summarized financial information of majority-owned subsidiaries not consolidated and of 50% or less owned persons have been omitted because they are not required pursuant to conditions set forth in Rules 3-09 and 1-02(w) of Regulation S-X.

All other schedules have been omitted because they are not required under the instructions contained in Regulation S-X because the information called for is contained in the financial statements and notes thereto.

(b)Exhibits

An "Exhibit Index" has been filed as part of this Report beginning on Page E-1 and is incorporated herein by this reference.

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

By: /S/ ROBERT A. RIECKER

Name: Robert A. Riecker

Title: Vice President, Controller and  
Chief Accounting Officer

Date: March 18, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities stated and on the dates indicated.

\* EDWARD S. LAMPERT

Edward S. Lampert

Director, Chairman of the Board of Directors, March 18, 2014  
and Chief Executive Officer (principal executive officer)

\* ROBERT A. SCHRIESHEIM

Robert A. Schriesheim

Executive Vice President and Chief Financial Officer (principal financial officer) March 18, 2014

\* ROBERT A. RIECKER

Robert A. Riecker

Vice President, Controller and Chief Accounting Officer (principal accounting officer) March 18, 2014

\* CESAR L. ALVAREZ

Cesar L. Alvarez

Director March 18, 2014

\* PAUL G. DEPODESTA

Paul G. DePodesta

Director March 18, 2014

\* WILLIAM C. KUNKLER, III

William C. Kunkler, III

Director March 18, 2014

\* STEVEN T. MNUCHIN

Steven T. Mnuchin

Director March 18, 2014

\* ANN N. REESE

Ann N. Reese

Director March 18, 2014

\* THOMAS J. TISCH

Thomas J. Tisch

Director March 18, 2014

By /S/ ROBERT A. RIECKER

\* Robert A. Riecker

Individually and as Attorney-in-fact



EXHIBIT INDEX

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000-51217)).
- 3.2 Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated January 22, 2014, filed on January 24, 2014 (File No. 000-51217)).
- 4.1 Registrant hereby agrees to furnish to the Commission, upon request, the instruments defining the rights of holders of each issue of long-term debt of Registrant and its consolidated subsidiaries.
- 4.2 Indenture, dated as of October 12, 2010, among Sears Holdings Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as Trustee and Collateral Agent (incorporated by reference to Exhibit 4.1 to Registrant's Current Report on Form 8-K, dated October 12, 2010, filed on October 15, 2010 (File No. 000-51217)).
- 4.3 Security Agreement, dated as of October 12, 2010, among Sears Holdings Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as Collateral Agent (incorporated by reference to Exhibit 4.2 to Registrant's Current Report on Form 8-K, dated October 12, 2010, filed on October 15, 2010 (File No. 000-51217)).
- 4.4 Intercreditor Agreement, dated as of October 12, 2010, among Bank of America, N.A., Wells Fargo Retail Finance, LLC and General Electric Capital Corporation, as ABL Agents, and Wells Fargo Bank, National Association, as Second Lien Agent (incorporated by reference to Exhibit 4.3 to Registrant's Current Report on Form 8-K, dated October 12, 2010, filed on October 15, 2010 (File No. 000-51217)).
- 4.5 Registration Rights Agreement, dated as of October 12, 2010, by and among Sears Holdings Corporation and the guarantors party thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 4.4 to Registrant's Current Report on Form 8-K, dated October 12, 2010, filed on October 15, 2010 (File No. 000-51217)).
- 4.6 Registration Rights Agreement, dated as of October 12, 2010, by and among Sears Holdings Corporation and the guarantors party thereto, Sears Holdings Corporation Investment Committee on behalf of the Sears Holdings Pension Plan and Sears Holdings Pension Trust (incorporated by reference to Exhibit 4.5 to Registrant's Current Report on Form 8-K, dated October 12, 2010, filed on October 15, 2010 (File No. 000-51217)).
- 10.1 Guarantee executed by Sears, Roebuck and Co. under the Indenture, dated as of May 15, 1995, between Sears Roebuck Acceptance Corp. and JP Morgan Chase Bank (successor to The Chase Manhattan Bank, N.A.), as supplemented by the First Supplemental Indenture, dated as of November 3, 2003 (incorporated by reference to Exhibit 4(g) to Sears Roebuck Acceptance Corp.'s Quarterly Report on Form 10-Q for the fiscal quarter ended September 27, 2003 (File No. 1-4040)).
- 10.2 Guarantee executed by Sears, Roebuck and Co. under the Indenture, dated as of October 1, 2002, between Sears Roebuck Acceptance Corp. and BNY Midwest Trust Company, as supplemented by the First Supplemental Indenture, dated as of November 3, 2003 (incorporated by reference to Exhibit 4(h) to Sears Roebuck Acceptance Corp.'s Quarterly Report on Form 10-Q for the fiscal quarter ended September 27, 2003 (File No. 1-4040)).

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10.3      Guarantee dated as of November 3, 2003 by Sears, Roebuck and Co. of the commercial paper master notes of Sears Roebuck Acceptance Corp. (incorporated by reference to Exhibit 10.38 to Sears, Roebuck and Co.'s Annual Report on Form 10-K for the fiscal year ended January 3, 2004 (File No. 1-416)).

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- 10.4 Second Amended and Restated Credit Agreement, dated as of April 8, 2011, among Sears Holdings Corporation, Sears Roebuck Acceptance Corp., Kmart Corporation, the lenders party thereto, Wells Fargo Bank, National Association and General Electric Capital Corporation, as Co-Collateral Agents, Wells Fargo Capital Finance, LLC and General Electric Capital Corporation, as Co-Syndication Agents, Barclays Bank PLC, JPMorgan Chase Bank, N.A. and Citigroup Global Markets Inc. as Co-Documentation Agents, and Bank of America, N.A. as Agent, Co-Collateral Agent and Swingline Lender (incorporated by reference to Exhibit 10.3 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011 (File No. 000-51217)).<sup>(1)</sup>
- 10.5 First Amendment to the Second Amended and Restated Credit Agreement, dated as of October 2, 2013, between Sears Holdings Corporation, Sears Roebuck Acceptance Corp. and Kmart Corporation, the Revolving Lenders party thereto, the Term Lenders party thereto, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10 to Registrant's Current Report on Form 8-K dated October 2, 2013, filed on October 2, 2013 (File No. 000-51217)).
- 10.6 Second Amended and Restated Guarantee and Collateral Agreement, dated as of April 8, 2011, among Sears Holdings Corporation, Sears, Roebuck and Co., Sears Roebuck Acceptance Corp., Kmart Holding Corporation, Kmart Corporation and certain of their respective subsidiaries, as Grantors, and Bank of America, N.A., Wells Fargo Bank, National Association 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 April 30, 2011 (File No. 000-51217)).
- 10.7 Purchase, Sale and Servicing Transfer Agreement, dated as of July 15, 2003, by and among Sears, Roebuck and Co., certain subsidiaries of Sears, Roebuck and Co. and Citicorp (incorporated by reference to Exhibit 10.1 to Sears, Roebuck and Co.'s Current Report on Form 8-K, dated July 15, 2003, filed on July 17, 2003 (File No. 1-416)).
- 10.8 Amendment No. 1, dated as of November 3, 2003, to the Purchase, Sale and Servicing Transfer Agreement, by and among Sears, Roebuck and Co., certain subsidiaries of Sears, Roebuck and Co. and Citicorp (incorporated by reference to Exhibit 2(b) to Sears, Roebuck and Co.'s Quarterly Report on Form 10-Q for the fiscal quarter ended September 27, 2003 (File No. 1-416)).
- 10.9 Amended and Restated Program Agreement, dated as of July 15, 2003, amended and restated as of November 3, 2003, by and between Sears, Roebuck and Co., Sears Intellectual Property Management Company and Citibank (USA) N.A. (incorporated by reference to Exhibit 10(a) to Sears, Roebuck and Co.'s Quarterly Report on Form 10-Q for the fiscal quarter ended September 27, 2003 (File No. 1-416)).
- 10.10 Terms Sheet For Revision of Program Agreement Between Sears, Roebuck and Co. and Citibank USA, N.A., dated April 29, 2005 (incorporated by reference to Exhibit 10.40 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2005 (File No. 000-51217)).
- 10.11 Sears Holdings Corporation Director Compensation Program, as amended (incorporated by reference to Exhibit 10.5 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended May 1, 2010 (File No. 000-51217)).\*\*
- 10.12 Sears Holdings Corporation 2006 Stock Plan, as amended (incorporated by reference to Appendix C to Registrant's Proxy Statement dated March 15, 2006 (File No. 00051217)).\*\*
- 10.13

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Sears Holdings Corporation 2013 Stock Plan (incorporated by reference to Appendix A to Registrant's Proxy Statement dated March 28, 2013 (File No. 00051217)).\*\*

- 10.14 Sears Holdings Corporation Amended and Restated Umbrella Incentive Program (incorporated by reference to Appendix C to Registrant's Proxy Statement dated March 28, 2013 (File No. 00051217)).\*\*
- 10.15 Amendment to the Performance Measures under the Amended and Restated Sears Holdings Corporation Umbrella Incentive Program (incorporated by reference to Appendix B to Registrant's Proxy Statement dated March 28, 2013 (File No. 00051217)).\*\*
- 10.16 Form of Sears Holdings Corporation Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 2011(File No. 000-51217)).\*\*

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- \*10.17 Form of Sears Holdings Corporation Restricted Stock Award Agreement: Terms and Conditions.\*\*
- \*10.18 Form of Sears Holdings Corporation Restricted Stock Unit Award Agreement: Terms and Conditions.\*\*
- 10.19 Form of Cash Right - Addendum to Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.17 to Registrant's Annual Report on Form 10-K for the fiscal year ended January 28, 2012 (the "2011 10-K")).\*\*
- 10.20 Form of Cash Award - Addendum to Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated September 28, 2012, filed on September 28, 2012 (File No. 000-51217)).\*\*
- 10.21 Form of Cash Award - Addendum to Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated November 30, 2012, filed on November 30, 2012 (File No. 000-51217)).\*\*
- 10.22 Form of LTIP Award Agreement (incorporated by reference to Exhibit 10.45 to the 2006 10-K) (File No. 000-51217).\*\*
- 10.23 Sears Holdings Corporation Long-Term Incentive Program, effective April 27, 2011 (incorporated by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011 (File No. 000-51217)).\*\*
- 10.24 2012 Additional Definitions under the Sears Holdings Corporation Long-Term Incentive Program (incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K, dated September 15, 2012, filed on September 20, 2012 (File No. 000-51217)).\*\*
- 10.25 2013 Additional Definitions under Sears Holdings Corporation Long-Term Incentive Program (Amended and Restated Effective February 12, 2013) (incorporated by reference to Exhibit 10.3 to Registrant's Current Report on Form 8-K, dated February 12, 2013, filed on February 19, 2013 (File No. 000-51217)).\*\*
- 10.26 Sears Holdings Corporation Cash Long-Term Incentive Plan (Effective February 12, 2013) (incorporated by reference to Exhibit 10.4 to Registrant's Current Report on Form 8-K, dated February 12, 2013, filed on February 19, 2013 (File No. 000-51217)).\*\*
- 10.27 Sears Holdings Corporation Annual Incentive Plan (Amended and Restated Effective February 12, 2013) (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated February 12, 2013, filed on February 19, 2013 (File No. 000-51217)).\*\*
- 10.28 2013 Additional Definitions under Sears Holdings Corporation Annual Incentive Plan (Amended and Restated Effective February 12, 2013) (incorporated by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K, dated February 12, 2013, filed on February 19, 2013 (File No. 000-51217)).\*\*
- \*10.29 Form of Executive Severance Agreement\*\*
- 10.30 Form of letter from Registrant to Edward S. Lampert relating to employment dated March 18, 2013 (incorporated by reference to Exhibit 10.30 to Registrant's Annual Report on Form 10-K for the fiscal year ended February 2, 2013 (the "2012 10-K")).\*\*

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- \*10.31 Letter from Registrant to Jeffrey A. Balagna relating to employment dated April 26, 2013.\*\*
- 10.32 Letter from Registrant to Ronald D. Boire relating to employment dated February 10, 2012 (incorporated by reference to Exhibit 10.38 to the 2011 10-K).\*\*
- 10.33 Executive Severance Agreement, dated and effective as of January 8, 2012, between Sears Holdings Corporation and its affiliates and subsidiaries and Ronald D. Boire (incorporated by reference to Exhibit 10.39 to the 2011 10-K).\*\*<sup>(1)</sup>

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- 10.34 Letter from Registrant to Imran Jooma relating to employment dated December 20, 2011(incorporated by reference to Exhibit 10.35 to the 2012 10-K).\*\*
- 10.35 Letter from Registrant to Imran Jooma relating to employment dated February 5, 2013 (incorporated by reference to Exhibit 10.36 to the 2012 10-K).\*\*
- 10.36 Letter from Registrant to Robert A. Schriesheim relating to employment dated August 15, 2011 (incorporated by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 2011(File No. 000-51217)).\*\*
- 10.37 Executive Severance Agreement, dated and effective as of August 16, 2011, between Sears Holdings Corporation and its affiliates and subsidiaries and Robert A. Schriesheim (incorporated by reference to Exhibit 10.3 to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 2011(File No. 000-51217))).\*\*<sup>(1)</sup>
- \*12 Computation of ratio of earnings to fixed charges for Registrant and consolidated subsidiaries.
- \*21 Subsidiaries of the Registrant.
- \*23 Consent of Deloitte & Touche LLP.
- \*24 Powers of Attorney of certain officers and directors of Registrant.
- \*31.1 Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*31.2 Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following financial information from the Annual Report on Form 10-K for the year ended February 1, 2014, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Statements of Operations for the years ended February 1, 2014, February 2, 2013 and January 28, 2012; (ii) the Consolidated Statements of Comprehensive Income (Loss) for the years ended February 1, 2014, February 2, 2013 and January 28, 2012; (iii) the Consolidated Balance Sheets at February 1, 2014 and February 2, 2013; (iv) the Consolidated Statements of Cash Flows for the years ended February 1, 2014, February 2, 2013 and January 28, 2012; (v) the Consolidated Statements of Equity for the years ended February 1, 2014, February 2, 2013 and January 28, 2012; and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text and including detailed tags.

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\* Filed herewith

\*\* A management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 15(b) of Form 10-K.

(1) Confidential treatment was granted as to omitted portions of this Exhibit. The omitted material has been filed separately with the Securities and Exchange Commission.