SEARS HOLDINGS CORP
Form 10-Q
August 18, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

OR

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

Commission file number 000-51217

SEARS HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**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 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 12, 2011, the registrant had 106,901,958 common shares, $0.01 par value, outstanding.

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SEARS HOLDINGS CORPORATION

INDEX TO QUARTERLY REPORT ON FORM 10-Q

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

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SEARS HOLDINGS CORPORATION

Condensed Consolidated Statements of Operations

(Unaudited)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

See accompanying notes.

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SEARS HOLDINGS CORPORATION

Condensed Consolidated Balance Sheets

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

See accompanying notes.

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SEARS HOLDINGS CORPORATION

Condensed Consolidated Statements of Cash Flows

(Unaudited)

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

SUPPLEMENTAL CASH FLOW DATA:		
Income taxes paid, net of refunds	$ 85	$ 126
Cash interest paid	124	91

See accompanying notes.

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SEARS HOLDINGS CORPORATION

Condensed Consolidated Statements of Equity

(Unaudited)

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

See accompanying notes.

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

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

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

NOTE 2 BORROWINGS

Total borrowings were as follows:

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

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

Unsecured Commercial Paper

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

Domestic Credit Agreement

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

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

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

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

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

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

Senior Secured Notes

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

Sears Canada Credit Agreement

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

Letters of Credit Facility

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

NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS

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

Earnings Effects of Derivatives on the Statements of Operations

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

Sears Canada Hedges of Merchandise Purchases

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

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

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

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

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

Hedges of Net Investment in Sears Canada

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

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

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

Counterparty Credit Risk

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

NOTE 4 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

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

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

Level 3 inputs unobservable inputs for the asset or liability.

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

millions	Total Fair Value Amounts at July 30, 2011	Level 1	Level 2	Level 3
Cash equivalents[(1)]	$ 181	$ 181	$	$
Restricted cash[(2)]	21	21		

Foreign currency derivative assets[3]	1		1	
Foreign currency derivative liabilities[4]	(19)		(19)	
Total	$ 184	$ 202	$ (18)	$

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

millions	Total Fair Value Amounts at July 31, 2010	Level 1	Level 2	Level 3
Cash equivalents[1]	$ 691	$ 691	$	$
Restricted cash[2]	6	6		
Foreign currency derivative assets[3]	4		4	
Foreign currency derivative liabilities[4]	(7)		(7)	
Total	$ 694	$ 697	$ (3)	$

millions	Total Fair Value Amounts at January 29, 2011	Level 1	Level 2	Level 3
Cash equivalents[1]	$ 416	$ 416	$	$
Restricted cash[2]	15	15		
Foreign currency derivative assets[3]	3		3	
Foreign currency derivative liabilities[4]	(3)		(3)	
Total	$ 431	$ 431	$	$

(1) Included within Cash and cash equivalents in our Condensed Consolidated Balance Sheets.
(2) Included within Restricted cash in our Condensed Consolidated Balance Sheets.
(3) Included within Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets.
(4) Included within Accrued expenses and other current liabilities in our Condensed Consolidated Balance Sheets.

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

NOTE 5 SEARS CANADA

Acquisition of Noncontrolling Interest

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

Sears Canada Share Repurchases

During the second quarter of 2011, Sears Canada renewed its Normal Course Issuer Bid with the Toronto Stock Exchange that permits it to purchase for cancellation up to 5% of its issued and outstanding common shares, representing approximately 5.3 million common shares. The purchase authorization expires on May 24, 2012 or on such earlier date as Sears Canada may complete its purchases pursuant to the Normal Course Issuer Bid. Sears Canada may not purchase common shares under the Normal Course Issuer Bid if they cannot be purchased at

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

Sears Holdings Ownership of Sears Canada

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

Dividends

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

NOTE 6 STORE CLOSINGS AND CONVERSIONS

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

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

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 7 EQUITY

Share Repurchase Program

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

Accumulated Other Comprehensive Loss

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

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

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

NOTE 8 BENEFIT PLANS

Pension and Post-retirement Benefit Plans

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

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

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Contributions

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

NOTE 9 INCOME TAXES

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

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

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

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

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

NOTE 10 SUMMARY OF SEGMENT DATA

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

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

millions	Kmart
	26 Weeks Ended July 30, 2011

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

NOTE 11 SUPPLEMENTAL FINANCIAL INFORMATION

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

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

NOTE 12 LEGAL PROCEEDINGS

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

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

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

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

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

NOTE 13 RECENT ACCOUNTING PRONOUNCEMENTS

Disclosures about Fair Value Measurements

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

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

SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

Presentation of Comprehensive Income

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

NOTE 14 RELATED PARTY DISCLOSURE

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

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

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

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During the first half of 2011, ESL purchased unsecured commercial paper issued by SRAC, an indirect wholly owned subsidiary of Sears Holdings. The weighted average of maturity, annual interest rate, and principal amount outstanding for this commercial paper in the first half of 2011 was 30.2 days, 1.00% and $240 million, respectively. At July 30, 3011, ESL held $240 million in principal amount of 30-day unsecured commercial paper issued by Sears Roebuck Acceptance Corp. under its commercial paper program, which includes $120 million held by ESL for the benefit of Mr. Lampert. The commercial paper purchases were made in the ordinary course of business on substantially the same terms, including the interest rate, as terms prevailing for comparable transactions with other persons, and did not present features unfavorable to the Company.

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

NOTE 15 SPIN-OFF OF ORCHARD SUPPLY HARDWARE STORES CORPORATION

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

NOTE 16 GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION

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

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

July 30, 2011

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

July 31, 2010

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

January 29, 2011

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