SEARS HOLDINGS CORP
Form 10-Q
August 20, 2015

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

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED AUGUST 1, 2015

OR

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

Commission file number 000-51217, 001-36693
SEARS HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 20-1920798 |
| (State of Incorporation) | (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 x 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 x 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 x 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 x

As of August 14, 2015, the registrant had 106,639,657 common shares, $0.01 par value, outstanding.

SEARS HOLDINGS CORPORATION
INDEX TO QUARTERLY REPORT ON FORM 10-Q
13 and 26 Weeks Ended August 1, 2015 and August 2, 2014

SEARS HOLDINGS CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)
PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

| millions, except per share data | 13 Weeks Ended August 1, 2015 | 13 Weeks Ended August 2, 2014 | 26 Weeks Ended August 1, 2015 | 26 Weeks Ended August 2, 2014 |
|---|---|---|---|---|
| REVENUES | | | | |
| Merchandise sales and services[1][2] | $6,211 | $8,013 | $12,093 | $15,892 |
| COSTS AND EXPENSES | | | | |
| Cost of sales, buying and occupancy[1][3] | 4,776 | 6,271 | 9,140 | 12,322 |
| Selling and administrative | 1,694 | 2,118 | 3,375 | 4,207 |
| Depreciation and amortization | 114 | 152 | 236 | 307 |
| Impairment charges | 54 | 20 | 54 | 25 |
| Gain on sales of assets | (526) | (34) | (633) | (80) |
| Total costs and expenses | 6,112 | 8,527 | 12,172 | 16,781 |
| Operating income (loss) | 99 | (514) | (79) | (889) |
| Interest expense | (85) | (72) | (175) | (143) |
| Interest and investment income (loss) | (26) | 32 | (44) | 36 |
| Other income (loss) | (1) | 5 | — | 2 |
| Loss before income taxes | (13) | (549) | (298) | (994) |
| Income tax (expense) benefit | 221 | (32) | 203 | (29) |
| Net income (loss) | 208 | (581) | (95) | (1,023) |
| Loss attributable to noncontrolling interests | — | 8 | — | 48 |
| NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $208 | $(573) | $(95) | $(975) |
| NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | | | | |
| Basic earnings (loss) per share | $1.95 | $(5.39) | $(0.89) | $(9.17) |
| Diluted earnings (loss) per share | $1.84 | $(5.39) | $(0.89) | $(9.17) |
| Basic weighted average common shares outstanding | 106.5 | 106.3 | 106.5 | 106.3 |
| Diluted weighted average common shares outstanding | 113.3 | 106.3 | 106.5 | 106.3 |

(1) Includes merchandise sales to Sears Hometown and Outlet Stores, Inc. ("SHO") of $350 million and $383 million for the 13 weeks ended August 1, 2015 and August 2, 2014, respectively, and $685 million and $741 million for the 26 weeks ended August 1, 2015 and August 2, 2014, respectively. Pursuant to the terms of the separation, merchandise is sold to SHO at cost.

(2) Includes revenue from Lands' End, Inc. ("Lands' End") for retail services and rent for Lands' End Shops at Sears, participation in the Shop Your Way® program and corporate shared services of $16 million and $17 million for the 13 weeks ended August 1, 2015 and August 2, 2014, respectively, and $31 million and $23 million for the 26 weeks ended August 1, 2015 and August 2, 2014, respectively.

(3) Includes $5 million rent expense and $5 million installment expenses pursuant to the master lease with Seritage for the 13 and 26 weeks ended August 1, 2015.

See accompanying notes.

SEARS HOLDINGS CORPORATION
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

| millions | 13 Weeks Ended August 1, 2015 | 13 Weeks Ended August 2, 2014 | 26 Weeks Ended August 1, 2015 | 26 Weeks Ended August 2, 2014 |
|---|---|---|---|---|
| Net income (loss) | $208 | $(581) | $(95) | $(1,023) |
| Other comprehensive income | | | | |
| Pension and postretirement adjustments, net of tax | 66 | 35 | 131 | 65 |
| Deferred loss on derivatives, net of tax | — | (1) | — | (2) |
| Currency translation adjustments, net of tax | — | 3 | — | 14 |
| Total other comprehensive income | 66 | 37 | 131 | 77 |
| Comprehensive income (loss) | 274 | (544) | 36 | (946) |
| Comprehensive loss attributable to noncontrolling interests | — | 3 | — | 37 |
| Comprehensive income (loss) attributable to Holdings' shareholders | $274 | $(541) | $36 | $(909) |

See accompanying notes.

SEARS HOLDINGS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

| millions | August 1, 2015 | August 2, 2014 | January 31, 2015 |
|---|---|---|---|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | $1,819 | $829 | $250 |
| Restricted cash | — | 10 | — |
| Accounts receivable[(1)] | 460 | 516 | 429 |
| Merchandise inventories | 5,028 | 6,383 | 4,943 |
| Prepaid expenses and other current assets[(2)] | 270 | 419 | 241 |
| Total current assets | 7,577 | 8,157 | 5,863 |
| Property and equipment (net of accumulated depreciation and amortization of $3,097, $4,829 and $3,864) | 2,732 | 5,091 | 4,449 |
| Goodwill | 269 | 269 | 269 |
| Trade names and other intangible assets | 2,091 | 2,302 | 2,097 |
| Other assets | 517 | 619 | 531 |
| TOTAL ASSETS | $13,186 | $16,438 | $13,209 |
| LIABILITIES | | | |
| Current liabilities | | | |
| Short-term borrowings[(3)] | $6 | $1,404 | $615 |
| Current portion of long-term debt and capitalized lease obligations | 70 | 85 | 75 |
| Merchandise payables | 1,704 | 2,506 | 1,621 |
| Other current liabilities | 2,068 | 2,374 | 2,087 |
| Unearned revenues | 802 | 889 | 818 |
| Other taxes | 363 | 436 | 380 |
| Short-term deferred tax liabilities | 472 | 484 | 480 |
| Total current liabilities | 5,485 | 8,178 | 6,076 |
| Long-term debt and capitalized lease obligations[(4)] | 3,068 | 2,815 | 3,110 |
| Pension and postretirement benefits | 2,258 | 1,721 | 2,404 |
| Deferred gain on sale-leaseback | 798 | — | — |
| Sale-leaseback financing obligation | 164 | — | — |
| Other long-term liabilities | 1,830 | 2,007 | 1,849 |
| Long-term deferred tax liabilities | 489 | 798 | 715 |
| Total Liabilities | 14,092 | 15,519 | 14,154 |
| Commitments and contingencies | | | |
| EQUITY (DEFICIT) | | | |
| Total Equity (Deficit) | (906) | 919 | (945) |
| TOTAL LIABILITIES AND EQUITY (DEFICIT) | $13,186 | $16,438 | $13,209 |

(1) Includes $95 million, $84 million and $61 million at August 1, 2015, August 2, 2014 and January 31, 2015, respectively, of net amounts receivable from SHO, and a net amount receivable from Lands' End of $4 million, $3 million and $5 million at August 1, 2015, August 2, 2014 and January 31, 2015, respectively.

(2) Includes $11 million prepaid rent to Seritage at August 1, 2015.

(3) Includes a $400 million secured short-term loan with JPP II, LLC and JPP, LLC, entities affiliated with ESL, at January 31, 2015.

(4) Includes $205 million of Senior Secured Notes and $3 million of Subsidiary Notes held by ESL and its affiliates at August 1, 2015, August 2, 2014 and January 31, 2015. Also includes $299 million of Senior Unsecured Notes held

by ESL and its affiliates at August 1, 2015 and January 31, 2015.

See accompanying notes.

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

| millions | 26 Weeks Ended August 1, 2015 | 26 Weeks Ended August 2, 2014 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | (95) | (1,023) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Deferred tax valuation allowance | (500) | — |
| Depreciation and amortization | 236 | 307 |
| Impairment charges | 54 | 25 |
| Gain on sales of assets | (633) | (80) |
| Gain on sales of investments | — | (23) |
| Pension and postretirement plan contributions | (129) | (205) |
| Mark-to-market adjustments of financial instruments | 54 | — |
| Amortization of deferred gain on sale-leaseback | (7) | — |
| Settlement of Canadian dollar hedges | — | 1 |
| Change in operating assets and liabilities (net of acquisitions and dispositions): | | |
| Deferred income taxes | 258 | (36) |
| Merchandise inventories | (85) | 308 |
| Merchandise payables | 83 | 46 |
| Income and other taxes | (13) | (59) |
| Other operating assets | (24) | (23) |
| Other operating liabilities | (31) | 15 |
| Net cash used in operating activities | (832) | (747) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from sales of property and investments[1][2] | 2,678 | 164 |
| Purchases of property and equipment | (86) | (126) |
| Net cash provided by investing activities | 2,592 | 38 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Repayments of debt[3] | (443) | (42) |
| Increase (decrease) in short-term borrowings, primarily 90 days or less | (209) | 72 |
| Proceeds from sale-leaseback financing[2] | 508 | — |
| Lands' End, Inc. pre-separation funding | — | 515 |
| Separation of Lands' End, Inc. | — | (31) |
| Debt issuance costs | (47) | (11) |
| Net cash provided by (used in) financing activities | (191) | 503 |
| Effect of exchange rate changes on cash and cash equivalents | — | 7 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 1,569 | (199) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 250 | 1,028 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $1,819 | $829 |
| Supplemental Cash Flow Data: | | |
| Income taxes paid, net of refunds | $30 | $89 |
| Cash interest paid | 139 | 117 |
| Unpaid liability to acquire equipment and software | 24 | 28 |

(1) The Seritage transaction was partially financed through the sale of common shares and limited partnership units (the "rights offering"), totaling $1.6 billion, including $745 million received from ESL and its affiliates.
(2) Holdings received cash proceeds of $2.7 billion ($2.6 billion, net of closing costs) from the Seritage transaction and $429 million ($426 million, net of closing costs) from the JV transactions. Proceeds from the Seritage transaction are included in Proceeds from sales of property and investments ($2.6 billion), and Proceeds from sale-leaseback financing ($82 million) for the 26 weeks ended August 1, 2015. Proceeds from the JV transactions are included in Proceeds from sale-leaseback financing ($426 million) for the 26 weeks ended August 1, 2015.
(3) Repayments in 2015 include $400 million of a secured short-term loan with JPP II, LLC and JPP, LLC, entities affiliated with ESL.

See accompanying notes.

SEARS HOLDINGS CORPORATION
Consolidated Statements of Equity (Deficit)
(Unaudited)

| | Equity (Deficit) Attributable to Holdings' Shareholders | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| dollars and shares in millions | Number of Shares | Common Stock | Treasury Stock | Capital in Excess of Par Value | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests | Total |
| Balance at February 1, 2014 | 106 | $1 | $(5,963) | $9,298 | $(480) | $ (1,117) | $ 444 | $2,183 |
| Comprehensive loss | | | | | | | | |
| Net loss | — | — | — | — | (975) | — | (48) | (1,023) |
| Pension and postretirement adjustments, net of tax | — | — | — | — | — | 61 | 4 | 65 |
| Deferred loss on derivatives, net of tax | — | — | — | — | — | (2) | — | (2) |
| Currency translation adjustments, net of tax | — | — | — | — | — | 7 | 7 | 14 |
| Total Comprehensive Loss | | | | | | | | (946) |
| Stock awards | — | — | 3 | (2) | — | — | — | 1 |
| Separation of Lands' End, Inc. | — | — | — | (323) | — | 2 | — | (321) |
| Associate stock purchase | — | — | 2 | — | — | — | — | 2 |
| Balance at August 2, 2014 | 106 | $1 | $(5,958) | $8,973 | $(1,455) | $ (1,049) | $ 407 | $919 |
| Balance at January 31, 2015 | 107 | 1 | (5,949) | 9,189 | (2,162) | (2,030) | 6 | (945) |
| Comprehensive income | | | | | | | | |
| Net loss | — | — | — | — | (95) | — | — | (95) |
| Pension and postretirement adjustments, net of tax | — | — | — | — | — | 131 | — | 131 |
| Total Comprehensive Income | | | | | | | | 36 |
| Stock awards | — | — | 8 | (7) | — | — | — | 1 |
| Associate stock purchase | — | — | 2 | — | — | — | — | 2 |
| Balance at August 1, 2015 | 107 | $1 | $(5,939) | $9,182 | $(2,257) | $ (1,899) | $ 6 | $(906) |

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 1,702 full-line and specialty retail stores in the United States, operating through Kmart and Sears. Through the third quarter of 2014, we conducted our operations under three reportable segments: Kmart, Sears Domestic and Sears Canada. Following the de-consolidation of Sears Canada in the third quarter of 2014 discussed below, we have operated under two reportable segments: Kmart and Sears Domestic.

These interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full fiscal year. The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. These interim financial statements and related notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

### Depreciation Expense

Depreciation expense included within depreciation and amortization expense reported on the Condensed Consolidated Statements of Operations was $113 million, $232 million, $147 million and $297 million for the 13- and 26- week periods ended August 1, 2015 and August 2, 2014, respectively.

### Vendor Credits

During the 13- and 26-week periods ended August 1, 2015, the Company received $33 million and $126 million related to one-time credits from vendors associated with prior supply arrangements, which have been reflected as a credit within cost of sales, buying and occupancy on the Condensed Consolidated Statement of Operations.

### Liquidity

Our primary need for liquidity is to fund working capital requirements of our businesses, capital expenditures and for general corporate purposes, including debt repayment and pension plan contributions. We have incurred losses and experienced negative operating cash flows for the past several years; accordingly, the Company has taken a number of actions to enhance its financial flexibility and fund its continued transformation, support its operations and meet its obligations.

As we progress in our transformation, we are primarily focusing on profitability instead of revenues, market share and other metrics which relate to, but do not necessarily drive profit. This approach may negatively impact our sales, however, it should also reduce the risk of material profit declines. We believe that our focus on profitability will contribute to a meaningful performance in 2015 and beyond. If we continue to experience operating losses, and we are not able to generate sufficient liquidity through some combination of actions, the availability under our Domestic Credit Facility might be fully utilized and we would need to secure additional sources of funds. Moreover, if the borrowing base (as calculated pursuant to the indenture) falls below the principal amount of the notes plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for the notes on the last day of any two consecutive quarters, it could trigger an obligation to repurchase notes in an amount equal to such deficiency.

We also continue to take action to evolve and transition our capital structure toward a structure that is more flexible, long-term oriented and less dependent on inventory and receivables. During the second quarter of 2015, the

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

Company completed its previously announced rights offering and sale-leaseback transaction with Seritage Growth Properties and received aggregate gross proceeds from the transaction of $2.7 billion. In addition, as discussed in Note 2, the Company completed an amendment and extension of its existing domestic credit facility in which the maturity date for $1.971 billion of the domestic credit facility has been extended to July 2020, while $1.304 billion retains the existing maturity date of April 2016. These actions have substantially enhanced our liquidity and achieved our objective of reducing our reliance on inventory as a source of financing. We intend to continue taking significant actions to alter our capital structure, as circumstances allow, to position Holdings for success and profitability, which could include further reductions in debt or changes in the composition of our debt.

Sears Canada Rights Offering

On October 2, 2014, the Company announced that its board of directors had approved a rights offering of up to 40 million shares of Sears Canada Inc. ("Sears Canada"). In connection with the rights offering, each holder of Holdings' common stock received one subscription right for each share of common stock held at the close of business on October 16, 2014, the record date for the rights offering. On October 16, 2014, ESL Partners, L.P. and Edward S. Lampert, our Chairman and Chief Executive Officer and Chairman and Chief Executive Officer of ESL Investments Inc. and related entities (collectively "ESL") exercised a portion of its pro rata portion of the basic subscription rights to the offering, resulting in the sale of approximately 18 million common shares of Sears Canada to ESL. After the sale of Sears Canada shares to ESL on October 16, 2014, the Company was the beneficial holder of approximately 34 million shares, or 34%, of the common shares of Sears Canada. As such, the Company no longer maintained control of Sears Canada resulting in the de-consolidation of Sears Canada. The Sears Canada rights offering closed on November 7, 2014 and was oversubscribed. Accordingly, the Company sold a total of 40 million common shares of Sears Canada and received total aggregate proceeds of $380 million for the rights offering by the closing date.

We accounted for the de-consolidation of Sears Canada in accordance with accounting standards applicable to consolidation and de-recognized the assets, liabilities, accumulated other comprehensive income and non-controlling interest related to Sears Canada and recognized a gain of approximately $70 million recorded within Interest and investment income on the Consolidated Statement of Operations and within gain on sales of investments on the Consolidated Statements of Cash Flows for the year ended January 31, 2015, of which $42 million relates to the remeasurement of our retained equity interest to its fair value.

Also, we determined that we have the ability to exercise significant influence over Sears Canada as a result of our ownership interest in Sears Canada and as a result of Mr. Lampert's role as our Chairman and Chief Executive Officer, and Chairman and Chief Executive Officer of ESL. Accordingly, we accounted for our retained investment in the common shares of Sears Canada as an equity method investment in accordance with accounting standards applicable to investments. We elected the fair value option for the equity method investment in Sears Canada in accordance with accounting standards applicable to financial instruments. The fair value of our equity method investment is recorded in Other assets on the Condensed Consolidated Balance Sheet and is disclosed in Note 4, and the change in fair value is recorded in Interest and investment income (loss) on the Condensed Consolidated Statement of Operations.

In addition, since the Company has retained an equity interest in Sears Canada, the operating results for Sears Canada through October 16, 2014 are presented within the consolidated operations of Holdings and the Sears Canada segment in the accompanying Condensed Consolidated Financial Statements in accordance with accounting standards applicable to presentation of financial statements.

At both August 1, 2015 and January 31, 2015, the Company was the beneficial holder of approximately 12 million, or 12%, of the common shares of Sears Canada. At August 2, 2014, Sears Holdings was the beneficial holder of approximately 52 million, or 51%, of the common shares of Sears Canada.

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

Separation of Lands' End, Inc.
On April 4, 2014, we completed the separation of our Lands' End business through a spin-off transaction. The separation was structured to be tax free to our U.S. shareholders for U.S. federal income tax purposes. Prior to the separation, Lands' End, Inc. ("Lands' End") entered into an asset-based senior secured revolving credit facility, which provided for maximum borrowings of approximately $175 million with a letter of credit sub-limit, and a senior secured term loan facility of approximately $515 million. The proceeds of the term loan facility were used to fund a $500 million dividend to Holdings and pay fees and expenses associated with the foregoing facilities. We accounted for this spin-off in accordance with accounting standards applicable to spin-off transactions. Accordingly, we classified the carrying value of net assets of $323 million contributed to Lands' End as a reduction of capital in excess of par value in the Consolidated Statement of Equity (Deficit) for the year ended January 31, 2015.
Additionally, as a result of Mr. Lampert's role as our Chairman and Chief Executive Officer, and Chairman and Chief Executive Officer of ESL, and the continuing arrangements between Holdings and Lands' End (as further described in Note 13), Holdings has determined that it has significant influence over Lands' End. Accordingly, the operating results for Lands' End through the date of the spin-off are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Condensed Consolidated Financial Statements.
In connection with the separation, Holdings and certain of its subsidiaries entered into various agreements with Lands' End under the terms described in Note 13.
NOTE 2—BORROWINGS
Total borrowings were as follows:

| millions | August 1, 2015 | August 2, 2014 | January 31, 2015 |
|---|---|---|---|
| Short-term borrowings: | | | |
| Unsecured commercial paper | $6 | $7 | $2 |
| Secured short-term loan | — | — | 400 |
| Secured borrowings | — | 1,397 | 213 |
| Long-term debt, including current portion: | | | |
| Notes and debentures outstanding | 2,917 | 2,566 | 2,913 |
| Capitalized lease obligations | 221 | 334 | 272 |
| Total borrowings | $3,144 | $4,304 | $3,800 |

The fair value of long-term debt, excluding capitalized lease obligations, was $2.9 billion at August 1, 2015, $2.3 billion at August 2, 2014 and $2.9 billion at January 31, 2015. 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 4 to the Condensed Consolidated Financial Statements.
Debt Repurchase Authorization
During the second quarter of 2015, the Board of Directors authorized the repurchase, subject to market conditions and other factors, of up to $1.0 billion of our outstanding indebtedness in open market or privately negotiated transactions, superseding the previously disclosed debt repurchase authorization from 2005. The unused balance of this authorization is $1.0 billion at August 1, 2015.
On August 3, 2015, the Company commenced a tender offer (the "Offer") to purchase for cash up to $1.0 billion principal amount of its outstanding 6 5/8% Senior Secured Notes Due 2018 (the "Senior Secured Notes"). The aggregate principal amount of Senior Secured Notes currently outstanding is approximately $1.24 billion. As of the early tender date, approximately $936 million principal amount of the Senior Secured Notes were validly tendered and not validly withdrawn in the Offer. Pursuant to the terms of the Offer, holders of Senior Secured Notes may tender additional notes at or prior to 11:59 p.m., New York City time, on August 28, 2015, unless the Offer is

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

earlier terminated or extended by the Company in its sole discretion. As such, the unused balance of our debt repurchase authorization is $74 million at August 20, 2015. As a result of the Notes received from the early tender, we have mitigated our annualized cash interest expense by approximately $62 million.

Unsecured Commercial Paper

We borrow through the commercial paper markets. At August 1, 2015, August 2, 2014 and January 31, 2015, we had outstanding commercial paper borrowings of $6 million, $7 million and $2 million, respectively.

Secured Short-Term Loan

On September 15, 2014, the Company, through Sears, Sears Development Co. and Kmart Corporation ("Borrowers"), entities wholly-owned and controlled, directly or indirectly by the Company, entered into a $400 million secured short-term loan (the "Loan'") with JPP II, LLC and JPP, LLC (together, the "Lender"), entities affiliated with ESL. The first $200 million of the Loan was funded at the closing on September 15, 2014 and the remaining $200 million was funded on September 30, 2014. Proceeds of the Loan were used for general corporate purposes.

The Loan was originally scheduled to mature on December 31, 2014. As permitted by the Loan agreement, the Company paid an extension fee equal to 0.5% of the principal amount to extend the maturity date to February 28, 2015. The Loan had an annual base interest rate of 5%. The Borrowers paid an upfront fee of 1.75% of the full principal amount. The Loan was guaranteed by the Company and was secured by a first priority lien on certain real properties owned by the Borrowers.

On February 25, 2015, we entered into an agreement effective February 28, 2015, to amend and extend the $400 million secured short-term loan. Under the terms of the amendment, we repaid $200 million of the $400 million on March 2, 2015 and the remaining $200 million on June 1, 2015. At January 31, 2015, the outstanding balance of the Loan was $400 million.

Domestic Credit Agreement

During the first quarter of 2011, SRAC, Kmart Corporation (together with SRAC, the "Borrowers") and Holdings entered into an amended credit agreement (the "Domestic Credit Agreement"). On October 2, 2013, Holdings and the Borrowers entered into a First Amendment (the "Amendment") to the Domestic Credit Agreement with a syndicate of lenders. Pursuant to the Amendment, the Borrowers borrowed $1.0 billion under a new senior secured term loan facility (the "Term Loan"). On July 21, 2015, the Borrowers and Holdings entered into an amended and restated credit agreement (the "Amended Domestic Credit Agreement") with a syndicate of lenders that amended and restated the then-existing Domestic Credit Agreement. The Amended Domestic Credit Agreement provides a $3.275 billion asset-based revolving credit facility (the "Revolving Facility") with a $1.0 billion letter of credit sub-facility. The maturity date for $1.971 billion of the Revolving Facility has been extended to July 20, 2020, while $1.304 billion retains the existing maturity date of April 8, 2016. The Amended Domestic Credit Agreement also governs the existing Term Loan, which retains its maturity date of June 30, 2018. The Amended Domestic Credit Agreement includes an accordion feature that allows the Borrowers to use existing collateral for the facility to obtain up to $1.0 billion of additional borrowing capacity, subject to borrowing base requirements, as well as a "FILO" ("first in last out") tranche feature that allows an additional $500 million of borrowing capacity. The Amended Domestic Credit Agreement also increases Holdings' ability to undertake short-term borrowings from $500 million to $750 million. Revolving advances under the Amended 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 dependent on Holdings' consolidated leverage ratio (as measured under the Amended Domestic Credit Agreement). The margin with respect to borrowings under the extended commitments ranges from 3.25% to 3.75% for LIBOR loans and from 2.25% to 2.75% for base rate loans. The margin with respect to borrowings under the non-extended commitments remains 2.00% to 2.50% for LIBOR loans and 1.00% to 1.50% for base rate loans. The Amended Domestic Credit Agreement also provides for the payment of fees with respect to issued and undrawn letters of credit at a rate equal to the margin applicable to LIBOR loans and a commitment fee with respect to unused amounts of the Revolving Facility at a rate, depending on facility usage, between 0.375% to 0.625%, per

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annum, with a minimum of 0.50% applicable to commitments under the extended tranche. From and after April 8, 2016, such commitment fees with respect to the extended tranche will change to a flat 0.50%.

The Revolving Facility is in place as a funding source for general corporate purposes and is secured by a first lien on substantially all of our domestic inventory and credit card and pharmacy receivables, and is subject to a borrowing base formula to determine availability. The Revolving Facility is guaranteed by all domestic subsidiaries of Holdings that own inventory or credit card or pharmacy receivables. The Revolving Facility also permits aggregate second lien indebtedness of up to $2.0 billion, of which $1.24 billion in second lien notes were outstanding at August 1, 2015, resulting in $760 million of permitted second lien indebtedness, subject to limitations imposed by a borrowing base requirement under the indenture that governs our 6 5/8% senior secured notes due 2018.

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

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

At August 1, 2015, August 2, 2014 and January 31, 2015, we had $0 million, $1.4 billion and $213 million, respectively, of Revolving Facility borrowings and $657 million, $646 million and $667 million, respectively, of letters of credit outstanding under the Revolving Facility. At August 1, 2015, August 2, 2014 and January 31, 2015, the amount available to borrow under the Revolving Facility was $1.2 billion, $240 million and $808 million, respectively, which reflects the effect of the springing fixed charge coverage ratio covenant and the borrowing base limitation. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

At August 1, 2015, August 2, 2014 and January 31, 2015, we had borrowings of $985 million, $995 million and $990 million, respectively, under the Term Loan.

Senior Secured Notes

In October 2010, we sold $1.0 billion aggregate principal amount of senior secured notes (the "Senior Secured 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 Senior Secured Notes, the Company sold $250 million aggregate principal amount of Senior Secured Notes to the Company's domestic pension plan in a private placement, of which approximately $110 million remains in the domestic pension plan. The Senior Secured 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 Senior Secured Notes is junior in priority to the lien on such assets that secures obligations under the Amended Domestic Credit Agreement, as well as certain other first priority lien obligations. The Company used the net proceeds of this offering to repay borrowings outstanding under 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 Senior Secured 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

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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 Senior Secured Notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Senior Secured 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 Senior Secured 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 Senior Secured 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 Senior Secured Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

Senior Unsecured Notes

On October 20, 2014, the Company announced its board of directors had approved a rights offering allowing its stockholders to purchase up to $625 million in aggregate principal amount of 8% senior unsecured notes due 2019 and warrants to purchase shares of its common stock. The subscription rights were distributed to all stockholders of the Company as of October 30, 2014, the record date for this rights offering, and every stockholder had the right to participate on the same terms in accordance with its pro rata ownership of the Company's common stock, except that holders of the Company's restricted stock that was unvested as of the record date received cash awards in lieu of subscription rights. This rights offering closed on November 18, 2014 and was oversubscribed.

Accordingly, on November 21, 2014, the Company issued $625 million aggregate original principal amount of 8% senior unsecured notes due 2019 (the "Senior Unsecured Notes") and received proceeds of $625 million which were used for general corporate purposes. The Senior Unsecured Notes are the unsecured and unsubordinated obligations of the Company and rank equal in right of payment with the existing and future unsecured and unsubordinated indebtedness of the Company. The Senior Unsecured Notes bear interest at a rate of 8% per annum and the Company will pay interest semi-annually on June 15 and December 15 of each year. The Senior Unsecured Notes are not guaranteed.

We accounted for the Senior Unsecured Notes in accordance with accounting standards applicable to distinguishing liabilities from equity and debt with conversion and other options. Accordingly, we allocated the proceeds received for the Senior Unsecured Notes based on the relative fair values of the Senior Unsecured Notes and warrants, which resulted in a discount to the notes of approximately $278 million. The fair value of the Senior Unsecured Notes and warrants was estimated based on quoted market prices for the same issues using Level 1 measurements as defined in Note 4. The discount is being amortized over the life of the Senior Unsecured Notes using the effective interest method with an effective interest rate of 11.55%. Approximately $5 million of the discount was amortized during 2014, resulting in a remaining discount of approximately $273 million at January 31, 2015. The book value of the Senior Unsecured Notes net of the remaining discount was approximately $352 million at January 31, 2015. Approximately $16 million of the discount was amortized during the 26-week period ended August 1, 2015, resulting in a remaining discount of approximately $257 million at August 1, 2015. The book value of the Senior Unsecured Notes net of the remaining discount was approximately $368 million at August 1, 2015.

Wholly owned Insurance Subsidiary and Intercompany Securities

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

In accordance with applicable insurance regulations, Sears Re holds marketable securities to support the insurance coverage it provides. Sears has utilized two securitization structures to issue specific securities in which Sears Re has invested its capital to fund its insurance obligations. In November 2003, Sears formed a Real Estate Mortgage Investment Conduit ("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

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REMIC issued to wholly owned subsidiaries of Sears (including Sears Re) $1.3 billion (par value) of securities (the "REMIC Securities") that are secured by the mortgages and collateral assignments of the store leases. Payments to the holders on the REMIC Securities are funded by the lease payments. In May 2006, a subsidiary of Holdings contributed the rights to use the Kenmore, Craftsman and DieHard trademarks in the U.S. and its possessions and territories to KCD IP, LLC, an indirect wholly owned subsidiary of Holdings. KCD IP, LLC has licensed the use of the trademarks to subsidiaries of Holdings, including Sears and Kmart. Asset-backed securities with a par value of $1.8 billion (the "KCD Securities") were issued by KCD IP, LLC and subsequently purchased by Sears Re, the collateral for which includes the trademark rights and royalty income. Payments to the holders on the KCD Securities are funded by the royalty payments. The issuers of the REMIC Securities and KCD Securities and the owners of these real estate and trademark assets are bankruptcy remote, special purpose entities that are indirect wholly owned subsidiaries of Holdings. Cash flows received from rental streams and licensing fee streams paid by Sears, Kmart, other affiliates and third parties, are used for the payment of fees and interest on these securities. In the fourth quarter of fiscal 2013, Holdings contributed all of the outstanding capital stock of Sears Re to SRe Holding Corporation, a direct wholly owned subsidiary of Holdings. Sears Re thereafter reduced its excess statutory capital through the distribution of all REMIC Securities held by it to SRe Holding Corporation. Since the inception of the REMIC and KCD IP, LLC, the REMIC Securities and the KCD Securities have been entirely held by our wholly owned consolidated subsidiaries. At August 1, 2015, August 2, 2014 and January 31, 2015, 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 $0.6 billion at August 1, 2015, and approximately $0.7 billion at both August 2, 2014 and January 31, 2015.

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—DERIVATIVE FINANCIAL INSTRUMENTS

We primarily used derivatives as a risk management tool to decrease our exposure to fluctuations in the foreign currency market, and do not use derivative financial instruments for trading or speculative purposes. We were exposed to fluctuations in foreign currency exchange rates as a result of our net investment in Sears Canada. Further, Sears Canada was exposed to fluctuations in foreign currency exchange rates due to inventory purchase contracts denominated in U.S. dollars. We had no material outstanding derivatives at August 1, 2015 or January 31, 2015. The recorded amounts and corresponding gains on the hedging activity were not material at August 2, 2014 or for the 13-and 26- week periods ended August 2, 2014.

Hedges of Net Investment in Sears Canada

During the 13-week period ended August 2, 2014, we entered into foreign currency forward contracts with a total Canadian notional value of $300 million, and with a weighted-average remaining life of 0.1 years at August 2, 2014. These contracts were designated and qualify as hedges of the foreign currency exposure of our net investment in Sears Canada.

For derivatives that were designated as hedges of our net investment in Sears Canada, we assessed effectiveness based on changes in forward currency exchange rates. Changes in forward rates on the derivatives were recorded in the currency translation adjustments line in accumulated other comprehensive loss prior to the de-consolidation of Sears Canada on October 16, 2014. Subsequent to that date, the change in forward rates on the remaining derivative contracts that were no longer designated as hedges was recorded in interest and investment income in the Condensed Consolidated Statements of Operations.

We settled foreign currency forward contracts during the 13-week period ended August 2, 2014 and paid $0.5 million relative to these contract settlements during the third quarter of 2014. We settled foreign currency forward contracts and received a net amount of $1 million during the 26-week period ended August 2, 2014 relative to these

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contract settlements. As hedge accounting was applied to these contracts, an offsetting amount was recorded as a component of other comprehensive loss.

Sears Canada Hedges of Merchandise Purchases

At August 2, 2014, Sears Canada had $205 million notional amount of foreign exchange forward contracts. These forward contracts were used to reduce the foreign exchange risk with respect to U.S. dollar denominated assets and liabilities and purchases of goods or services.

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

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

Counterparty Credit Risk

We actively manage the risk of nonpayment by our derivative counterparties by limiting our exposure to individual counterparties based on credit ratings, value at risk and maturities. The counterparties to these instruments were major financial institutions with investment grade credit ratings or better at August 2, 2014.

NOTE 4—FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

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

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

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

Accounts receivable, merchandise payables, short-term borrowings, accrued liabilities, cash and domestic 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 long-term debt is disclosed in Note 2. 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 August 1, 2015, August 2, 2014 and January 31, 2015:

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| millions | Total Fair Value Amounts at August 1, 2015 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Cash equivalents(1) | $1,533 | $1,533 | $— | $— |
| Equity method investments(2) | 69 | 69 | — | — |
| Total | $1,602 | $1,602 | $— | $— |

| millions | Total Fair Value Amounts at August 2, 2014 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Cash equivalents(1) | $55 | $55 | $— | $— |
| Restricted cash(3) | 10 | 10 | — | — |
| Foreign currency derivative assets(4) | 4 | — | 4 | — |
| Total | $69 | $65 | $4 | $— |

| millions | Total Fair Value Amounts at January 31, 2015 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Equity method investments(2) | $111 | $111 | $— | $— |

(1) Included within Cash and cash equivalents on the Condensed Consolidated Balance Sheets.
(2) Included within Other assets on the Condensed Consolidated Balance Sheets.
(3) Included within Restricted cash on the Condensed Consolidated Balance Sheets.
(4) Included within Prepaid expenses and other current assets on the 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.

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

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible fixed assets, goodwill and other intangible assets, which are remeasured when the derived fair value is below carrying value on our Condensed Consolidated Balance Sheets. For these assets, we do not periodically adjust carrying value to fair value except in the event of impairment. When we determine that impairment has occurred, we measure the impairment and adjust the carrying value. With the exception of the fixed asset impairments described in Note 5, we had no significant remeasurements of such assets or liabilities to fair value during the 13- and 26- week periods ended August 1, 2015 and August 2, 2014.

NOTE 5—STORE CLOSING CHARGES, SEVERANCE COSTS, IMPAIRMENTS AND REAL ESTATE TRANSACTIONS

Store Closings and Severance

During the 13-week period ended August 1, 2015, we closed 10 stores in our Kmart segment and four stores in our Sears Domestic segment we previously announced would close. During the 26-week period ended August 1, 2015, we closed 16 stores in our Kmart segment and six stores in our Sears Domestic segment we previously announced would close. We made the decision to close 10 stores in our Kmart segment and five stores in our Sears Domestic segment during the 13-week period ended August 1, 2015, and 22 stores in our Kmart segment and seven stores in our Sears Domestic segment during the 26-week period ended August 1, 2015.

During the 13-week period ended August 2, 2014, we closed 46 stores in our Kmart segment and eight stores in our Sears Domestic segment we previously announced would close. During the 26-week period ended August 2, 2014,

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we closed 75 stores in our Kmart segment and 21 stores in our Sears Domestic segment we previously announced would close. We made the decision to close 26 stores in our Kmart segment and two stores in our Sears Domestic segment during the 13-week period ended August 2, 2014, and 40 stores in our Kmart segment and six stores in our Sears Domestic segment during the 26-week period ended August 2, 2014.

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.

Store closing costs and severance recorded for the 13- and 26- week periods ended August 1, 2015 and August 2, 2014 were as follows:

| millions | Markdowns[(1)] | Severance Costs[(2)] | Lease Termination Costs[(2)] | Other Charges[(2)] | Impairment and Accelerated Depreciation[(3)] | Total Store Closing Costs |
|---|---|---|---|---|---|---|
| Kmart | $4 | $1 | $(1) | $1 | $— | $5 |
| Sears Domestic | 1 | — | (9) | 1 | 2 | (5) |
| Total for the 13-week period ended August 1, 2015 | $5 | $1 | $(10) | $2 | $2 | $— |
| | | | | | | |
| Kmart | $10 | $3 | $11 | $3 | $3 | $30 |
| Sears Domestic | — | 2 | 4 | 1 | 3 | 10 |
| Sears Canada | 1 | 4 | — | — | — | 5 |
| Total for the 13-week period ended August 2, 2014 | $11 | $9 | $15 | $4 | $6 | $45 |
| | | | | | | |
| Kmart | $9 | $2 | $27 | $3 | $— | $41 |
| Sears Domestic | 2 | 2 | (9) | 1 | 2 | (2) |
| Total for the 26-week period ended August 1, 2015 | $11 | $4 | $18 | $4 | $2 | $39 |
| | | | | | | |
| Kmart | $15 | $4 | $11 | $6 | $3 | $39 |
| Sears Domestic | 2 | 2 | $2 | 1 | 8 | 15 |
| Sears Canada | 1 | 9 | 5 | — | — | 15 |
| Total for the 26-week period ended August 2, 2014 | $18 | $15 | $18 | $7 | $11 | $69 |

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

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

(3) Costs for the 13- and 26-week periods ended August 1, 2015 are recorded within Depreciation and amortization on the Condensed Consolidated Statement of Operations. Costs for the 13-week period ended August 2, 2014 include $5 million recorded withing Impairment charges and $1 million recorded within Depreciation and amortization on the Condensed Consolidated Statement of Operations. Costs for the 26-week period ended August 2, 2014 include $10 million recorded within Impairment charges and $1 million recorded within Depreciation and amortization on the Condensed Consolidated Statement of Operations.

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Store closing cost accruals of $182 million, $175 million and $207 million at August 1, 2015, August 2, 2014 and January 31, 2015, respectively, were as follows:

| millions | Severance Costs | Lease Termination Costs | Other Charges | Total |
|---|---|---|---|---|
| Balance at August 2, 2014 | $39 | $125 | $11 | $175 |
| Store closing costs | 41 | 57 | 13 | 111 |
| Payments/utilizations | (37) | (26) | (16) | (79) |
| Balance at January 31, 2015 | 43 | 156 | 8 | 207 |
| Store closing costs | 4 | 18 | 4 | 26 |
| Payments/utilizations | (18) | (28) | (5) | (51) |
| Balance at August 1, 2015 | $29 | $146 | $7 | $182 |

Long-Lived Assets

In accordance with accounting standards governing the impairment or disposal of long-lived assets, we performed an impairment test of certain of our long-lived assets due to events and changes in circumstances during the 13-week period ended August 1, 2015 that indicated an impairment might have occurred. The impairment review was triggered by the Seritage transaction (as defined below). As a result of this impairment testing, the Company recorded impairment charges of $54 million, of which $52 million and $2 million were recorded within the Sears Domestic and Kmart segments, respectively, during the 13- and 26-week periods ended August 1, 2015. As a result of impairment testing, triggered by a decline in operating performance at certain locations within the Sears Canada segment, the Company recorded impairment charges of $15 million during the 13- and 26- week periods ended August 2, 2014 within the Sears Canada segment.

Real Estate Transactions

On April 1, 2015, April 13, 2015, and April 30, 2015, Holdings and General Growth Properties, Inc. ("GGP"), Simon Property Group, Inc. ("Simon") and The Macerich Company ("Macerich"), respectively, announced that they entered into three distinct real estate joint ventures (collectively, the "JVs"). Holdings contributed 31 properties to the JVs where Holdings currently operates stores (or leases former stores to third-party tenants) (the "JV properties"), in exchange for a 50% interest in the JVs and $429 million in cash ($426 million, net of closing costs) (the "JV transactions"). The JV transactions valued the JV properties at $858 million in the aggregate.

On July 7, 2015, Holdings completed its rights offering and sale-leaseback transaction (the "Seritage transaction") with Seritage Growth Properties ("Seritage"), a recently formed, independent publicly traded real estate investment trust ("REIT"). As part of the Seritage transaction, Holdings sold 235 properties to Seritage (the "REIT properties") along with Holdings' 50% interest in the JVs. Holdings received aggregate gross proceeds from the Seritage transaction of $2.7 billion ($2.6 billion, net of closing costs). The Seritage transaction was partially financed through the sale of common shares and limited partnership units, totaling $1.6 billion, including $745 million received from ESL and its affiliates as further described in Note 13. The Seritage transaction was also partially financed by Seritage through mortgage and mezzanine loan proceeds totaling $1.2 billion. Immediately prior to completing the Seritage transaction, subsidiaries of Kmart and Sears obtained mortgage and mezzanine financing for the REIT properties. Upon completion of the Seritage transaction, all obligations with respect to such financing were assumed by Seritage. The Seritage transaction valued the REIT properties at $2.3 billion in the aggregate.

In connection with the Seritage transaction and JV transactions, Holdings has entered into agreements with Seritage and the JVs under which Holdings leases 255 of the properties (the "Master Leases"), with the remaining properties being leased by Seritage to third parties. The Master Leases generally are triple net leases with respect to the space occupied by Holdings, and Holdings has the obligation to pay rent, costs and expenses of operation, repair, and maintenance of the space occupied. The Master Leases have an initial term of 10 years. The master lease for the REIT properties provides Holdings three options for five-year renewals of the term and a final option for a four-year renewal. The Master Leases for the JV properties provide Holdings two options for five-year renewals of the term.

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Seritage and the JVs have a recapture right with respect to approximately 50% of the space within the stores at the REIT properties and JV properties (subject to certain exceptions), in addition to all of the automotive care centers which are free-standing or attached as “appendages”, and all outparcels or outlots, as well as certain portions of parking areas and common areas, except as set forth in the Master Leases, for no additional consideration. With respect to 21 stores identified in the Master Leases, Seritage has the further additional right to recapture 100% of the space within the Holdings’ main store, effectively terminating the Master Leases with respect to such properties. The Master Leases also provide Holdings certain rights to terminate the Master Leases with respect to REIT properties or JV properties that cease to be profitable for operation by Holdings. In order to terminate the Master Lease with respect to a certain property, Holdings must make a payment to Seritage or the JV of an amount equal to one year of rent (together with taxes and other expenses) with respect to such property. Such termination right, however, is limited so that it will not have the effect of reducing the fixed rent under the Master Lease for the REIT properties by more than 20% per annum.

Also, in connection with the Seritage transaction and JV transactions, Holdings assigned its lease agreements with third party tenants for REIT properties and JV properties to Seritage and each of the JVs, respectively, and also assigned rental income from Lands' End for REIT properties and JV properties to Seritage and each of the JVs, respectively.

The initial amount of aggregate annual base rent under the Master Leases is $134 million for the REIT properties and $42 million for the JV properties, with increases of 2% per year beginning in the second lease year for the REIT properties and in the fourth lease year for the JV properties. Holdings recorded rent expense of $16 million in Cost of sales, buying and occupancy for the 13 weeks ended August 1, 2015. Rent expense consists of straight-line rent expense of $23 million offset by amortization of a deferred gain on sale-leaseback of $7 million. For the 13 weeks ended August 1, 2015, rent expense of $15 million (consisting of straight-line rent expense of $21 million offset by amortization of a deferred gain on sale-leaseback of $6 million) was recorded in our Sears Domestic segment, and rent expense of $1 million (consisting of straight-line rent expense of $2 million offset by amortization of a deferred gain on sale-leaseback of $1 million) was recorded in our Kmart segment.

We accounted for the Seritage transaction and JV transactions in accordance with accounting standards applicable to real estate sales and sale-leaseback transactions. We determined that the Seritage transaction qualifies for sales recognition and sale-leaseback accounting. Because of our initial ownership interest in the JVs and continuing involvement in the properties, we determined that the JV transactions, which occurred in the first quarter of 2015, did not initially qualify for sale-leaseback accounting and, therefore, accounted for the JV transactions as financing transactions and, accordingly, recorded a sale-leaseback financing obligation of $426 million and continued to report the real property assets on our Condensed Consolidated Balance Sheets at May 2, 2015. Upon the sale of our 50% interest in the JVs to Seritage, the continuing involvement through an ownership interest in the buyer-lessor no longer exists, and Holdings determined that the JV transactions then qualified for sales recognition and sale-leaseback accounting, with the exception of four properties for which we still have continuing involvement as a result of an obligation to redevelop the stores for a third-party tenant and pay rent on behalf of the third-party tenant until it commences rent payments to the JVs.

With the exception of the four properties that have continuing involvement, in accordance with accounting standards related to sale-leaseback transactions, Holdings recognized any loss on sale immediately, any gain on sale in excess of the present value of minimum lease payments immediately, and any remaining gain was deferred and will be recognized in proportion to the related rent expense over the lease term. Holdings received aggregate net proceeds of $3.1 billion for the Seritage transaction and JV transactions. The carrying amount of Property and equipment, net and lease balances related to third-party leases that were assigned to Seritage and the JVs was $1.5 billion at July 7, 2015, of which $1.3 billion was recorded in our Sears Domestic segment and $175 million in our Kmart segment. Accordingly, Holdings recognized an immediate net gain of $508 million within Gain on sales of assets on the Condensed Consolidated Statement of Operations for the 13- and 26- weeks ended August 1, 2015, comprised of a gain of $625 million for the amount of gain on sale in excess of the present value of minimum lease payments, offset by a loss of $117 million for properties where the fair value was less than the carrying value and the write-off of lease balances related to third-party leases that were assigned to Seritage and the JVs. For the 13- and 26- weeks ended August 1, 2015, an immediate net gain of $371 million (comprised of a gain of $471 million and loss of $100 million) was recorded in our Sears Domestic segment, and an immediate net gain of $137 million (comprised of a gain of $154 million and loss of $17 million) was recorded in our Kmart segment. The remaining gain of $894 million was deferred and will be recognized in proportion to the related rent expense over the lease term. At August 1, 2015, $89 million of the deferred gain on sale-leaseback is classified as current within Other current liabilities and $798 million is classified as long-term as Deferred gain on sale-leaseback on the Condensed Consolidated Balance Sheets.

Holdings accounted for the four properties that have continuing involvement as a financing transaction in accordance with accounting standards related to sale-leaseback transactions. Accordingly, Holdings recorded a sale-leaseback financing obligation of $164 million, which is classified as long-term as Sale-leaseback financing obligation on the Condensed Consolidated Balance Sheet at August 1, 2015. The decrease in the sale-leaseback financing obligation from $426 million at May 2, 2015 to $164 million at August 1, 2015 represents a noncash change. We continued to report the real property assets of $45 million at August 1, 2015 on our Condensed Consolidated Balance Sheets, which are included in our Sears Domestic segment.

The obligation for future minimum lease payments at August 1, 2015 for the four properties that have continuing involvement is $109 million over the 10 year lease term, and is $10 million for each of 2016, 2017, 2018, and 2019, respectively, and $11 million for 2020. This obligation for future minimum lease payments includes $62 million of rent on behalf of a third-party tenant over the 10 year lease term. We will no longer have the obligation to pay rent on behalf of the third-party tenant when it commences rent payments to the JVs, which we expect to occur within one to two years.

During the first half of 2015, we also recorded gains on the sales of assets of $86 million recognized on the sale of two Sears Full-line stores for which we received $96 million of cash proceeds, and $10 million recognized on the surrender and early termination of one Kmart store lease. In connection with one of the Sears Full-line stores, we entered into a leaseback agreement for up to six months. We determined that we have surrendered substantially all of our rights and obligations, and, therefore, immediate gain recognition is appropriate on these transactions.

During the first half of 2014, we recorded gains on the sales of assets of $80 million in connection with real estate transactions, which included a gain of $13 million recognized on the sale of a distribution facility in our Sears Domestic segment for which we received $16 million of cash proceeds and a gain of $10 million recognized on sale of a Kmart store for which we received $10 million of cash proceeds.

Also, during the first half of 2014, we entered into an agreement for the surrender and early termination of two Sears Full-line store leases for which we received $64 million of cash proceeds. The gains were deferred until the lease termination agreements were effective in the third quarter of 2014.

Additionally, during the second quarter of 2014, we recorded investment income of $23 million related to the sale of a 15% joint venture interest in one property Sears Canada owned with Ivanhoe Cambridge II Inc., for which Sears Canada received $30 million ($33 million Canadian) in cash proceeds.

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

NOTE 6—EQUITY
Earnings per Share
The following table sets forth the components used to calculate basic and diluted earnings (loss) per share attributable to Holdings' shareholders. During the 26 week period ended August 1, 2015, warrants, restricted stock awards and restricted stock units, totaling 8.6 million shares, were not included in the computation of diluted loss per share attributable to Holdings' shareholders because the effect of their inclusion would have been antidilutive. During both the 13- and 26- week periods ended August 2, 2014, restricted stock awards and restricted stock units, totaling 0.1 million shares, were not included in the computation of diluted loss per share attributable to Holdings' shareholders because the effect of their inclusion would have been antidilutive.

| millions, except earnings per share | 13 Weeks Ended August 1, 2015 | 13 Weeks Ended August 2, 2014 | 26 Weeks Ended August 1, 2015 | 26 Weeks Ended August 2, 2014 |
|---|---|---|---|---|
| Basic weighted average shares | 106.5 | 106.3 | 106.5 | 106.3 |
| Dilutive effect of restricted stock awards, restricted stock units and warrants | 6.8 | — | — | — |
| Diluted weighted average shares | 113.3 | 106.3 | 106.5 | 106.3 |
| Net income (loss) attributable to Holdings' shareholders | $208 | $(573) | $(95) | $(975) |
| Earnings (loss) per share attributable to Holdings' shareholders: | | | | |
| Basic | $1.95 | $(5.39) | $(0.89) | $(9.17) |
| Diluted | $1.84 | $(5.39) | $(0.89) | $(9.17) |

Accumulated Other Comprehensive Loss
The following table displays the components of accumulated other comprehensive loss:

| millions | August 1, 2015 | August 2, 2014 | January 31, 2015 |
|---|---|---|---|
| Pension and postretirement adjustments (net of tax of $(296), $(326) and $(296), respectively) | $(1,897) | $(975) | $(2,028) |
| Cumulative unrealized derivative gain (net of tax of $0 for all periods presented) | — | — | — |
| Currency translation adjustments (net of tax of $0, $(37) and $0, respectively) | (2) | (74) | (2) |
| Accumulated other comprehensive loss | $(1,899) | $(1,049) | $(2,030) |

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 August 2, 2014 was $42 million.

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

Income Tax Expense Allocated to Each Component of Other Comprehensive Income

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

| | 13 Weeks Ended August 1, 2015 | | | 13 Weeks Ended August 2, 2014 | | |
|---|---|---|---|---|---|---|
| millions | Before Tax Amount | Tax Expense | Net of Tax Amount | Before Tax Amount | Tax Expense | Net of Tax Amount |
| Other comprehensive income | | | | | | |
| Pension and postretirement adjustments[(1)] | $66 | $— | $66 | $37 | $(2) | $35 |
| Deferred loss on derivatives | — | — | — | (1) | — | (1) |
| Currency translation adjustments | — | — | — | 3 | — | 3 |
| Total other comprehensive income | $66 | $— | $66 | $39 | $(2) | $37 |

| | 26 Weeks Ended August 1, 2015 | | | 26 Weeks Ended August 2, 2014 | | |
|---|---|---|---|---|---|---|
| millions | Before Tax Amount | Tax Expense | Net of Tax Amount | Before Tax Amount | Tax Expense | Net of Tax Amount |
| Other comprehensive income | | | | | | |
| Pension and postretirement adjustments[(1)] | $131 | $— | $131 | $68 | $(3) | $65 |
| Deferred loss on derivatives | — | — | — | (2) | — | (2) |
| Currency translation adjustments | — | — | — | 15 | (1) | 14 |
| Total other comprehensive income | $131 | $— | $131 | $81 | $(4) | $77 |

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

Common Share Repurchase Program

During the 13- and 26- week periods ended August 1, 2015 and August 2, 2014, we did not repurchase any shares of our common stock under our common share repurchase program. At August 1, 2015, 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.

Issuance of Warrants to Purchase Common Stock

On November 21, 2014, the Company issued an aggregate of approximately 22 million warrants pursuant to the exercise of rights in the rights offering for $625 million in aggregate principal amount of 8% Senior Unsecured Notes due 2019 and warrants to purchase shares of its common stock. The exercise price and the number of shares of common stock issuable upon exercise of a warrant are both subject to adjustment in certain circumstances. As of August 1, 2015, each warrant, when exercised, will entitle the holder thereof to purchase 1.11 shares of the Company's common stock at an exercise price of $25.686 per share under the terms of the warrant agreement, adjusted from the previously disclosed one share of Company common stock at an exercise price of $28.41 per share. The exercise price is payable in cash or by surrendering 8% senior unsecured notes due 2019 with a principal amount at least equal to the exercise price. The warrants may be exercised at any time after November 24, 2014. Unless earlier exercised, the warrants will expire on December 15, 2019.

We accounted for the warrants in accordance with accounting standards applicable to distinguishing liabilities from equity and debt with conversion and other options. Accordingly, the warrants have been classified as Additional

Paid-In Capital on the Condensed Consolidated Balance Sheet based on the relative fair value of the warrants and the related 8% Senior Unsecured Notes due 2019 at the time of issuance. The fair value of the warrants and the related 8% Senior Unsecured Notes due 2019 was estimated based on quoted market prices for the same issues using Level 1 measurements as defined in Note 4.

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

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 | | 26 Weeks Ended | |
|---|---|---|---|---|
| | August 1, 2015 | August 2, 2014 | August 1, 2015 | August 2, 2014 |
| Components of net periodic expense: | | | | |
| Interest cost | $54 | $82 | $108 | $151 |
| Expected return on plan assets | (62) | (92) | (124) | (169) |
| Amortization of experience losses | 65 | 31 | 130 | 62 |
| Net periodic expense | $57 | $21 | $114 | $44 |

Contributions

During the 13- and 26- week periods ended August 1, 2015, we made total contributions of $62 million and $129 million, respectively, to our pension and postretirement plans. During the 13- and 26- week periods ended August 2, 2014, we made total contributions of $103 million and $205 million, respectively, to our pension and postretirement plans. We anticipate making aggregate contributions to our defined benefit and postretirement plans of approximately $188 million over the remainder of 2015.

NOTE 8—INCOME TAXES

We had gross unrecognized tax benefits of $138 million at August 1, 2015, $141 million at August 2, 2014 and $131 million at January 31, 2015. Of the amount at August 1, 2015, $90 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 August 1, 2015, gross unrecognized tax benefits were increased by $4 million due to state activity. During the 26-week period ended August 1, 2015, gross unrecognized tax benefits were increased by $7 million. During the 13-week period ended August 2, 2014, we made no reductions to gross unrecognized tax benefits. During the 26-week period ended August 2, 2014, gross unrecognized tax benefits were decreased by $9 million due to the Lands' End spin-off and foreign activity. We expect that our unrecognized tax benefits could decrease by as much as $6 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 August 1, 2015, August 2, 2014 and January 31, 2015, the total amount of interest and penalties included in our tax accounts in our Condensed Consolidated Balance Sheet was $54 million ($35 million net of federal benefit), $53 million ($36 million net of federal benefit), and $49 million ($32 million net of federal benefit), respectively. The total amount of net interest expense recognized as part of income tax expense in our Condensed Consolidated Statements of Operations was $1 million (net of federal benefit) and $3 million, respectively, for the 13- and 26- week periods ended August 1, 2015.

We file income tax returns in both the United States and various foreign jurisdictions. The U.S. Internal Revenue Service ("IRS") has completed its examination of all federal tax returns of Holdings through the 2009 return, and all matters arising from such examinations have been resolved. In addition, Holdings and Sears are under examination by various state, local and