

SEARS HOLDINGS CORP  
Form 10-Q  
May 24, 2013

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MAY 4, 2013

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 000-51217  
SEARS HOLDINGS CORPORATION  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State of Incorporation) 20-1920798  
(I.R.S. Employer Identification No.)

3333 BEVERLY ROAD, HOFFMAN ESTATES,  
ILLINOIS 60179  
(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Yes  No

As of May 17, 2013, the registrant had 106,407,219 common shares, \$0.01 par value, outstanding.

SEARS HOLDINGS CORPORATION  
 INDEX TO QUARTERLY REPORT ON FORM 10-Q  
 13 Weeks Ended May 4, 2013 and April 28, 2012

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SEARS HOLDINGS CORPORATION  
Condensed Consolidated Statements of Operations  
(Unaudited)

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

|  | 13 Weeks Ended |                   |
|--|----------------|-------------------|
| millions, except per share data  | May 4,<br>2013 | April 28,<br>2012 |
| <b>REVENUES</b>  |                |                   |
| Merchandise sales and services   | \$8,452        | \$9,270           |
| <b>COSTS AND EXPENSES</b>  |                |                   |
| Cost of sales, buying and occupancy  | 6,296          | 6,703             |
| Selling and administrative   | 2,218          | 2,445             |
| Depreciation and amortization  | 191            | 202               |
| Impairment charges   | 8              | —                 |
| Gain on sales of assets  | (14            | ) (395            |
| Total costs and expenses   | 8,699          | 8,955             |
| Operating income (loss)  | (247           | ) 315             |
| Interest expense   | (61            | ) (66             |
| Interest and investment income   | 7              | 12                |
| Income (loss) before income taxes  | (301           | ) 261             |
| Income tax (expense) benefit   | 9              | (67               |
| Net income (loss)  | (292           | ) 194             |
| (Income) loss attributable to noncontrolling interests                           | 13             | (5                |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b>                  | <b>\$(279</b>  | <b>) \$189</b>    |
| <b>NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b> |                |                   |
| Basic earnings (loss) per share  | \$(2.63        | ) \$1.78          |
| Diluted earnings (loss) per share  | \$(2.63        | ) \$1.78          |
| Basic weighted average common shares outstanding                                 | 106.0          | 105.9             |
| Diluted weighted average common shares outstanding                               | 106.0          | 106.1             |

See accompanying notes.

## SEARS HOLDINGS CORPORATION

## Condensed Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

| millions   | 13 Weeks Ended |                   |
|--|----------------|-------------------|
|  | May 4,<br>2013 | April 28,<br>2012 |
| Net income (loss)  | \$ (292 )      | \$ 194            |
| Other comprehensive income   |                |                   |
| Pension and postretirement adjustments, net of tax                   | 46             | 46                |
| Deferred gain on derivatives, net of tax                             | —              | 2                 |
| Currency translation adjustments, net of tax                         | (7 )           | (6 )              |
| Total other comprehensive income                                     | 39             | 42                |
| Comprehensive income (loss)  | (253 )         | 236               |
| Comprehensive (income) loss attributable to noncontrolling interests | 14             | (6 )              |
| Comprehensive income (loss) attributable to Holdings' shareholders   | \$ (239 )      | \$ 230            |
| See accompanying notes.  |                |                   |

SEARS HOLDINGS CORPORATION  
Condensed Consolidated Balance Sheets

| millions  | (Unaudited)     |                   |                     |
|---|-----------------|-------------------|---------------------|
|   | May 4,<br>2013  | April 28,<br>2012 | February 2,<br>2013 |
| <b>ASSETS</b>   |                 |                   |                     |
| Current assets  |                 |                   |                     |
| Cash and cash equivalents   | \$471           | \$777             | \$ 609              |
| Restricted cash   | 10              | 7                 | 9                   |
| Accounts receivable   | 608             | 644               | 635                 |
| Merchandise inventories   | 7,900           | 8,817             | 7,558               |
| Prepaid expenses and other current assets                           | 462             | 383               | 454                 |
| Total current assets  | 9,451           | 10,628            | 9,265               |
| Property and equipment, net   | 5,910           | 6,436             | 6,053               |
| Goodwill  | 379             | 841               | 379                 |
| Trade names and other intangible assets                             | 2,871           | 2,922             | 2,881               |
| Other assets  | 785             | 780               | 762                 |
| <b>TOTAL ASSETS</b>   | <b>\$19,396</b> | <b>\$21,607</b>   | <b>\$ 19,340</b>    |
| <b>LIABILITIES</b>  |                 |                   |                     |
| Current liabilities   |                 |                   |                     |
| Short-term borrowings <sup>(1)</sup>                                | \$1,754         | \$1,103           | \$ 1,094            |
| Current portion of long-term debt and capitalized lease obligations | 72              | 151               | 83                  |
| Merchandise payables  | 2,862           | 3,258             | 2,761               |
| Other current liabilities   | 2,403           | 2,885             | 2,683               |
| Unearned revenues   | 922             | 961               | 931                 |
| Other taxes   | 440             | 511               | 480                 |
| Short-term deferred tax liabilities                                 | 382             | 518               | 382                 |
| Total current liabilities   | 8,835           | 9,387             | 8,414               |
| Long-term debt and capitalized lease obligations <sup>(2)</sup>     | 1,929           | 1,975             | 1,943               |
| Pension and postretirement benefits                                 | 2,638           | 2,666             | 2,730               |
| Other long-term liabilities   | 2,107           | 2,134             | 2,126               |
| Long-term deferred tax liabilities                                  | 966             | 867               | 955                 |
| Total Liabilities   | 16,475          | 17,029            | 16,168              |
| Commitments and contingencies                                       |                 |                   |                     |
| <b>EQUITY</b>   |                 |                   |                     |
| Total Equity  | 2,921           | 4,578             | 3,172               |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                 | <b>\$19,396</b> | <b>\$21,607</b>   | <b>\$ 19,340</b>    |

<sup>(1)</sup> Includes \$305 million, \$225 million and \$285 million at May 4, 2013, April 28, 2012 and February 2, 2013, respectively, of unsecured commercial paper held by ESL and its affiliates.

<sup>(2)</sup> Includes \$95 million of senior secured notes and \$3 million of subsidiary notes held by ESL and its affiliates at both May 4, 2013 and February 2, 2013. Includes \$95 million of senior secured notes and \$4 million of subsidiary notes held by ESL and its affiliates at April 28, 2012.

See accompanying notes.

SEARS HOLDINGS CORPORATION  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

| millions  | 13 Weeks Ended |                   |
|---|----------------|-------------------|
|   | May 4,<br>2013 | April 28,<br>2012 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                |                   |
| Net income (loss)   | \$ (292 )      | \$ 194            |
| Adjustments to reconcile net income (loss) to net cash used in operating activities:    |                |                   |
| Depreciation and amortization   | 191            | 202               |
| Impairment charges  | 8              | —                 |
| Gain on sales of assets   | (14 )          | (395 )            |
| Pension and postretirement plan contributions   | (89 )          | (86 )             |
| Settlement of Canadian dollar hedges  | —              | (17 )             |
| Change in operating assets and liabilities (net of acquisitions and dispositions):      |                |                   |
| Deferred income taxes   | (1 )           | 72                |
| Merchandise inventories   | (350 )         | (394 )            |
| Merchandise payables  | 105            | 338               |
| Income and other taxes  | (60 )          | (8 )              |
| Mark-to-market adjustments and settlements on Sears Canada U.S. dollar collar contracts | —              | (1 )              |
| Other operating assets  | 18             | 19                |
| Other operating liabilities   | (229 )         | 17                |
| Net cash used in operating activities   | (713 )         | (59 )             |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                |                   |
| Proceeds from sales of property and investments   | 5              | 446               |
| Net (increase) decrease in investments and restricted cash                              | (1 )           | 1                 |
| Purchases of property and equipment   | (60 )          | (80 )             |
| Net cash provided by (used in) investing activities                                     | (56 )          | 367               |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                |                   |
| Proceeds from debt issuances  | 1              | 1                 |
| Repayments of long-term debt  | (28 )          | (211 )            |
| Increase (decrease) in short-term borrowings, primarily 90 days or less                 | 660            | (72 )             |
| Purchase of Sears Canada shares   | —              | (3 )              |
| Net cash provided by (used in) financing activities                                     | 633            | (285 )            |
| Effect of exchange rate changes on cash and cash equivalents                            | (2 )           | 7                 |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                             | <b>(138 )</b>  | <b>30</b>         |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>                                     | <b>609</b>     | <b>747</b>        |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>   | <b>\$471</b>   | <b>\$777</b>      |
| Supplemental Cash Flow Data:  |                |                   |
| Income taxes paid, net of refunds   | \$ 16          | \$ 1              |
| Cash interest paid  | 68             | 71                |
| Unpaid liability to acquire equipment and software                                      | 26             | 38                |
| See accompanying notes.   |                |                   |

SEARS HOLDINGS CORPORATION  
Condensed Consolidated Statements of Equity  
(Unaudited)

| millions   | Equity Attributable to Holdings' Shareholders |              |                |                                |                   |   |                          | Total    |
|--|---|--------------|----------------|--------------------------------|-------------------|---|--------------------------|----------|
|  | Number of Shares                              | Common Stock | Treasury Stock | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests |          |
| Balance at January 28, 2012                        | 106   | \$ 1         | \$(5,981)      | \$ 10,005                      | \$ 1,865          | \$ (1,609)                                    | \$ 60                    | \$ 4,341 |
| Comprehensive income                               |   |              |                |                                |                   |   |                          |          |
| Net income   | —   | —            | —              | —                              | 189               | —   | 5                        | 194      |
| Pension and postretirement adjustments, net of tax | —   | —            | —              | —                              | —                 | 45  | 1                        | 46       |
| Deferred gain on derivatives, net of tax           | —   | —            | —              | —                              | —                 | 2   | —                        | 2        |
| Currency translation adjustments, net of tax       | —   | —            | —              | —                              | —                 | (6)   | —                        | (6)      |
| Total Comprehensive Income                         |   |              |                |                                |                   |   |                          | 236      |
| Stock awards                                       | —   | —            | 9              | (6)                            | —                 | —   | —                        | 3        |
| Purchase of Sears Canada shares                    | —   | —            | —              | (1)                            | —                 | —   | (2)                      | (3)      |
| Associate stock purchase                           | —   | —            | 1              | —                              | —                 | —   | —                        | 1        |
| Balance at April 28, 2012                          | 106   | \$ 1         | \$(5,971)      | \$ 9,998                       | \$ 2,054          | \$ (1,568)                                    | \$ 64                    | \$ 4,578 |
| Balance at February 2, 2013                        | 106   | \$ 1         | \$(5,970)      | \$ 9,298                       | \$ 885            | \$ (1,459)                                    | \$ 417                   | \$ 3,172 |
| Comprehensive loss                                 |   |              |                |                                |                   |   |                          |          |
| Net loss   | —   | —            | —              | —                              | (279)             | —   | (13)                     | (292)    |
| Pension and postretirement adjustments, net of tax | —   | —            | —              | —                              | —                 | 44  | 2                        | 46       |
| Currency translation adjustments, net of tax       | —   | —            | —              | —                              | —                 | (4)   | (3)                      | (7)      |
| Total Comprehensive Loss                           |   |              |                |                                |                   |   |                          | (253)    |
| Stock awards                                       | —   | —            | (1)            | 2                              | —                 | —   | —                        | 1        |
| Associate stock purchase                           | —   | —            | 1              | —                              | —                 | —   | —                        | 1        |
| Balance at May 4, 2013                             | 106   | \$ 1         | \$(5,970)      | \$ 9,300                       | \$ 606            | \$ (1,419)                                    | \$ 403                   | \$ 2,921 |

See accompanying notes.

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1 – 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 2,009 full-line and 53 specialty retail stores in the United States, operating through Kmart and Sears, and 461 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. These interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full fiscal year. The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. These interim financial statements and related notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

Depreciation Expense

Depreciation expense included within depreciation and amortization expense reported on the Condensed Consolidated Statements of Operations was \$181 million and \$189 million for the 13-week periods ended May 4, 2013 and April 28, 2012, respectively.

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. 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 Sears Hometown and Outlet Stores, Inc. (“SHO”) as a result of exercising subscription rights pursuant to the rights offering. Accordingly, we classified the difference between the proceeds received and 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 13. 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 the Sears Hometown and Outlet businesses through the date of the separation are presented within the consolidated operations of Holdings and the Sears Domestic segment in the accompanying Condensed Consolidated Financial Statements. Additionally, the Company has guaranteed lease obligations for certain SHO store leases that were assigned as a result of the separation. See Note 13 to the Condensed Consolidated Financial Statements for further information related to the agreements with SHO.



## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## NOTE 2 – BORROWINGS

Total borrowings were as follows:

| millions                                   | May 4,<br>2013 | April 28,<br>2012 | February 2,<br>2013 |
|--|----------------|-------------------|---------------------|
| Short-term borrowings:                     |                |                   |                     |
| Unsecured commercial paper                 | \$ 377         | \$ 302            | \$ 345              |
| Secured borrowings                         | 1,377          | 801               | 749                 |
| Long-term debt, including current portion: |                |                   |                     |
| Notes and debentures outstanding           | 1,582          | 1,669             | 1,593               |
| Capitalized lease obligations              | 419            | 457               | 433                 |
| Total borrowings                           | \$ 3,755       | \$ 3,229          | \$ 3,120            |

The fair value of long-term debt, excluding capitalized lease obligations, was \$1.5 billion at May 4, 2013 and \$1.4 billion at both April 28, 2012 and 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 3 to the Condensed Consolidated Financial Statements.

## Unsecured Commercial Paper

We borrow through the commercial paper markets. At May 4, 2013, April 28, 2012 and February 2, 2013, we had outstanding commercial paper borrowings of \$377 million, \$302 million and \$345 million, respectively. ESL held \$305 million, \$225 million and \$285 million, respectively, of our commercial paper at May 4, 2013, April 28, 2012 and February 2, 2013, including \$178 million, \$123 million and \$169 million, respectively, held by Edward S. Lampert. See Note 13 for further discussion of these borrowings.

## Domestic Credit Agreement

During the first quarter of 2011, we entered into a \$3.275 billion credit agreement (the “Domestic Credit Agreement”) which expires in April 2016. We view this credit facility as our most cost efficient funding mechanism and therefore use it as a primary source of funding.

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 Domestic Credit Agreement includes a \$1.5 billion letter of credit sub-limit and an uncommitted accordion feature that provides us the flexibility, subject to certain terms and conditions, to use the existing collateral under the credit facility to obtain an aggregate amount of up to \$1.0 billion in additional borrowing capacity if we so choose. The Domestic Credit Agreement permits aggregate second lien indebtedness of up to \$2.0 billion, of which \$1.2 billion second lien notes were outstanding at May 4, 2013, providing the Company the capacity to issue up to an additional \$760 million in second lien indebtedness. The Domestic Credit Agreement is in place as a funding source for general corporate purposes and is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. (“SRAC”) and Kmart Corporation are the borrowers. The Domestic Credit Agreement 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 Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, under certain circumstances, including if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements, which take effect if availability falls below designated thresholds,



## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

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 May 4, 2013, April 28, 2012 and February 2, 2013, we had \$1.4 billion, \$801 million and \$749 million, respectively, of borrowings and \$747 million, \$694 million and \$754 million, respectively, of letters of credit outstanding under the Domestic Credit Agreement. As a result, our availability under the agreement was \$1.2 billion at May 4, 2013, and \$1.8 billion at both April 28, 2012 and February 2, 2013. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

## Senior Secured Notes

In October 2010, we sold \$1 billion aggregate principal amount of senior secured notes (the “Notes”), which bear interest at 6 5/8% per annum and mature on October 15, 2018. Concurrent with the closing of the sale of the Notes, the Company sold \$250 million aggregate principal amount of Notes to the Company’s domestic pension plan in a private placement. The Notes are guaranteed by certain subsidiaries of the Company and are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables (the “Collateral”). The lien that secures the Notes is junior in priority to the lien on such assets that secures obligations under the 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 account and credit card receivables, subject to certain limitations. At May 4, 2013, April 28, 2012 and February 2, 2013, we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$602 million (\$607 million Canadian), \$592 million (\$581 million Canadian) and \$503 million (\$502 million Canadian), respectively, at May 4, 2013, April 28, 2012 and February 2, 2013. The current availability may be reduced by reserves currently estimated by the Company to be \$440 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 \$150 million the lenders could apply. The potential additional reserve amount may increase or decrease in the future based on estimated net pension liabilities.

## 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

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## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

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 utilizes two securitization structures to issue specific securities in which Sears Re invests 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 securities that are secured by the mortgages and collateral assignments of the store leases. Sears Re and two other indirect wholly owned subsidiaries of Holdings own \$1.3 billion (par value) of these mortgage-backed securities. Payments to Sears Re on these 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 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 Sears Re on these asset-backed securities are funded by the royalty payments. The issuers of these mortgage-backed and asset-backed 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. Since the inception of the REMIC and KCD IP, LLC, these mortgage-backed and asset-backed securities have been entirely held by our wholly owned consolidated subsidiaries in support of our insurance activities. At May 4, 2013, April 28, 2012 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 May 4, 2013, and approximately \$0.8 billion at both April 28, 2012 and February 2, 2013.

**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 3 – 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 Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

Accounts receivable, merchandise payables, short-term borrowings, accrued liabilities and domestic cash and cash equivalents are reflected in the Condensed Consolidated Balance Sheets at cost, which approximates fair value due to the short-term nature of these instruments. The fair value of our debt is disclosed in Note 2 to the Condensed Consolidated Financial Statements. The following tables provide the fair value measurement amounts for other financial assets and liabilities recorded in our Condensed Consolidated Balance Sheets at fair value at May 4, 2013, April 28, 2012 and February 2, 2013:

| millions   | Total Fair Value<br>Amounts at<br>May 4, 2013         | Level 1 | Level 2 | Level 3 |
|--|---|---------|---------|---------|
| Cash equivalents <sup>(1)</sup>                        | \$35  | \$35    | \$—     | \$—     |
| Restricted cash <sup>(2)</sup>                         | 10  | 10      | —       | —       |
| Total  | \$45  | \$45    | \$—     | \$—     |
| millions   | Total Fair Value<br>Amounts at<br>April 28, 2012      | Level 1 | Level 2 | Level 3 |
| Cash equivalents <sup>(1)</sup>                        | \$291   | \$291   | \$—     | \$—     |
| Restricted cash <sup>(2)</sup>                         | 7   | 7       | —       | —       |
| Foreign currency derivative assets <sup>(3)</sup>      | 2   | —       | 2       | —       |
| Foreign currency derivative liabilities <sup>(4)</sup> | (3 )  | —       | (3 )    | —       |
| Total  | \$297   | \$298   | \$(1 )  | \$—     |
| millions   | Total Fair Value<br>Amounts at<br>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   | \$—     | \$—     |

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

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

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

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

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

## NOTE 4 – SEARS CANADA

## Sears Holdings Ownership of Sears Canada

At both May 4, 2013 and February 2, 2013, Sears Holdings was the beneficial holder of approximately 52 million, or 51% of the common shares of Sears Canada. At April 28, 2012, Sears Holdings was the beneficial holder of approximately 97 million, or 95% of the common shares of Sears Canada.

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## 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 2011, Sears Canada renewed its Normal Course Issuer Bid with the Toronto Stock Exchange that permits it to purchase for cancellation up to 5% of its issued and outstanding common shares, representing approximately 5.3 million common shares. The purchase authorization expired on May 24, 2012. Prior to the expiration, Sears Canada purchased and canceled approximately 0.2 million common shares for \$3 million during the 13-week period ended April 28, 2012.

## NOTE 5 – STORE CLOSING COSTS, IMPAIRMENTS AND REAL ESTATE TRANSACTIONS

## Store Closing Costs and Severance

We made the decision to close 13 stores in our Kmart segment and 6 stores in our Sears Domestic segment during the first quarter of 2013. 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 the first quarter of 2013, we closed 4 stores we previously announced would close and recorded charges of \$1 million at Kmart for the related lease obligations. During the first quarter of 2012, we closed 31 stores we previously announced would close and recorded charges of \$31 million at Sears Domestic and \$3 million at Kmart for the related lease obligations.

Store closing costs recorded for the 13-week periods ended May 4, 2013 and April 28, 2012 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   | \$5                      | \$1                            | \$(1)                                  | \$3                          | \$1  | \$9                       |
| Sears Domestic                                    | 3                        | 1                              | (3)                                    | 2                            | 8  | 11                        |
| Sears Canada                                      | —                        | 2                              | —                                      | —                            | —  | 2                         |
| Total for the 13-week period ended May 4, 2013    | \$8                      | \$4                            | \$(4)                                  | \$5                          | \$9  | \$22                      |
| Kmart   | \$—                      | \$—                            | \$3                                    | \$—                          | \$—  | \$3                       |
| Sears Domestic                                    | —                        | —                              | 31                                     | —                            | —  | 31                        |
| Total for the 13-week period ended April 28, 2012 | \$—                      | \$—                            | \$34                                   | \$—                          | \$—  | \$34                      |

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

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

<sup>(2)</sup> termination costs 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.





## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

(3) Costs for the 13-week period ended May 4, 2013 include \$8 million recorded within Impairment charges and \$1 million recorded within Depreciation and amortization on the Condensed Consolidated Statements of Operations. Store closing cost accruals of \$169 million, \$155 million and \$193 million at May 4, 2013, April 28, 2012 and February 2, 2013, respectively, were as follows:

| millions                                | Severance<br>Costs | Lease<br>Termination<br>Costs | Other<br>Charges | Total |
|---|--------------------|-------------------------------|------------------|-------|
| Balance at April 28, 2012               | \$32               | \$97                          | \$26             | \$155 |
| Store closing costs                     | 31                 | 52                            | 7                | 90    |
| Store closing capital lease obligations | —                  | 9                             | —                | 9     |
| Payments/utilizations                   | (22)               | (20)                          | (19)             | (61)  |
| Balance at February 2, 2013             | 41                 | 138                           | 14               | 193   |
| Store closing costs                     | 4                  | (4)                           | 5                | 5     |
| Payments/utilizations                   | (19)               | (7)                           | (3)              | (29)  |
| Balance at May 4, 2013                  | \$26               | \$127                         | \$16             | \$169 |

## Real Estate Transactions

During the first quarter of 2012, we recorded gains on the sales of assets of \$386 million 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 \$170 million Canadian in cash proceeds. In connection with these 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 from six to 23 months from the date of closing.

## NOTE 6 – EQUITY

## Accumulated Other Comprehensive Loss

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

| millions  | May 4,<br>2013 | April 28,<br>2012 | February 2,<br>2013 |
|---|----------------|-------------------|---------------------|
| Pension and postretirement adjustments (net of tax of \$(442), \$(490) and \$(443), respectively) | \$(1,364)      | \$(1,530)         | \$(1,408)           |
| Cumulative unrealized derivative loss (net of tax of \$0)   | —              | (3)               | —                   |
| Currency translation adjustments (net of tax of \$(40), \$(26) and \$(39), respectively)          | (55)           | (35)              | (51)                |
| Accumulated other comprehensive loss  | \$(1,419)      | \$(1,568)         | \$(1,459)           |

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

Accumulated other comprehensive loss attributable to noncontrolling interests at May 4, 2013, April 28, 2012, and February 2, 2013 was \$(64) million, \$(8) million and \$(64) million, respectively.

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Income Tax Expense Allocated to Each Component of Other Comprehensive Income (Loss)

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

| millions  | 13 Weeks Ended May 4, 2013 |             |                   | 13 Weeks Ended April 28, 2012 |             |                   |
|---|----------------------------|-------------|-------------------|-------------------------------|-------------|-------------------|
|   | Before Tax Amount          | Tax Expense | Net of Tax Amount | Before Tax Amount             | Tax Expense | Net of Tax Amount |
| Other comprehensive income (loss)                     |                            |             |                   |                               |             |                   |
| Pension and postretirement adjustments <sup>(1)</sup> | \$48                       | \$(2 )      | \$46              | \$48                          | \$(2 )      | \$46              |
| Deferred gain on derivatives                          | —                          | —           | —                 | 2                             | —           | 2                 |
| Currency translation adjustments                      | (8 )                       | 1           | (7 )              | (6 )                          | —           | (6 )              |
| Total other comprehensive income (loss)               | \$40                       | \$(1 )      | \$39              | \$44                          | \$(2 )      | \$42              |

<sup>(1)</sup> Included in the computation of net periodic benefit expense. See Note 7 to the Condensed Consolidated Financial Statements.

## Share Repurchase Program

During the 13-week periods ended May 4, 2013 and April 28, 2012, we repurchased no shares of our common stock under our common share repurchase program. At May 4, 2013, 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.

## NOTE 7 – BENEFIT PLANS

## Pension and Postretirement Benefit Plans

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

| millions                            | 13 Weeks Ended |                |
|-------------------------------------|----------------|----------------|
|                                     | May 4, 2013    | April 28, 2012 |
| Components of net periodic expense: |                |                |
| Interest cost                       | \$75           | \$96           |
| Expected return on plan assets      | (77 )          | (93 )          |
| Amortization of experience losses   | 48             | 48             |
| Net periodic expense                | \$46           | \$51           |
| Contributions                       |                |                |

During the 13-week periods ended May 4, 2013 and April 28, 2012, we made total contributions of \$89 million and \$86 million, respectively, to our pension and postretirement plans. We anticipate making aggregate contributions to our domestic and Canadian defined benefit and postretirement plans of approximately \$323 million over the remainder of 2013.

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

NOTE 8 – INCOME TAXES

We had gross unrecognized tax benefits of \$151 million at May 4, 2013, and \$161 million at both April 28, 2012 and February 2, 2013. Of the amount at May 4, 2013, \$88 million, would, if recognized, impact our effective tax rate, with the remaining amount being comprised of unrecognized tax benefits related to gross temporary differences or any other indirect benefits. During the 13-week period ended May 4, 2013, gross unrecognized tax benefits were decreased by \$10 million due to foreign and state audit activity. During the 13-week period ended April 28, 2012, gross unrecognized tax benefits were decreased by \$31 million due to federal, foreign, and state audit activity. We expect that our unrecognized tax benefits could decrease by as much as \$28 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 May 4, 2013, April 28, 2012, and February 2, 2013, the total amount of interest and penalties included in our tax accounts in our Condensed Consolidated Balance Sheet was \$53 million (\$37 million net of federal benefit), \$55 million (\$37 million net of federal benefit), and \$57 million (\$39 million net of federal benefit), respectively. The total amount of net interest income recognized as part of income tax benefit in our Condensed Consolidated Statements of Operations was \$2 million (net of federal benefit) for the 13-week period ended May 4, 2013.

We file income tax returns in the United States, as well as various foreign jurisdictions. The IRS has completed its examination of Holdings' 2006 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 2011, and Kmart is under examination by such jurisdictions for the years 2003 through 2011.

At the end of 2012, we had a federal and state net operating loss ("NOL") deferred tax asset of \$722 million, which will expire predominately between 2019 and 2033. We have federal credit carryforwards of \$605 million, which will expire between 2015 and 2033.

At February 2, 2013, we had a valuation allowance of \$2.7 billion 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 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 as the year progresses for any change in circumstances that causes a change in judgment about the realizability of the deferred tax asset.

The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax accounting income. For the first quarter of 2013, our effective income tax rate was a benefit of 3.0% primarily due to 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. In addition, the first quarter of 2013 benefited from favorable audit settlements.

NOTE 9 – 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 Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

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 and garden, tools and 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 and household, pharmacy and drugstore; and
- (iv) Service and Other—includes repair, installation and automotive service and extended contract revenue as well as revenues earned in connection with our agreements with SHO.

| millions                             | 13 Weeks Ended May 4, 2013 |                   |                 |                   |   |
|--------------------------------------|----------------------------|-------------------|-----------------|-------------------|---|
|                                      | Kmart                      | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |   |
| Merchandise sales and services       |                            |                   |                 |                   |   |
| Hardlines                            | \$898                      | \$2,183           | \$441           | \$3,522           |   |
| Apparel and Soft Home                | 993                        | 1,165             | 354             | 2,512             |   |
| Food and Drug                        | 1,190                      | 3                 | —               | 1,193             |   |
| Service and Other                    | 22                         | 1,156             | 47              | 1,225             |   |
| Total merchandise sales and services | 3,103                      | 4,507             | 842             | 8,452             |   |
| Costs and expenses                   |                            |                   |                 |                   |   |
| Cost of sales, buying and occupancy  | 2,398                      | 3,293             | 605             | 6,296             |   |
| Selling and administrative           | 713                        | 1,255             | 250             | 2,218             |   |
| Depreciation and amortization        | 33                         | 133               | 25              | 191               |   |
| Impairment charges                   | —                          | 8                 | —               | 8                 |   |
| Gain on sales of assets              | (13                        | ) (1              | ) —             | (14               | ) |
| Total costs and expenses             | 3,131                      | 4,688             | 880             | 8,699             |   |
| Operating loss                       | \$(28                      | ) \$(181          | ) \$(38         | ) \$(247          | ) |
| Total assets                         | \$4,284                    | \$12,829          | \$2,283         | \$19,396          |   |
| Capital expenditures                 | \$21                       | \$29              | \$10            | \$60              |   |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

| millions                             | 13 Weeks Ended April 28, 2012 |                   |                 |                   |
|--------------------------------------|-------------------------------|-------------------|-----------------|-------------------|
|                                      | Kmart                         | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| Merchandise sales and services       |                               |                   |                 |                   |
| Hardlines                            | \$968                         | \$2,975           | \$494           | \$4,437           |
| Apparel and Soft Home                | 1,062                         | 1,257             | 366             | 2,685             |
| Food and Drug                        | 1,362                         | 11                | —               | 1,373             |
| Service and Other                    | 23                            | 695               | 57              | 775               |
| Total merchandise sales and services | 3,415                         | 4,938             | 917             | 9,270             |
| Costs and expenses                   |                               |                   |                 |                   |
| Cost of sales, buying and occupancy  | 2,565                         | 3,487             | 651             | 6,703             |
| Selling and administrative           | 752                           | 1,415             | 278             | 2,445             |
| Depreciation and amortization        | 33                            | 143               | 26              | 202               |
| Gain on sales of assets              | (5                            | ) (228            | ) (162          | ) (395            |
| Total costs and expenses             | 3,345                         | 4,817             | 793             | 8,955             |
| Operating income                     | \$70                          | \$121             | \$124           | \$315             |
| Total assets                         | \$4,570                       | \$14,050          | \$2,987         | \$21,607          |
| Capital expenditures                 | \$32                          | \$32              | \$16            | \$80              |

## NOTE 10 – SUPPLEMENTAL FINANCIAL INFORMATION

Other long-term liabilities at May 4, 2013, April 28, 2012 and February 2, 2013 consisted of the following:

| millions                | May 4,<br>2013 | April 28,<br>2012 | February 2,<br>2013 |
|-------------------------|----------------|-------------------|---------------------|
| Unearned revenues       | \$848          | \$783             | \$843               |
| Self-insurance reserves | 713            | 733               | 714                 |
| Other                   | 546            | 618               | 569                 |
| Total                   | \$2,107        | \$2,134           | \$2,126             |

## NOTE 11 – 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.

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



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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 12 – RECENT ACCOUNTING PRONOUNCEMENTS

Disclosures about Reclassification Adjustments out of Accumulated Other Comprehensive Income

In February 2013, the Financial Accounting Standards Board (“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.

NOTE 13 – 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 55% of our outstanding common stock at May 4, 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





## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

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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.

## Unsecured Commercial Paper

During the first quarter of 2013 and 2012, ESL and its affiliates purchased unsecured commercial paper issued by Sears Roebuck Acceptance Corp. ("SRAC"), an indirect wholly owned subsidiary of Sears Holdings. For the commercial paper outstanding to ESL, the weighted average of each of maturity, annual interest rate, and principal amount outstanding was 30.7 days, 2.78% and \$284 million and 28.9 days, 1.78% and \$208 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 the first quarter of 2013 was \$1.6 million. ESL held \$305 million, \$225 million and \$285 million, respectively, in principal amount of commercial paper at May 4, 2013, April 28, 2012 and February 2, 2013, which included \$178 million, \$123 million and \$169 million, respectively, 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"). At both May 4, 2013 and February 2, 2013, Mr. Lampert and ESL held an aggregate of \$95 million of principal amount of 6 5/8% Notes and \$1 million and \$2 million, respectively, of principal amount of Subsidiary Notes. At April 28, 2012, Mr. Lampert and ESL held an aggregate of \$95 million of principal amount of 6 5/8% Notes and \$1 million and \$3 million, respectively, 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 May 4, 2013, April 28, 2012 and February 2, 2013, ESL held a participation interest totaling \$196 million, \$124 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 63% of the outstanding common stock of SHO (based on publicly available information as of October 11, 2012).



## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

These agreements were made in the context of a parent-subsidary 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.

SHO receives commissions from the Company for the sale of merchandise made through [www.sears.com](http://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 May 4, 2013 and February 2, 2013, Holdings reported a net amount receivable from SHO of \$89 million and \$79 million, respectively, in the Accounts receivable line of the Condensed Consolidated Balance Sheets. Amounts related to the sale of inventory and related services, royalties, and corporate shared services was \$434 million, and the net amounts SHO earned related to commissions was \$39 million for the quarter ended May 4, 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 of our Annual Report on Form 10-K for the fiscal year ended February 2, 2013 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 14 – GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION**

At May 4, 2013, 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 notes are guaranteed by certain of our 100% owned domestic subsidiaries that own the collateral for the notes, as well as by SRAC (the "guarantor subsidiaries"). The following condensed consolidated financial information presents the Condensed Consolidating Balance Sheets at May 4, 2013, April 28, 2012 and February 2, 2013, the Condensed Consolidating Statements of Operations and the Condensed Consolidating Statements of Comprehensive Income (Loss) for the 13-week periods ended May 4, 2013 and April 28, 2012, and the Condensed Consolidating Statements of Cash flows for the 13-week periods ended May 4, 2013 and April 28, 2012 of (i) Parent; (ii) the guarantor subsidiaries; (iii) the non-guarantor subsidiaries; (iv) eliminations and (v) the Company on a consolidated basis.

The following condensed consolidated financial statements had total assets and total liabilities of approximately \$670 million and \$130 million, respectively, at April 28, 2012 attributable to the Sears Hometown and Outlet businesses. Merchandise sales and services included revenues of approximately \$620 million from the Sears Hometown and Outlet businesses for the period ended April 28, 2012. Net income (loss) attributable to Holdings' shareholders included net income of approximately \$20 million from the Sears Hometown and Outlet businesses for the period ended April 28, 2012. The financial information for the Sears Hometown and Outlet businesses is reflected within the guarantor subsidiaries balances for this period. The condensed consolidated financial information at and for the period ended May 4, 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

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

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.

Condensed Consolidating Balance Sheet

May 4, 2013

| millions  | Parent           | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations       | Consolidated     |
|---|------------------|---------------------------|-----------------------------------|--------------------|------------------|
| <b>Current assets</b>   |                  |                           |                                   |                    |                  |
| Cash and cash equivalents   | \$—              | \$ 347                    | \$ 124                            | \$—                | \$ 471           |
| Intercompany receivables  | —                | —                         | 25,818                            | (25,818 )          | —                |
| Accounts receivable   | —                | 497                       | 111                               | —                  | 608              |
| Merchandise inventories   | —                | 7,019                     | 881                               | —                  | 7,900            |
| Prepaid expenses and other current assets                           | 92               | 951                       | 459                               | (1,030 )           | 472              |
| Total current assets  | 92               | 8,814                     | 27,393                            | (26,848 )          | 9,451            |
| Total property and equipment, net                                   | —                | 4,309                     | 1,601                             | —                  | 5,910            |
| Goodwill and intangible assets                                      | —                | 961                       | 2,289                             | —                  | 3,250            |
| Other assets  | 16               | 229                       | 3,118                             | (2,578 )           | 785              |
| Investment in subsidiaries  | 16,174           | 25,105                    | —                                 | (41,279 )          | —                |
| <b>TOTAL ASSETS</b>   | <b>\$ 16,282</b> | <b>\$ 39,418</b>          | <b>\$ 34,401</b>                  | <b>\$(70,705 )</b> | <b>\$ 19,396</b> |
| <b>Current liabilities</b>  |                  |                           |                                   |                    |                  |
| Short-term borrowings   | \$—              | \$ 1,754                  | \$—                               | \$—                | \$ 1,754         |
| Current portion of long-term debt and capitalized lease obligations | —                | 55                        | 17                                | —                  | 72               |
| Merchandise payables  | —                | 2,522                     | 340                               | —                  | 2,862            |
| Intercompany payables   | 12,556           | 13,262                    | —                                 | (25,818 )          | —                |
| Short-term deferred tax liabilities                                 | 3                | 412                       | —                                 | (33 )              | 382              |
| Other current liabilities   | 4                | 2,379                     | 2,379                             | (997 )             | 3,765            |
| Total current liabilities   | 12,563           | 20,384                    | 2,736                             | (26,848 )          | 8,835            |
| Long-term debt and capitalized lease obligations                    | 1,237            | 2,937                     | 132                               | (2,377 )           | 1,929            |
| Pension and postretirement benefits                                 | —                | 2,229                     | 409                               | —                  | 2,638            |
| Long-term deferred tax liabilities                                  | —                | 12                        | 943                               | 11                 | 966              |
| Other long-term liabilities   | —                | 843                       | 1,512                             | (248 )             | 2,107            |
| Total Liabilities   | 13,800           | 26,405                    | 5,732                             | (29,462 )          | 16,475           |
| <b>EQUITY</b>   |                  |                           |                                   |                    |                  |
| Shareholder's equity  | 2,482            | 13,013                    | 28,669                            | (41,646 )          | 2,518            |
| Noncontrolling interest   | —                | —                         | —                                 | 403                | 403              |
| Total Equity  | 2,482            | 13,013                    | 28,669                            | (41,243 )          | 2,921            |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                 | <b>\$ 16,282</b> | <b>\$ 39,418</b>          | <b>\$ 34,401</b>                  | <b>\$(70,705 )</b> | <b>\$ 19,396</b> |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Balance Sheet

April 28, 2012

| millions  | Parent          | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations      | Consolidated    |
|---|-----------------|---------------------------|-----------------------------------|-------------------|-----------------|
| <b>Current assets</b>   |                 |                           |                                   |                   |                 |
| Cash and cash equivalents   | \$—             | \$385                     | \$392                             | \$—               | \$777           |
| Intercompany receivables  | —               | —                         | 25,292                            | (25,292)          | —               |
| Accounts receivable   | —               | 429                       | 215                               | —                 | 644             |
| Merchandise inventories   | —               | 7,910                     | 907                               | —                 | 8,817           |
| Prepaid expenses and other current assets                           | 62              | 669                       | 466                               | (807)             | 390             |
| Total current assets  | 62              | 9,393                     | 27,272                            | (26,099)          | 10,628          |
| Total property and equipment, net                                   | —               | 4,717                     | 1,719                             | —                 | 6,436           |
| Goodwill and intangible assets                                      | —               | 1,167                     | 2,596                             | —                 | 3,763           |
| Other assets  | 21              | 194                       | 2,585                             | (2,020)           | 780             |
| Investment in subsidiaries  | 17,614          | 25,899                    | —                                 | (43,513)          | —               |
| <b>TOTAL ASSETS</b>   | <b>\$17,697</b> | <b>\$41,370</b>           | <b>\$34,172</b>                   | <b>\$(71,632)</b> | <b>\$21,607</b> |
| <b>Current liabilities</b>  |                 |                           |                                   |                   |                 |
| Short-term borrowings   | \$—             | \$1,103                   | \$—                               | \$—               | \$1,103         |
| Current portion of long-term debt and capitalized lease obligations | —               | 134                       | 17                                | —                 | 151             |
| Merchandise payables  | —               | 2,811                     | 447                               | —                 | 3,258           |
| Intercompany payables   | 11,934          | 13,358                    | —                                 | (25,292)          | —               |
| Short-term deferred tax liabilities                                 | 5               | 543                       | —                                 | (30)              | 518             |
| Other current liabilities   | 7               | 2,806                     | 2,321                             | (777)             | 4,357           |
| Total current liabilities   | 11,946          | 20,755                    | 2,785                             | (26,099)          | 9,387           |
| Long-term debt and capitalized lease obligations                    | 1,237           | 2,412                     | 111                               | (1,785)           | 1,975           |
| Pension and postretirement benefits                                 | —               | 2,210                     | 456                               | —                 | 2,666           |
| Other long-term liabilities   | —               | 56                        | 817                               | (6)               | 867             |
| Non-current liabilities of discontinued operations                  | —               | 846                       | 1,517                             | (229)             | 2,134           |
| Total Liabilities   | 13,183          | 26,279                    | 5,686                             | (28,119)          | 17,029          |
| <b>EQUITY</b>   |                 |                           |                                   |                   |                 |
| Shareholder's equity  | 4,514           | 15,091                    | 28,486                            | (43,577)          | 4,514           |
| Noncontrolling interest   | —               | —                         | —                                 | 64                | 64              |
| Total Equity  | 4,514           | 15,091                    | 28,486                            | (43,513)          | 4,578           |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                 | <b>\$17,697</b> | <b>\$41,370</b>           | <b>\$34,172</b>                   | <b>\$(71,632)</b> | <b>\$21,607</b> |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Balance Sheet

February 2, 2013

| millions  | Parent          | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>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 Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Operations

For the 13 Weeks Ended May 4, 2013

| millions  | Parent          | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated    |
|---|-----------------|---------------------------|-----------------------------------|--------------|-----------------|
| Merchandise sales and services                                      | \$—             | \$7,578                   | \$1,695                           | \$(821 )     | \$8,452         |
| Cost of sales, buying and occupancy                                 | —               | 5,767                     | 912                               | (383 )       | 6,296           |
| Selling and administrative  | —               | 2,087                     | 569                               | (438 )       | 2,218           |
| Depreciation and amortization                                       | —               | 144                       | 47                                | —            | 191             |
| Impairment charges  | —               | 8                         | —                                 | —            | 8               |
| Gain on sales of assets   | —               | (14 )                     | —                                 | —            | (14 )           |
| Total costs and expenses  | —               | 7,992                     | 1,528                             | (821 )       | 8,699           |
| Operating income (loss)   | —               | (414 )                    | 167                               | —            | (247 )          |
| Interest expense  | (55 )           | (94 )                     | (26 )                             | 114          | (61 )           |
| Interest and investment income                                      | —               | 9                         | 112                               | (114 )       | 7               |
| Income (loss) before income taxes                                   | (55 )           | (499 )                    | 253                               | —            | (301 )          |
| Income tax (expense) benefit  | —               | 49                        | (40 )                             | —            | 9               |
| Equity (loss) in earnings in subsidiaries                           | (237 )          | 127                       | —                                 | 110          | —               |
| Net income (loss)   | (292 )          | (323 )                    | 213                               | 110          | (292 )          |
| Loss attributable to noncontrolling interests                       | —               | —                         | —                                 | 13           | 13              |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO<br/>HOLDINGS' SHAREHOLDERS</b> | <b>\$(292 )</b> | <b>\$(323 )</b>           | <b>\$213</b>                      | <b>\$123</b> | <b>\$(279 )</b> |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Operations

For the 13 Weeks Ended April 28, 2012

| millions   | Parent | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------|---------------------------|-----------------------------------|--------------|--------------|
| Merchandise sales and services                       | \$—    | \$8,310                   | \$1,826                           | \$(866 )     | \$9,270      |
| Cost of sales, buying and occupancy                  | —      | 6,099                     | 1,030                             | (426 )       | 6,703        |
| Selling and administrative                           | —      | 2,283                     | 602                               | (440 )       | 2,445        |
| Depreciation and amortization                        | —      | 153                       | 49                                | —            | 202          |
| Gain on sales of assets                              | —      | (233 )                    | (162 )                            | —            | (395 )       |
| Total costs and expenses                             | —      | 8,302                     | 1,519                             | (866 )       | 8,955        |
| Operating income                                     | —      | 8                         | 307                               | —            | 315          |
| Interest expense                                     | (56 )  | (96 )                     | (27 )                             | 113          | (66 )        |
| Interest and investment income                       | —      | 11                        | 114                               | (113 )       | 12           |
| Income (loss) before income taxes                    | (56 )  | (77 )                     | 394                               | —            | 261          |
| Income tax (expense) benefit                         | 19     | (18 )                     | (68 )                             | —            | (67 )        |
| Equity in earnings in subsidiaries                   | 231    | 244                       | —                                 | (475 )       | —            |
| Net income (loss)                                    | 194    | 149                       | 326                               | (475 )       | 194          |
| Loss attributable to noncontrolling interests        | —      | —                         | —                                 | (5 )         | (5 )         |
| NET INCOME ATTRIBUTABLE TO<br>HOLDINGS' SHAREHOLDERS | \$194  | \$149                     | \$326                             | \$(480 )     | \$189        |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Comprehensive Income (Loss)

For the 13 Weeks Ended May 4, 2013

| millions   | Parent   | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|----------|---------------------------|-----------------------------------|--------------|--------------|
| Net income (loss)  | \$(292 ) | \$(323 )                  | \$213                             | \$110        | \$(292 )     |
| Other comprehensive income   |          |                           |                                   |              |              |
| Pension and postretirement adjustments, net of tax                 | —        | 42                        | 4                                 | —            | 46           |
| Currency translation adjustments, net of tax                       | —        | —                         | (7 )                              | —            | (7 )         |
| Unrealized net gain, net of tax                                    | —        | 1                         | 56                                | (57 )        | —            |
| Total other comprehensive income                                   | —        | 43                        | 53                                | (57 )        | 39           |
| Comprehensive income (loss)  | (292 )   | (280 )                    | 266                               | 53           | (253 )       |
| Comprehensive loss attributable to noncontrolling interests        | —        | —                         | —                                 | 14           | 14           |
| Comprehensive income (loss) attributable to Holdings' shareholders | \$(292 ) | \$(280 )                  | \$266                             | \$67         | \$(239 )     |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Comprehensive Income (Loss)

For the 13 Weeks Ended April 28, 2012

| millions  | Parent | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--------|---------------------------|-----------------------------------|--------------|--------------|
| Net income (loss)   | \$ 194 | \$ 149                    | \$ 326                            | \$(475 )     | \$ 194       |
| Other comprehensive income (loss)                             |        |                           |                                   |              |              |
| Pension and postretirement adjustments, net of tax            | —      | 42                        | 4                                 | —            | 46           |
| Deferred gain on derivatives, net of tax                      | 2      | —                         | —                                 | —            | 2            |
| Currency translation adjustments, net of tax                  | (17 )  | —                         | 11                                | —            | (6 )         |
| Total other comprehensive income (loss)                       | (15 )  | 42                        | 15                                | —            | 42           |
| Comprehensive income  | 179    | 191                       | 341                               | (475 )       | 236          |
| Comprehensive income attributable to noncontrolling interests | —      | —                         | —                                 | (6 )         | (6 )         |
| Comprehensive income attributable to Holdings' shareholders   | \$ 179 | \$ 191                    | \$ 341                            | \$(481 )     | \$ 230       |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Cash Flows

For the 13 Weeks Ended May 4, 2013

| millions   | Parent | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------|---------------------------|-----------------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities          | \$—    | \$(816 )                  | \$103                             | \$—          | \$(713 )     |
| Proceeds from sales of property and investments              | —      | 5                         | —                                 | —            | 5            |
| Net increase in investments and restricted cash              | —      | —                         | (1 )                              | —            | (1 )         |
| Purchases of property and equipment                          | —      | (50 )                     | (10 )                             | —            | (60 )        |
| Net investing with Affiliates                                | —      | —                         | 45                                | (45 )        | —            |
| Net cash provided by (used in) investing activities          | —      | (45 )                     | 34                                | (45 )        | (56 )        |
| Proceeds from debt issuances                                 | —      | —                         | 1                                 | —            | 1            |
| Repayments of long-term debt                                 | —      | (27 )                     | (1 )                              | —            | (28 )        |
| Increase in short-term borrowings, primarily 90 days or less | —      | 660                       | —                                 | —            | 660          |
| Intercompany dividend  | 112    | —                         | (112 )                            | —            | —            |
| Net borrowing with Affiliates                                | (112 ) | 255                       | (188 )                            | 45           | —            |
| Net cash provided by (used in) financing activities          | —      | 888                       | (300 )                            | 45           | 633          |
| Effect of exchange rate changes on cash and cash equivalents | —      | —                         | (2 )                              | —            | (2 )         |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS         | —      | 27                        | (165 )                            | —            | (138 )       |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR                 | —      | 320                       | 289                               | —            | 609          |
| CASH AND CASH EQUIVALENTS, END OF PERIOD                     | \$—    | \$347                     | \$124                             | \$—          | \$471        |

## SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements — (Continued)

(Unaudited)

## Condensed Consolidating Statement of Cash Flows

For the 13 Weeks Ended April 28, 2012

| millions   | Parent | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------|---------------------------|-----------------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities          | \$—    | \$(150 )                  | \$91                              | \$—          | \$(59 )      |
| Proceeds from sales of property and investments              | —      | 274                       | 172                               | —            | 446          |
| Net increase in investments and restricted cash              | —      | —                         | 1                                 | —            | 1            |
| Purchases of property and equipment                          | —      | (64 )                     | (16 )                             | —            | (80 )        |
| Net investing with Affiliates                                | —      | —                         | (12 )                             | 12           | —            |
| Net cash provided by investing activities                    | —      | 210                       | 145                               | 12           | 367          |
| Proceeds from debt issuances                                 | —      | —                         | 1                                 | —            | 1            |
| Repayments of long-term debt                                 | —      | (106 )                    | (105 )                            | —            | (211 )       |
| Decrease in short-term borrowings, primarily 90 days or less | —      | (72 )                     | —                                 | —            | (72 )        |
| Purchase of Sears Canada shares                              | —      | —                         | (3 )                              | —            | (3 )         |
| Net borrowing with Affiliates                                | —      | 167                       | (155 )                            | (12 )        | —            |
| Net cash used in financing activities                        | —      | (11 )                     | (262 )                            | (12 )        | (285 )       |
| Effect of exchange rate changes on cash and cash equivalents | —      | —                         | 7                                 | —            | 7            |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS         | —      | 49                        | (19 )                             | —            | 30           |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR                 | —      | 336                       | 411                               | —            | 747          |
| CASH AND CASH EQUIVALENTS, END OF PERIOD                     | \$—    | \$385                     | \$392                             | \$—          | \$777        |

SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with Part II, Item 7 of our Annual Report on Form 10-K for the year ended February 2, 2013.

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 2,009 full-line and 53 specialty retail stores in the United States, operating through Kmart and Sears, and 461 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 70 million products and provide the capability for our customers to engage in cross-channel transactions such as buy online/pick-up in store; buy in store/ship to home; and buy online, return in store. We are also the home of SHOP YOUR WAY™, a social shopping experience where members have the ability to earn points, receive additional benefits and interact/shop with each other through shopyourway.com. 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®, Craftsman® and DieHard®. We also maintain a broad apparel offering including such well-known labels as Lands' End®, the Kardashian Kollection, Jaclyn Smith, Joe Boxer, Sandra Lee and Levi's, as well as Sofia by Sofia Vergara and the Country Living Home Collection. We are the nation's largest provider of Home Services, with more than 14 million service calls made annually.

We conduct our operations in three business segments: Kmart, Sears Domestic and Sears Canada. The nature of operations conducted within each of these segments is discussed within the "Business Segments" section of Part I, Item 1 of our Annual Report on Form 10-K for the year ended February 2, 2013.

On October 11, 2012, we completed the separation of our Sears Hometown and Outlet businesses through a rights offering transaction. In connection with the separation, the Company and certain of its subsidiaries have entered into various agreements with Sears Hometown and Outlet Stores, Inc. ("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. The financial impact of these agreements are presented within the Condensed Consolidated Results of Operations after the separation date.

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. Following the spin-off, Holdings was the beneficial holder of approximately 51% of the issued and outstanding common shares of Sears Canada.

## SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

## CONSOLIDATED RESULTS OF OPERATIONS

| millions, except per share data  | 13 Weeks Ended |                   |
|--|----------------|-------------------|
|  | May 4,<br>2013 | April 28,<br>2012 |
| <b>REVENUES</b>  |                |                   |
| Merchandise sales and services   | \$8,452        | \$9,270           |
| <b>COSTS AND EXPENSES</b>  |                |                   |
| Cost of sales, buying and occupancy  | 6,296          | 6,703             |
| Gross margin dollars   | 2,156          | 2,567             |
| Gross margin rate  | 25.5           | % 27.7            |
| Selling and administrative   | 2,218          | 2,445             |
| Selling and administrative expense as a percentage of total revenues             | 26.2           | % 26.4            |
| Depreciation and amortization  | 191            | 202               |
| Impairment charges   | 8              | —                 |
| Gain on sales of assets  | (14            | ) (395            |
| Total costs and expenses   | 8,699          | 8,955             |
| Operating income (loss)  | (247           | ) 315             |
| Interest expense   | (61            | ) (66             |
| Interest and investment income   | 7              | 12                |
| Income (loss) before income taxes  | (301           | ) 261             |
| Income tax (expense) benefit   | 9              | (67               |
| Net income (loss)  | (292           | ) 194             |
| (Income) loss attributable to noncontrolling interests                           | 13             | (5                |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b>                  | <b>\$(279</b>  | <b>) \$189</b>    |
| <b>NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS</b> |                |                   |
| Basic earnings (loss) per share  | \$(2.63        | ) \$1.78          |
| Diluted earnings (loss) per share  | \$(2.63        | ) \$1.78          |
| Basic weighted average common shares outstanding                                 | 106.0          | 105.9             |
| Diluted weighted average common shares outstanding                               | 106.0          | 106.1             |

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. In addition, comparable store sales amounts include online sales from sears.com and kmart.com shipped directly to customers and have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period.

Our fiscal 2013 first quarter was comprised of the 13-week period ended May 4, 2013, while our fiscal 2012 first quarter was comprised of the 13-week period ended April 28, 2012. This one week shift in sales 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 for the first quarter, weeks one through 13 for fiscal 2013 have been compared to weeks two through 14 of fiscal year 2012, thereby eliminating the impact of the one week shift.



SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

Net Income (Loss) Attributable to Holdings' Shareholders, Adjusted EBITDA and Adjusted Earnings (Loss) per Share  
We recorded a net loss attributable to Holdings' shareholders for the first quarter of 2013 of \$279 million, or \$2.63 loss per diluted share, and net income attributable to Holdings' shareholders for the first quarter of 2012 of \$189 million, or \$1.78 earnings per diluted share.

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

Adjusted EBITDA is computed as net income (loss) attributable to Sears Holdings Corporation appearing on the Condensed Consolidated Statements of Operations excluding income (loss) attributable to noncontrolling interests, income tax (expense) benefit, interest expense, interest and investment income, 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 operating performance because:

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

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

• Other significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, which affects comparability of results, including the results of the Sears Hometown and Outlet businesses that were included in our results of operations prior to the separation.

## SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

Adjusted EBITDA was determined as follows:

| millions  | 13 Weeks Ended |                   |
|---|----------------|-------------------|
|   | May 4,<br>2013 | April 28,<br>2012 |
| Net income (loss) attributable to SHC per statement of operations | \$(279 )       | \$189             |
| Income (loss) attributable to noncontrolling interests            | (13 )          | 5                 |
| Income tax expense (benefit)                                      | (9 )           | 67                |
| Interest expense  | 61             | 66                |
| Interest and investment income                                    | (7 )           | (12 )             |
| Operating income (loss)   | (247 )         | 315               |
| Depreciation and amortization                                     | 191            | 202               |
| Gain on sales of assets   | (14 )          | (395 )            |
| Before excluded items   | (70 )          | 122               |
| Closed store reserve and severance                                | 13             | 34                |
| Domestic pension expense  | 41             | 41                |
| Impairment charges  | 8              | —                 |
| Adjusted EBITDA   | \$(8 )         | \$197             |
| SHO separation  | —              | (37 )             |
| Adjusted EBITDA as defined  | \$(8 )         | \$160             |
| % to revenues   | (0.1 )%        | 1.8 %             |

Adjusted EBITDA for our segments was as follows:

| millions  | 13 Weeks Ended<br>May 4, 2013 |                   |                 |                   | April 28, 2012 |                   |                 |                   |
|---|-------------------------------|-------------------|-----------------|-------------------|----------------|-------------------|-----------------|-------------------|
|   | Kmart                         | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings | Kmart          | Sears<br>Domestic | Sears<br>Canada | Sears<br>Holdings |
| Operating income (loss)<br>per statement of<br>operations | \$(28 )                       | \$(181 )          | \$(38 )         | \$(247 )          | \$70           | \$121             | \$124           | \$315             |
| Depreciation and<br>amortization                          | 33                            | 133               | 25              | 191               | 33             | 143               | 26              | 202               |
| Gain on sales of assets                                   | (13 )                         | (1 )              | —               | (14 )             | (5 )           | (228 )            | (162 )          | (395 )            |
| Before excluded items                                     | (8 )                          | (49 )             | (13 )           | (70 )             | 98             | 36                | (12 )           | 122               |
| Closed store reserve and<br>severance                     | 8                             | 3                 | 2               | 13                | 3              | 31                | —               | 34                |
| Domestic pension<br>expense                               | —                             | 41                | —               | 41                | —              | 41                | —               | 41                |
| Impairment charges  | —                             | 8                 | —               | 8                 | —              | —                 | —               | —                 |
| Adjusted EBITDA   | \$—                           | \$3               | \$(11 )         | \$(8 )            | \$101          | \$108             | \$(12 )         | \$197             |
| SHO separation  | —                             | —                 | —               | —                 | —              | (37 )             | —               | (37 )             |
| Adjusted EBITDA as<br>defined                             | \$—                           | \$3               | \$(11 )         | \$(8 )            | \$101          | \$71              | \$(12 )         | \$160             |
| % to revenues   | —                             | %0.1              | %(1.3 )         | %(0.1 )           | % 3.0          | %1.6              | %(1.3 )         | %1.8              |

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

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SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

| millions, except per share data                     | 13 Weeks Ended May 4, 2013 |                          |   |             |           |             |
|---|----------------------------|--------------------------|---|-------------|-----------|-------------|
|   | GAAP                       | Adjustments              |   |             |           | As Adjusted |
|   |                            | Domestic Pension Expense | Closed Store Reserve, Impairments and Severance | Tax Matters |           |             |
| Gross margin impact                                 | \$2,156                    | \$—                      | \$8   | \$—         | \$2,164   |             |
| Selling and administrative impact                   | 2,218                      | (41 )                    | (5 )  | —           | 2,172     |             |
| Depreciation and amortization impact                | 191                        | —                        | (1 )  | —           | 190       |             |
| Impairment charges impact                           | 8                          | —                        | (8 )  | —           | —         |             |
| Operating loss impact                               | (247 )                     | 41                       | 22  | —           | (184 )    |             |
| Income tax benefit impact                           | 9                          | (15 )                    | (9 )  | 104         | 89        |             |
| Loss attributable to noncontrolling interest impact | 13                         | —                        | (1 )  | —           | 12        |             |
| After tax and noncontrolling interest impact        | (279 )                     | 26                       | 12  | 104         | (137 )    |             |
| Diluted loss per share impact                       | \$(2.63 )                  | \$0.25                   | \$0.11  | \$0.98      | \$(1.29 ) |             |

| millions, except per share data                       | 13 Weeks Ended April 28, 2012 |                          |                                    |                         |                      |             |                |                            |           |  |
|---|-------------------------------|--------------------------|------------------------------------|-------------------------|----------------------|-------------|----------------|----------------------------|-----------|--|
|   | GAAP                          | Adjustments              |                                    |                         |                      | As Adjusted | SHO Separation | As Adjusted <sup>(1)</sup> |           |  |
|   |                               | Domestic Pension Expense | Closed Store Reserve and Severance | Gain on Sales of Assets | Mark-to-Market Gains | Tax Matters | - Reported     |                            |           |  |
| Gross margin impact                                   | \$2,567                       | \$—                      | \$—                                | \$—                     | \$ —                 | \$—         | \$2,567        | \$(159 )                   | \$2,408   |  |
| Selling and administrative impact                     | 2,445                         | (41 )                    | (34 )                              | —                       | —                    | —           | 2,370          | (122 )                     | 2,248     |  |
| Depreciation and amortization impact                  | 202                           | —                        | —                                  | —                       | —                    | —           | 202            | (2 )                       | 200       |  |
| Gain on sales of assets impact                        | (395 )                        | —                        | —                                  | 386                     | —                    | —           | (9 )           | —                          | (9 )      |  |
| Operating income impact                               | 315                           | 41                       | 34                                 | (386 )                  | —                    | —           | 4              | (35 )                      | (31 )     |  |
| Interest expense impact                               | (66 )                         | —                        | —                                  | —                       | —                    | —           | (66 )          | 1                          | (65 )     |  |
| Other income impact                                   | —                             | —                        | —                                  | —                       | 1                    | —           | 1              | —                          | 1         |  |
| Income tax expense impact                             | (67 )                         | (15 )                    | (13 )                              | 145                     | —                    | (37 )       | 13             | 13                         | 26        |  |
| Income attributable to noncontrolling interest impact | (5 )                          | —                        | —                                  | 8                       | —                    | —           | 3              | —                          | 3         |  |
| After tax and noncontrolling interest impact          | 189                           | 26                       | 21                                 | (233 )                  | 1                    | (37 )       | (33 )          | (21 )                      | (54 )     |  |
| Diluted earnings per share impact                     | \$1.78                        | \$0.25                   | \$0.20                             | \$(2.20 )               | \$ 0.01              | \$(0.35 )   | \$(0.31 )      | \$(0.20 )                  | \$(0.51 ) |  |

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

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, we have a legacy pension obligation for past service performed by Kmart and Sears, Roebuck and Co. associates. The annual pension expense included in our financial statements related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, our domestic pension expense was \$165 million in 2012, \$74 million in 2011, and \$120 million in 2010.

SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

The Company currently maintains a valuation allowance to record only the portion of deferred tax assets that more likely than not will be realized. Tax matters primarily relate to the tax benefit the Company would have recorded if it had been determined that it was more likely than not that such benefits would 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 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.

13-week period ended May 4, 2013 compared to the 13-week period ended April 28, 2012

Revenues and Comparable Store Sales

Revenues decreased \$818 million to \$8.5 billion for the quarter ended May 4, 2013, as compared to revenues of \$9.3 billion for the quarter ended April 28, 2012. The decrease in revenue was primarily due to the effect of having fewer Kmart and Sears Full-line stores in operation, lower comparable store sales and the separation of the Sears Hometown and Outlet businesses which occurred in the third quarter of 2012. We recorded revenues from SHO of approximately \$430 million, primarily related to merchandise sold to SHO for resale, in the first quarter of 2013. The prior year quarter included revenues of approximately \$620 million related to the Sears Hometown and Outlet businesses' merchandise sales to its customers. Domestic store closures accounted for approximately \$375 million of the decrease from the prior year quarter. First quarter 2013 revenues also included a decrease of \$19 million due to foreign currency exchange rates.

Domestic comparable store sales decreased 3.6% for the quarter comprised of decreases of 4.6% at Kmart and 2.4% at Sears Domestic. The decline at Kmart primarily reflects decreases in most categories, with the largest declines occurring in our highly competitive transactional categories such as grocery & household, pharmacy and drugstore. The decline at Sears Domestic of 2.4% was predominately driven by weather related declines in the lawn & garden category. In parts of the country, like our Western Region which had warmer weather, we saw better performance. Excluding lawn & garden, comparable store sales would have increased 0.3%. This slight increase was due to increases in the apparel and home categories, which were partially offset by declines in the consumer electronics and tools categories. The Sears Domestic apparel category has achieved comparable store sales increases for seven consecutive quarters.

Gross Margin

For the quarter, our gross margin decreased \$411 million to \$2.2 billion in 2013 due to the above noted decline in sales as well as a decline in gross margin rate for the quarter. Gross margin included charges of \$8 million related to store closures in the first quarter of 2013 while the first quarter of 2012 included gross margin of \$159 million from the Sears Hometown and Outlet businesses. Excluding these items, gross margin decreased \$244 million.

As compared to prior year, Kmart's gross margin rate for the first quarter declined 220 basis points primarily due to decreases in the apparel and grocery & household categories, resulting from increased clearance markdowns and timing of vendor allowances, respectively. Sears Domestic's gross margin rate declined 250 basis points for the quarter mainly due to selling merchandise to SHO at cost pursuant to the terms of the separation, which accounted for approximately 160 basis points of the decline. We also experienced a decrease in the automotive category due to increased commodity costs. Sears Canada's gross margin rate declined 90 basis points for the first quarter due to increases in inventory reserves requirements.

Selling and Administrative Expenses

Selling and administrative expenses decreased \$227 million in the first quarter of 2013 compared to the prior year quarter and included expenses related to domestic pension plans, store closings and severance of \$46 million and \$75 million for 2013 and 2012, respectively. The first quarter of 2012 also included selling and administrative expenses of \$122 million related to the Sears Hometown and Outlet businesses. Excluding these items, selling and administrative expenses declined \$76 million due to decreases in payroll and advertising expenses.



SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

Our selling and administrative expenses as a percentage of total revenues (“selling and administrative expense rate”) was 26.2% for the first quarter of 2013, compared to 26.4% in the prior year, as the decreases in overall selling and administrative expenses were partially offset by the above noted decline in revenues.

Gain on Sales of Assets

We recorded total gains on sales of assets for the quarter of \$14 million in 2013 and \$395 million in 2012. The gains recorded during the first quarter of 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 \$170 million Canadian in cash proceeds. In connection with these 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 from six to 23 months from the date of closing.

Operating Income (Loss)

We reported an operating loss for the first quarter of \$247 million in 2013 which compares to operating income of \$315 million in 2012. Operating loss for the first quarter of 2013 included expenses related to domestic pension plans, store closings, store impairments and severance which aggregated to \$63 million. Operating income for the first quarter of 2012 included expenses related to domestic pension plans, store closings and severance, as well as gains on sales of assets and operating income from the Sears Hometown and Outlet businesses, which aggregated to operating income of \$346 million. Excluding these items, we would have reported an operating loss of \$184 million and \$31 million in the first quarter of 2013 and 2012, respectively.

Income Taxes

Our effective tax rate for the first quarter of 2013 was a benefit of 3.0% compared with an expense rate of 25.7% in 2012. Our 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 would be realized. In addition, the first quarter of 2013 benefited from favorable audit settlements.

SEGMENT OPERATIONS

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



## SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

## Kmart

Kmart results and key statistics were as follows:

| millions, except number of stores                                    | 13 Weeks Ended |                   |   |   |
|--|----------------|-------------------|---|---|
|  | May 4,<br>2013 | April 28,<br>2012 |   |   |
| Merchandise sales and services                                       | \$3,103        | \$3,415           |   |   |
| Cost of sales, buying and occupancy                                  | 2,398          | 2,565             |   |   |
| Gross margin dollars   | 705            | 850               |   |   |
| Gross margin rate  | 22.7           | % 24.9            | % | % |
| Selling and administrative   | 713            | 752               |   |   |
| Selling and administrative expense as a percentage of total revenues | 23.0           | % 22.0            | % | % |
| Depreciation and amortization  | 33             | 33                |   |   |
| Gain on sales of assets  | (13            | ) (5              | ) | ) |
| Total costs and expenses   | 3,131          | 3,345             |   |   |
| Operating income (loss)  | \$(28          | ) \$70            |   |   |
| Adjusted EBITDA  | \$—            | \$101             |   |   |
| Number of stores   | 1,211          | 1,290             |   |   |

13-week period ended May 4, 2013 compared to the 13-week period ended April 28, 2012

## Revenues and Comparable Store Sales

For the quarter, Kmart's revenues decreased by \$312 million, while comparable store sales decreased 4.6%. The decline in revenues was also due to the impact of Kmart having fewer stores in operation during the first quarter of 2013. Store closures accounted for approximately \$185 million of the decrease from the prior year quarter. The decrease in comparable store sales reflects declines in most categories, with the largest declines occurring in our highly competitive transactional categories such as grocery & household, pharmacy and drugstore.

## Gross Margin

For the quarter, Kmart generated \$705 million in gross margin in 2013 compared to \$850 million in 2012. The decrease in Kmart's gross margin is due to both the decrease in sales as well as a decrease in gross margin rate. Kmart's gross margin rate declined 220 basis points to 22.7% in 2013 from 24.9% in 2012 due to decreases in the apparel and grocery & household categories, resulting from increased clearance markdowns and timing of vendor allowances, respectively. Gross margin for 2013 included charges of \$5 million related to store closures.

## Selling and Administrative Expenses

For the quarter, Kmart's selling and administrative expenses decreased \$39 million as compared to the first quarter in 2012. The decrease primarily reflects decreases in payroll and advertising expenses. Selling and administrative expenses for the first quarter of 2013 and 2012 were impacted by expenses of \$3 million in both periods related to store closings and severance.

Kmart's selling and administrative expense rate for the quarter was 23.0% in 2013 and 22.0% in 2012 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

## Operating Income (Loss)

For the quarter, Kmart recorded an operating loss of \$28 million in 2013 and operating income \$70 million in 2012. The increase in Kmart's operating loss was primarily the result of the above noted declines in sales and gross margin, partially offset by a decrease in selling and administrative expenses. Operating loss and operating income

## SEARS HOLDINGS CORPORATION

13 Weeks Ended May 4, 2013 and April 28, 2012

for the first quarter of 2013 and 2012, respectively, included expenses related to store closings and severance of \$9 million and \$3 million, respectively.

Sears Domestic

Sears Domestic results and key statistics were as follows:

| millions, except number of stores                                    | 13 Weeks Ended |                   |   |   |
|--|----------------|-------------------|---|---|
|  | May 4,<br>2013 | April 28,<br>2012 |   |   |
| Merchandise sales and services                                       | \$4,507        | \$4,938           |   |   |
| Cost of sales, buying and occupancy                                  | 3,293          | 3,487             |   |   |
| Gross margin dollars   | 1,214          | 1,451             |   |   |
| Gross margin rate  | 26.9           | % 29.4            |   | % |
| Selling and administrative   | 1,255          | 1,415             |   |   |
| Selling and administrative expense as a percentage of total revenues | 27.8           | % 28.7            |   | % |
| Depreciation and amortization  | 133            | 143               |   |   |
| Impairment charges   | 8              | —                 |   |   |
| Gain on sales of assets  | (1             | ) (228            | ) |   |
| Total costs and expenses   | 4,688          | 4,817             |   |   |
| Operating income (loss)  | \$(181         | ) \$121           |   |   |
| Adjusted EBITDA  | \$3            | \$108             |   |   |
| SHO separation   | —              | (37               | ) |   |
| Adjusted EBITDA <sup>(1)</sup>                                       | \$3            | \$71              |   |   |
| Number of:   |                |                   |   |   |
| Full-line stores <sup>(2)</sup>                                      | 798            | 831               |   |   |
| Specialty stores <sup>(3)</sup>                                      | 53             | 1,302             |   |   |
| Total Domestic Sears Stores  | 851            | 2,133             |   |   |

<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> The period ended May 4, 2013 included 788 Full-line stores and 10 Sears Essentials/Grand stores; The period ended April 28, 2012 included 809 Full-line stores and 22 Sears Essentials/Grand stores

<sup>(3)</sup> The period ended April 28, 2012 included 1,237 stores from Sears Hometown and Outlet businesses 13-week period ended May 4, 2013 compared to the 13-week period ended April 28, 2012

## Revenues and Comparable Store Sales

For the quarter, Sears Domestic's revenues decreased by \$431 million, while comparable store sales decreased 2.4%. The decline in revenue is due to the separation of the Sears Hometown and Outlet businesses which occurred in the third quarter of 2012, the impact of having fewer Sears Full-line stores in operation and the decline in comparable store sales. We recorded revenues from SHO of approximately \$430 million, primarily related to merchandise sold to SHO for resale, in the first quarter of 2013. The prior year quarter included revenues of approximately \$620 million related to the Sears Hometown and Outlet businesses' merchandise sales to its customers. Store closures accounted for approximately \$190 million of the decrease from the prior year quarter.

The comparable store sales decline of 2.4% was predominately driven by weather related declines in the lawn & garden category. In parts of the country, like our Western Region which had warmer weather, we saw better performance. Excluding lawn & garden, comparable store sales would have increased 0.3%. This slight increase was due to increases in the apparel and home categories, which were partially offset by declines in the consumer



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electronics and tools categories. The Sears apparel category has achieved comparable store sales increases for seven consecutive quarters.

Gross Margin

For the quarter, Sears Domestic generated gross margin dollars of \$1.2 billion and \$1.5 billion in 2013 and 2012, respectively. Gross margin for the first quarter of 2013 included charges of \$3 million related to store closures while the first quarter of 2012 included gross margin of \$159 million from the Sears Hometown and Outlet businesses. Excluding these items, gross margin decreased \$75 million.

Sears Domestic's gross margin rate during the first quarter was 26.9% in 2013 and 29.4% in 2012. The decrease of 250 basis points was mainly due to selling merchandise to SHO at cost pursuant to the terms of the separation, which accounted for approximately 160 basis points of the decline. We also experienced a decrease in the automotive category due to increased commodity costs.

Selling and Administrative Expenses

For the quarter, Sears Domestic's selling and administrative expenses decreased \$160 million in 2013 as compared to 2012. Selling and administrative expenses for the first quarter of 2013 were impacted by expenses related to domestic pension plans of \$41 million while the first quarter of 2012 was impacted by expenses related to domestic pension plans, store closings and severance of \$72 million. The first quarter of 2012 also included selling and administrative expenses of \$122 million related to the Sears Hometown and Outlet businesses. Excluding these items, selling and administrative expenses decreased \$7 million primarily due to decreases in payroll expenses.

Sears Domestic's selling and administrative expense rate for the quarter was 27.8% in 2013 and 28.7% in 2012 and decreased as a result of the above noted expense reduction.

Gain on Sales of Assets

Sears Domestic recorded a total gain on sales of assets for the quarter of \$1 million in 2013 and \$228 million in 2012. The gains recorded during the first quarter of 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. In connection with this transaction, 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 from 11 to 23 months from the date of closing.

Operating Income (Loss)

For the quarter, Sears Domestic reported an operating loss of \$181 million in 2013 compared to operating income of \$121 million in 2012. Sears Domestic's operating loss for the first quarter of 2013 included expenses of \$52 million related to domestic pension plans, store closings, store impairments and severance. Sears Domestic's operating income for the first quarter of 2012 included expenses related to domestic pension plans, store closings and severance, as well as gains on sales of assets and operating income from the Sears Hometown and Outlet businesses, which aggregated to operating income of \$186 million. Excluding these items, we would have reported an operating loss of \$129 million and \$65 million in the first quarter of 2013 and 2012, respectively.

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## 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                                    | 13 Weeks Ended |                   |   |   |
|--|----------------|-------------------|---|---|
|  | May 4,<br>2013 | April 28,<br>2012 |   |   |
| Merchandise sales and services                                       | \$842          | \$917             |   |   |
| Cost of sales, buying and occupancy                                  | 605            | 651               |   |   |
| Gross margin dollars   | 237            | 266               |   |   |
| Gross margin rate  | 28.1           | % 29.0            | % | % |
| Selling and administrative   | 250            | 278               |   |   |
| Selling and administrative expense as a percentage of total revenues | 29.7           | % 30.3            | % | % |
| Depreciation and amortization  | 25             | 26                |   |   |
| Gain on sales of assets  | —              | (162              | ) |   |
| Total costs and expenses   | 880            | 793               |   |   |
| Operating income (loss)  | \$(38          | ) \$124           |   |   |
| Adjusted EBITDA  | \$(11          | ) \$(12           | ) |   |
| Number of:   |                |                   |   |   |
| Full-line stores   | 118            | 122               |   |   |
| Specialty stores   | 343            | 371               |   |   |
| Total Sears Canada Stores  | 461            | 493               |   |   |

13-week period ended May 4, 2013 compared to the 13-week period ended April 28, 2012

## Revenues and Comparable Store Sales

Sears Canada's revenues decreased \$75 million for the first quarter of 2013 as compared to the same period last year and included a decrease of \$19 million due to the impact of exchange rates during the quarter. On a Canadian dollar basis, revenues decreased by \$56 million predominately due to a 2.6% decrease in comparable store sales primarily due to sales declines in most categories with the largest declines occurring in our home furnishings, home decor, electronics and tools categories.

## Gross Margin

Total gross margin dollars for the first quarter decreased \$29 million in 2013 to \$237 million and included a \$5 million decrease due to the impact of exchange rates. Gross margin decreased \$24 million on a Canadian dollar basis. For the quarter, Sears Canada's gross margin rate declined 90 basis points to 28.1%, from 29.0% in 2012 due to increases in inventory reserves requirements.

## Selling and Administrative Expenses

For the first quarter of 2013, Sears Canada's selling and administrative expenses decreased \$28 million, and included a decrease of \$6 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses decreased by \$22 million primarily due to a decrease in advertising expense. Selling and administrative expenses for the first quarter of 2013 were impacted by expenses of \$2 million related to severance.

Sears Canada's selling and administrative expense rate for the quarter was 29.7% in 2013 and 30.3% in 2012 and decreased as a result of the decline in selling and administrative expenses, partially offset by the above noted decline in revenues.

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## Gain on Sales of Assets

Sears Canada recorded a total gain on sales of assets for the quarter of \$162 million in 2012. The gains recorded during the first quarter of 2012 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 \$170 million Canadian in cash proceeds. In connection with this transaction, we surrendered substantially all of our rights and obligations under our preexisting lease agreements and agreed to surrender each of the premises in six months from the date of closing.

## Operating Income (Loss)

Sears Canada recorded an operating loss of \$38 million in the first quarter of 2013 and operating income of \$124 million in 2012. Sears Canada's operating loss for the first quarter included expense of \$2 million related to severance in 2013, while 2012 operating income included gains on sales of assets of \$163 million. Adjusting for these items, we would have reported an operating loss of \$36 million and \$39 million for the first quarter of 2013 and 2012, respectively.

## 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 May 4, 2013, April 28, 2012 and February 2, 2013 are detailed in the following table.

| millions                                 | May 4,<br>2013 | April 28,<br>2012 | February 2,<br>2013 |
|--|----------------|-------------------|---------------------|
| Domestic                                 |                |                   |                     |
| Cash and equivalents                     | \$197          | \$193             | \$227               |
| Cash posted as collateral                | 19             | 20                | 20                  |
| Credit card deposits in transit          | 162            | 202               | 133                 |
| Total domestic cash and cash equivalents | 378            | 415               | 380                 |
| Sears Canada                             | 93             | 362               | 229                 |
| Total cash and cash equivalents          | 471            | 777               | 609                 |
| Restricted cash                          | 10             | 7                 | 9                   |
| Total cash balances                      | \$481          | \$784             | \$618               |

We had total cash balances of \$481 million at May 4, 2013, \$784 million at April 28, 2012 and \$618 million at February 2, 2013. The decrease in cash during the first quarter of 2013 was primarily due to higher working capital needs at Sears Canada.

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 and with counterparties related to outstanding derivative contracts, as well as funds held in trust in accordance with regulatory requirements governing advance ticket sales related to Sears Canada's travel business. We classify outstanding checks in excess of funds on



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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 \$75 million, \$85 million and \$114 million as of May 4, 2013, April 28, 2012 and February 2, 2013, respectively.

Operating Activities

During the first quarter of 2013, we used \$713 million of cash compared to \$59 million in the first quarter of 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. We used more cash in operations in the first quarter of 2013 compared to the prior year quarter primarily due to the increase in net loss.

Merchandise inventories were \$7.9 billion at May 4, 2013 and \$8.8 billion at April 28, 2012. Merchandise payables were \$2.9 billion at May 4, 2013 and \$3.3 billion at April 28, 2012. Our Domestic inventory balances decreased approximately \$903 million from \$8.0 billion at April 28, 2012 to \$7.1 billion at May 4, 2013. Excluding the inventory related to the Sears Hometown and Outlet store businesses, domestic inventory decreased approximately \$500 million from the prior year first quarter due to both improved productivity and store closures. Sears Domestic inventory decreased in virtually all categories, with the most notable decreases in the tools, consumer electronics and apparel categories. Kmart inventory also decreased in virtually all categories with the most notable decreases in the consumer electronics, grocery & household, drug and apparel categories.

Investing Activities

For the first quarter of 2013, we used net cash flows in investing activities of \$56 million which included cash used for capital expenditures of \$60 million, partially offset by cash proceeds generated from the sale of properties of \$5 million. For the first quarter of 2012, we generated net cash flows from investing activities of \$367 million which included cash proceeds from the sales of properties of \$446 million, which were partially offset by cash used for capital expenditures of \$80 million.

Financing Activities

For the first quarter of 2013, we generated net cash flows from financing activities of \$633 million primarily due to an increase in short-term borrowings of \$660 million. This compares to cash used in financing activities of \$285 million in the first quarter of 2012 which included repayments of long-term debt of \$211 million and a decrease in short-term borrowings of \$72 million.

During the first quarter of 2013, our revolver borrowings increased by approximately \$600 million from February 2, 2013, as opposed to the prior year first quarter, when our revolver borrowings decreased by approximately \$40 million. Since 2012 was a 53-week year, the current year quarter ended a week later than the prior year, after the fiscal month. This is important as many disbursements, such as rent and payroll, are made at the end or beginning of the calendar month. As such, through the comparable period last year, first quarter revolver borrowings would have increased by \$145 million. In addition, the prior year benefited from the \$270 million of cash proceeds for the domestic real estate sales which closed in April 2012. The current year increase in borrowings included higher incentive compensation and was impacted by the timing of medical benefit payments, due to the transition from a self-insured medical benefit plan to an Exchange program.

We did not repurchase any of our common shares under our share repurchase program in the first quarter of 2013 or 2012. 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 May 4, 2013, we had \$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.

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, pension plan contributions and common share





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repurchases. 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 credit Canadian revolver through September 2015, which may be subject to potential reserves, and \$1.24 billion of senior secured notes due in 2018. Further, there is approximately \$327 million of remaining Sears, Roebuck and Co. debt from the merger. These funding resources are described in more detail below. At May 4, 2013, we had liquid assets of \$5.5 billion consisting of cash balances of \$481 million and \$5.0 billion of inventory, net of payables.

The domestic revolver and senior secured notes are in place for the next several years and are supported by an asset base which includes \$7.1 billion of inventory, owned and leased real estate assets, market leading proprietary brands such as Kenmore, Craftsman and DieHard, and stand-alone businesses such as Lands' End and Sears Canada. This asset base provides us flexibility as we continue to transform our business.

In November 2012, we announced that we would be considering actions to raise at least \$500 million of additional liquidity in 2013. As one of a number of options available to us, we are currently in the process of evaluating strategic alternatives for our Protection Agreement business, including a possible sale, joint venture or recapitalization of the business, or some combination of these alternatives. These alternatives could, if successful, create additional liquidity in excess of our minimum target of \$500 million, but there is of course no assurance that we will complete any transaction relating to the Protection Agreement business in 2013.

The protection agreement business provides customers with the ability to purchase a service contract related to merchandise. The service contract protects against product failures caused by workmanship, materials, mechanical or electrical breakdown and not caused by usage and normal wear and tear. Service contracts can be purchased at point of sale or in the aftermarket. Products eligible for service contracts include appliances, consumer electronics, mobile electronics and fitness equipment, among other categories. Regardless of the outcome of this process, Protection Agreements are and will continue to be an integral part of our value proposition for our members, particularly in our Home Appliance business. Sears of course will continue to service all existing agreements as well as continue to sell and service protection agreements going forward. In addition, we are exploring real estate related transactions, which could include sales or financings.

In addition to our asset monetization efforts, we expect to reduce 2013 peak domestic inventory by \$500 million from the 2012 level of \$8.6 billion at the end of the third quarter as a result of stores already closed or expected to close, initiatives underway to reduce slow-moving inventory and modest productivity improvement. This action is expected to generate \$300 million of cash after consideration of related payables. We also expect to further reduce our fixed cost base by another \$200 million in 2013.

Our outstanding borrowings at May 4, 2013, April 28, 2012 and February 2, 2013 were as follows:

| millions                                   | May 4,<br>2013 | April 28,<br>2012 | February 2,<br>2013 |
|--|----------------|-------------------|---------------------|
| Short-term borrowings:                     |                |                   |                     |
| Unsecured commercial paper                 | \$ 377         | \$ 302            | \$ 345              |
| Secured borrowings                         | 1,377          | 801               | 749                 |
| Long-term debt, including current portion: |                |                   |                     |
| Notes and debentures outstanding           | 1,582          | 1,669             | 1,593               |
| Capitalized lease obligations              | 419            | 457               | 433                 |
| Total borrowings                           | \$ 3,755       | \$ 3,229          | \$ 3,120            |
| Domestic Credit Agreement                  |                |                   |                     |

During the first quarter of 2011, we entered into a \$3.275 billion credit agreement (the "Domestic Credit Agreement") which expires in April 2016. We view this credit facility as our most cost efficient funding mechanism and therefore use it as a primary source of funding.

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

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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 Domestic Credit Agreement includes a \$1.5 billion letter of credit sub-limit and an uncommitted accordion feature that provides us the flexibility, subject to certain terms and conditions, to use the existing collateral under the credit facility to obtain an aggregate amount of up to \$1.0 billion in additional borrowing capacity if we so choose. The Domestic Credit Agreement permits aggregate second lien indebtedness of up to \$2.0 billion, of which \$1.2 billion second lien notes were outstanding at May 4, 2013, providing the Company the capacity to issue up to an additional \$760 million in second lien indebtedness. The Domestic Credit Agreement is in place as a funding source for general corporate purposes and is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. ("SRAC") and Kmart Corporation are the borrowers. The Domestic Credit Agreement 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 Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, under certain circumstances, including if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0. Based on availability, none of these requirements was in effect at May 4, 2013.

At May 4, 2013, April 28, 2012 and February 2, 2013, we had \$1.4 billion, \$801 million and \$749 million, respectively, of borrowings and \$747 million, \$694 million and \$754 million, respectively, of letters of credit outstanding under the Domestic Credit Agreement. As a result, our availability under the agreement was \$1.2 billion at May 4, 2013, and \$1.8 billion at both April 28, 2012 and February 2, 2013. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

#### Senior Secured Notes

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

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Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. At May 4, 2013, April 28, 2012 and February 2, 2013, we had no borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately \$602 million (\$607 million Canadian), \$592 million (\$581 million Canadian) and \$503 million (\$502 million Canadian), respectively, at May 4, 2013, April 28, 2012 and February 2, 2013. The current availability may be reduced by reserves currently estimated by the Company to be \$440 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 \$150 million the lenders could apply. The potential additional reserve amount may increase or decrease in the future based on estimated net pension liabilities.

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.

Unsecured Commercial Paper

We borrow through the commercial paper markets. At May 4, 2013, April 28, 2012 and February 2, 2013, we had outstanding commercial paper borrowings of \$377 million, \$302 million and \$345 million, respectively. ESL held \$305 million, \$225 million and \$285 million, respectively, of our commercial paper at May 4, 2013, April 28, 2012 and February 2, 2013, including \$178 million, \$123 million and \$169 million, respectively, held by Edward S. Lampert. See Note 13 for further discussion of these borrowings.

Debt Ratings

Our corporate family debt ratings at May 4, 2013 appear in the table below:

|                   |                   |               |
|-------------------|-------------------|---------------|
| Moody's           | Standard & Poor's | Fitch Ratings |
| Investors Service | Ratings Services  |               |
| B3                | CCC+              | CCC           |

Domestic Pension Plan Funding

In our Annual Report on Form 10-K for the fiscal year ended February 2, 2013, we disclosed that we expected our contributions to our domestic pension plans to be approximately \$352 million in 2013 and \$510 million in 2014. The ultimate amount of pension contributions and timing could be affected by changes in the applicable regulations as well as financial market and investment performance.

Recent Accounting Pronouncements

See Part I, Item 1, "Financial Statements – Notes to Condensed Consolidated Financial Statements," Note 12 – "Recent Accounting Pronouncements," for information regarding new accounting pronouncements.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements made in this Quarterly Report on Form 10-Q and in other public announcements by us contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are subject to risks and uncertainties that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Forward-looking statements include information concerning our future financial performance, business strategy, plans, goals and objectives. Statements preceded or followed by, or that



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otherwise include, the words “believes,” “expects,” “anticipates,” “intends,” “estimates,” “plans,” “forecast,” “is likely to” and expressions or 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; our ability to successfully implement 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; possible limits on our access to capital markets and other financing sources, including incremental financings under the accordion feature of our domestic credit agreement and additional second lien financings, with respect to which we do not have commitments from our lenders; our ability to successfully achieve our plans to generate liquidity, reduce inventory and reduce fixed costs; whether we choose to pursue, and, if so, our ability to complete, possible strategic alternatives we are exploring, including with respect to our protection agreement business, and possible real estate related transactions such as sales or financings, on terms that are favorable to us, on intended timetables or at all; vendors' lack of willingness to provide acceptable payment terms or otherwise restricting financing to purchase inventory or services; the impact of seasonal buying patterns, including seasonal fluctuations due to weather conditions, which are difficult to forecast with certainty; our dependence on sources outside the United States for significant amounts of our merchandise; our extensive reliance on computer systems, including legacy systems, to implement our integrated retail strategy, process transactions, summarize results and manage our business, which may be subject to disruptions or security breaches; 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 of 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 claims and proceedings with respect to which the parties have reached a preliminary settlement; and the timing and amount of required pension plan funding; and other risks, uncertainties and factors discussed in our most recent Annual Report on Form 10-K and other filings with the Securities and Exchange Commission. 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.

Certain of these and other factors are discussed in more detail in our filings with the Securities and Exchange Commission and the Annual Report on Form 10-K of Sears Holdings Corporation for the fiscal year ended February 2, 2013, which may be accessed through the Commission's website at [www.sec.gov](http://www.sec.gov).

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

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

We face market risk exposure in the form of interest rate risk. This market risk arises from our debt obligations.

#### Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding and interest rate derivatives. All debt securities and interest-rate derivative instruments are considered non-trading. At May 4, 2013, 47% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at May 4, 2013, which totaled approximately \$1.8 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by \$18 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.

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Item 4. Controls and Procedures

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

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

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## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

See Part II, Item 8, "Financial Statements-Notes to Consolidated Financial Statements," Note 11-"Legal Proceedings," for additional information regarding legal proceedings, which information is incorporated herein by this reference.

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

The following table provides information about shares of common stock we acquired during the first quarter of 2013. During the 13 weeks ended May 4, 2013, we did not repurchase any shares of our common stock under our common share repurchase program. At May 4, 2013, we had approximately \$504 million of remaining authorization under the program.

|                                   | Total<br>Number of<br>Shares<br>Purchased(1) | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as Part of<br>Publicly<br>Announced<br>Program(2) | Average<br>Price Paid<br>per Share<br>for<br>Publicly<br>Announced<br>Program | Approximate<br>Dollar Value of<br>Shares that May<br>Yet Be Purchased<br>Under<br>the Program |
|-----------------------------------|--|------------------------------------|--|---|---|
| February 3, 2013 to March 2, 2013 | 14,635                                       | \$46.03                            | —  | \$—   |   |
| March 3, 2013 to April 6, 2013    | 636  | 50.58                              | —  | \$—   |   |
| April 7, 2013 to May 4, 2013      | 4,068  | 51.02                              | —  | \$—   |   |
| Total                             | 19,339                                       | \$47.23                            | —  | \$—   | \$503,907,832   |

(1) Consists entirely of 19,339 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock.

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

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 6. Exhibits

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

(a) Exhibits.

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

SEARS HOLDINGS CORPORATION

SIGNATURE

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

SEARS HOLDINGS CORPORATION

By: /s/ ROBERT A. RIECKER

Name: Robert A. Riecker  
Title: Vice President, Controller and Chief  
Accounting Officer

Date: May 23, 2013

SEARS HOLDINGS CORPORATION

EXHIBIT INDEX

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000-51217)).
- 3.2 Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated December 2, 2009, filed on December 4, 2009 (File No. 000-51217)).
- 10.1 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)).
- 10.2 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)).
- 10.3 Sears Holdings Corporation Annual Incentive Plan (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)).
- 10.4 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)).
- 10.5 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 (File No. 000-51217)).
- 10.6 Letter from Registrant to Imran Jooma relating to employment dated February 5, 2013 (incorporated by reference to Exhibit 10.36 to Registrant's Annual Report on Form 10-K for the fiscal year ended February 2, 2013 (File No. 000-51217)).
- 10.7 Letter from Registrant to Dane A. Drobny relating to employment dated February 5, 2013 (incorporated by reference to Exhibit 10.40 to Registrant's Annual Report on Form 10-K for the fiscal year ended February 2, 2013 (File No. 000-51217)).
- 10.8 Sears Holdings Corporation 2013 Stock Plan (incorporated by reference to Appendix A to Registrant's Proxy Statement dated March 28, 2013 (File No. 000-51217)).
- \*31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended May 4, 2013, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Statements of Operations (Unaudited) for the 13 Weeks Ended May 4, 2013 and April 28, 2012; (ii) the Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the 13 Weeks Ended May 4, 2013 and April 28, 2012 (iii) the Condensed Consolidated Balance Sheets (Unaudited) as of May 4, 2013, April 28, 2012 and February 2, 2013; (iv) the Condensed Consolidated Statements of Cash Flows (Unaudited) for the 13 Weeks Ended May 4, 2013 and April 28, 2012; (v) the Condensed Consolidated Statements of Equity (Unaudited) for the 13 Weeks Ended May 4, 2013 and April 28, 2012; and (vi) the Notes to the Condensed Consolidated Financial Statements (Unaudited).

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\* Filed herewith.

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