SEARS HOLDINGS CORP
Form 10-Q
August 25, 2016

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, 2016

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 (Do not check if a smaller reporting company) ¨ 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 19, 2016, the registrant had 106,922,970 common shares, $0.01 par value, outstanding.

SEARS HOLDINGS CORPORATION
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13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

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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 July 30, 2016	13 Weeks Ended August 1, 2015	26 Weeks Ended July 30, 2016	26 Weeks Ended August 1, 2015
REVENUES				
Merchandise sales and services[1][2]	$5,663	$6,211	$11,057	$12,093
COSTS AND EXPENSES				
Cost of sales, buying and occupancy[1][3]	4,403	4,776	8,620	9,140
Selling and administrative	1,484	1,694	2,987	3,375
Depreciation and amortization	92	114	187	236
Impairment charges	7	54	15	54
Gain on sales of assets	(54)	(526)	(115)	(633)
Total costs and expenses	5,932	6,112	11,694	12,172
Operating income (loss)	(269)	99	(637)	(79)
Interest expense	(99)	(85)	(184)	(175)
Interest and investment loss	(13)	(26)	(17)	(44)
Other loss	(1)	(1)	—	—
Loss before income taxes	(382)	(13)	(838)	(298)
Income tax (expense) benefit	(13)	221	(28)	203
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(395)	$208	$(866)	$(95)
NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS				
Basic earnings (loss) per share	$(3.70)	$1.95	$(8.11)	$(0.89)
Diluted earnings (loss) per share	$(3.70)	$1.84	$(8.11)	$(0.89)
Basic weighted average common shares outstanding	106.9	106.5	106.8	106.5
Diluted weighted average common shares outstanding	106.9	113.3	106.8	106.5

(1) Includes merchandise sales to Sears Hometown and Outlet Stores, Inc. ("SHO") of $283 million and $350 million for the 13 weeks ended July 30, 2016 and August 1, 2015, respectively, and $576 million and $685 million for the 26 weeks ended July 30, 2016 and August 1, 2015, 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 owned Sears locations, participation in the Shop Your Way® program and corporate shared services of $12 million and $16 million for the 13 weeks ended July 30, 2016 and August 1, 2015, respectively, and $23 million and $31 million for the 26 weeks ended July 30, 2016 and August 1, 2015, respectively.

(3) Includes rent expense (consisting of straight-line rent expense offset by amortization of a deferred gain on sale-leaseback) of $21 million and $5 million for the 13 weeks ended July 30, 2016 and August 1, 2015, respectively, and $42 million and $5 million for the 26 weeks ended July 30, 2016 and August 1, 2015, respectively. Includes installment expenses of $17 million and $5 million for the 13 weeks ended July 30, 2016 and August 1, 2015, respectively, and $34 million and $5 million for the 26 weeks ended July 30, 2016 and August 1, 2015, respectively, pursuant to the master lease with Seritage Growth Properties ("Seritage").

See accompanying notes.

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

millions	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net income (loss)	$(395)	$ 208	$(866)	$ (95)
Other comprehensive income				
Pension and postretirement adjustments, net of tax	64	66	128	131
Total other comprehensive income	64	66	128	131
Comprehensive income (loss) attributable to Holdings' shareholders	$(331)	$ 274	$(738)	$ 36

See accompanying notes.

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SEARS HOLDINGS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

millions	July 30, 2016	August 1, 2015	January 30, 2016
ASSETS			
Current assets			
Cash and cash equivalents	$276	$1,819	$ 238
Accounts receivable[1]	390	460	419
Merchandise inventories	4,684	5,028	5,172
Prepaid expenses and other current assets[2]	275	270	216
Total current assets	5,625	7,577	6,045
Property and equipment (net of accumulated depreciation and amortization of $3,032, $3,097 and $2,960)	2,465	2,732	2,631
Goodwill	269	269	269
Trade names and other intangible assets	1,906	2,091	1,909
Other assets	349	498	483
TOTAL ASSETS	$10,614	$13,167	$ 11,337
LIABILITIES			
Current liabilities			
Short-term borrowings[3]	$164	$6	$ 797
Current portion of long-term debt and capitalized lease obligations[4]	550	70	71
Merchandise payables	1,345	1,704	1,574
Other current liabilities[5]	1,802	2,068	1,925
Unearned revenues	775	802	787
Other taxes	317	363	284
Total current liabilities	4,953	5,013	5,438
Long-term debt and capitalized lease obligations[6]	2,837	3,049	2,108
Pension and postretirement benefits	2,072	2,258	2,206
Deferred gain on sale-leaseback	686	798	753
Sale-leaseback financing obligation	164	164	164
Other long-term liabilities	1,703	1,830	1,731
Long-term deferred tax liabilities	892	961	893
Total Liabilities	13,307	14,073	13,293
Commitments and contingencies			
DEFICIT			
Total Deficit	(2,693)	(906)	(1,956)
TOTAL LIABILITIES AND DEFICIT	$10,614	$13,167	$ 11,337

(1) Includes $35 million, $95 million and $51 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively, of net amounts receivable from SHO, and a net amount receivable from Lands' End of $4 million at August 1, 2015. Also, includes $9 million and $7 million of net amounts receivable from Seritage at July 30, 2016 and January 30, 2016, respectively.

(2) Includes $9 million prepaid rent to Seritage at both July 30, 2016 and January 30, 2016, and $11 million at August 1, 2015.

(3) Includes $100 million held by ESL Investments, Inc. and its affiliates ("ESL") of unsecured commercial paper at July 30, 2016.

(4) Includes balances held by related parties of $216 million at July 30, 2016 related to our Secured Loan Facility.

(5) Includes $1 million of net amounts payable to Lands' End at January 30, 2016.

(6) Includes balances held by related parties of $874 million, $1.04 billion and $603 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively, related to our Senior Secured Notes, Subsidiary Notes, Senior Unsecured Notes, and 2016 Term Loan. See Note 11 for further information.

See accompanying notes.

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

millions	26 Weeks Ended July 30, 2016	August 1, 2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(866)	$(95)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred tax valuation allowance	(37)	(500)
Depreciation and amortization	187	236
Impairment charges	15	54
Gain on sales of assets	(115)	(633)
Pension and postretirement plan contributions	(148)	(129)
Mark-to-market adjustments of financial instruments	13	54
Amortization of deferred gain on sale-leaseback	(44)	(7)
Change in operating assets and liabilities (net of acquisitions and dispositions):		
Deferred income taxes	36	258
Merchandise inventories	488	(85)
Merchandise payables	(229)	83
Income and other taxes	49	(13)
Other operating assets	(8)	(24)
Other operating liabilities	19	(31)
Net cash used in operating activities	(640)	(832)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of property and investments[1]	214	2,678
Purchases of property and equipment	(75)	(86)
Net cash provided by investing activities	139	2,592
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt issuances[2]	1,228	—
Repayments of debt[3]	(35)	(443)
Decrease in short-term borrowings, primarily 90 days or less	(633)	(209)
Proceeds from sale-leaseback financing[1]	—	508
Debt issuance costs	(21)	(47)
Net cash provided by (used in) financing activities	539	(191)
NET INCREASE IN CASH AND CASH EQUIVALENTS	38	1,569
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	238	250
CASH AND CASH EQUIVALENTS, END OF PERIOD	$276	$1,819
Supplemental Cash Flow Data:		
Income taxes paid, net of refunds	$15	$30
Cash interest paid[4]	119	139
Unpaid liability to acquire equipment and software	15	24

[1] Holdings received cash proceeds of $2.7 billion ($2.6 billion, net of closing costs) from the Seritage transaction (including $745 million and $297 million, respectively, received from ESL and its affiliates, and Fairholme Capital Management, LLC and its affiliates ("Fairholme") 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. See Note 3 for further information and defined terms.

(2) Proceeds in 2016 include $146 million (net of original issue discount) from JPP, LLC and JPP II, LLC, entities affiliated with ESL, and $100 million from the Company's domestic pension plan in connection with the 2016 Term Loan, and $250 million from entities affiliated with ESL and Fairholme in connection with the Secured Loan Facility.

(3) Repayments in 2015 include $400 million of a secured short-term loan with JPP II, LLC and JPP, LLC, entities affiliated with ESL.

(4) Cash interest paid includes $36 million and $43 million interest paid to related parties related to our unsecured commercial paper, Secured Loan Facility, Senior Secured Notes, Subsidiary Notes, Senior Unsecured Notes, and 2016 Term Loan during the 26 weeks ended July 30, 2016 and August 1, 2015, respectively. See Note 11 for further information.

See accompanying notes.

SEARS HOLDINGS CORPORATION
Condensed Consolidated Statements of Deficit
(Unaudited)

	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 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)
Balance at January 30, 2016	107	$ 1	$(5,928)	$ 9,173	$(3,291)	$ (1,918)	$ 7	$(1,956)
Comprehensive loss								
Net loss	—	—	—	—	(866)	—	—	(866)
Pension and postretirement adjustments, net of tax	—	—	—	—	—	128	—	128
Total Comprehensive Loss								(738)
Stock awards	—	—	15	(16)	—	—	—	(1)
Associate stock purchase	—	—	4		—	—	—	4
Distribution to noncontrolling interest	—	—	—	—	—	—	(2)	(2)
Balance at July 30, 2016	107	$ 1	$(5,909)	$ 9,157	$(4,157)	$ (1,790)	$ 5	$(2,693)

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 1,592 full-line and specialty retail stores in the United States, operating through Kmart and Sears. We operate 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 30, 2016.

Depreciation Expense

Depreciation expense included within depreciation and amortization expense reported on the Condensed Consolidated Statements of Operations was $90 million and $113 million for the 13 week periods ended July 30, 2016 and August 1, 2015, respectively, and $184 million and $232 million for the 26 week periods ended July 30, 2016 and August 1, 2015, respectively.

Vendor Credits

During the 13- and 26- week periods ended August 1, 2015, the Company received $33 million and $126 million, respectively, 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.

During the first half of 2016, the Company closed the $750 million Senior Secured Term Loan (the "2016 Term Loan") maturing in July 2020, as discussed in Note 2, and received approximately $722 million in net proceeds. The Company entered into a $500 million committed secured loan facility (the "Secured Loan Facility") maturing in July 2017, as also discussed in Note 2, and received net proceeds of approximately $485 million. Additionally, the Company generated over $200 million in cash proceeds from the sale of real estate and other asset sales. The funds received from these actions were used to reduce outstanding borrowings under the Company's asset-based revolving credit facility and for general corporate purposes. These actions provided the Company with additional financial flexibility as we execute on our transformation to a more asset-light integrated retailer leveraging our membership-based Shop Your Way® program.

As we progress in our transformation, we are primarily focusing on profitability instead of revenues, market share and other metrics, each of which relate to, but do not necessarily drive profit. This approach may negatively impact our sales. However, it is aimed at returning the Company to profitability. We continue to face a challenging competitive environment and while we continue to focus on our overall profitability, including managing expenses,

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

we reported a loss during the second quarter of 2016. In addition to the previously described actions taken to date in 2016, we expect to pursue other near-term actions to improve liquidity, position the Company for success and profitability with the goal of creating long-term value and funding our transformation. These additional actions may include expense reductions, additional debt financing, generating liquidity through our previously announced intention to explore alternatives for our Kenmore®, Craftsman® and DieHard® brands and our Sears Home Services business by evaluating potential partnerships or other transactions that could expand distribution of our brands and service offerings to realize significant growth, or other asset sales. Our Amended Domestic Credit Agreement discussed in Note 2 provides us flexibility of up to $500 million of "FILO" ("first in last out") capacity and up to $2.0 billion of second lien capacity (of which $304 million is currently utilized), all depending on the applicable and available borrowing base as defined in our Amended Domestic Credit Agreement, as well as our ability to secure commitments from lenders. Our ability to utilize these features of the Amended Domestic Credit Agreement is currently constrained by our available borrowing base; however, we also have flexibility to obtain longer-term secured or unsecured financing maturing outside of the credit facility maturity date which would not be subject to these limitations (see Note 2). In August 2016, we received an offer from ESL Investments, Inc. ("the ESL proposal") to provide $300 million of additional debt financing secured by a junior lien against our inventory, receivables and other working capital, which offer has been accepted. Under the ESL proposal, the Company may, in its discretion, offer to third party investors the right to participate in up to an additional $200 million of debt financing on the same terms and conditions. The financing is subject to customary conditions and is expected to close in the next 7 to 10 business days. We believe that our liquidity needs will be satisfied by the actions discussed through the foreseeable future; however, we cannot predict the outcome of any actions to generate liquidity, whether such actions would generate the expected liquidity as currently planned, or the availability of additional debt financing. The specific actions taken or assets involved, the timing, and the overall amount will depend on a variety of factors, including market conditions, interest in specific assets, valuations of those assets and our underlying operating performance.

If we continue to experience operating losses, and we are not able to generate enough funds from the above actions (or some combination of other actions), the availability under our Amended Domestic Credit Agreement 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.

Sears Canada

At each of July 30, 2016, August 1, 2015 and January 30, 2016, the Company was the beneficial holder of approximately 12 million, or 12%, of the common shares of Sears Canada. Our equity method investment in Sears Canada was $32 million, $69 million and $52 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively, and is included within other assets on the Condensed Consolidated Balance Sheets. The fair value of our equity method investment in Sears Canada was determined based on quoted market prices for its common stock. Our equity method investment in Sears Canada is valued using Level 1 measurements as defined in Note 5 of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

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

NOTE 2—BORROWINGS

Total borrowings were as follows:

millions	July 30, 2016	August 1, 2015	January 30, 2016
Short-term borrowings:			
Unsecured commercial paper	$ 101	$ 6	$ —
Secured borrowings	63	—	797
Long-term debt, including current portion:			
Notes and debentures outstanding	3,211	2,898	1,984
Capitalized lease obligations	176	221	195
Total borrowings	$ 3,551	$ 3,125	$ 2,976

The fair value of long-term debt, excluding capitalized lease obligations, was $3.2 billion at July 30, 2016, $2.9 billion at August 1, 2015 and $1.9 billion at January 30, 2016. The fair value of our debt was estimated based on quoted market prices for the same or similar issues or on current rates offered to us for debt of the same remaining maturities. Our long-term debt instruments are valued using Level 2 measurements as defined in Note 5 of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

Unsecured Commercial Paper

We borrow through the commercial paper markets. At July 30, 2016 and August 1, 2015, we had outstanding commercial paper borrowings of $101 million and $6 million, respectively, while at January 30, 2016, we had no commercial paper borrowings outstanding.

Secured Short-Term Loan

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

The Short-Term Loan was originally scheduled to mature on December 31, 2014. As permitted by the Short-Term 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 Short-Term Loan had an annual base interest rate of 5%. The Short-Term Borrowers paid an upfront fee of 1.75% of the full principal amount. The Short-Term Loan was guaranteed by the Company and was secured by a first priority lien on certain real properties owned by the Short-Term 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, resulting in no balance outstanding at July 30, 2016, August 1, 2015 or January 30, 2016. During the 13- and 26- week periods ended August 1, 2015, the Short-Term Borrowers paid interest of $1 million and $6 million, respectively, to the Short-Term Lender.

Secured Loan Facility

On April 8, 2016, the Company, through Sears, Roebuck and Co., Sears Development Co., Innovel Solutions, Inc., Big Beaver of Florida Development, LLC and Kmart Corporation (collectively, "Secured Loan Borrowers"), entities wholly-owned and controlled, directly or indirectly by the Company, obtained a $500 million secured loan facility (the "Secured Loan Facility") from JPP, LLC, JPP II, LLC, and Cascade Investment, LLC (collectively, the "Secured Loan Lenders"). JPP, LLC and JPP II, LLC are entities affiliated with ESL. The first $250 million of the Secured Loan Facility was funded on April 8, 2016 and the remaining $250 million was funded on April 22, 2016. The Secured Loan Facility has a maturity date of July 7, 2017, and is included within current portion of long-term debt

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

on the Condensed Consolidated Balance Sheets at July 30, 2016. The Company used the proceeds of the Secured Loan Facility to reduce outstanding borrowings under the Company's asset-based revolving credit facility and for general corporate purposes. The carrying value of the secured loan facility, net of the remaining debt issuance costs, was $489 million at July 30, 2016.

The Secured Loan Facility has an annual base interest rate of 8%, with accrued interest payable monthly during the term of the Secured Loan Facility. The Secured Loan Borrowers paid an upfront commitment fee equal to 1.0% of the full principal amount of the Secured Loan Facility and also are required to pay a funding fee equal to 1.0% of the amounts drawn under the Secured Loan Facility at the time such amounts are drawn. If amounts remain outstanding or committed under the Secured Loan Facility after nine months, a delayed origination fee equal to 0.5% of such amounts becomes payable, and if amounts remain outstanding or committed under the Secured Loan Facility after 12 months, an additional delayed origination fee equal to 0.5% of such amounts becomes payable.

The Secured Loan Facility is guaranteed by the Company and is secured by a first priority lien on 21 real properties owned by the Secured Loan Borrowers. The Secured Loan Facility includes customary representations and warranties, indemnities and covenants, including with respect to the condition and maintenance of the real property collateral.

The Secured Loan Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, and bankruptcy or insolvency proceedings. If there is an event of default, the Secured Loan Lenders may declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have under any of the Secured Loan Facility documents (including against the collateral), and require the Secured Loan Borrowers to pay a default interest rate equal to the greater of (i) 2.5% in excess of the base interest rate and (ii) the prime rate plus 1%. The Loan Facility may be prepaid at any time in whole or in part, without penalty or premium.

Domestic Credit Agreement

During the first quarter of 2011, Sears Roebuck Acceptance Corporation ("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 expired on April 8, 2016. The Amended Domestic Credit Agreement also governs the 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, subject to borrowing base requirements, existing collateral for the facility to obtain up to $1.0 billion of additional borrowing capacity, of which $750 million was utilized for the 2016 Term Loan (described below). The Amended Domestic Credit Agreement also includes a "FILO" ("first in last out") tranche feature that allows an additional $500 million of borrowing capacity and increased 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 are 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 $304 million in second lien notes were outstanding at July 30, 2016, resulting in $1.7 billion 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. At July 30, 2016, August 1, 2015 and January 30, 2016, respectively, we had borrowings of $975 million, $985 million and $980 million under the Term Loan, and carrying value, net of the remaining discount and debt issuance costs, of $965 million, $972 million and $968 million.

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 July 30, 2016, August 1, 2015 and January 30, 2016, we had $63 million, $0 and $797 million, respectively, of Revolving Facility borrowings and $656 million, $657 million and $652 million, respectively, of letters of credit outstanding under the Revolving Facility. At July 30, 2016, August 1, 2015 and January 30, 2016, the amount available to borrow under the Revolving Facility was $191 million, $1.2 billion and $316 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.

2016 Term Loan

On April 8, 2016, the Company, SRAC, and Kmart Corporation (together with SRAC, the "ABL Borrowers") entered into an amendment to the Amended Domestic Credit Agreement, with a syndicate of lenders, including Bank of America, N.A. (the "Bank"), as agent. The amendment to the Amended Domestic Credit Agreement was executed in connection with the closing of the Company’s previously announced $750 million Senior Secured Term Loan under the Amended Domestic Credit Agreement (the "2016 Term Loan").

Amounts borrowed pursuant to the 2016 Term Loan will bear interest at a rate equal to the London Interbank Offered Rate ("LIBOR") plus 750 basis points, subject to a 1.00% LIBOR floor. The Company received approximately $722 million in net proceeds from the 2016 Term Loan, which proceeds were used to reduce outstanding borrowings under

its asset-based revolving credit facility. The 2016 Term Loan has a maturity date of July 20, 2020, which is the same maturity date as the Company's $1.971 billion revolving credit facility commitments, and does not amortize. The amendment provides for a premium of 2% of the aggregate principal amount of the 2016 Term Loan prepaid on or prior to April 8, 2017 and 1% of the aggregate principal amount of the

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2016 Term Loan prepaid after April 8, 2017 and on or prior to April 8, 2018. The obligations under the Amended Domestic Credit Agreement, including the 2016 Term Loan, are secured by a first lien on substantially all of the domestic inventory and credit card and pharmacy receivables of the Company and its subsidiaries and aggregate advances under the Amended Domestic Credit Agreement are subject to a borrowing base formula. The Amended Domestic Credit Agreement is guaranteed by all domestic subsidiaries of the Company that own inventory or credit card or pharmacy receivables. The other material terms of the Amended Domestic Credit Agreement were not modified by the amendment. The carrying value of the 2016 Term Loan, net of the remaining discount and debt issuance costs, was $723 million at July 30, 2016.

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, none of which remain in the domestic pension plan as a result of the Tender Offer discussed below. 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 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. The Company completed a Tender Offer for $936 million principal amount of its outstanding Senior Secured Notes during the third quarter of 2015. The carrying value of Senior Secured Notes, net of the remaining discount and debt issuance costs, was $302 million, $1.2 billion and $302 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively.

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

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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 5 of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016. 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 $21 million and $16 million of the discount was amortized during the 26 week periods ended July 30, 2016 and August 1, 2015, respectively. The remaining discount was approximately $218 million, $257 million, and $238 million at July 30, 2016, August 1, 2015, and January 30, 2016, respectively. The carrying value of the Senior Unsecured Notes, net of the remaining discount and debt issuance costs, was approximately $404 million, $364 million, and $383 million at July 30, 2016, August 1, 2015, and January 30, 2016, respectively.

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 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 each of July 30, 2016, August 1, 2015 and January 30, 2016, 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 each of July 30, 2016, August 1, 2015 and January 30, 2016.

On March 18, 2016, the Company announced it and certain of its subsidiaries have entered into a five-year pension plan protection and forbearance agreement (the "Definitive Agreement") with the Pension Benefit Guaranty

Corporation ("PBGC") implementing the terms of the previously announced term sheet, dated as of September 4, 2015, entered into by the Company and PBGC. Under the terms of the Definitive Agreement, the Company will continue to protect, or "ring-fence," pursuant to customary covenants, the assets of certain special purpose subsidiaries (the "Relevant Subsidiaries") holding real estate and/or intellectual property assets. Also under the

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Definitive Agreement, the Relevant Subsidiaries have granted PBGC a springing lien on the ring-fenced assets, which lien will be triggered only by (a) failure to make required contributions to the Company's pension plan (the "Plan"), (b) prohibited transfers of ownership interests in the Relevant Subsidiaries, (c) termination events with respect to the Plan, and (d) bankruptcy events with respect to the Company or certain of its material subsidiaries.

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

Store Closings and Severance

We closed 13 stores in our Kmart segment and 18 stores in our Sears Domestic segment we previously announced would close during the 13 week period ended July 30, 2016, and 58 stores in our Kmart segment and 23 stores in our Sears Domestic segment during the 26 week period ended July 30, 2016. We made the decision to close two stores in our Kmart segment and two stores in our Sears Domestic segment during the 13 week period ended July 30, 2016, and 95 stores in our Kmart segment and 26 stores in our Sears Domestic segment during the 26 week period ended July 30, 2016.

We closed 10 stores in our Kmart segment and four stores in our Sears Domestic segment we previously announced would close during the 13 week period ended August 1, 2015, and 16 stores in our Kmart segment and six stores in our Sears Domestic segment during the 26 week period ended August 1, 2015. 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.

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.

We expect to record additional charges of approximately $30 million during 2016 related to stores that we had previously made the decision to close, but have not yet closed.

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Store closing costs and severance recorded for the 13- and 26- week periods ended July 30, 2016 and August 1, 2015 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	$ 3	$ 1	$ (25)	$ —	$ —	$ (21)
Sears Domestic	1	1	1	—	1	4
Total for the 13 week period ended July 30, 2016	$ 4	$ 2	$ (24)	$ —	$ 1	$ (17)
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	$ 54	$ 6	$ (19)	$ 11	$ 4	$ 56
Sears Domestic	10	2	2	3	1	18
Total for the 26 week period ended July 30, 2016	$ 64	$ 8	$ (17)	$ 14	$ 5	$ 74
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

(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 July 30, 2016 and August 1, 2015 are recorded within depreciation and amortization on the Condensed Consolidated Statement of Operations.

Store closing cost and severance accruals of $126 million, $182 million and $180 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively, were as follows:

millions	Severance Costs	Lease Termination Costs	Other Charges	Total
Balance at August 1, 2015	$ 29	$ 146	$ 7	$182
Store closing costs	33	(10)	7	30
Payments/utilizations	(4)	(22)	(6)	(32)
Balance at January 30, 2016	58	114	8	180
Store closing costs	8	(13)	14	9
Payments/utilizations	(28)	(19)	(16)	(63)
Balance at July 30, 2016	$ 38	$ 82	$ 6	$126

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- and

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26- week periods ended July 30, 2016 that indicated an impairment might have occurred. As a result of impairment testing, the Company recorded impairment charges of $7 million, of which $6 million and $1 million were recorded within the Sears Domestic and Kmart segments, respectively, during the 13 week period ended July 30, 2016, and $15 million, of which $11 million and $4 million were recorded within the Sears Domestic and Kmart segments, respectively, during the 26 week period ended July 30, 2016.

As a result of 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 both the 13- and 26-week periods ended August 1, 2015.

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 (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 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. During the 26 week period ended July 30, 2016, Holdings closed three stores pursuant to recapture notices from Seritage. Holdings recorded rent expense of $26 million and $16 million in cost of sales, buying and occupancy for the 13 week periods ended July 30, 2016 and August 1, 2015, respectively, and $50 million and $16 million in cost of sales, buying and occupancy for the 26 week periods ended July 30, 2016 and August 1, 2015, respectively. Rent expense consisted of straight-line rent expense offset by amortization of deferred gain on sale-leaseback, as shown in the tables below.

	13 Weeks Ended July 30, 2016			13 Weeks Ended August 1, 2015		
millions	Kmart	Sears Domestic	Sears Holdings	Kmart	Sears Domestic	Sears Holdings
Straight-line rent expense	$8	$ 40	$ 48	$2	$ 21	$ 23
Amortization of deferred gain on sale-leaseback	(5)	(17)	(22)	(1)	(6)	(7)
Rent expense	$3	$ 23	$ 26	$1	$ 15	$ 16

	26 Weeks Ended July 30, 2016			26 Weeks Ended August 1, 2015		
millions	Kmart	Sears Domestic	Sears Holdings	Kmart	Sears Domestic	Sears Holdings
Straight-line rent expense	$17	$ 77	$ 94	$2	$ 21	$ 23
Amortization of deferred gain on sale-leaseback	(9)	(35)	(44)	(1)	(6)	(7)
Rent expense	$8	$ 42	$ 50	$1	$ 15	$ 16

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

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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, which is a component of cost of sales, buying and occupancy, on the Condensed Consolidated Statement of Operations, 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, during the 13- and 26- week periods ended August 1, 2015, Holdings recognized an immediate net gain of $508 million within gain on sales of assets on the Consolidated Statement of Operations for 2015, comprised of a gain for the amount of gain on sale in excess of the present value of minimum lease payments, offset by a loss 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, as shown in the table below.

	2015		
millions	Kmart	Sears Domestic	Sears Holdings
Gain	$154	$ 471	$ 625
Loss	(17)	(100)	(117)
Immediate Net Gain	$137	$ 371	$ 508

The remaining gain of $894 million was deferred and will be recognized in proportion to the related rent expense over the lease term. At July 30, 2016, $90 million of the deferred gain on sale-leaseback is classified as current within other current liabilities. At both August 1, 2015 and January 30, 2016, $89 million of the deferred gain on sale-leaseback is classified as current within other current liabilities on the Condensed Consolidated Balance Sheets. At July 30, 2016, August 1, 2015, and January 30, 2016, $686 million, $798 million, and $753 million is classified as long-term as deferred gain on sale-leaseback on the Condensed Consolidated Balance Sheets.

During the 26 week period ended July 30, 2016, Holdings recorded gains of $26 million related to the 100% recapture of three stores that closed pursuant to recapture notices from Seritage, of which $13 million related to the gain that had previously been deferred as we no longer have continuing involvement in those properties, and $13 million related to lease termination proceeds. In addition, the Master Leases provide Seritage and the JVs 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, 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. As space is recaptured pursuant to the recapture right, Holdings' obligation to pay rent is reduced proportionately. Accordingly, Holdings recognizes gains equal to the unamortized portion of the gain that had previously been deferred which exceeds the present value of minimum lease payments, as reduced due to recapture activity. During the 13- and 26-week periods ended July 30, 2016, Holdings recorded gains as a result of recapture activity of $9 million that had previously been deferred.

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 July 30, 2016, August 1, 2015, and January 30, 2016. We continued to report the real property assets of $61 million, $45 million, and $56 million at July 30, 2016, August 1, 2015, and January 30, 2016 respectively, on our Condensed Consolidated Balance Sheets, which are included in our Sears Domestic segment.

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During the 26 week period ended July 30, 2016, we also recorded gains on the sales of assets of $12 million recognized on the sale of one distribution center for which we received $23 million of cash proceeds.
During the 26 week period ended August 1, 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 all of these transactions.

NOTE 4—EQUITY

Earnings per Share

The following table sets forth the components used to calculate basic and diluted 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.

millions, except earnings per share	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Basic weighted average shares	106.9	106.5	106.8	106.5
Dilutive effect of restricted stock awards, restricted stock units and warrants	—	6.8	—	—
Diluted weighted average shares	106.9	113.3	106.8	106.5
Net income (loss) attributable to Holdings' shareholders	$(395)	$ 208	$(866)	$ (95)
Earnings (loss) per share attributable to Holdings' shareholders:				
Basic	$(3.70)	$ 1.95	$(8.11)	$ (0.89)
Diluted	$(3.70)	$ 1.84	$(8.11)	$ (0.89)

Accumulated Other Comprehensive Loss

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

millions	July 30, 2016	August 1, 2015	January 30, 2016
Pension and postretirement adjustments (net of tax of $(296) for all periods presented)	$(1,787)	$(1,897)	$ (1,915)
Currency translation adjustments (net of tax of $0 for all periods presented)	(3)	(2)	(3)
Accumulated other comprehensive loss	$(1,790)	$(1,899)	$ (1,918)

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.

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Income Tax Expense Allocated to Each Component of Other Comprehensive Income
Income tax expense allocated to each component of other comprehensive income was as follows:

millions	13 Weeks Ended July 30, 2016 Before Tax Amount	Tax Expense	Net of Tax Amount	13 Weeks Ended August 1, 2015 Before Tax Amount	Tax Expense	Net of Tax Amount
Other comprehensive income						
Pension and postretirement adjustments[1]	$64	$—	$64	$66	$—	$66
Total other comprehensive income	$64	$—	$64	$66	$—	$66

millions	26 Weeks Ended July 30, 2016 Before Tax Amount	Tax Expense	Net of Tax Amount	26 Weeks Ended August 1, 2015 Before Tax Amount	Tax Expense	Net of Tax Amount
Other comprehensive income						
Pension and postretirement adjustments[1]	$128	$—	$128	$131	$—	$131
Total other comprehensive income	$128	$—	$128	$131	$—	$131

(1) Included in the computation of net periodic benefit expense. See Note 5 to the Condensed Consolidated Financial Statements.

NOTE 5—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 July 30, 2016	August 1, 2015	26 Weeks Ended July 30, 2016	August 1, 2015
Components of net periodic expense:				
Interest cost	$58	$ 54	$116	$ 108
Expected return on plan assets	(51)	(62)	(101)	(124)
Amortization of experience losses	64	65	128	130
Net periodic expense	$71	$ 57	$143	$ 114

Contributions
During the 13- and 26- week periods ended July 30, 2016, we made total contributions of $72 million and $148 million, respectively, to our pension and postretirement plans. 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. We anticipate making aggregate contributions to our defined benefit and postretirement plans of approximately $185 million over the remainder of 2016.

NOTE 6—INCOME TAXES
We had gross unrecognized tax benefits of $144 million at July 30, 2016, $138 million at August 1, 2015 and $137 million at January 30, 2016. Of the amount at July 30, 2016, $94 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, 2016, gross

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unrecognized tax benefits increased by $3 million and $7 million, respectively, due to state activity. During the 13 week period ended August 1, 2015, gross unrecognized tax benefits increased by $4 million due to state activity. During the 26 week period ended August 1, 2015, gross unrecognized tax benefits increased by $7 million. 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 July 30, 2016, August 1, 2015 and January 30, 2016, the total amount of interest and penalties included in our tax accounts in our Condensed Consolidated Balance Sheet was $60 million ($39 million net of federal benefit), $54 million ($35 million net of federal benefit), and $56 million ($36 million net of federal benefit), respectively. The total amount of net interest expense (net of federal benefit) recognized as part of income tax expense in our Condensed Consolidated Statements of Operations was $2 million and $1 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $3 million and $3 million, respectively, for the 26 week periods ended July 30, 2016 and 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 foreign income tax jurisdictions for the years 2003 through 2013, and Kmart is under examination by such jurisdictions for the years 2006 through 2013.

At the end of 2015, we had a federal and state net operating loss ("NOL") deferred tax asset of $1.6 billion, which will expire predominately between 2019 and 2036. We have credit carryforwards of $832 million, which will expire between 2016 and 2036.

In July, 2016, the Company sold shares of an investment for $106 million. The sale resulted in a U.S. taxable gain of $105 million, but no current income tax is payable due to the utilization of NOL attributes of $37 million with a valuation allowance release of the same amount.

In connection with the sale-leaseback transaction with Seritage in the second quarter of 2015, along with the JV transactions in the first quarter of 2015, the Company realized a tax benefit of $229 million on the deferred taxes related to the indefinite-life assets associated with the properties sold in the transaction with Seritage and the JV transactions. In addition, the Company incurred a taxable gain of approximately $2.2 billion, taking into account any related party loss disallowance, on these transactions. There was no federal income tax payable resulting from the taxable gain due to the utilization of NOL tax attributes of approximately $863 million with a valuation allowance release of the same amount. However, there was a minor amount of state and city income tax payable of $5 million after the utilization of state and city tax attributes. As a result of all the effects from these transactions, the net valuation allowance release was approximately $500 million.

At January 30, 2016, we had a valuation allowance of $4.8 billion to record only the portion of the deferred tax asset that more likely than not will be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted in the future if estimates of future taxable income during the carryforward period are reduced or increased, or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth. We will continue to evaluate our valuation allowance as the year progresses for any change in circumstances that causes a change in judgment about the realizability of the deferred tax asset.

The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax accounting income. As such, for the 13- and 26- week periods ended July 30, 2016, our effective income tax rates were an expense of 3.4% and 3.3%, respectively. Our tax rate continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic jurisdictions where it is not more likely than not that such benefits would be realized. In addition, the 13- and 26- week periods ended July 30, 2016 were negatively impacted by foreign

branch taxes and state income taxes.

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NOTE 7—SUMMARY OF SEGMENT DATA

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

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

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

	13 Weeks Ended July 30, 2016		
millions	Kmart	Sears Domestic	Sears Holdings
Merchandise sales and services			
Hardlines	$666	$ 1,869	$2,535
Apparel and Soft Home	759	571	1,330
Food and Drug	781	2	783
Service	2	561	563
Other	13	439	452
Total merchandise sales and services	2,221	3,442	5,663
Costs and expenses			
Cost of sales, buying and occupancy	1,760	2,643	4,403
Selling and administrative	498	986	1,484
Depreciation and amortization	15	77	92
Impairment charges	1	6	7
Gain on sales of assets	(44)	(10)	(54)
Total costs and expenses	2,230	3,702	5,932
Operating loss	$(9)	$ (260)	$(269)
Total assets	$2,719	$ 7,895	$10,614
Capital expenditures	$12	$ 23	$35

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	13 Weeks Ended August 1, 2015		
millions	Kmart	Sears Domestic	Sears Holdings
Merchandise sales and services			
Hardlines	$730	$2,040	$2,770
Apparel and Soft Home	797	627	1,424
Food and Drug	911	2	913
Service	4	559	563
Other	17	524	541
Total merchandise sales and services	2,459	3,752	6,211
Costs and expenses			
Cost of sales, buying and occupancy	1,950	2,826	4,776
Selling and administrative	594	1,100	1,694
Depreciation and amortization	19	95	114
Impairment charges	2	52	54
Gain on sales of assets	(143)	(383)	(526)
Total costs and expenses	2,422	3,690	6,112
Operating income	$37	$62	$99
Total assets	$3,030	$10,137	$13,167
Capital expenditures	$6	$36	$42

	26 Weeks Ended July 30, 2016		
millions	Kmart	Sears Domestic	Sears Holdings
Merchandise sales and services			
Hardlines	$1,226	$ 3,577	$4,803
Apparel and Soft Home	1,488	1,142	2,630
Food and Drug	1,614	3	1,617
Service	5	1,077	1,082
Other	27	898	925
Total merchandise sales and services	4,360	6,697	11,057
Costs and expenses			
Cost of sales, buying and occupancy	3,495	5,125	8,620
Selling and administrative	1,042	1,945	2,987
Depreciation and amortization	34	153	187
Impairment charges	4	11	15
Gain on sales of assets	(90)	(25)	(115)
Total costs and expenses	4,485	7,209	11,694
Operating loss	$(125)	$ (512)	$(637)
Total assets	$2,719	$ 7,895	$10,614
Capital expenditures	$23	$ 52	$75

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	26 Weeks Ended August 1, 2015		
millions	Kmart	Sears Domestic	Sears Holdings
Merchandise sales and services			
Hardlines	$1,366	$3,872	$5,238
Apparel and Soft Home	1,573	1,278	2,851
Food and Drug	1,834	4	1,838
Service	7	1,081	1,088
Other	35	1,043	1,078
Total merchandise sales and services	4,815	7,278	12,093
Costs and expenses			
Cost of sales, buying and occupancy	3,788	5,352	9,140
Selling and administrative	1,217	2,158	3,375
Depreciation and amortization	39	197	236
Impairment charges	2	52	54
Gain on sales of assets	(161)	(472)	(633)
Total costs and expenses	4,885	7,287	12,172
Operating loss	$(70)	$(9)	$(79)
Total assets	$3,030	$10,137	$13,167
Capital expenditures	$11	$75	$86

NOTE 8—SUPPLEMENTAL FINANCIAL INFORMATION

Other long-term liabilities at July 30, 2016, August 1, 2015 and January 30, 2016 consisted of the following:

millions	July 30, 2016	August 1, 2015	January 30, 2016
Unearned revenues	$686	$ 716	$ 694
Self-insurance reserves	571	605	567
Other	446	509	470
Total	$1,703	$ 1,830	$ 1,731

NOTE 9—LEGAL PROCEEDINGS

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

We are subject to various other legal and governmental proceedings and investigations, including some involving the practices and procedures in our more highly regulated businesses. Some matters contain class action allegations, environmental and asbestos exposure allegations and other consumer-based, regulatory or qui tam claims, each of which may seek compensatory, punitive or treble damage claims (potentially in large amounts), as well as other

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types of relief. Additionally, some of these claims or actions, such as the qui tam claims, have the potential for significant statutory penalties. At this time, the Company is not able to either predict the outcome of these lawsuits or reasonably estimate a potential range of loss with respect to these lawsuits.

In May and June of 2015, four shareholder lawsuits were filed in the Delaware Chancery Court, which have since been consolidated into a single action. A consolidated complaint has been filed, naming Holdings, the members of our Board of Directors, ESL Investments, Inc., Seritage, our CEO, and Fairholme, alleging, among other things, breaches of fiduciary duties in connection with the Seritage transaction. Among other forms of relief, the plaintiffs are currently seeking damages in unspecified amounts and equitable relief related to the Seritage transaction. The Company believes that the Seritage transaction has provided substantial benefits to Holdings and its shareholders and believes further that the plaintiffs' claims are legally without merit. Holdings intends to contest these lawsuits vigorously. At this time, the Company is not able to either predict the outcome of these lawsuits or reasonably estimate a potential range of loss with respect to these lawsuits.

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 10—RECENT ACCOUNTING PRONOUNCEMENTS

Stock-based Compensation

In March 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standards update which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory withholding requirements, as well as classification in the statement of cash flows. The update is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. We are currently evaluating the effect the update will have on our consolidated financial statements.

Derivatives and Hedging

In March 2016, the FASB issued an accounting standards update which clarifies the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. The update is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The amendments in the update must be applied on a modified retrospective basis to existing debt instruments as of the beginning of the fiscal year for which the amendments are effective. We are currently evaluating the effect the update will have on our consolidated financial statements.

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Recognition of Breakage for Certain Prepaid Store-Value Products
In March 2016, the FASB issued an accounting standards update which amends the guidance on extinguishing financial liabilities for certain prepaid store-value products. If an entity selling prepaid store-value products expects to be entitled to an amount that will not be redeemed, the entity will recognize the expected breakage in proportion to the pattern of rights expected to be exercised by the product holder to the extent that it is probable that a significant reversal of the breakage amount will not subsequently occur. The update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted, including adoption before the effective date of Revenue from Contracts with Customers. We are currently evaluating the effect the update will have on our consolidated financial statements.

Leases
In February 2016, the FASB issued an accounting standards update which replaces the current lease accounting standard. The update will require, among other items, lessees to recognize a right-of-use asset and a lease liability for most leases. Extensive quantitative and qualitative disclosures, including significant judgments made by management, will be required to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing contracts. The update is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. We are currently evaluating the effect the update will have on our consolidated financial statements.

Balance Sheet Classification of Deferred Taxes
In November 2015, the FASB issued an accounting standards update which simplifies the presentation of deferred income taxes by requiring that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. As permitted, the Company early adopted the update beginning in the fourth quarter of fiscal 2015 utilizing retrospective application. The impact of this update was a reclassification of deferred income tax liabilities from short-term deferred tax liabilities to long-term deferred tax liabilities of $472 million at August 1, 2015.

Presentation of Debt Issuance Costs
In April 2015, the FASB issued an accounting standards update which simplifies the presentation of debt issuance costs by requiring that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with discounts or premiums. In August 2015, the FASB issued an accounting standards update which adds paragraphs about the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements, and allows for the presentation of debt issuance costs as an asset regardless of whether or not there is an outstanding balance on the line-of-credit arrangement. As permitted, the Company early adopted the update beginning in the fourth quarter of fiscal 2015. The impact of this update was a reclassification of unamortized debt issuance costs from other assets to long-term debt and capitalized lease obligations of $19 million at August 1, 2015. The Company continued to report unamortized debt issuance costs related to the Revolving Facility of $43 million, $57 million and $49 million at July 30, 2016, August 1, 2015 and January 30, 2016, respectively, within other assets.

Presentation of Financial Statements - Going Concern
In August 2014, the FASB issued an accounting standards update which requires management to assess whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the financial statements are issued. If substantial doubt exists, additional disclosures are required. This update will be effective for the Company in the first quarter of 2017. The adoption of the new standard is not expected to have a material impact on the Company’s consolidated financial position, results of operations, cash flows or disclosures.

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Revenue from Contracts with Customers

In May 2014, the FASB issued an accounting standards update which replaces the current revenue recognition standards. Subsequently, the FASB has also issued accounting standards updates which clarify the guidance. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard was initially released as effective for fiscal years beginning after December 15, 2016, however, the FASB has decided to defer the effective date of this accounting standard update for one year. Early adoption of the update is permitted, but not before the original date for fiscal years beginning after December 15, 2016. The update may be applied retrospectively for each period presented or as a cumulative-effect adjustment at the date of adoption. The Company is evaluating the effect of adopting this new standard.

NOTE 11—RELATED PARTY DISCLOSURE

Mr. Lampert is Chairman of our Board of Directors and its Finance Committee and is the Chairman and Chief Executive Officer of ESL. Additionally, on February 1, 2013, Mr. Lampert became our Chief Executive Officer, in addition to his role as Chairman of the Board. ESL owned approximately 50% of our outstanding common stock at July 30, 2016 (excluding shares of common stock that ESL may acquire within 60 days upon the exercise of warrants to purchase shares of our common stock).

On February 25, 2016, Holdings announced the election of Bruce R. Berkowitz to membership on our Board of Directors. Mr. Berkowitz serves as the Chief Investment Officer of Fairholme Capital Management, LLC, an investment adviser registered with the U.S. Securities and Exchange Commission ("SEC"), and is the President and a Director of Fairholme Funds, Inc., a SEC-registered investment company providing investment management services to three mutual funds (together with Fairholme Capital Management, LLC and other affiliates, "Fairholme"). Fairholme owned approximately 26% of our outstanding common stock at July 30, 2016 (excluding shares of common stock that Fairholme may acquire within 60 days upon the exercise of warrants to purchase shares of our common stock).

Unsecured Commercial Paper

During the 26 week periods ended July 30, 2016 and August 1, 2015, ESL and its affiliates held unsecured commercial paper issued by SRAC, an indirect wholly owned subsidiary of Holdings. For the commercial paper outstanding to ESL, the weighted average of each of maturity, annual interest rate and principal amount outstanding was 34.4 days, 7.97% and $55 million and 32.0 days, 4.55% and $18 million, respectively, during the 26 week periods ended July 30, 2016 and August 1, 2015. The largest aggregate amount of principal outstanding to ESL at any time since the beginning of 2016 was $150 million and $2 million of interest was paid by SRAC to ESL during the 26 week period ended July 30, 2016. ESL held $100 million of our commercial paper at July 30, 2016, which included $63 million held by Mr. Lampert.

During the 26 week period ended July 30, 2016, Fairholme and its affiliates held unsecured commercial paper issued by SRAC. For the commercial paper outstanding to Fairholme, the weighted average of each maturity, annual interest rate and principal amount outstanding was 11.5 days, 6.05% and $354 thousand during the 13 week period ended April 30, 2016. Fairholme did not hold any unsecured commercial paper issued by SRAC during the 13 week period ended July 30, 2016. The largest aggregate amount of principal outstanding to Fairholme at any time since the beginning of 2016 was $1 million and the aggregate amount of interest paid by SRAC to Fairholme was $6 thousand during the 26 week period ended July 30, 2016.

The commercial paper sales were made in accordance with guidelines reviewed and approved by the Company’s audit committee.

Secured Short-Term Loan

In September 2014, the Company, through the Short-Term Borrowers, entities wholly-owned and controlled, directly or indirectly by the Company, entered into the $400 million Short-Term Loan with the Short-Term Lender, entities

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affiliated with ESL. The Company repaid the Short-Term Loan during 2015. See Note 2 for additional information regarding the Short-Term Loan.

Secured Loan Facility

In April 2016, the Company, through the Secured Loan Borrowers, entities wholly-owned and controlled, directly or indirectly by the Company, obtained a $500 million secured short-term loan facility with the Secured Loan Lenders, some of which are entities affiliated with ESL. At July 30, 2016, entities affiliated with ESL held $216 million of principal amount of the Secured Loan Facility. See Note 2 for additional information regarding the Secured Loan Facility.

2016 Term Loan

In April 2016, the Company, through the ABL Borrowers, obtained a $750 million Senior Secured Term Loan under the Amended Domestic Credit Agreement with a syndicate of lenders, including $146 million (net of original issue discount) from JPP, LLC and JPP II, LLC, entities affiliated with ESL, and $100 million from the Company's domestic pension plan. See Note 2 for additional information regarding the 2016 Term Loan. At July 30, 2016, JPP LLC and JPP II, LLC, and the Company's domestic pension plan held $150 million and $100 million, respectively, of principal of the 2016 Term Loan.

Senior Secured Notes

At both July 30, 2016 and January 30, 2016, Mr. Lampert and ESL held an aggregate of approximately $11 million of principal of the Company's Senior Secured Notes. At August 1, 2015, Mr. Lampert and ESL held an aggregate of $205 million of principal amount of the Company's Senior Secured Notes.

At July 30, 2016, August 1, 2015, and January 30, 2016, respectively, Fairholme held an aggregate of approximately $46 million, $214 million, and $22 million of principal of the Company's Senior Secured Notes.

At August 1, 2015, the Company's domestic pension plan held $110 million of principal of the Company's Senior Secured Notes.

Subsidiary Notes

At each of July 30, 2016, August 1, 2015 and January 30, 2016, Mr. Lampert and ESL held an aggregate of $3 million of principal amount of unsecured notes issued by SRAC (the "Subsidiary Notes").

At both July 30, 2016 and January 30, 2016, Fairholme held an aggregate of $14 million of principal amount of Subsidiary Notes.

Senior Unsecured Notes and Warrants

At both July 30, 2016 and January 30, 2016, Mr. Lampert and ESL held an aggregate of approximately $193 million of principal amount of the Company's Senior Unsecured Notes, and 10,033,472 warrants to purchase shares of Holdings common stock. At August 1, 2015, Mr. Lampert and ESL held an aggregate of approximately $299 million of principal amount of the Company's Senior Unsecured Notes, and 10,530,633 warrants to purchase shares of Holdings common stock.

At July 30, 2016, August 1, 2015 and January 30, 2016, respectively, Fairholme held an aggregate of approximately $357 million, $207 million and $360 million of principal amount of the Company's Senior Unsecured Notes, and 6,732,415, 6,489,297 and 6,839,379 warrants to purchase shares of Holdings common stock.

Sears Canada

ESL owns approximately 45% of the outstanding common shares of Sears Canada (based on publicly available information as of January 5, 2016). Fairholme owns approximately 19% of the outstanding common shares of Sears Canada (based on publicly available information as of March 31, 2016).

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Lands' End

ESL owns approximately 58% of the outstanding common stock of Lands' End (based on publicly available information as of June 28, 2016). Fairholme owns approximately 9% of the outstanding common shares of Lands' End (based on publicly available information as of March 31, 2016). Holdings and certain of its subsidiaries entered into a transition services agreement in connection with the spin-off pursuant to which Lands' End and Holdings agreed to provide, on an interim, transitional basis, various services, including but not limited to, tax services, logistics services, auditing and compliance services, inventory management services, information technology services and continued participation in certain contracts shared with Holdings and its subsidiaries, as well as agreements related to Lands' End Shops at Sears and participation in the Shop Your Way® program. The majority of the services under the transition services agreement with Lands' End have expired or been terminated. In July 2016, the Company and Lands' End executed an agreement pursuant to which the Company will provide foreign buying office support and sourcing services to Lands' End. The agreement expires on March 31, 2017 and has three one-year renewal options.

Amounts due to or from Lands' End are non-interest bearing, and generally settled on a net basis. Holdings invoices Lands' End on at least a monthly basis. At January 30, 2016, Holdings reported a net amount payable to Lands' End of $1 million in other current liabilities on the Condensed Consolidated Balance Sheet. At August 1, 2015, Holdings reported a net amount receivable from Lands' End of $4 million in accounts receivable on the Condensed Consolidated Balance Sheet. Amounts related to revenue from retail services and rent for Lands' End Shops at Sears, participation in the Shop Your Way® program and corporate shared services were $15 million and $18 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $30 million and $34 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015. The amounts Lands' End earned related to call center services and commissions were $3 million and $2 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $5 million and $4 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015.

SHO

ESL owns approximately 51% of the outstanding common stock of SHO (based on publicly available information as of February 10, 2016). Holdings and certain of its subsidiaries engage in transactions with SHO pursuant to various agreements with SHO which, among other things, (1) govern the principal transactions relating to the rights offering and certain aspects of our relationship with SHO following the separation, (2) establish terms under which Holdings and certain of its subsidiaries will provide SHO with services, and (3) establish terms pursuant to which Holdings and certain of its subsidiaries will obtain merchandise for SHO.

These agreements were originally made in the context of a parent-subsidiary relationship and were negotiated in the overall context of the separation. In May 2016, the Company and SHO agreed to changes to a number of their related agreements, including extending the merchandise and services agreement until February 1, 2020.

A summary of the nature of related party transactions involving SHO is as follows:

- SHO obtains a significant amount of its merchandise from the Company. We have also entered into certain agreements with SHO to provide logistics, handling, warehouse and transportation services. SHO also pays a royalty related to the sale of Kenmore, Craftsman and DieHard products and fees for participation in the Shop Your Way® program.
- SHO receives commissions from the Company for the sale of merchandise made through www.sears.com, extended service agreements, delivery and handling services and credit revenues.
- The Company provides SHO with shared corporate services. These services include accounting and finance, human resources and information technology.

Amounts due to or from SHO are non-interest bearing, settled on a net basis, and have payment terms of 10 days after the invoice date. The Company invoices SHO on a weekly basis. At July 30, 2016, August 1, 2015 and January 30, 2016, Holdings reported a net amount receivable from SHO of $35 million, $95 million and $51 million, respectively, in accounts receivable on the Condensed Consolidated Balance Sheets. Amounts related to the sale of inventory and

related services, royalties, and corporate shared services were $321 million and $399 million,

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

respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $656 million and $781 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015. The net amounts SHO earned related to commissions were $22 million and $25 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $44 million and $49 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015. Additionally, the Company has guaranteed lease obligations for certain SHO store leases that were assigned as a result of the separation. See Note 4 of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016 for further information related to these guarantees.

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

Seritage

ESL owns approximately 9.8% of the total voting power of Seritage, and approximately 43.5% of the limited partnership units of Seritage Growth Properties, L.P. (the "Operating Partnership"), the entity that now owns the properties sold by the Company in the Seritage transaction and through which Seritage conducts its operations (based on publicly available information as of August 14, 2015). Mr. Lampert is also currently the Chairman of the Board of Trustees of Seritage. Fairholme owns approximately 14% of the outstanding Class A common shares of Seritage and 100% of the outstanding Class C non-voting common shares of Seritage (based on publicly available information as of March 31, 2016).

In connection with the Seritage transaction as described in Note 3, Holdings entered into a master lease agreement with Seritage. The initial amount of aggregate annual base rent under the master lease is $134 million for the REIT properties, with increases of 2% per year beginning in the second lease year. At both July 30, 2016 and January 30, 2016, Holdings reported prepaid rent of $9 million in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheet. At August 1, 2015, Holdings reported prepaid rent of $11 million in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheet. Holdings recorded rent expense of $21 million and $5 million, respectively, in cost of sales, buying and occupancy for the 13 week periods ended July 30, 2016 and August 1, 2015. Rent expense consists of straight-line rent expense of $36 million and $10 million, respectively, offset by amortization of a deferred gain recognized pursuant to the sale and leaseback of properties from Seritage of $15 million and $5 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015. Holdings recorded rent expense of $42 million and $5 million, respectively, in cost of sales, buying and occupancy for the 26 week periods ended July 30, 2016 and August 1, 2015. Rent expense consists of straight-line rent expense of $72 million and $10 million, respectively, offset by amortization of a deferred gain recognized pursuant to the sale and leaseback of properties from Seritage of $30 million and $5 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015.

In addition to base rent under the Master Lease, Holdings pays monthly installment expenses for property taxes and insurance at all REIT properties where Holdings is a tenant and installment expenses for common area maintenance, utilities and other operating expenses at REIT properties that are multi-tenant locations where Holdings and other third parties are tenants. The initial amount of aggregate installment expenses under the Master Lease is $70 million, based on estimated installment expenses, and will be reconciled annually based on actual installment expenses. Holdings paid $17 million and $5 million, respectively, for the 13 week periods ended July 30, 2016 and August 1, 2015, and $34 million and $5 million, respectively, for the 26 week periods ended July 30, 2016 and August 1, 2015, recorded in cost of sales, buying and occupancy. At July 30, 2016 and January 30, 2016, respectively, Holdings reported a net amount receivable from Seritage primarily related to installment expenses of $9 million and $7 million in accounts receivable on the Condensed Consolidated Balance Sheets.

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

Holdings and Seritage entered into a transition services agreement pursuant to which Holdings will provide certain limited services to Seritage for up to 18 months. The services include specified facilities management, accounting, treasury, tax, information technology, risk management, human resources, and related support services. Under the terms of the transition services agreement, the scope and level of the facilities management services will be substantially consistent with the scope and level of the services provided in connection with the operation of the transferred properties held by Holdings prior to the closing of the Seritage transaction. The majority of the services under the transition services agreement with Seritage have expired or have been terminated. Amounts due from Seritage are generally settled on a net basis. Holdings invoices Seritage on at least a monthly basis. Revenues recognized related to the transition services agreement were not material for the 13- and 26- week periods ended July 30, 2016.

NOTE 12—GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION

At July 30, 2016, the principal amount outstanding of the Company's 6 5/8% Senior Secured Notes due 2018 was $302 million. The Senior Secured Notes were issued in 2010 by Sears Holdings Corporation ("Parent"). The Senior Secured Notes are guaranteed by certain of our 100% owned domestic subsidiaries that own the collateral for the notes, as well as by SRAC (the "guarantor subsidiaries"). The following condensed consolidated financial information presents the Condensed Consolidating Balance Sheets at July 30, 2016, August 1, 2015 and January 30, 2016, the Condensed Consolidating Statements of Operations and the Condensed Consolidating Statements of Comprehensive Income (Loss) for the 13- and 26- week periods ended July 30, 2016 and August 1, 2015, and the Condensed Consolidating Statements of Cash flows for the 26 week periods ended July 30, 2016 and August 1, 2015 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 intercompany balances and transactions including transactions with our wholly-owned non-guarantor insurance subsidiary. The Company has accounted for investments in subsidiaries under the equity method. The guarantor subsidiaries are 100% owned directly or indirectly by the Parent and all guarantees are joint, several and unconditional. Additionally, the notes are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables of the guarantor subsidiaries, and consequently may not be available to satisfy the claims of the Company's general creditors. Certain investments primarily held by non-guarantor subsidiaries are recorded by the issuers at historical cost and are recorded at fair value by the holder.

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

Condensed Consolidating Balance Sheet
July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current assets					
Cash and cash equivalents	$—	$ 236	$ 40	$ —	$ 276
Intercompany receivables	—	—	27,413	(27,413)	—
Accounts receivable	—	357	33	—	390
Merchandise inventories	—	4,684	—	—	4,684
Prepaid expenses and other current assets	114	597	255	(691)	275
Total current assets	114	5,874	27,741	(28,104)	5,625
Total property and equipment, net	—	1,698	767	—	2,465
Goodwill and intangible assets	—	364	1,909	(98)	2,175
Other assets	—	265	1,785	(1,701)	349
Investment in subsidiaries	10,209	26,879	—	(37,088)	—
TOTAL ASSETS	$10,323	$ 35,080	$ 32,202	$ (66,991)	$ 10,614
Current liabilities					
Short-term borrowings	$—	$ 164	$ —	$ —	$ 164
Current portion of long-term debt and capitalized lease obligations	—	549	1	—	550
Merchandise payables	—	1,345	—	—	1,345
Intercompany payables	12,236	15,177	—	(27,413)	—
Other current liabilities	12	2,258	1,315	(691)	2,894
Total current liabilities	12,248	19,493	1,316	(28,104)	4,953
Long-term debt and capitalized lease obligations	706	3,631	1	(1,501)	2,837
Pension and postretirement benefits	—	2,068	4	—	2,072
Deferred gain on sale-leaseback	—	686	—	—	686
Sale-leaseback financing obligation	—	164	—	—	164
Long-term deferred tax liabilities	58	—	901	(67)	892
Other long-term liabilities	—	804	1,121	(222)	1,703
Total Liabilities	13,012	26,846	3,343	(29,894)	13,307
EQUITY (DEFICIT)					
Shareholder's equity (deficit)	(2,689)	8,234	28,859	(37,102)	(2,698)
Noncontrolling interest	—	—	—	5	5
Total Equity (Deficit)	(2,689)	8,234	28,859	(37,097)	(2,693)
TOTAL LIABILITIES AND EQUITY (DEFICIT)	$10,323	$ 35,080	$ 32,202	$ (66,991)	$ 10,614

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

Condensed Consolidating Balance Sheet
August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current assets					
Cash and cash equivalents	$—	$ 1,779	$ 40	$ —	$ 1,819
Intercompany receivables	—	—	27,040	(27,040)	—
Accounts receivable	10	415	35	—	460
Merchandise inventories	—	5,028	—	—	5,028
Prepaid expenses and other current assets	39	796	263	(828)	270
Total current assets	49	8,018	27,378	(27,868)	7,577
Total property and equipment, net	—	1,902	830	—	2,732
Goodwill and intangible assets	—	271	2,089	—	2,360
Other assets	—	274	2,255	(2,031)	498
Investment in subsidiaries	11,690	25,575	—	(37,265)	—
TOTAL ASSETS	$11,739	$ 36,040	$ 32,552	$ (67,164)	$ 13,167
Current liabilities					
Short-term borrowings	$—	$ 6	$ —	$ —	$ 6
Current portion of long-term debt and capitalized lease obligations	—	68	2	—	70
Merchandise payables	—	1,704	—	—	1,704
Intercompany payables	11,057	15,983	—	(27,040)	—
Other current liabilities	40	2,359	1,662	(828)	3,233
Total current liabilities	11,097	20,120	1,664	(27,868)	5,013
Long-term debt and capitalized lease obligations	1,595	3,244	39	(1,829)	3,049
Pension and postretirement benefits	—	2,253	5	—	2,258
Deferred gain on sale-leaseback	—	798	—	—	798
Sale-leaseback financing obligation	—	164	—	—	164
Long-term deferred tax liabilities	59	5	958	(61)	961
Other long-term liabilities	—	874	1,194	(238)	1,830
Total Liabilities	12,751	27,458	3,860	(29,996)	14,073
EQUITY (DEFICIT)					
Shareholder's equity (deficit)	(1,012)	8,582	28,692	(37,174)	(912)
Noncontrolling interest	—	—	—	6	6
Total Equity (Deficit)	(1,012)	8,582	28,692	(37,168)	(906)
TOTAL LIABILITIES AND EQUITY (DEFICIT)	$11,739	$ 36,040	$ 32,552	$ (67,164)	$ 13,167

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

Condensed Consolidating Balance Sheet
January 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current assets					
Cash and cash equivalents	$—	$ 200	$ 38	$ —	$ 238
Intercompany receivables	—	—	26,935	(26,935)	—
Accounts receivable	7	383	29	—	419
Merchandise inventories	—	5,172	—	—	5,172
Prepaid expenses and other current assets	114	453	257	(608)	216
Total current assets	121	6,208	27,259	(27,543)	6,045
Total property and equipment, net	—	1,829	802	—	2,631
Goodwill and intangible assets	—	269	1,909	—	2,178
Other assets	—	265	1,910	(1,692)	483
Investment in subsidiaries	10,419	26,616	—	(37,035)	—
TOTAL ASSETS	$10,540	$ 35,187	$ 31,880	$ (66,270)	$ 11,337
Current liabilities					
Short-term borrowings	$—	$ 797	$ —	$ —	$ 797
Current portion of long-term debt and capitalized lease obligations	—	70	1	—	71
Merchandise payables	—	1,574	—	—	1,574
Intercompany payables	11,892	15,043	—	(26,935)	—
Other current liabilities	20	2,273	1,311	(608)	2,996
Total current liabilities	11,912	19,757	1,312	(27,543)	5,438
Long-term debt and capitalized lease obligations	685	2,998	1	(1,576)	2,108
Pension and postretirement benefits	—	2,201	5	—	2,206
Deferred gain on sale-leaseback	—	753	—	—	753
Sale-leaseback financing obligation	—	164	—	—	164
Long-term deferred tax liabilities	58	—	873	(38)	893
Other long-term liabilities	—	832	1,128	(229)	1,731
Total Liabilities	12,655	26,705	3,319	(29,386)	13,293
EQUITY (DEFICIT)					
Shareholder's equity (deficit)	(2,115)	8,482	28,561	(36,891)	(1,963)
Noncontrolling interest	—	—	—	7	7
Total Equity (Deficit)	(2,115)	8,482	28,561	(36,884)	(1,956)
TOTAL LIABILITIES AND EQUITY (DEFICIT)	$10,540	$ 35,187	$ 31,880	$ (66,270)	$ 11,337

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

Condensed Consolidating Statement of Operations
For the 13 Weeks Ended July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Merchandise sales and services	$—	$ 5,708	$ 756	$ (801)	$ 5,663
Cost of sales, buying and occupancy	—	4,527	264	(388)	4,403
Selling and administrative	1	1,596	300	(413)	1,484
Depreciation and amortization	—	74	18	—	92
Impairment charges	—	7	—	—	7
Gain on sales of assets	—	(152)	—	98	(54)
Total costs and expenses	1	6,052	582	(703)	5,932
Operating income (loss)	(1)	(344)	174	(98)	(269)
Interest expense	(115)	(159)	14	161	(99)
Interest and investment income (loss)	11	55	82	(161)	(13)
Other loss	—	—	(1)	—	(1)
Income (loss) before income taxes	(105)	(448)	269	(98)	(382)
Income tax (expense) benefit	—	34	(47)	—	(13)
Equity (deficit) in earnings in subsidiaries	(192)	140	—	52	—
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(297)	$ (274)	$ 222	$ (46)	$ (395)

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

Condensed Consolidating Statement of Operations
For the 13 Weeks Ended August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Merchandise sales and services	$—	$ 6,271	$ 693	$ (753)	$ 6,211
Cost of sales, buying and occupancy	—	4,894	280	(398)	4,776
Selling and administrative	1	1,826	222	(355)	1,694
Depreciation and amortization	—	97	17	—	114
Impairment charges	—	54	—	—	54
Gain on sales of assets	—	(519)	(7)	—	(526)
Total costs and expenses	1	6,352	512	(753)	6,112
Operating income (loss)	(1)	(81)	181	—	99
Interest expense	(72)	(117)	(21)	125	(85)
Interest and investment income (loss)	(11)	11	99	(125)	(26)
Other loss	—	—	(1)	—	(1)
Income (loss) before income taxes	(84)	(187)	258	—	(13)
Income tax (expense) benefit	—	266	(45)	—	221
Equity in earnings in subsidiaries	292	108	—	(400)	—
NET INCOME ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$208	$ 187	$ 213	$ (400)	$ 208

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

Condensed Consolidating Statement of Operations
For the 26 Weeks Ended July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Merchandise sales and services	$—	$ 11,128	$ 1,378	$ (1,449)	$ 11,057
Cost of sales, buying and occupancy	—	8,862	512	(754)	8,620
Selling and administrative	2	3,195	485	(695)	2,987
Depreciation and amortization	—	151	36	—	187
Impairment charges	—	15	—	—	15
Gain on sales of assets	—	(211)	(2)	98	(115)
Total costs and expenses	2	12,012	1,031	(1,351)	11,694
Operating income (loss)	(2)	(884)	347	(98)	(637)
Interest expense	(189)	(304)	(6)	315	(184)
Interest and investment income (loss)	11	76	211	(315)	(17)
Income (loss) before income taxes	(180)	(1,112)	552	(98)	(838)
Income tax (expense) benefit	—	70	(98)	—	(28)
Equity (deficit) in earnings in subsidiaries	(588)	286	—	302	—
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(768)	$ (756)	$ 454	$ 204	$ (866)

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

Condensed Consolidating Statement of Operations
For the 26 Weeks Ended August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Merchandise sales and services	$—	$ 12,188	$ 1,435	$ (1,530)	$ 12,093
Cost of sales, buying and occupancy	—	9,381	547	(788)	9,140
Selling and administrative	1	3,620	496	(742)	3,375
Depreciation and amortization	—	200	36	—	236
Impairment charges	—	54	—		54
Gain on sales of assets	—	(625)	(8)	—	(633)
Total costs and expenses	1	12,630	1,071	(1,530)	12,172
Operating income (loss)	(1)	(442)	364	—	(79)
Interest expense	(144)	(238)	(42)	249	(175)
Interest and investment income (loss)	(11)	20	196	(249)	(44)
Income (loss) before income taxes	(156)	(660)	518	—	(298)
Income tax (expense) benefit	—	299	(96)	—	203
Equity in earnings in subsidiaries	61	204	—	(265)	—
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$ (95)	$ (157)	$ 422	$ (265)	$ (95)

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the 13 Weeks Ended July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income (loss)	$(297)	$ (274)	$ 222	$ (46)	$ (395)
Other comprehensive income					
Pension and postretirement adjustments, net of tax	—	64	—	—	64
Unrealized net gain, net of tax	—	—	22	(22)	—
Total other comprehensive income	—	64	22	(22)	64
Comprehensive income (loss) attributable to Holdings' shareholders	$(297)	$ (210)	$ 244	$ (68)	$ (331)

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

Condensed Consolidating Statement of Comprehensive Income
For the 13 Weeks Ended August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	$ 208	$ 187	$ 213	$ (400)	$ 208
Other comprehensive income					
Pension and postretirement adjustments, net of tax	—	66	—	—	66
Unrealized net gain, net of tax	—	—	3	(3)	—
Total other comprehensive income	—	66	3	(3)	66
Comprehensive income attributable to Holdings' shareholders	$ 208	$ 253	$ 216	$ (403)	$ 274

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the 26 Weeks Ended July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income (loss)	$(768)	$ (756)	$ 454	$ 204	$ (866)
Other comprehensive income					
Pension and postretirement adjustments, net of tax	—	128	—	—	128
Unrealized net gain, net of tax	—	—	63	(63)	—
Total other comprehensive income	—	128	63	(63)	128
Comprehensive income (loss) attributable to Holdings' shareholders	$(768)	$ (628)	$ 517	$ 141	$ (738)

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the 26 Weeks Ended August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income (loss)	$(95)	$ (157)	$ 422	$ (265)	$ (95)
Other comprehensive income (loss)					
Pension and postretirement adjustments, net of tax	—	131	—	—	131
Unrealized net loss, net of tax	—	—	(16)	16	—
Total other comprehensive income (loss)	—	131	(16)	16	131
Comprehensive income (loss) attributable to Holdings' shareholders	$(95)	$ (26)	$ 406	$ (249)	$ 36

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

Condensed Consolidating Statement of Cash Flows
For the 26 Weeks Ended July 30, 2016

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	$184	$ (1,066)	$ 433	$ (191)	$ (640)
Proceeds from sales of property and investments	—	101	113	—	214
Purchases of property and equipment	—	(70)	(5)	—	(75)
Net investing with Affiliates	(184)	—	(347)	531	—
Net cash provided by (used in) investing activities	(184)	31	(239)	531	139
Proceeds from debt issuances	—	1,228	—	—	1,228
Repayments of long-term debt	—	(34)	(1)	—	(35)
Decrease in short-term borrowings, primarily 90 days or less	—	(633)	—	—	(633)
Debt issuance costs	—	(21)	—	—	(21)
Intercompany dividend	—	—	(191)	191	—
Net borrowing with Affiliates	—	531	—	(531)	—
Net cash provided by (used in) financing activities	—	1,071	(192)	(340)	539
NET INCREASE IN CASH AND CASH EQUIVALENTS	—	36	2	—	38
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	—	200	38	—	238
CASH AND CASH EQUIVALENTS, END OF PERIOD	$—	$ 236	$ 40	$ —	$ 276

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

Condensed Consolidating Statement of Cash Flows
For the 26 Weeks Ended August 1, 2015

millions	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	$186	$ (1,346)	$ 519	$ (191)	$ (832)
Proceeds from sales of property and investments	—	2,673	5	—	2,678
Purchases of property and equipment	—	(82)	(4)	—	(86)
Net investing with Affiliates	(186)	—	(318)	504	—
Net cash provided by (used in) investing activities	(186)	2,591	(317)	504	2,592
Repayments of long-term debt	—	(441)	(2)	—	(443)
Decrease in short-term borrowings, primarily 90 days or less	—	(209)	—	—	(209)
Proceeds from sale-leaseback financing	—	508	—	—	508
Debt issuance costs	—	(47)	—	—	(47)
Intercompany dividend	—	—	(191)	191	—
Net borrowing with Affiliates	—	504	—	(504)	—
Net cash provided by (used in) financing activities	—	315	(193)	(313)	(191)
NET INCREASE IN CASH AND CASH EQUIVALENTS	—	1,560	9	—	1,569
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	—	219	31	—	250
CASH AND CASH EQUIVALENTS, END OF PERIOD	$—	$ 1,779	$ 40	$ —	$ 1,819

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

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

The following discussion should be read in conjunction with Part II, Item 7 of our Annual Report on Form 10-K for the year ended January 30, 2016.

OVERVIEW OF HOLDINGS

Holdings, the parent company of Kmart and Sears, was formed in connection with the March 24, 2005 Merger of these two companies. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 1,592 full-line and specialty retail stores in the United States, operating as Kmart and Sears. Further, we operate a number of websites under the Sears.com and Kmart.com banners which offer millions of products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way®, a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way® connects all of the ways members shop - in store, at home, online and by phone.

We conduct our operations in two business segments: Kmart and Sears Domestic. The nature of operations conducted within each of these segments is discussed within the "Business Segments" section of Item 1 of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016. Our business segments have been determined in accordance with accounting standards regarding the determination, and reporting, of business segments.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

CONSOLIDATED RESULTS OF OPERATIONS

millions, except per share data	13 Weeks Ended July 30, 2016		13 Weeks Ended August 1, 2015		26 Weeks Ended July 30, 2016		26 Weeks Ended August 1, 2015	
REVENUES								
Merchandise sales and services	$5,663		$6,211		$11,057		$12,093	
COSTS AND EXPENSES								
Cost of sales, buying and occupancy	4,403		4,776		8,620		9,140	
Gross margin dollars	1,260		1,435		2,437		2,953	
Gross margin rate	22.2	%	23.1	%	22.0	%	24.4	%
Selling and administrative	1,484		1,694		2,987		3,375	
Selling and administrative expense as a percentage of total revenues	26.2	%	27.3	%	27.0	%	27.9	%
Depreciation and amortization	92		114		187		236	
Impairment charges	7		54		15		54	
Gain on sales of assets	(54)		(526)		(115)		(633)	
Total costs and expenses	5,932		6,112		11,694		12,172	
Operating income (loss)	(269)		99		(637)		(79)	
Interest expense	(99)		(85)		(184)		(175)	
Interest and investment loss	(13)		(26)		(17)		(44)	
Other loss	(1)		(1)		—		—	
Loss before income taxes	(382)		(13)		(838)		(298)	
Income tax (expense) benefit	(13)		221		(28)		203	
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(395)		$208		$(866)		$(95)	
NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS								
Basic earnings (loss) per share	$(3.70)		$1.95		$(8.11)		$(0.89)	
Diluted earnings (loss) per share	$(3.70)		$1.84		$(8.11)		$(0.89)	
Basic weighted average common shares outstanding	106.9		106.5		106.8		106.5	
Diluted weighted average common shares outstanding	106.9		113.3		106.8		106.5	

References to comparable store sales amounts within the following discussion include sales for all stores operating for a period of at least 12 full months, including remodeled and expanded stores, but excluding store relocations and stores that have undergone format changes. Comparable store sales amounts include sales from sears.com and kmart.com shipped directly to customers. These online sales did not impact comparable store sales for the 13 week period ended July 30, 2016, resulted in a benefit of 10 basis points for the 26 week period ended July 30, 2016, and resulted in a negative impact of approximately 40 basis points and 60 basis points, respectively, for the 13- and 26-week periods ended August 1, 2015. In addition, comparable store sales have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period, which resulted in a negative impact of approximately 10 basis points for the 13 week period ended July 30, 2016 and did not have any impact on the 26 week period ended July 30, 2016. The change in unshipped sales reserves resulted in a benefit of approximately 20 basis points and 30 basis points, respectively, for the 13- and 26- week periods ended August 1, 2015.

Net Income (Loss) Attributable to Holdings' Shareholders, Adjusted EBITDA and Adjusted Loss per Share

We recorded a net loss attributable to Holdings' shareholders for the second quarter of $395 million, or $3.70 loss per diluted share, and net income of $208 million, or $1.84 earnings per diluted share, for 2016 and 2015,

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respectively. We recorded a net loss attributable to Holdings' shareholders of $866 million, or $8.11 loss per diluted share, and $95 million, or $0.89 loss per diluted share, for the first half of 2016 and 2015, respectively.

In addition to our net income (loss) attributable to Sears Holdings' shareholders determined in accordance with Generally Accepted Accounting Principles ("GAAP"), for purposes of evaluating operating performance, we use Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA"), as well as Adjusted Earnings per Share ("Adjusted EPS").

Adjusted EBITDA was determined as follows:

millions	13 Weeks Ended July 30, 2016	13 Weeks Ended August 1, 2015	26 Weeks Ended July 30, 2016	26 Weeks Ended August 1, 2015
Net income (loss) attributable to Holdings per statement of operations	$(395)	$ 208	$(866)	$ (95)
Income tax expense (benefit)	13	(221)	28	(203)
Interest expense	99	85	184	175
Interest and investment loss	13	26	17	44
Other loss	1	1	—	—
Operating income (loss)	(269)	99	(637)	(79)
Depreciation and amortization	92	114	187	236
Gain on sales of assets	(54)	(526)	(115)	(633)
Before excluded items	(231)	(313)	(565)	(476)
Closed store reserve and severance	(18)	(2)	69	37
Pension expense	72	57	144	114
Other[1]	1	(15)	9	(89)
Amortization of deferred Seritage gain	(22)	(7)	(44)	(7)
Impairment charges	7	54	15	54
Adjusted EBITDA	$(191)	$ (226)	$(372)	$ (367)

[1] The 13- and 26- week periods ended July 30, 2016 consisted of expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses, while the 13- and 26- week periods ended August 1, 2015 consisted of one-time credits from vendors, expenses associated with legal matters, transactions costs associated with strategic initiatives and other expenses.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Adjusted EBITDA for our segments was as follows:

millions	13 Weeks Ended July 30, 2016 Kmart	Sears Domestic	Sears Holdings	August 1, 2015 Kmart	Sears Domestic	Sears Holdings
Operating income (loss) per statement of operations	$(9)	$(260)	$(269)	$37	$62	$99
Depreciation and amortization	15	77	92	19	95	114
Gain on sales of assets	(44)	(10)	(54)	(143)	(383)	(526)
Before excluded items	(38)	(193)	(231)	(87)	(226)	(313)
Closed store reserve and severance	(21)	3	(18)	5	(7)	(2)
Pension expense	—	72	72	—	57	57
Other[1]	—	1	1	—	(15)	(15)
Amortization of deferred Seritage gain	(5)	(17)	(22)	(1)	(6)	(7)
Impairment charges	1	6	7	2	52	54
Adjusted EBITDA	$(63)	$(128)	$(191)	$(81)	$(145)	$(226)
% to revenues	(2.8)%	(3.7)%	(3.4)%	(3.3)%	(3.9)%	(3.6)%

millions	26 Weeks Ended July 30, 2016 Kmart	Sears Domestic	Sears Holdings	August 1, 2015 Kmart	Sears Domestic	Sears Holdings
Operating loss per statement of operations	$(125)	$(512)	$(637)	$(70)	$(9)	$(79)
Depreciation and amortization	34	153	187	39	197	236
Gain on sales of assets	(90)	(25)	(115)	(161)	(472)	(633)
Before excluded items	(181)	(384)	(565)	(192)	(284)	(476)
Closed store reserve and severance	52	17	69	41	(4)	37
Pension expense	—	144	144	—	114	114
Other[1]	8	1	9	8	(97)	(89)
Amortization of deferred Seritage gain	(9)	(35)	(44)	(1)	(6)	(7)
Impairment charges	4	11	15	2	52	54
Adjusted EBITDA	$(126)	$(246)	$(372)	$(142)	$(225)	$(367)
% to revenues	(2.9)%	(3.7)%	(3.4)%	(2.9)%	(3.1)%	(3.0)%

[1] The 13- and 26- week periods ended July 30, 2016 consisted of expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses, while the 13- and 26- week periods ended August 1, 2015 consisted of one-time credits from vendors, expenses associated with legal matters, transactions costs associated with strategic initiatives and other expenses.

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The following tables set forth results of operations on a GAAP and "As Adjusted" basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Condensed Consolidated Statements of Operations during the 13- and 26- week periods ended July 30, 2016 and August 1, 2015.

	13 Weeks Ended July 30, 2016								
		Adjustments							
millions, except per share data	GAAP	Pension Expense	Closed Store Reserve, Store Impairments and Severance	Gain on Sales of Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other[1]	Tax Matters	As Adjusted
Gross margin impact	$1,260	$—	$ 4	$—	$ —	$ (22)	$—	$ —	$1,242
Selling and administrative impact	1,484	(72)	22	—	—	—	(1)	—	1,433
Depreciation and amortization impact	92	—	(1)	—	—	—	—	—	91
Impairment charges impact	7	—	(7)	—	—	—	—	—	—
Gain on sales of assets impact	(54)	—	—	21	—	—	—	—	(33)
Operating loss impact	(269)	72	(10)	(21)	—	(22)	1	—	(249)
Interest and investment loss impact	(13)	—	—	—	14	—	—	—	1
Income tax expense impact	(13)	(27)	4	8	(5)	8	—	156	131
After tax and noncontrolling interests impact	(395)	45	(6)	(13)	9	(14)	1	156	(217)
Diluted loss per share impact	$(3.70)	$0.42	$ (0.05)	$(0.12)	$ 0.08	$ (0.13)	$0.01	$ 1.46	$(2.03)

[1] Consists of transaction costs associated with strategic initiatives and other expenses.

	13 Weeks Ended August 1, 2015								
		Adjustments							
millions, except per share data	GAAP	Pension Expense	Closed Store Reserve, Store Impairments and Severance	Gain on Sales of Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other[1]	Tax Matters	As Adjusted
Gross margin impact	$1,435	$—	$ 5	$—	$ —	$ (7)	$(33)	$—	$1,400
Selling and administrative impact	1,694	(57)	7	—	—	—	(18)	—	1,626
Depreciation and amortization impact	114	—	(2)	—	—	—	—	—	112
Impairment charges impact	54	—	(54)	—	—	—	—	—	—
Gain on sales of assets impact	(526)	—	—	508	—	—	—	—	(18)
Operating income impact	99	57	54	(508)	—	(7)	(15)	—	(320)
Interest and investment loss impact	(26)	—	—	—	23	—	—	—	(3)
Income tax benefit impact	221	(21)	(20)	190	(9)	2	6	(216)	153
	208	36	34	(318)	14	(5)	(9)	(216)	(256)

After tax and noncontrolling interests impact								
Diluted earnings per share impact	$1.84	$0.32	$ 0.30	$(2.81)	$ 0.12	$ (0.04)	$(0.08)	$(1.91)	$(2.40)

(1) Consists of one-time credits from vendors, expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses.

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	26 Weeks Ended July 30, 2016								
		Adjustments							
millions, except per share data	GAAP	Pension Expense	Closed Store Reserve, Store Impairments and Severance	Gain on Sales of Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other[1]	Tax Matters	As Adjusted
Gross margin impact	$2,437	$—	$ 64	$—	$ —	$ (44)	$—	$ —	$2,457
Selling and administrative impact	2,987	(144)	(5)	—	—	—	(9)	—	2,829
Depreciation and amortization impact	187	—	(5)	—	—	—	—	—	182
Impairment charges	15	—	(15)	—	—	—	—	—	—
Gain on sales of assets impact	(115)	—	—	47	—	—	—	—	(68)
Operating loss impact	(637)	144	89	(47)	—	(44)	9	—	(486)
Interest and investment loss impact	(17)	—	—	—	20	—	—	—	3
Income tax expense impact	(28)	(54)	(33)	18	(8)	16	(3)	342	250
After tax and noncontrolling interests impact	(866)	90	56	(29)	12	(28)	6	342	(417)
Diluted loss per share impact	$(8.11)	$0.85	$ 0.52	$(0.27)	$ 0.11	$ (0.26)	$0.06	$ 3.20	$(3.90)

[1] Consists of expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses.

	26 Weeks Ended August 1, 2015								
.		Adjustments							
millions, except per share data	GAAP	Pension Expense	Closed Store Reserve, Store Impairments and Severance	Gain on Sales of Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other[1]	Tax Matters	As Adjusted
Gross margin impact	$2,953	$—	$ 11	$—	$ —	$ (7)	$(126)	$—	$2,831
Selling and administrative impact	3,375	(114)	(26)	—	—	—	(37)	—	3,198
Depreciation and amortization impact	236	—	(2)	—	—	—	—	—	234
Impairment charges impact	54	—	(54)	—	—	—	—	—	—
Gain on sales of assets impact	(633)	—	—	604	—	—	—	—	(29)
Operating loss impact	(79)	114	93	(604)	—	(7)	(89)	—	(572)
Interest and investment loss impact	(44)	—	—	—	42	—	—	—	(2)
Income tax benefit impact	203	(43)	(35)	226	(16)	2	33	(89)	281
After tax and noncontrolling interests impact	(95)	71	58	(378)	26	(5)	(56)	(89)	(468)
Diluted loss per share impact	$(0.89)	$0.67	$ 0.55	$(3.55)	$ 0.24	$ (0.05)	$(0.52)	$(0.84)	$(4.39)

[1] Consists of one-time credits from vendors, expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses.

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

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

- EBITDA excludes the effects of financings and investing activities by eliminating the effects of interest and depreciation costs;
- Management considers gains/losses on the sale of assets to result from investing decisions rather than ongoing operations; and
- Other significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, which affects comparability of results. We have adjusted our results for these items to make our statements more comparable and therefore more useful to investors as the items are not representative of our ongoing operations and reflect past investment decisions.

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

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

Pension expense – Contributions to our pension plans remain a significant use of our cash on an annual basis. Cash contributions to our pension and postretirement plans are separately disclosed on the cash flow statement. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, we have a legacy pension obligation for past service performed by Kmart and Sears associates. The annual pension expense included in our statement of operations related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, and the resulting abnormally low interest rates, which continue to persist, our domestic pension expense was $229 million in 2015, $89 million in 2014 and $162 million in 2013. Pension expense is comprised of interest cost, expected return on plan assets and recognized net loss and other. This adjustment eliminates the entire pension expense from the statement of operations to improve comparability. Pension expense is included in the determination of net income (loss).

The components of the adjustments to EBITDA related to domestic pension expense were as follows:

millions	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Components of net periodic expense:				
Interest cost	$57	$ 53	$114	$ 105
Expected return on plan assets	(51)	(63)	(101)	(125)
Recognized net loss and other	66	67	131	134

Net periodic expense	$72	$ 57	$144	$ 114

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

Actuarial gains and losses occur when actual experience differs from the estimates used to allocate the change in value of pension plans to expense throughout the year or when assumptions change, as they may each year. Significant factors that can contribute to the recognition of actuarial gains and losses include changes in discount rates used to remeasure pension obligations on an annual basis or upon a qualifying remeasurement, differences between actual and expected returns on plan assets and other changes in actuarial assumptions. Management believes these actuarial gains and losses are primarily financing activities that are more reflective of changes in current conditions in global financial markets (and in particular interest rates) that are not directly related to the underlying business and that do not have an immediate, corresponding impact on the benefits provided to eligible retirees. For further information on the actuarial assumptions and plan assets referenced above, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Application of Critical Accounting Policies and Estimates - Defined Benefit Pension Plans, and Note 7 of Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

- Closed store reserve and severance – We are transforming our Company to a less asset-intensive business model. Throughout this transformation, we continue to make choices related to our stores, which could result in sales, closures, lease terminations or a variety of other decisions.
- Impairment charges – Accounting standards require the Company to evaluate the carrying value of fixed assets, goodwill and intangible assets for impairment. As a result of the Company's analysis, we have recorded impairment charges related to certain fixed asset and indefinite-lived intangible asset balances.
- Gains on sales of assets – We have recorded significant gains on sales of assets, as well as gains on sales of joint venture interests, which were primarily attributable to several real estate transactions, including gains recognized due to recaptures by Seritage and the JVs. Management considers these gains on sale of assets to result from investing decisions rather than ongoing operations.
- Mark-to-market adjustments – We elected the fair value option for the equity method investment in Sears Canada, and the change in fair value is recorded in interest and investment income on the Condensed Consolidated Statement of Operations. Management considers activity related to our retained investment in Sears Canada to result from investing decisions rather than ongoing operations. Furthermore, we do not consider the short term fluctuations in Sears Canada's stock price useful in assessing our operating performance.
- Amortization of deferred Seritage gain – A portion of the gain on the Seritage transaction was deferred and will be recognized in proportion to the related rent expense, which is a component of cost of sales, buying and occupancy, on the Condensed Consolidated Statement of Operations, over the lease term. Management considers the amortization of the deferred Seritage gain to result from investing decisions rather than ongoing operations.
- Other – consists of one-time credits from vendors, transaction costs associated with strategic initiatives, expenses associated with legal matters and other expenses.
- Domestic tax matters – In 2011, we recorded a non-cash charge to establish a valuation allowance against substantially all of our domestic deferred tax assets. Accounting rules generally require that a valuation reserve be established when income has not been generated over a three-year cumulative period to support the deferred tax asset. While an accounting loss was recorded, we believe no economic loss has occurred as these net operating losses and tax benefits

remain available to reduce future taxes as income is generated in

subsequent periods. As this valuation allowance has a significant impact on the effective tax rate, we have adjusted our results to reflect a standard effective tax rate for the Company beginning in fiscal 2011 when the valuation allowance was first established.

13-week period ended July 30, 2016 compared to the 13-week period ended August 1, 2015

Revenues and Comparable Store Sales

Revenues decreased $548 million to $5.7 billion for the second quarter of 2016, as compared to revenues of $6.2 billion for the second quarter of 2015. The decrease in revenue was primarily driven by a 5.2% decline in comparable store sales during the quarter, which accounted for $240 million of the revenue decline, and by having fewer Kmart and Sears Full-line stores in operation, which accounted for $199 million of the decline. In addition, we also experienced a decline in revenues from Sears Hometown and Outlet Stores, Inc. ("SHO") of approximately $75 million during the second quarter of 2016.

Kmart comparable store sales declined 3.3% with declines in the pharmacy, grocery & household and consumer electronics categories, partially offset by increases in toys, jewelry, mattresses and apparel. Sears Domestic comparable store sales decreased 7.0%, primarily driven by decreases in home appliances, apparel, consumer electronics, footwear, lawn & garden and tools.

Gross Margin

Gross margin decreased $175 million to $1.3 billion for the second quarter of 2016, as compared to the prior year second quarter due to the above noted decline in sales, as well as a decline in gross margin rate. The decline in margin rate is primarily attributed to a decrease in overall product margin, as well as a decrease in occupancy leverage. Gross margin for the second quarter of 2016 included a credit of $22 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, as well as charges of $4 million related to store closures. Gross margin for the second quarter of 2015 included one-time vendor credits of $33 million, a credit of $7 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, as well as charges of $5 million related to store closures.

Kmart's gross margin rate for the second quarter improved 10 basis points compared to the prior year second quarter, while Sears Domestic's gross margin rate decreased 150 basis points for the quarter. Excluding the impact of significant items noted in our Adjusted Earnings Per Share tables, Kmart's gross margin rate would have declined 10 basis points, while Sears Domestic's gross margin rate would have declined 100 basis points compared to the prior year second quarter. While we experienced improvement in several categories in our Kmart format, the overall decline in Kmart's gross margin rate was primarily due to declines in the grocery & household and apparel categories. The decline in Sears Domestic's gross margin rate was primarily driven by a decline in the apparel category. The margin rate in both segments was negatively impacted by increased promotional markdowns, including an increase in Shop Your Way® expense.

In addition, as a result of the Seritage and JV transactions, the second quarter of 2016 included additional rent expense of approximately $48 million and the second quarter of 2015 included additional rent expense and assigned sub-tenant rental income of approximately $26 million. Due to the structure of the leases, we expect that our cash rent obligations to Seritage and the joint venture partners will decline, over time, as space in these stores is recaptured. From the inception of Seritage to date, we have received recapture notices on 15 properties, which is estimated to reduce the rent expense by approximately $8 million on an annual basis.

Selling and Administrative Expenses

Selling and administrative expenses decreased $210 million in the second quarter of 2016 compared to the prior year. The second quarter of 2016 and 2015 included significant items related to our pension plan, store closings and severance, transaction costs associated with strategic initiatives and other expenses which aggregated to expense of $51 million and $68 million, respectively. Excluding these items, selling and administrative expenses declined $193 million from the prior year quarter primarily due to a decrease in payroll expense. In addition, advertising expense

also declined as we shift away from traditional advertising to use of Shop Your Way® points expense, which is included within gross margin.

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Our selling and administrative expenses as a percentage of total revenues ("selling and administrative expense rate") was 26.2% for the second quarter of 2016, compared to 27.3% in the prior year, and decreased due to the decrease in expenses noted above, partially offset by the decline in revenues.

Depreciation and Amortization

Depreciation and amortization expense decreased by $22 million in the second quarter of 2016 to $92 million, primarily due to having fewer assets to depreciate.

Impairment Charges

We recorded impairment charges of $7 million and $54 million during the second quarter of 2016 and 2015, respectively, related to the impairment of long-lived assets. Impairment charges recorded are described further in Note 3 of Notes to Condensed Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets for the quarter of $54 million in 2016 and $526 million in 2015. The gains recorded in the second quarter of 2016 included a gain of $12 million recognized on the sale of one distribution center, as well as gains of $9 million related to recapture activity of JV properties which had previously been deferred. The gains recorded during the second quarter of 2015 included gains of $508 million (comprised of a gain of $625 million and loss of $117 million) recognized in connection with the first quarter 2015 JV transactions and the transaction with Seritage. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

The Company reported an operating loss of $269 million in the second quarter of 2016 compared to operating income of $99 million in the second quarter of 2015. Operating loss for the second quarter of 2016 included significant items noted above which aggregated to operating expense of $20 million. Operating income for the second quarter of 2015 included significant items noted above which aggregated to operating income of $419 million. Excluding these items, we would have reported an operating loss of $249 million and $320 million for the second quarter of 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was primarily due to the decline in selling and administrative and depreciation and amortization expenses, partially offset by the decline in gross margin dollars.

Interest and Investment Loss

We recorded interest and investment loss of $13 million during the second quarter of 2016 compared to $26 million during the second quarter of 2015. The second quarter of 2016 and 2015 included a loss of $14 million and $23 million, respectively, related to our equity investment in Sears Canada.

Income Taxes

Our effective tax rate for the second quarter of 2016 was an expense rate of 3.4%. The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2016 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. During the second quarter of 2015, the Company realized a significant tax benefit on the deferred taxes related to indefinite-life assets associated with the properties sold in the transaction with Seritage. As such, our effective tax rate for the second quarter of 2015 was a benefit of 1,700.0%. In addition, the second quarters of 2016 and 2015 were negatively impacted by foreign branch taxes and state income taxes.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

26-week period ended July 30, 2016 compared to the 26-week period ended August 1, 2015

Revenues and Comparable Store Sales

For the first half of 2016, revenues decreased $1.0 billion to $11.1 billion, as compared to revenues of $12.1 billion for the first half of 2015. The decrease in revenue was primarily driven by a 5.6% decline in comparable store sales during the first half of 2016, which accounted for $508 million of the revenue decline, and by having fewer Kmart and Sears Full-line stores in operation, which accounted for $348 million of the decline. In addition, we also experienced a decline in revenues from SHO of approximately $121 million during the first half of 2016.

Kmart comparable store sales declined 4.2% primarily driven by declines in the grocery & household, consumer electronics, pharmacy and drugstore categories. Sears Domestic comparable store sales decreased 7.0% primarily driven by decreases in home appliances, apparel, consumer electronics and footwear.

Gross Margin

Gross margin decreased $516 million to $2.4 billion for the first half of 2016, as compared to the first half of the prior year due to the above noted decline in sales, as well as a decline in gross margin rate. The decline in margin rate is primarily attributed to a decrease in overall product margin, as well as a decrease in occupancy leverage. Gross margin for the first half of 2016 included a credit of $44 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, as well as charges of $64 million related to store closures. Gross margin for the first half of 2015 included one-time vendor credits of $126 million, a credit of $7 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, as well as charges of $11 million related to store closures.

As compared to the prior year period, Kmart's gross margin rate for the first half of 2016 declined 150 basis points, while Sears Domestic's gross margin rate declined 300 basis points. Excluding the impact of significant items noted in our Adjusted Earnings Per Share tables, Kmart's gross margin rate would have declined 60 basis points with the most notable decreases experienced in the grocery & household, drugstore, pharmacy and home categories, while Sears Domestic's gross margin rate would have declined 160 basis points driven by declines experienced in the apparel, home appliances and home categories. The decline in margin rate experienced in both Kmart and Sears Domestic is primarily attributable to increased markdowns, including an increase in Shop Your Way® expense.

In addition, as a result of the Seritage and JV transactions, the first half of 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately $102 million and $26 million, respectively. Due to the structure of the leases, we expect that our cash rent obligations to Seritage and the joint venture partners will decline, over time, as space in these stores is recaptured. From the inception of Seritage to date, we have received recapture notices on 15 properties, which is estimated to reduce the rent expense by approximately $8 million on an annual basis.

Selling and Administrative Expenses

Selling and administrative expenses decreased $388 million in the first half of 2016 compared to the first half of 2015. The first half of 2016 included significant items related to our pension plan, store closings and severance, legal matters, transaction costs associated with strategic initiatives and other expenses which aggregated to expense of $158 million, while the first half of 2015 included items related to our pension plan, store closings and severance, transaction costs associated with strategic initiatives and other expenses which aggregated to expense of $177 million. Excluding these items, selling and administrative expenses declined $369 million from the first half of the prior year half primarily due to a decrease in payroll expense. In addition, advertising expense also declined as we shift away from traditional advertising to use of Shop Your Way® points expense, which is included within gross margin.

Our selling and administrative expense rate was 27.0% for the first half of 2016, compared to 27.9% in the prior year, and decreased due to the decrease in expenses noted above, partially offset by the decline in revenues.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Depreciation and Amortization

Depreciation and amortization expense decreased by $49 million in the first half of 2016 to $187 million, primarily due to having fewer assets to depreciate.

Impairment Charges

We recorded impairment charges of $15 million and $54 million during the first half of 2016 and 2015, respectively, related to the impairment of long-lived assets. Impairment charges recorded are described further in Note 3 of Notes to Condensed Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets $115 million and $633 million for the first half of 2016 and 2015, respectively. The gains recorded in the first half of 2016 included gains of $26 million related to three stores that closed pursuant to recapture notices from Seritage, of which $13 million related to the gain that had previously been deferred as we no longer have continuing involvement with those properties, and $13 million related to lease termination proceeds. The gains recorded in the first half of 2016 also included gains of $9 million related to recapture activity of JV properties which had previously been deferred, as well as a gain of $12 million recognized on the sale of one distribution center. The gains recorded during the first half of 2015 included gains of $508 million (comprised of a gain of $625 million and loss of $117 million) recognized in connection with the first quarter 2015 JV transactions and the transaction with Seritage. Gains on sales of assets in the first half of 2015 also included gains of $86 million recognized on the sale of two Sears Full-line stores, and $10 million recognized on the surrender and early termination of one Kmart store lease. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

The Company reported an operating loss of $637 million and $79 million in the first half of 2016 and 2015, respectively. Operating loss for the first half of 2016 and 2015 included significant items noted above which aggregated to operating expense of $151 million and operating income of $493 million, respectively. Excluding these items, we would have reported an operating loss of $486 million and $572 million for the first half of 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was primarily due to the decline in selling and administrative and depreciation and amortization expenses, partially offset by the decline in gross margin dollars.

Interest and Investment Loss

We recorded an interest and investment loss of $17 million during the first half of 2016 compared to $44 million during the first half of 2015. The first half of 2016 and 2015 included a loss of $20 million and $42 million, respectively, related to our equity investment in Sears Canada.

Income Taxes

Our effective tax rate for the first half of 2016 was an expense rate of 3.3% compared to a benefit rate of 68.1% in the prior year first half. The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2016 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. During the first half of 2015, the Company realized a significant tax benefit on the deferred taxes related to indefinite-life assets associated with the property sold in the transaction with Seritage. In addition, the first half of 2016 and 2015 were negatively impacted by foreign branch taxes and state income taxes.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

SEGMENT OPERATIONS

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

Kmart

Kmart results and key statistics were as follows:

millions, except number of stores	13 Weeks Ended July 30, 2016		13 Weeks Ended August 1, 2015		26 Weeks Ended July 30, 2016		26 Weeks Ended August 1, 2015	
Merchandise sales and services	$2,221		$2,459		$4,360		$4,815	
Cost of sales, buying and occupancy	1,760		1,950		3,495		3,788	
Gross margin dollars	461		509		865		1,027	
Gross margin rate	20.8	%	20.7	%	19.8	%	21.3	%
Selling and administrative	498		594		1,042		1,217	
Selling and administrative expense as a percentage of total revenues	22.4	%	24.2	%	23.9	%	25.3	%
Depreciation and amortization	15		19		34		39	
Impairment charges	1		2		4		2	
Gain on sales of assets	(44)		(143)		(90)		(161)	
Total costs and expenses	2,230		2,422		4,485		4,885	
Operating income (loss)	$(9)		$37		$(125)		$(70)	
Adjusted EBITDA	$(63)		$(81)		$(126)		$(142)	
Number of stores					883		963	

13-week period ended July 30, 2016 compared to the 13-week period ended August 1, 2015

Revenues and Comparable Store Sales

For the quarter, Kmart's revenues decreased by $238 million to $2.2 billion in 2016, primarily due to the effect of having fewer stores in operation, which accounted for approximately $157 million of the decline, as well as the decrease in comparable store sales of 3.3%, which accounted for approximately $76 million of the decline.

Comparable store sales declined 3.3% with declines in the pharmacy, grocery & household and consumer electronics categories, partially offset by increases in toys, jewelry, mattresses and apparel.

Gross Margin

For the quarter, Kmart generated gross margin dollars of $461 million in 2016 compared to $509 million in 2015. The decrease in Kmart's gross margin dollars is due to a decrease in revenues, which was slightly offset by an increase in gross margin rate. Gross margin for the second quarter included credits of $5 million and $1 million in 2016 and 2015, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction. Gross margin for the second quarter also included charges of $3 million and $4 million in 2016 and 2015, respectively, related to store closures.

Kmart's gross margin rate for the quarter improved 10 basis points to 20.8% in 2016 from 20.7% in 2015. Excluding the impact of significant items recorded in gross margin during the quarter, Kmart's gross margin rate would have declined 10 basis points. While we experienced improvement in several categories in our Kmart format, the overall decline in Kmart's gross margin rate was primarily due to declines in the grocery & household and apparel categories driven by increased promotional markdowns, including an increase in Shop Your Way® expense.

SEARS HOLDINGS CORPORATION
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In addition, as a result of the Seritage and JV transactions, the second quarter of 2016 included additional rent expense of approximately $8 million and the second quarter of 2015 included additional rent expense and assigned sub-tenant rental income of approximately $4 million.

Selling and Administrative Expenses

For the quarter, Kmart's selling and administrative expenses decreased $96 million in 2016 as compared to the second quarter in 2015. Selling and administrative expenses for the second quarter of 2016 and 2015 were impacted by significant items related to store closings and severance which aggregated to a credit of $24 million and expense of $1 million, respectively. Excluding these items, selling and administrative expenses decreased $71 million primarily due to a decrease in payroll expense.

Kmart's selling and administrative expense rate for the quarter was 22.4% in 2016 and 24.2% in 2015 and decreased primarily as a result of the decreased expenses noted above, partially offset by the decline in revenues.

Gain on Sales of Assets

Kmart recorded a total gain on sales of assets for the quarter of $44 million and $143 million in 2016 and 2015, respectively. The gains recorded during the second quarter of 2016 included a gain of $12 million recognized on the sale of one distribution center. The gains recorded during the second quarter of 2015 included gains of $137 million (comprised of a gain of $154 million and loss of $17 million) recognized in connection with the transaction with Seritage. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

For the quarter, Kmart recorded an operating loss of $9 million in 2016 compared to operating income of $37 million in 2015. Operating loss for the second quarter of 2016 included significant items noted above which aggregated to operating expense of $37 million. Operating income for the second quarter of 2015 included significant items noted above which aggregated to operating income of $131 million. Excluding these items, Kmart would have reported an operating loss of $46 million and $94 million for the second quarter of 2016 and 2015, respectively. The decrease in Kmart's adjusted operating loss was primarily driven by the decrease in selling and administrative expenses, partially offset by the decline in gross margin dollars.

26-week period ended July 30, 2016 compared to the 26-week period ended August 1, 2015

Revenues and Comparable Store Sales

For the first half of 2016, Kmart's revenues decreased by $455 million to $4.4 billion in 2016, primarily due to the effect of having fewer stores in operation, which accounted for approximately $257 million of the decline, as well as the decrease in comparable store sales of 4.2%, which accounted for approximately $187 million of the decline. Comparable store sales declined primarily driven by declines in the grocery & household, consumer electronics, pharmacy and drugstore categories.

Gross Margin

For the first half of 2016, Kmart generated $865 million in gross margin compared to $1.0 billion in the first half of 2015. The decrease in Kmart's gross margin dollars is due to a decrease in revenues, as well as a decrease in gross margin rate. Gross margin for the first half of the year included credits of $9 million and $1 million in 2016 and 2015, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction. Gross margin for the first half of the year also included charges of $54 million and $9 million in 2016 and 2015, respectively, related to store closures.

Kmart's gross margin rate for the first half of the year declined 150 basis points to 19.8% in 2016 from 21.3% in 2015. Excluding the impact of significant items recorded in gross margin during the first half of the year, Kmart's gross margin rate would have declined 60 basis points, with the most notable decreases experienced in the grocery &

household, drugstore, pharmacy and home categories driven by increased markdowns, including an increase in Shop Your Way® expense.

In addition, as a result of the Seritage and JV transactions, the first half of 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately $19 million and $4 million, respectively.

Selling and Administrative Expenses

For the first half of 2016, Kmart's selling and administrative expenses decreased $175 million as compared to the first half of 2015. Selling and administrative expenses for the first half of 2016 and 2015 were impacted by significant items related to store closings and severance, as well as legal matters, which aggregated to expense of $6 million and $40 million, respectively. Excluding these items, selling and administrative expenses decreased $141 million primarily due to decreases in payroll and advertising expenses.

Kmart's selling and administrative expense rate for the first half was 23.9% in 2016 and 25.3% in 2015 and decreased primarily as a result of the decreased expenses noted above, partially offset by the decline in revenues.

Gain on Sales of Assets

Kmart recorded a total gain on sales of assets for the first half of $90 million and $161 million in 2016 and 2015, respectively. The gains recorded during the first half of 2016 included gains of $22 million related to two stores that closed pursuant to recapture notices from Seritage, of which $10 million related to the gain that had previously been deferred as we no longer have continuing involvement with those properties, and $12 million related to lease termination proceeds, as well as a gain of $12 million recognized on the sale of one distribution center. The gains recorded during the first half of 2015 included gains of $137 million (comprised of a gain of $154 million and loss of $17 million) recognized in connection with the transaction with Seritage. The first half of 2015 also included a gain of $10 million recognized on the surrender and early termination of one Kmart store lease. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

For the first half of the year, Kmart recorded an operating loss of $125 million and $70 million in 2016 and 2015, respectively. Operating loss for the first half included significant items noted above which aggregated to operating expense of $25 million in 2016 and operating income of $97 million in 2015. Excluding these items, Kmart would have reported an operating loss of $100 million and $167 million for the first half of 2016 and 2015, respectively. The decrease in Kmart's adjusted operating loss was primarily driven by the decrease in selling and administrative expenses, partially offset by the decline in gross margin dollars.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Sears Domestic
Sears Domestic results and key statistics were as follows:

millions, except number of stores	13 Weeks Ended July 30, 2016	13 Weeks Ended August 1, 2015	26 Weeks Ended July 30, 2016	26 Weeks Ended August 1, 2015
Merchandise sales and services	$3,442	$3,752	$6,697	$7,278
Cost of sales, buying and occupancy	2,643	2,826	5,125	5,352
Gross margin dollars	799	926	1,572	1,926
Gross margin rate	23.2 %	24.7 %	23.5 %	26.5 %
Selling and administrative	986	1,100	1,945	2,158
Selling and administrative expense as a percentage of total revenues	28.6 %	29.3 %	29.0 %	29.7 %
Depreciation and amortization	77	95	153	197
Impairment charges	6	52	11	52
Gain on sales of assets	(10)	(383)	(25)	(472)
Total costs and expenses	3,702	3,690	7,209	7,287
Operating income (loss)	$(260)	$62	$(512)	$(9)
Adjusted EBITDA	$(128)	$(145)	$(246)	$(225)
Number of:				
Full-line stores			683	711
Specialty stores			26	28
Total Sears Domestic Stores			709	739

13-week period ended July 30, 2016 compared to the 13-week period ended August 1, 2015

Revenues and Comparable Store Sales

For the quarter, Sears Domestic's revenues decreased by $310 million to $3.4 billion. The decline in revenue was primarily driven by a decrease in comparable store sales of 7.0%, which accounted for $164 million of the decline, and the effect of having fewer Full-line stores in operation, which accounted for $42 million of the decline. In addition, we also experienced a decline in revenues from SHO of approximately $75 million during the quarter. Comparable store sales for the quarter declined primarily due to decreases in home appliances, apparel, consumer electronics, footwear, lawn & garden and tools.

Gross Margin

For the quarter, Sears Domestic generated gross margin dollars of $799 million in 2016, compared to $926 million in 2015. Gross margin for the second quarter of 2016 and 2015 included credits of $17 million and $6 million, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, while the second quarter of 2015 included one-time vendor credits of $33 million. Gross margin for the second quarter also included charges of $1 million in both 2016 and 2015 related to store closures.

Sears Domestic's gross margin rate for the quarter declined 150 basis points to 23.2% in 2016 from 24.7% in 2015. Excluding the impact of significant items recorded in gross margin during the quarter, Sears Domestic's gross margin rate would have declined 100 basis points primarily driven by a decline in the apparel category as a result of increased promotional markdowns, including an increase in Shop Your Way® expense.

In addition, as a result of the Seritage and JV transactions, the second quarter of 2016 included additional rent expense of approximately $40 million and the second quarter of 2015 included additional rent expense and assigned sub-tenant rental income of approximately $22 million.

Selling and Administrative Expenses

For the quarter, Sears Domestic's selling and administrative expenses decreased $114 million in 2016 as compared to the prior year. Selling and administrative expenses for the second quarter of 2016 and 2015 were impacted by significant items related to store closures and severance and transactions costs associated with strategic initiatives, which aggregated to expense of $75 million and $67 million, respectively. Excluding these items, selling and administrative expenses decreased $122 million primarily due to a decrease in payroll expense and advertising expenses.

Sears Domestic's selling and administrative expense rate for the quarter was 28.6% in 2016 and 29.3% in 2015 and decreased as a result of the decline in expenses noted above, partially offset by the decline in sales.

Depreciation and Amortization

Depreciation and amortization expense decreased by $18 million in the second quarter of 2016 to $77 million, primarily due to having fewer assets to depreciate.

Gain on Sales of Assets

Sears Domestic recorded a total gain on sales of assets for the quarter of $10 million and $383 million in 2016 and 2015, respectively. The gains recorded during the second quarter of 2016 included gains of $9 million related to recapture activity of JV properties which had previously been deferred. The gains recorded during the second quarter of 2015 included gains of $371 million (comprised of a gain of $471 million and loss of $100 million) recognized in connection with the first quarter 2015 JV transactions and the transaction with Seritage. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

For the quarter, Sears Domestic reported an operating loss of $260 million in 2016 and operating income of $62 million in 2015. Sears Domestic's operating loss for the second quarter of 2016 and operating income for the second quarter of 2015 included significant items which aggregated to operating expense of $57 million and operating income of $288 million, respectively. Excluding these items, we would have reported an operating loss of $203 million and $226 million for the second quarter of 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was driven by the above noted decrease in selling and administrative and depreciation and amortization expenses, partially offset by a decrease in gross margin.

26-week period ended July 30, 2016 compared to the 26-week period ended August 1, 2015

Revenues and Comparable Store Sales

For the first half of 2016, Sears Domestic's revenues decreased by $581 million to $6.7 billion. The decline in revenue was primarily driven by a decrease in comparable store sales of 7.0%, which accounted for $321 million of the decline, and the effect of having fewer Full-line stores in operation, which accounted for $91 million of the decline. In addition, we also experienced a decline in revenues from SHO of approximately $121 million during the first half of 2016.

Comparable store sales for the first half of 2016 declined primarily due to decreases in home appliances, apparel, consumer electronics and footwear.

Gross Margin

For the first half of the year, Sears Domestic generated gross margin dollars of $1.6 billion and $1.9 billion in 2016 and 2015, respectively. Gross margin for the first half of 2016 and 2015 included credits of $35 million and $6

million, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, while the first half of 2015 also included one-time vendor credits of $126 million. Gross margin for the first half of the year also included charges of $10 million and $2 million in 2016 and 2015, respectively, related to store closures.

Sears Domestic's gross margin rate for the first half of the year declined 300 basis points to 23.5% in 2016 from 26.5% in 2015. Excluding the impact of significant items recorded in gross margin during the first half of 2016 and 2015, Sears Domestic's gross margin rate would have declined 160 basis points driven by declines experienced in the apparel, home and footwear categories due to increased markdowns, including an increase in Shop Your Way® expense.

In addition, as a result of the Seritage and JV transactions, the first half of 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately $83 million and $22 million, respectively.

Selling and Administrative Expenses

For the first half of the year, Sears Domestic's selling and administrative expenses decreased $213 million in 2016 as compared to the prior year. Selling and administrative expenses for the first half of 2016 and 2015 were impacted by significant items related to store closures and severance and transactions costs associated with strategic initiatives, which aggregated to expense of $152 million and $137 million, respectively. Excluding these items, selling and administrative expenses decreased $228 million in the first half of 2016 primarily due to a decrease in payroll expense.

Sears Domestic's selling and administrative expense rate for the first half of the year was 29.0% in 2016 and 29.7% in 2015 and decreased as a result of the decline in expenses noted above, partially offset by the decline in sales.

Depreciation and Amortization

Depreciation and amortization expense decreased by $44 million in the first half of 2016 to $153 million, primarily due to having fewer assets to depreciate.

Gain on Sales of Assets

Sears Domestic recorded a total gain on sales of assets of $25 million and $472 million for the first half of 2016 and 2015, respectively. The gains recorded during the first half of 2016 included gains of $9 million related to recapture activity of JV properties which had previously been deferred, as well as a gain of $4 million related to one store that closed pursuant to a recapture notice from Seritage, of which $3 million related to the gain that had previously been deferred as we no longer have continuing involvement with those properties, and $1 million related to lease termination proceeds. The gains recorded during the first half of 2015 included gains of $371 million (comprised of a gain of $471 million and loss of $100 million) recognized in connection with the JV transactions and the transaction with Seritage. The gains recorded during the first half of 2015 also included gains of $86 million recognized on the sale of two Sears Full-line stores for which we received $96 million of cash proceeds. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

For the first half of the year, Sears Domestic reported an operating loss of $512 million and $9 million in 2016 and 2015, respectively. Sears Domestic's operating loss for the first half of 2016 and 2015 included significant items which aggregated to operating expense of $126 million and operating income of $396 million, respectively. Excluding these items, we would have reported an operating loss of $386 million and $405 million for the first half of 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was driven by the above noted decrease in selling and administrative and depreciation and amortization expenses, partially offset by a decrease in gross margin.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION

Cash Balances

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. Our cash balances as of July 30, 2016, August 1, 2015 and January 30, 2016 are detailed in the following table.

millions	July 30, 2016	August 1, 2015	January 30, 2016
Cash and equivalents	$ 160	$ 1,698	$ 141
Cash posted as collateral	3	2	2
Credit card deposits in transit	113	119	95
Total cash balances	$ 276	$ 1,819	$ 238

We had total cash balances of $276 million at July 30, 2016, compared to $1.8 billion at August 1, 2015 and $238 million at January 30, 2016. During the first half of 2016, the Company received net proceeds of approximately $722 million from the new senior secured term loan (the "2016 Term Loan"), as well as net proceeds of approximately $485 million from the secured loan facility (the "Secured Loan Facility). In addition, the Company generated approximately $214 million from the sale of properties and investments. These proceeds were primarily used to reduce outstanding borrowings under the Company's asset-based revolving credit facility and for general corporate purposes.

At various times, we have posted cash collateral for certain outstanding letters of credit and self-insurance programs. Such cash collateral is classified within cash and cash equivalents given we have the ability to substitute letters of credit at any time for this cash collateral and it is therefore readily available to us.

Our invested cash may include, from time to time, investments in, but not limited to, commercial paper, federal, state and municipal government securities, floating-rate notes, repurchase agreements and money market funds. Cash amounts held in these short-term investments are readily available to us.

Credit card deposits in transit include deposits in transit from banks for payments related to third-party credit card and debit card transactions.

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash balances when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit were $41 million, $67 million and $59 million as of July 30, 2016, August 1, 2015 and January 30, 2016, respectively.

Operating Activities

During the first half of 2016, we used net cash in operating activities of $640 million compared to $832 million in the first half of 2015. Our primary source of operating cash flows is the sale of goods and services to customers, while the primary use of cash in operations is the purchase of merchandise inventories. We used less cash in operations in the first half of 2016 compared to the prior year first half primarily due a decrease in our net inventory.

Merchandise inventories were $4.7 billion and $5.0 billion at July 30, 2016 and August 1, 2015, respectively, while merchandise payables were $1.3 billion and $1.7 billion at July 30, 2016 and August 1, 2015. Sears Domestic inventory decreased in a majority of the categories with the most notable decreases in the consumer electronics, home appliances, tools and footwear categories. Kmart inventory also decreased with the most notable decreases in the drugstore, grocery & household and pharmacy categories, which were partially offset by an increase in apparel inventory.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Investing Activities

During the first half of 2016, we generated net cash flows in investing activities of $139 million, which consisted of cash proceeds from the sale of properties and investments of $214 million, offset by cash used for capital expenditures of $75 million. During the first half of 2015, we generated net cash flows from investing activities of $2.6 billion, which consisted of cash proceeds from the sale of properties and investments of $2.7 billion, partially offset by cash used for capital expenditures of $86 million. Proceeds from the sales of properties and investments included $2.6 billion of proceeds from the Seritage transaction.

Financing Activities

For the first half of 2016, we generated net cash flows from financing activities of $539 million, which consisted of net proceeds from the 2016 Term Loan of $722 million, as well as net cash proceeds from the Secured Loan Facility of $485 million, which were partially offset by a decrease in short-term borrowings of $633 million and debt repayments of $35 million. During the first half of 2015, we used net cash flows in financing activities of $191 million, which consisted of debt repayments of $443 million, of which $200 million was the repayment of a portion of the secured short-term loan, a decrease in short-term borrowings of $209 million and the payment of debt issuance costs of $47 million related to the amendment and extension of our Domestic Credit Facility, partially offset by $508 million net cash proceeds from sale-leaseback financing, which consisted of $426 million of proceeds from the JV transactions received during the first quarter of 2015 and $82 million of proceeds from the four JV properties that have continuing involvement received during the second quarter of 2015.

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, and 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.

During 2015, we entered into three different real estate joint ventures with General Growth Properties, Inc., Simon Property Group, Inc. and The Macerich Company, in which we contributed a total of 31 properties to the joint ventures in exchange for a 50% interest in each of the joint ventures and $429 million in cash proceeds ($426 million net of closing costs). During the second quarter of 2015, the Company also completed the rights offering and sale-leaseback transaction with Seritage and received aggregate gross proceeds from the transaction of $2.7 billion, of which a portion were used to reduce our debt, fund our pension plan and to absorb operating losses. Holdings' lease payments to the Seritage and real estate joint ventures, respectively, will be approximately $134 million and $42 million annually, with increases of 2% per year beginning in the second lease year for the REIT properties and in the fourth lease year for the joint venture properties.

Also during the second quarter of 2015, the Company completed an amendment and extension of our $3.275 billion Domestic Credit Facility, with approximately $2.0 billion maturing in 2020 and the remaining approximately $1.3 billion of the existing credit facility expiring on the original maturity date in April of 2016. Finally, during the third quarter of 2015, the Company completed 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"). Approximately $936 million principal amount of the Senior Secured Notes were validly tendered in the Offer. The reacquisition cost was $929 million. As a result of the Senior Secured Notes validly tendered in the Offer, we have mitigated our annualized cash interest expense by approximately $62 million.

During the first half of 2016, the Company closed the $750 million Senior Secured Term Loan (the "2016 Term Loan") maturing in July 2020, as discussed in Note 2, and received approximately $722 million in net proceeds. Additionally, the Company entered into a $500 million committed secured loan facility (the "Secured Loan Facility") maturing in July 2017, as discussed in Note 2, and received net proceeds of approximately $485 million. Additionally,

the Company generated over $200 million in cash proceeds from the sale of real estate and other asset sales. These actions provided the Company with additional financial flexibility as we execute on our transformation to a more asset-light integrated retailer leveraging our membership-based Shop Your Way® program.

As discussed in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016, we are taking further actions to accelerate our transformation, which is focused on our Shop Your Way® membership program and our Integrated Retail offerings. As we leverage Shop Your Way® and Integrated Retail, we expect to continue to right-size, redeploy and highlight the value of our assets, including our real estate portfolio, in our transition from an asset intensive, historically "store-only" based retailer to a more asset light, integrated membership-focused company. We intend to continue to evaluate and optimize our cost structure, including optimizing store-level marketing expenditures and overall staffing levels, and we will be taking action to reduce our fixed costs, and to improve our inventory management and gross margin realization. As we progress in our transformation, we are primarily focusing on profitability instead of revenues, market share and other metrics each of which relate to, but do not necessarily drive profit. This approach may negatively impact our sales, however, it is aimed at returning the Company to profitability. We continue to face a challenging competitive environment and while we continue to focus on our overall profitability, including managing expenses, we reported a loss during the second quarter of 2016. In addition to the previously described actions taken to date in 2016, we expect to pursue other near-term actions to improve liquidity, position the Company for success and profitability with the goal of creating long-term value and funding our transformation. These additional actions may include expense reductions, additional debt financing, generating liquidity through our previously announced intention to explore alternatives for our Kenmore®, Craftsman® and DieHard® brands and our Sears Home Services business by evaluating potential partnerships or other transactions that could expand distribution of our brands and service offerings to realize significant growth, or asset sales. Our Amended Domestic Credit Agreement discussed in Note 2 provides us flexibility of up to $500 million of FILO capacity and up to $2.0 billion of second lien capacity (of which $304 million is currently utilized), all depending on the applicable and available borrowing base as defined in our Amended Domestic Credit Agreement, as well as our ability to secure commitments from lenders. Our ability to utilize these features of the Amended Domestic Credit Agreement is currently constrained by our available borrowing base; however, we also have flexibility to obtain longer-term secured or unsecured financing maturing outside of the credit facility maturity date which would not be subject to these limitations (see Note 2 of Notes to Condensed Consolidated Financial Statements). In August 2016, we received an offer from ESL Investments, Inc. ("the ESL proposal") to provide $300 million of additional debt financing secured by a junior lien against our inventory, receivables and other working capital, which offer has been accepted. Under the ESL proposal, the Company may, in its discretion, offer to third party investors the right to participate in up to an additional $200 million of debt financing on the same terms and conditions. The financing is subject to customary conditions and is expected to close in the next 7 to 10 business days.

We believe that our liquidity needs will be satisfied by the actions discussed through the foreseeable future; however, we cannot predict the outcome of the actions to generate liquidity, or whether such actions would generate the expected liquidity as currently planned, or the availability of additional debt financing. The specific actions taken or assets involved, the timing, and the overall amount will depend on a variety of factors, including market conditions, interest in specific assets, valuations of those assets and our underlying operating performance.

If we continue to experience operating losses, and we are not able to generate enough funds from 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.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Our outstanding borrowings at July 30, 2016, August 1, 2015 and January 30, 2016 were as follows:

millions	July 30, 2016	August 1, 2015	January 30, 2016
Short-term borrowings:			
Unsecured commercial paper	$ 101	$ 6	$ —
Secured borrowings	63	—	797
Long-term debt, including current portion:			
Notes and debentures outstanding	3,211	2,898	1,984
Capitalized lease obligations	176	221	195
Total borrowings	$ 3,551	$ 3,125	$ 2,976

We fund our peak sales season working capital needs through our domestic revolving credit facility and commercial paper markets and secured short-term debt.

millions	13 Weeks Ended July 30, 2016		August 1, 2015		26 Weeks Ended July 30, 2016		August 1, 2015	
Secured borrowings:								
Maximum daily amount outstanding during the period	$ 312		$ 799		$ 1,150		$ 799	
Average amount outstanding during the period	111		426		463		483	
Amount outstanding at period-end	63		—		63		—	
Weighted average interest rate	5.2	%	2.8	%	4.4	%	2.9	%
Unsecured commercial paper:								
Maximum daily amount outstanding during the period	$ 137		$ 104		$ 184		$ 104	
Average amount outstanding during the period	61		43		64		24	
Amount outstanding at period-end	101		6		101		6	
Weighted average interest rate	7.9	%	4.0	%	7.8	%	4.1	%
Secured short-term loan:								
Maximum daily amount outstanding during the period	$ —		$ 200		$ —		$ 400	
Average amount outstanding during the period	—		69		—		169	
Amount outstanding at period-end	—		—		—		—	
Weighted average interest rate	—	%	5.0	%	—	%	5.0	%

Information about our Domestic Credit Agreement, Term Loan, Secured Loan Facility, Secured Short-term Loan, 2016 Term Loan, Senior Secured Notes, Senior Unsecured Notes, Unsecured Commercial Paper, and Wholly-owned Insurance Subsidiary and Intercompany Securities is included in Note 2 of Notes to Condensed Consolidated Financial Statements.

Intangible Asset Impairment Assessment

We continue to monitor our performance and do not believe an event has occurred that would result in an indefinite-lived intangible asset impairment at quarter end. However, further indefinite-lived intangible impairment charges may be recognized in future periods to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry, deterioration in our performance or our future projections, if actual results are not consistent with our estimates and assumptions used in the 2015 year-end impairment analysis, or changes in our plans for one or more indefinite-lived intangible assets. Further, our business is seasonal in nature, and we generate a high proportion of our revenues, operating income and operating cash flows during the fourth quarter of our year, which includes the holiday season. As a result, our overall profitability is heavily impacted by our fourth quarter operating results. The intangible asset impairment analysis is particularly sensitive to changes in the projected revenue growth rate and the assumed weighted-average cost of capital. We will continue to monitor for such changes in facts or circumstances, which may be indicators of potential impairment triggers, and may result in impairment charges in the future, which could be material to our results of operations.

Domestic Pension Plan Funding

In our Annual Report on Form 10-K for the fiscal year ended January 30, 2016, we disclosed that we expected our contributions to our domestic pension plans to be approximately $318 million in 2016 and $416 million in 2017. The ultimate amount of pension contributions and timing could be affected by changes in the applicable regulations, or other regulatory actions, as well as financial market and investment performance.

Recent Accounting Pronouncements

See Part I, Item 1, "Financial Statements – Notes to Condensed Consolidated Financial Statements," Note 10 – "Recent Accounting Pronouncements," for information regarding new accounting pronouncements.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements made in this Quarterly Report on Form 10-Q and in other public announcements by us contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements include information concerning our future financial performance and liquidity, business strategy, plans, goals and objectives. Statements preceded or followed by, or that otherwise include, the words "believes," "expects," "anticipates," "intends," "estimates," "plans," "forecast," "is likely to" and similar expressions or future or conditional verbs such as "will," "may" and "could" are generally forward-looking in nature and not historical facts. Such statements are based upon the current beliefs and expectations of the Company's management and are subject to significant risks and uncertainties, many of which are beyond the Company's control, that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Actual results may differ materially from those set forth in the forward-looking statements.

The following factors, among others, could cause actual results to differ from those set forth in the forward-looking statements: our ability to successfully implement our integrated retail strategy to transform our business; our ability to successfully manage our inventory levels; initiatives to improve our liquidity through inventory management and other actions; vendors' lack of willingness to provide acceptable payment terms or otherwise restricting financing to purchase inventory or services; possible limits on our access to our domestic credit facility, which is subject to a borrowing base limitation and a springing fixed charge coverage ratio covenant, capital markets and other financing sources, including additional second lien financings, with respect to which we do not have commitments from lenders; our ability to successfully achieve our plans to generate liquidity through potential transactions or otherwise; our ability to achieve cost savings initiatives; potential liabilities in connection with the separation of Lands' End and disposition of a portion of our ownership interest in Sears Canada; payment-related risks that could increase our operating costs, expose us to fraud or theft, subject us to potential liability and potentially disrupt our business operations, the impact of seasonal buying patterns, including seasonal fluctuations in weather conditions, which are difficult to forecast with certainty; fluctuations in our sales due to changes in customers' spending patterns and prevailing economic conditions; our dependence on sources outside the United States for significant amounts of our merchandise; our reliance on third parties to provide us with services in connection with the administration of certain aspects of our business and the transfer of significant internal historical knowledge to such parties; impairment charges for goodwill and intangible assets or fixed-asset impairment for long-lived assets; our ability to attract, motivate and retain key executives and other associates; the substantial influence exerted over the Company by affiliates of our Chairmen and Chief Executive Officer, whose interests may diverge from other stockholders' interests; our ability to protect or preserve the image of our brands; the outcome of pending and/or future legal proceedings, including shareholder litigation, product liability, patent infringement and qui tam claims and proceedings with respect to which the parties have reached a preliminary settlement; and the timing, amount and other risks related to required pension plan funding.

Certain of these and other factors are discussed in more detail in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016 and in our other filings with the Securities and Exchange Commission, which may be accessed through the Commission's website at www.sec.gov.

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

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 30, 2016 and August 1, 2015

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding. All debt securities are considered non-trading. At July 30, 2016, 53% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at July 30, 2016, which totaled approximately $1.9 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by $19 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

Item 4. Controls and Procedures

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

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

SEARS HOLDINGS CORPORATION

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Part I, Item 1, "Financial Statements—Notes to Condensed Consolidated Financial Statements," Note 9—"Legal Proceedings," for additional information regarding legal proceedings, which information is incorporated herein by this reference.

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

The following table provides information about shares of common stock we acquired during the second quarter of 2016. During the 13-week period ended July 30, 2016, we did not repurchase any shares of our common stock under our common share repurchase program. At July 30, 2016, we had approximately $504 million of remaining authorization under the program.

	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program[2]	Average Price Paid per Share for Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
May 1, 2016 to May 28, 2016	—	$ —	—	$	—
May 29, 2016 to July 2, 2016	8,709	12.31	—	—	
July 3, 2016 to July 30, 2016	—	—	—	—	
Total	8,709	$ 12.31	—	$	—$ 503,907,832

(1) Consists entirely of 8,709 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock.

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

The 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.

Item 6. Exhibits

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

(b) Exhibits

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

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SEARS HOLDINGS CORPORATION

SIGNATURES

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

SEARS HOLDINGS CORPORATION

Date: August 25, 2016 By: /s/ ROBERT A. RIECKER
Name: Robert A. Riecker
Title: Vice President, Controller and Chief Accounting Officer*

*Mr. Riecker is signing this report both as a duly authorized officer and as the principal accounting officer.

SEARS HOLDINGS CORPORATION
EXHIBIT INDEX

3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000-51217)).
3.2	Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated January 22, 2014, filed on January 24, 2014 (File No. 000-51217)).
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 2016, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Statements of Operations (Unaudited) for the 13 and 26 weeks ended July 30, 2016 and August 1, 2015; (ii) the Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the 13 and 26 weeks ended July 30, 2016 and August 1, 2015; (iii) the Condensed Consolidated Balance Sheets (Unaudited) as of July 30, 2016, August 1, 2015 and January 30, 2016; (iv) the Condensed Consolidated Statements of Cash Flows (Unaudited) for the 26 weeks ended July 30, 2016 and August 1, 2015; (v) the Condensed Consolidated Statements of Equity (Deficit) (Unaudited) for the 26 weeks ended July 30, 2016 and August 1, 2015; and (vi) the Notes to the Condensed Consolidated Financial Statements (Unaudited).

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