Sears Holdings CORP
Form S-4/A
February 15, 2005

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As filed with the Securities and Exchange Commission on February 15, 2005

Registration No. 333-120954

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 3
TO
FORM S-4

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

SEARS HOLDINGS CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**5311**	**20-1920798**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

**c/o Kmart Holding Corporation
3100 West Big Beaver Road
Troy, Michigan 48084
(248) 463-1000**
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

**Aylwin B. Lewis
President
c/o Kmart Holding Corporation
Sears Holdings Corporation
3100 West Big Beaver Road
Troy, Michigan 48084
(248) 463-1000**
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

James E. Defebaugh, Esq. Kmart Holding Corporation 3100 West Big Beaver Road Troy, Michigan 48084 (248) 463-1000	John G. Finley, Esq. Mario A. Ponce, Esq. Simpson Thacher & Bartlett LLP 425 Lexington Avenue New York, New York 10017 (212) 455-2000	Andrea L. Zopp, Esq. Sears, Roebuck and Co. 3333 Beverly Road Hoffman Estates, Illinois 60179 (847) 286-2500	Andrew R. Brownstein, Esq. Joshua R. Cammaker, Esq. Wachtell, Lipton, Rosen & Katz 51 West 52nd Street New York, New York 10019 (212) 403-1000

Approximate date of commencement of proposed sale of the securities to the public: As soon as practicable after this Registration Statement becomes effective and all other conditions to the proposed mergers described herein have been satisfied or waived.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this joint proxy statement-prospectus is not complete and may be changed. We may not sell the securities offered by this joint proxy statement-prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This joint proxy statement-prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction where an offer or solicitation is not permitted.

Subject to completion dated February 15, 2005

**TO THE STOCKHOLDERS OF
KMART HOLDING CORPORATION AND
SEARS, ROEBUCK AND CO.**

MERGER PROPOSALS YOUR VOTE IS VERY IMPORTANT

Kmart Holding Corporation and Sears, Roebuck and Co. have entered into a merger agreement that will combine Sears and Kmart to form a major new retail company named Sears Holdings Corporation (which we refer to in this joint proxy statement-prospectus as Holdings). Holdings is expected to be the third largest retailer in the United States, initially with approximately $55 billion in annual revenues and with approximately 3,800 full-line and specialty retail stores in the United States and Canada.

In the proposed mergers, Sears common stockholders will have the right to elect to receive either $50.00 in cash or 0.5 of a share of Holdings common stock for each share of Sears common stock that they own. The elections are subject to proration so that, in the aggregate, 45% of Sears common stock will be exchanged for cash and 55% of Sears common stock will be exchanged for Holdings common stock. In addition, Kmart stockholders will receive one share of Holdings common stock for each share of Kmart common stock that they own. Upon completion of the mergers, we estimate that Holdings will issue approximately 156 million shares of Holdings common stock and that, assuming the exercise of certain options shortly after the mergers, Sears' former stockholders will own approximately 37%, and former Kmart stockholders will own approximately 63%, of the common stock of Holdings. The common stock of Holdings has been approved for quotation on the Nasdaq National Market under the symbol "   ".

We will each hold a special meeting of stockholders at which, among other business to be considered by Kmart stockholders, we will ask our respective common stockholders to adopt the merger agreement. Information about these meetings, the mergers and other business to be considered by Kmart stockholders is contained in this joint proxy statement-prospectus. **In particular, see "Risk Factors" beginning on page 17.** We urge you to read this joint proxy statement-prospectus, and the documents incorporated by reference into this joint proxy statement-prospectus, carefully and in their entirety.

Whether or not you plan to attend your special meeting, please vote as soon as possible to make sure that your shares are represented at that meeting. If you do not vote, it will have the same effect as voting against the adoption of the merger agreement.

Each of our boards of directors unanimously recommends that stockholders vote FOR the adoption of the merger agreement. We strongly support this combination of our companies and join our boards in their recommendations.

Aylwin B. Lewis
President and Chief Executive Officer
Kmart Holding Corporation

Alan J. Lacy
Chairman, Chief Executive Officer and President
Sears, Roebuck and Co.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities to be issued in connection with the mergers or determined if this joint proxy statement-prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

This joint proxy statement-prospectus is dated , 2005, and is first being mailed to stockholders of Kmart and Sears on or about , 2005.

ADDITIONAL INFORMATION

This joint proxy statement-prospectus incorporates important business and financial information about Kmart and Sears from other documents that are not included in or delivered with this joint proxy statement-prospectus. This information is available to you without charge upon your written or oral request. You can obtain the documents incorporated by reference in this joint proxy statement-prospectus through the Securities and Exchange Commission website at http://www.sec.gov or by requesting them in writing or by telephone at the appropriate address below:

if you are a Kmart stockholder:		if you are a Sears stockholder:	
By Mail:	Kmart Holding Corporation 3100 West Big Beaver Road Troy, Michigan 48084 Attention: Office of the Secretary	By Mail:	Sears, Roebuck and Co. 3333 Beverly Road Hoffman Estates, Illinois 60179 Attention: Office of the Secretary
By Telephone:	(248) 463-1000	By Telephone:	(847) 286-2500

IF YOU WOULD LIKE TO REQUEST ANY DOCUMENTS, PLEASE DO SO BY   , 2005 IN ORDER TO RECEIVE THEM BEFORE THE MEETINGS.

See "Where You Can Find More Information" beginning on page 145.

VOTING ELECTRONICALLY OR
BY TELEPHONE

Stockholders of record of Kmart common stock at the close of business on January 26, 2005, the record date for the Kmart special meeting, may submit their proxies:

- through the Internet by visiting a website established for that purpose at http://www.eproxyvote.com/kmrt and following the instructions; or

- by telephone by calling the toll-free number (877) PRX-VOTE (1-877-779-8683) in the United States, Puerto Rico or Canada on a touch-tone phone and following the recorded instructions. Kmart stockholders calling from another country may call (201) 536-8073.

Stockholders of record of Sears common stock at the close of business on January 26, 2005, the record date for the Sears special meeting, may submit their proxies:

- through the Internet by visiting a website established for that purpose at http://www.proxyvote.com and following the instructions; or

- by telephone by calling the toll-free number (800) 690-6903 in the United States, Puerto Rico or Canada on a touch-tone phone and following the recorded instructions.

In order to vote via the telephone or the Internet, please have in front of you either your proxy card, or if you have consented to receive your materials electronically, your e-mail notification advising that materials are available on-line. A phone number and an Internet website address are contained on each of the documents. Upon entering either the phone number or the Internet website address, you will be instructed on how to proceed.

If a Kmart or Sears stockholder holds shares registered in the name of a broker, bank or other nominee, that broker, bank or other nominee will enclose or provide a voting instruction card for use in directing that broker, bank or other nominee how to vote those shares.

KMART HOLDING CORPORATION

Notice of Special Meeting of Stockholders
to be Held , 2005

To the Stockholders of Kmart Holding Corporation:

A special meeting of the stockholders of Kmart Holding Corporation will be held at , on , 2005 at a.m., local time, for the following purposes:

1. To consider and vote on a proposal to combine Kmart Holding Corporation and Sears, Roebuck and Co. through the adoption of the Agreement and Plan of Merger, dated as of November 16, 2004, by and among Kmart Holding Corporation, Sears, Roebuck and Co., Sears Holdings Corporation, Kmart Acquisition Corp. and Sears Acquisition Corp., pursuant to which, among other things, separate subsidiaries of Sears Holdings Corporation will be merged with and into Sears, Roebuck and Co. and Kmart Holding Corporation.

2. To consider and vote on proposals to exclude from the restated certificate of incorporation of Holdings certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart relating to (1) the prohibition on the issuance of nonvoting equity securities and (2) the rights of certain named stockholders to designate directors.

3. To approve the grants of (1) 50,781 restricted shares of Kmart common stock, (2) options to acquire 150,000 shares of Kmart common stock, and (3) a number of restricted shares of Kmart common stock equal to $1 million (based on a per share price determined immediately prior to the consummation of the mergers), in each case, to Aylwin B. Lewis, Chief Executive Officer, President and a director of Kmart.

4. To transact such other business as may properly come before the special meeting or any adjournment or postponement of the Kmart special meeting.

The adoption of the merger agreement requires the affirmative vote of a majority of the outstanding shares of Kmart common stock. Pursuant to a support agreement with certain companies directly or indirectly controlled by Edward S. Lampert, the Chairman of Kmart, these companies have agreed, subject to limited exceptions, to vote their shares of Kmart common stock in favor of the adoption of the merger agreement and the proposals to exclude certain bankruptcy-related charter provisions. As of January 26, 2005, the record date, these companies beneficially owned approximately 42.0 million shares of Kmart common stock which represent the power to vote approximately 47% of the outstanding shares of Kmart common stock (without giving effect to the exercise of certain unexercised options to acquire shares of Kmart common stock and without including the shares of Kmart common stock that were issued upon conversion of certain convertible notes after the record date). Accordingly, the adoption of the merger agreement and the approval of the exclusion of certain bankruptcy-related charter provisions by the Kmart stockholders are practically assured.

The approval of each proposal to exclude certain bankruptcy-related charter provisions and the approval of the grants of restricted shares and options to Mr. Lewis require the affirmative vote of a majority of the shares of Kmart common stock represented at the special meeting and entitled to vote. The support agreement does not require those companies, directly or indirectly, controlled by Mr. Lampert to vote in favor of the equity grants to Mr. Lewis, although it is expected that they will do so. Accordingly, the approval of the equity grants to Mr. Lewis is practically assured.

The board of directors of Kmart Holding Corporation unanimously recommends that you vote FOR adoption of the Agreement and Plan of Merger, FOR approval of each proposal to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings, and FOR approval of the grants of restricted shares and options to Mr. Lewis. Completion of the mergers is conditioned on approval of each proposal to exclude certain bankruptcy-related provisions from the certificate of incorporation of Holdings. As a result, a vote against either of such proposals effectively will be a vote against adoption of the merger agreement.

Only stockholders of record at the close of business on January 26, 2005 are entitled to notice of and to vote at the special meeting and any adjournments or postponements thereof. To vote your shares, please complete and return the enclosed proxy card to us or grant your proxy by telephone or through the Internet. You may also cast your vote in person at the special meeting. Please vote promptly whether or not you expect to attend the special meeting.

By order of the board of directors,

James E. Defebaugh
Senior Vice President, Chief Legal Officer

, 2005

PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE MERGER PROPOSAL OR THE EQUITY GRANTS OR ABOUT VOTING YOUR SHARES, PLEASE CALL INNISFREE M&A INCORPORATED TOLL-FREE AT (888)750-5834. BANKS AND BROKERS MAY CALL COLLECT AT (212)750-5833.

SEARS, ROEBUCK AND CO.

Notice of Special Meeting of Stockholders
to be Held , 2005

To the Stockholders of Sears, Roebuck and Co.:

A special meeting of the stockholders of Sears, Roebuck and Co. will be held at , on , 2005 at a.m., local time, for the following purposes:

1. To consider and vote on a proposal to combine Kmart Holding Corporation and Sears, Roebuck and Co. through the adoption of the Agreement and Plan of Merger, dated as of November 16, 2004, by and among Kmart Holding Corporation, Sears, Roebuck and Co., Sears Holdings Corporation, Kmart Acquisition Corp. and Sears Acquisition Corp., pursuant to which, among other things, separate subsidiaries of Sears Holdings Corporation will be merged with and into Sears, Roebuck and Co. and Kmart Holding Corporation.

2. To transact such other business as may properly come before the special meeting or any adjournment or postponement of the special meeting.

The adoption of the merger agreement requires the affirmative vote of at least two-thirds of the outstanding shares of Sears common stock. Pursuant to a support agreement with certain companies directly or indirectly controlled by Edward S. Lampert, the Chairman of Kmart, these companies have agreed to vote their shares of Sears common stock in favor of the adoption of the merger agreement. As of January 26, 2005, the record date, these companies beneficially owned approximately 31.1 million shares of Sears common stock, which represent the power to vote approximately 14% of the outstanding shares of Sears common stock at the special meeting.

The board of directors of Sears, Roebuck and Co. unanimously recommends that you vote FOR adoption of the Agreement and Plan of Merger.

Only stockholders of record at the close of business on January 26, 2005 are entitled to notice of and to vote at the special meeting and any adjournments or postponements thereof. To vote your shares, please complete and return the enclosed proxy card to us or grant your proxy by telephone or through the Internet. You may also cast your vote in person at the special meeting. Please vote promptly whether or not you expect to attend the special meeting.

By order of the board of directors,

Andrea L. Zopp
Senior Vice President and General Counsel
, 2005

PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE MERGER PROPOSAL OR ABOUT VOTING YOUR SHARES, PLEASE CALL D.F. KING & CO., INC. AT (800)549-6650 (TOLL FREE) OR (212)269-5550 (CALL COLLECT).

TABLE OF CONTENTS

	Page
QUESTIONS AND ANSWERS ABOUT VOTING PROCEDURES FOR THE SPECIAL MEETINGS AND MAKING CASH AND SHARE ELECTIONS	1
SUMMARY	6
THE COMPANIES	6
Kmart Holding Corporation	6
Sears, Roebuck and Co.	6
Sears Holdings Corporation	6
THE MERGERS	7
Sears Common Stockholders to Choose between Receiving Shares of Holdings Common Stock or Cash, Subject to Proration	8
Kmart Common Stockholders to Receive Shares of Holdings Common Stock	8
Stock Exchange Listing and Stock Prices	8
Receipt of Shares of Holdings Common Stock in Mergers Generally Nontaxable to Stockholders	8
Our Boards of Directors Unanimously Recommend that Kmart and Sears Stockholders Vote to Adopt the Merger Agreement	9
Interests of Our Directors and Executive Officers in the Mergers	9
The ESL Companies and Support Agreement	9
Appraisal Rights	10
Directors and Management Following the Mergers	10
Regulatory Approvals and Conditions to Completion of the Mergers	10
Termination of the Merger Agreement; Fees Payable	10
SPECIAL MEETINGS	11
Kmart Special Meeting	11
Sears Special Meeting	11
SELECTED HISTORICAL AND PRO FORMA FINANCIAL DATA	12
Selected Historical Financial Data of Kmart	12
Selected Historical Financial Data of Sears	14
Selected Unaudited Pro Forma Condensed Consolidated Financial Data of Holdings	15
COMPARATIVE PER SHARE DATA	16
RISK FACTORS	17
INFORMATION REGARDING FORWARD-LOOKING STATEMENTS	22
RECENT DEVELOPMENTS	24
INFORMATION ABOUT THE COMPANIES	25
THE SPECIAL MEETINGS	27
Joint Proxy Statement-Prospectus	27
Date, Time and Place of the Special Meetings	27
Purpose of the Special Meetings	27
Record Date for the Special Meetings	27
Votes Required	28
Adjournment or Postponement	29
Proxies	29
Voting Electronically or by Telephone	31
Solicitation of Proxies	31
Voting and Elections by Participants in the Sears ASPP and Sears Plans	32

i

KMART PROPOSAL 1 AND SEARS PROPOSAL 1: THE MERGERS	33
Effect of the Kmart Merger; What You Will Receive in the Kmart Merger	33
Effect of the Sears Merger; What You Will Receive in the Sears Merger	33
Background of the Mergers	34
Kmart's Reasons for the Kmart Merger; Recommendation of the Kmart Merger by the Kmart Board of Directors	41
Sears' Reasons for the Sears Merger; Recommendation of the Sears Merger by the Sears Board of Directors	45
Certain Kmart Projections	48
Opinion of Kmart's Financial Advisor	50
Certain Sears Projections	58
Opinion of Sears' Financial Advisor	60
Interests of Directors and Executive Officers in the Mergers	68
Board of Directors and Management after the Mergers	75
Material United States Federal Income Tax Consequences	78
Accounting Treatment	82
Regulatory Approvals	82
Sears Stockholders Making Cash and Share Elections	83
Conversion of Shares; Exchange of Certificates; Dividends; Withholding	87
Treatment of Stock Options and Restricted Shares	89
Sears ASPP	89
Dividend Policy and Share Repurchases	90
Restrictions on Sales of Shares by Affiliates of Kmart and Sears	90
Stock Exchange Listing and Stock Prices	91
Rights of Dissenting Stockholders	91
Delisting and Deregistration of Kmart and Sears Stock after the Mergers	94
Legal Proceedings Relating to the Mergers	95
The Merger Agreement	96
The Support Agreement	105
SEARS HOLDINGS CORPORATION UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL DATA	106
SEARS HOLDINGS CORPORATION UNAUDITED PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET	108
SEARS HOLDINGS CORPORATION UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS	112
SEARS FISCAL 2003 UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS	117
KMART FISCAL 2003 UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS	119
DESCRIPTION OF HOLDINGS CAPITAL STOCK	121
Common Stock	121
Preferred Stock	121
COMPARISON OF STOCKHOLDER RIGHTS	122
Capitalization	122
Voting Rights	122
Class Voting	123
Number and Election of Directors	123
Qualification of Directors	124
Vacancies on the Board of Directors and Removal of Directors	124
Amendments to the Certificate of Incorporation	126
Amendments to By-laws	126
Action by Written Consent of Stockholders	127

Notice of Stockholders' Meeting	127
Ability to Call Special Meetings of Stockholders	128
Notice of Stockholder Action	128
Limitation of Personal Liability of Directors and Officers	130
Indemnification of Directors and Officers	131
Preemptive Rights of Stockholders	132
Dividends	133
Inspection of Stockholder Lists	133
State Anti-Takeover Statutes	134
Rights of Dissenting Stockholders	135
Transactions Involving Officers or Directors	135
Mergers, Acquisitions, Share Purchases and Certain Other Transactions	136
Bankruptcy-Related Charter Provisions	137
Office of the Chairman	138
KMART PROPOSAL 2: EXCLUSION OF BANKRUPTCY-RELATED CHARTER PROVISIONS	139
Proposal No. 2A: Approval to have no prohibition on the issuance of nonvoting equity securities	139
Proposal No. 2B: Approval to exclude the rights of certain named stockholders to designate directors to the board of directors	139
Votes Required	140
KMART PROPOSAL 3: EQUITY GRANTS TO AYLWIN B. LEWIS	141
Purpose of the Grants	141
Summary of the Grants	141
Votes Required	142
LEGAL MATTERS	143
EXPERTS	143
STOCKHOLDER PROPOSALS	143
WHERE YOU CAN FIND MORE INFORMATION	145
ANNEX A Agreement and Plan of Merger	A-1
ANNEX B Support Agreement and Irrevocable Proxy	B-1
ANNEX C Opinion of Lehman Brothers	C-1
ANNEX D Opinion of Morgan Stanley	D-1
ANNEX E Section 623 and Section 910 of The New York Business Corporation Law	E-1
ANNEX F Form of Restated Certificate of Incorporation of Sears Holdings Corporation	F-1
ANNEX G Form of Restated By-laws of Sears Holdings Corporation	G-1

QUESTIONS AND ANSWERS ABOUT VOTING PROCEDURES FOR THE SPECIAL MEETINGS AND MAKING CASH AND SHARE ELECTIONS

The questions and answers below highlight only selected procedural information from this joint proxy statement-prospectus. They do not contain all of the information that may be important to you. You should read carefully the entire joint proxy statement-prospectus and the additional documents incorporated by reference into this joint proxy statement-prospectus to fully understand the voting procedures for the special meetings and the procedures for making cash and share elections.

Q:

WHAT IS THE PROPOSED TRANSACTION FOR WHICH I AM BEING ASKED TO VOTE?

A:

You, as a stockholder of Kmart Holding Corporation and/or a stockholder of Sears, Roebuck and Co., are being asked to vote to adopt an Agreement and Plan of Merger entered into by and among Kmart Holding Corporation, Sears, Roebuck and Co., Sears Holdings Corporation, Kmart Acquisition Corp. and Sears Acquisition Corp. Subject to the terms and conditions of this merger agreement, Kmart and Sears would enter into simultaneous mergers with newly formed subsidiaries of Sears Holdings Corporation (which we refer to in this joint proxy statement-prospectus as Holdings), and after the mergers would become wholly-owned subsidiaries of Holdings.

In the proposed mergers, Sears common stockholders will have the right to elect either $50.00 in cash or 0.5 of a share of Holdings common stock. The elections are subject to proration so that, in the aggregate, 45% of the shares of Sears common stock will be exchanged for cash and 55% of the shares of Sears common stock will be exchanged for shares of Holdings common stock. Kmart stockholders will receive one share of Holdings common stock for each share of Kmart common stock that they own.

Stockholders of Kmart are also being asked to vote to approve the exclusion of certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings, and to approve specific grants of restricted shares and options to Aylwin B. Lewis, the current Chief Executive Officer, President and a director of Kmart.

Q:

HOW AND WHEN DO SEARS STOCKHOLDERS MAKE A CASH ELECTION OR A SHARE ELECTION?

A:

A form of election is being mailed to Sears stockholders of record under separate cover. Sears stockholders should carefully review and follow the instructions accompanying the form of election. To make a cash election or a share election, Sears stockholders of record must properly complete, sign and send the form of election and any stock certificates representing their Sears shares to EquiServe Trust Company, N.A., the exchange agent, at the following address:

EquiServe Trust Company, N.A.
Kmart/Sears Transaction
c/o Corporate Actions
PO Box 43092
Providence, RI 02940-3092

Questions regarding the cash or share elections should be directed to:

D.F. King & Co., Inc.
48 Wall Street
New York, NY 10005
Telephone: (800) 549-6650
(or (212) 269-5550 for calls from outside the United States)

The exchange agent must receive the form of election and any stock certificates representing Sears shares, a book-entry transfer of shares or a guarantee of delivery as described in the instructions

accompanying the form of election by the election deadline. **The election deadline will be 5:00 p.m., New York City time, on , 2005, the date of the Sears special meeting, unless the completion of the Sears merger will occur more than four business days following the date of the Sears special meeting, in which case the election deadline will be extended until two business days before the completion of the Sears merger.** Kmart and Sears will publicly announce the election deadline at least five business days prior to the anticipated completion date of the Sears merger.

If you own Sears shares in "street name" through a bank, broker or other financial institution and you wish to make an election, you will receive or should seek instructions from the financial institution holding your shares concerning how to make your election. If you are a participant in the Sears associate stock ownership plan (which we refer to in this joint proxy statement-prospectus as the Sears ASPP), you should receive instructions from the Sears ASPP administrator concerning how to make your election.

If you are a participant in the Sears 401(k) savings plan, the Sears Puerto Rico savings plan or the Lands' End retirement plan (which we collectively refer to in this joint proxy statement-prospectus as the Sears Plans), you will receive instructions from the relevant plan trustee on how to elect to have cash consideration or share consideration allocated to your plan account in exchange for Sears shares in your plan account. See "The Special Meetings Voting and Elections by Participants in the Sears ASPP and Sears Plans" beginning on page 32 for detailed instructions.

"Street name," Sears ASPP and Sears Plan holders may be subject to an election deadline earlier than the general deadline of the date of the Sears special meeting. Therefore, you should carefully read any materials you receive from your broker or the relevant plan trustee or administrator.

Q:

CAN SEARS STOCKHOLDERS ELECT TO RECEIVE CASH CONSIDERATION FOR A PORTION OF THEIR SEARS SHARES AND SHARE CONSIDERATION FOR THEIR REMAINING SEARS SHARES?

A:

Yes. The form of election allows an election to be made for cash consideration or share consideration for all or any portion of their Sears shares.

Q:

CAN SEARS STOCKHOLDERS CHANGE THEIR ELECTION AFTER THE FORM OF ELECTION HAS BEEN SUBMITTED?

A:

Yes. You may revoke your election prior to the election deadline by submitting a written notice of revocation to the exchange agent or by submitting new election materials. Revocations must specify the name in which your shares are registered on the stock transfer books of Sears and other information that the exchange agent may request. If you wish to submit a new election, you must do so in accordance with the election procedures described in this joint proxy statement-prospectus and the form of election. If you instructed a broker or plan trustee or administrator to submit an election for your shares, you must follow such person's directions for changing those instructions. **Whether you revoke your election by submitting a written notice of revocation or by submitting new election materials, the notice or materials must be received by the exchange agent by the election deadline in order for the revocation to be valid.**

Q:

MAY I TRANSFER SEARS SHARES AFTER AN ELECTION IS MADE?

A:

No. Sears stockholders who have made elections will be unable to sell or otherwise transfer their shares after making the election, unless the election is properly revoked before the election deadline or unless the merger agreement is terminated.

Q:

WHAT IF A SEARS STOCKHOLDER DOES NOT MAKE AN ELECTION OR ITS FORM OF ELECTION IS NOT RECEIVED?

A:

If the exchange agent does not receive a properly completed form of election from you before the election deadline, together with any stock certificates representing the shares you wish to exchange for cash or shares, properly endorsed for transfer, a book-entry transfer of shares or a guarantee of delivery as described in the form of election, then you will have no control over the type of merger consideration you receive. As a result, your Sears shares may be exchanged for cash consideration, share consideration, or a combination of cash consideration and share consideration consistent with the proration procedures contained in the merger agreement and described under "The Mergers Sears Stockholders Making Cash and Share Elections" beginning on page 83. Because the value of the share consideration and cash consideration may differ and other stockholders would likely elect the consideration having the higher value, in such a circumstance, you would likely receive the consideration having the lower value at the time. **You bear the risk of delivery and should send any form of election by courier or by hand to the appropriate addresses shown in the form of election.**

If you do not make a valid election with respect to Sears shares you own of record and have not exercised your dissenter's rights, after the completion of the Sears merger, you will receive written instructions from the exchange agent on how to exchange your Sears stock certificates for the shares of Holdings common stock and/or cash that you are entitled to receive in the Sears merger as a non-electing Sears stockholder. If you do not make a valid election and the Sears shares you hold of record are in book-entry form, they will be automatically converted into the merger consideration payable to non-electing stockholders, and you do not need to take any action.

Q:

MAY SEARS STOCKHOLDERS SUBMIT A FORM OF ELECTION IF THEY VOTE AGAINST THE SEARS MERGER?

A:

Yes. Sears stockholders may submit a form of election even if they vote against adopting the merger agreement. However, any Sears stockholder that submits a properly executed election form will thereby withdraw any previously filed written demand for appraisal and will not be entitled to appraisal rights. See "Rights of Dissenting Stockholders" beginning on page 91.

Q:

DO KMART STOCKHOLDERS HAVE AN ELECTION?

A:

No. If you are a Kmart stockholder, you will receive one share of Holdings common stock for each share of Kmart common stock, and have no right to receive any other consideration.

Q:

WHAT DO I NEED TO DO NOW TO VOTE?

A:

After carefully reading and considering the information contained in this joint proxy statement-prospectus, please vote by telephone, the Internet or by mail as soon as possible so that your shares may be represented and voted at your meeting. If you hold your shares in your own name, you may vote by telephone or through the Internet by following the instructions on or accompanying your proxy card. If you hold shares registered in the name of a broker, bank or other nominee, that broker, bank or other nominee has enclosed or will provide a voting instruction card for use in directing your broker, bank or other nominee how to vote those shares.

Q:

IF MY KMART OR SEARS SHARES ARE HELD IN "STREET NAME" BY A BROKER, BANK OR OTHER NOMINEE, WILL MY BROKER OR BANK VOTE MY SHARES FOR ME?

A:

If you hold your shares in "street name" and do not provide voting instructions to your broker, your shares will not be voted on any proposal on which your broker does not have discretionary authority to vote. Generally, your broker, bank or other nominee does not have discretionary authority to vote on the merger proposal. Accordingly, your broker, bank or other nominee will vote your shares held by it in "street name" only if you provide instructions to it on how to vote. You should follow the directions your broker, bank or other nominee provides. Shares that are not

voted because you do not properly instruct your broker, bank or other nominee will have the effect of votes against the adoption of the merger agreement.

Q:

IF MY SEARS OR KMART SHARES ARE HELD IN MY OWN NAME, WHAT HAPPENS IF I DON'T VOTE?

A:

If you fail to respond with a vote on the merger proposal, it will have the same effect as a vote against adoption of the merger agreement. If you respond but do not indicate how you want to vote, your proxy will be counted as a vote in favor of adopting the merger agreement. If you respond and indicate that you are abstaining from voting, your proxy will have the same effect as a vote against adoption of the merger agreement.

Q:

IF I BENEFICIALLY OWN SEARS SHARES HELD PURSUANT TO THE SEARS ASPP OR ANY SEARS PLAN, WILL I BE ABLE TO VOTE ON ADOPTION OF THE MERGER AGREEMENT?

A:

Yes. If you are a participant in the Sears ASPP or any Sears Plan, please submit the voting form you receive from the plan administrator or trustee to indicate to the relevant plan administrator or trustee how you want the Sears shares allocated to your plan account to be voted. See "The Special Meetings Voting and Elections by Participants in the Sears ASPP and Sears Plans" beginning on page 32 for detailed instructions.

Q:

CAN I CHANGE MY VOTE AFTER I HAVE DELIVERED MY PROXY?

A:

Yes. A registered stockholder may revoke a properly executed proxy at any time by (1) notifying Kmart or Sears, as appropriate, in writing to the addresses set forth under "Additional Information", (2) submitting a new properly completed and signed proxy to Kmart or Sears, as appropriate, either by mail or as described under "Additional Information", (3) delivering another proxy to Kmart or Sears, as appropriate, that is dated later than the proxy originally submitted or (4) voting in person at the Kmart or Sears special meeting, as appropriate.

If your shares are held in an account at a broker, bank or other nominee, in the Sears ASPP or in a Sears Plan, you should contact your broker, bank or other nominee or the plan trustee or administrator to change your vote. Beneficial holders cannot revoke their proxies in person at the special meeting because the actual stockholders of record, i.e., the banks or brokers or their nominees, will not be present.

Q:

SHOULD SEARS STOCKHOLDERS SEND THEIR STOCK CERTIFICATES WITH THEIR PROXY CARD OR THEIR FORM OF ELECTION?

A:

Please DO NOT send your Sears stock certificates with your proxy card. You should send your Sears stock certificates to the exchange agent with your form of election.

Q:

SHOULD KMART STOCKHOLDERS SEND IN THEIR STOCK CERTIFICATES NOW?

A:

No. **Please DO NOT send your Kmart stock certificates with your proxy card.** If you are a Kmart stockholder of record, you will receive written instructions from the exchange agent after the Kmart merger is completed on how to exchange any Kmart stock certificates you may have for Holdings common stock. If the Kmart shares you hold of record are in book-entry form, they will be automatically converted into Holdings shares, and you do not need to take any action.

Q: WHO CAN HELP ANSWER MY QUESTIONS?

A: If you have any questions about the mergers or how to submit your proxy, or if you need additional copies of this joint proxy statement-prospectus, the form of election or the enclosed proxy card, you should contact:

if you are a Kmart stockholder:

Innisfree M&A Incorporated
By Mail: 501 Madison Avenue, 20th Floor
New York, NY 10022
By Telephone: (888) 750-5834
Banks and Brokers call collect: (212) 750-5833

if you are a Sears stockholder:

D.F. King & Co., Inc.
By Mail: 48 Wall Street
New York, NY 10005
By Telephone: (800) 549-6650 (or (212) 269-5550 for calls from outside the United States)

SUMMARY

This summary highlights selected information in this joint proxy statement-prospectus and may not contain all of the information that is important to you. You should carefully read this entire joint proxy statement-prospectus and the documents incorporated by reference into this joint proxy statement-prospectus for a more complete understanding of the matters being considered at the meetings. In addition, we incorporate by reference important business and financial information about Kmart Holding Corporation and Sears, Roebuck and Co. into this joint proxy statement-prospectus. You may obtain the information incorporated by reference into this joint proxy statement-prospectus without charge by following the instructions in the section entitled "Where You Can Find More Information" that begins on page 145 of this joint proxy statement-prospectus.

THE COMPANIES

Kmart Holding Corporation (see page 25)

Kmart, the nation's third largest discount retailer, is a mass merchandising company that serves America through its 1,480 Kmart and Kmart Supercenter retail outlets in 49 states, Puerto Rico, the U.S. Virgin Islands and Guam and through its e-commerce shopping site, www.kmart.com. The address of Kmart's principal executive offices is 3100 West Big Beaver Road, Troy, Michigan 48084, and its telephone number is (248) 463-1000.

Sears, Roebuck and Co. (see page 26)

Sears is a multi-line retailer that offers an array of merchandise and related services through a wide network of multiple channels, including 2,300 Sears-branded and affiliated stores in the United States and Canada, a product repair and services network with over 10,000 technicians, leading Internet sites, including www.sears.com, www.sears.ca and www.landsend.com and direct to customer catalog programs. The address of Sears' principal executive offices is 3333 Beverly Road, Hoffman Estates, Illinois 60179, and its telephone number is (847) 286-2500.

Sears Holdings Corporation (see page 26)

Holdings is a newly incorporated Delaware corporation and will become the new holding company of Kmart and Sears upon consummation of the mergers. The address of Holdings' current principal executive offices is c/o Kmart Holding Corporation, 3100 West Big Beaver Road, Troy, Michigan 48084, and its current telephone number is (248) 463-1000. After the mergers, Holdings' headquarters will be in Hoffman Estates, Illinois.

Holdings does not expect to pay dividends in the foreseeable future.

THE MERGERS

Structure of the Mergers (see page 33)

The organization of Kmart, Sears and Holdings before and after the mergers is illustrated below.

Before the Mergers

After the Mergers

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(1) As of February 1, 2005, the ESL Companies' beneficial ownership percentage of approximately 53% of the outstanding shares of Kmart common stock consists of approximately 48.3 million shares of Kmart common stock and options to acquire approximately 6.5 million shares of Kmart common

stock.

(2)
As of February 1, 2005, the ESL Companies' beneficial ownership percentage of approximately 14% of the outstanding shares of Sears common stock consists of approximately 31.1 million shares of Sears common stock.

(3)
This includes beneficial ownership of approximately 6.5 million shares of common stock of Holdings underlying certain options of Kmart currently held by the ESL Companies and to be exchanged for options exercisable for Holdings common stock.

(4)
The percentage is based on an assumption that approximately 156 million shares of Holdings common stock are issued in the mergers. The actual percentage will depend on the actual number of shares of Holdings common stock issued in the mergers and also on the elections of Sears stockholders.

Sears Common Stockholders to Choose between Receiving Shares of Holdings Common Stock or Cash, Subject to Proration (see page 83)

In the Sears merger, Sears common stockholders will have the right to chose between receiving $50.00 in cash or 0.5 of a share of Holdings common stock per share of Sears common stock, subject to proration. These proration procedures are designed to ensure that 55% of Sears shares outstanding at the completion of the Sears merger are converted into Holdings shares and 45% of Sears shares outstanding at the completion of the Sears merger are converted into cash.

Kmart Common Stockholders to Receive Shares of Holdings Common Stock (see page 33)

In the Kmart merger, Kmart stockholders will exchange their shares of Kmart common stock for Holdings common stock on a one-for-one basis.

Stock Exchange Listing and Stock Prices (see page 91)

Holdings common stock is currently not traded or quoted on a stock exchange or quotation system. However, Holdings common stock has been approved for quotation on the Nasdaq National Market under the symbol "   ."

Kmart common stock trades on the Nasdaq National Market under the symbol "KMRT," and Sears common stock trades on the New York Stock Exchange under the symbol "S." Sears common stock is also listed on the Chicago Stock Exchange and the Pacific Stock Exchange. The table below shows the pro forma equivalent per share value of Kmart and Sears common stock at the close of the regular trading session on November 16, 2004, the last trading day before our public announcement of the mergers, and February 14, 2005, the most recent trading day for which that information was available.

Date	Kmart Closing Price	Sears Closing Price	Kmart Pro Forma Equivalent(1)	Sears Pro Forma Equivalent(2)
November 16, 2004	$ 101.22	$ 45.20	$ 101.22	$ 50.61
February 14, 2005	102.29	51.89	102.29	51.15

(1) The pro forma equivalent per share value of Kmart common stock is calculated by multiplying the Kmart closing price by the Kmart merger exchange ratio of 1.0.

(2) The pro forma equivalent per share value of Sears common stock is calculated by multiplying the Kmart closing price by the Sears merger exchange ratio of 0.5.

Because the 0.5 and 1.0 exchange ratios in the Sears and Kmart mergers, respectively, are fixed and will not be adjusted as a result of changes in market prices, the implied value of the merger consideration will fluctuate with the market price of Kmart common stock. You should obtain current market quotations for the shares of both companies from a newspaper, the Internet or your broker.

Receipt of Shares of Holdings Common Stock in Mergers Generally Nontaxable to Stockholders (see page 78)

We expect that the exchange of shares by a Sears stockholder solely for Holdings common stock will be nontaxable to such stockholder for U.S. federal income tax purposes, except in respect of any cash that such stockholder receives instead of fractional Holdings shares. We expect that a stockholder who exchanges shares of Sears common stock for a combination of Holdings common stock and cash will not recognize gain except up to the amount of cash received. We expect that the exchange of shares of Sears common stock by a Sears stockholder solely for cash will be taxable to such stockholder for U.S. federal income tax purposes. We expect that the exchange of shares by Kmart stockholders will be nontaxable to them for U.S. federal income tax purposes. You should consult with your own tax advisor for a full understanding of the tax consequences to you of the mergers.

Our Boards of Directors Unanimously Recommend that Kmart and Sears Stockholders Vote to Adopt the Merger Agreement (see pages 41 and 45)

Kmart Stockholders. The Kmart board of directors unanimously recommends that the Kmart stockholders vote FOR the adoption of the merger agreement.

Sears Stockholders. The Sears board of directors unanimously recommends that the Sears stockholders vote FOR the adoption of the merger agreement.

Fairness Opinions. Our boards received fairness opinions from our respective financial advisors. See "The Mergers Opinion of Kmart's Financial Advisor" beginning on page 50 and "The Mergers Opinion of Sears' Financial Advisor" beginning on page 60.

Interests of Our Directors and Executive Officers in the Mergers (see page 68)

You should be aware that some of the directors and executive officers of Kmart and Sears have interests in the mergers that are different from, or are in addition to, the interests of stockholders of Kmart or Sears. These interests include, but are not limited to, the relationship of certain directors and executive officers of Kmart with the ESL Companies, the treatment of restricted shares, options and other rights held by directors and executive officers of Kmart and Sears in the mergers, the continued employment of certain executive officers in Holdings, the continued positions of certain directors of Kmart and Sears as directors of Holdings, and the indemnification of former Kmart and Sears directors by Holdings.

The ESL Companies and Support Agreement (see page 105)

ESL Partners, L.P., ESL Investors, L.L.C., ESL Institutional Partners, L.P., ESL Investment Management, L.L.C., CRK Partners, LLC and CRK Partners II, L.P. (which we refer to collectively in this joint proxy statement-prospectus as the ESL Companies) entered into a Support Agreement and Irrevocable Proxy with Kmart and Sears. The ESL Companies (except for ESL Investment Management, L.L.C.) are controlled, directly or indirectly, by ESL Investments, Inc., which in turn is controlled by Edward S. Lampert, the Chairman of Kmart. Mr. Lampert directly controls ESL Investment Management, L.L.C. The support agreement is attached as Annex B to this joint proxy statement-prospectus.

Pursuant to the support agreement, among other things, the ESL Companies have agreed, subject to limited exceptions, to vote their shares of common stock of Kmart and common stock of Sears in favor of adopting the merger agreement and to irrevocably elect to receive Holdings common stock in the Sears merger, subject to proration like all Sears stockholders. The ESL Companies have acknowledged that, as a part of their obligation to vote in favor of the adoption of the merger agreement, they are obligated by the support agreement to vote in favor of the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings. Because of the ESL Companies' percentage ownership of Kmart common stock, the adoption of the merger agreement and the approval of the exclusion of certain bankruptcy-related charter provisions by the Kmart stockholders are practically assured.

The support agreement does not require the ESL Companies to vote in favor of approving the grants of restricted shares and options to Mr. Lewis, although it is expected that they will do so. Accordingly, the approval of these equity grants to Mr. Lewis is practically assured.

The ESL Companies, and thus Mr. Lampert, will have substantial influence over many if not all actions to be taken by Holdings stockholders after the mergers. For additional information on Mr. Lampert's influence over Holdings, see "Risk Factors Affiliates of the Chairman of Holdings,

whose interests may be different than your interests, will have substantial influence over Holdings" on page 19.

Appraisal Rights (see page 91)

Under Delaware law, Kmart stockholders are not entitled to appraisal rights in connection with the Kmart merger.

Under New York law, Sears stockholders who timely submit a written demand for appraisal of their shares and who perfect their appraisal rights by complying with the other applicable statutory procedures will be entitled to be paid the fair value of their shares of Sears common stock in connection with the Sears merger in accordance with New York law. Any Sears stockholder who wants to exercise appraisal rights should not submit a form of election, which will be considered a withdrawal of any previously filed written demand for appraisal.

Directors and Management Following the Mergers (see page 75)

Following the mergers, the board of directors of Holdings will consist of seven current Kmart directors and three current Sears directors. The initial term of the directors will end with Holdings' annual stockholders meeting in 2006. Thereafter, the directors will serve for one-year terms.

Following the mergers, Edward S. Lampert (current Chairman of Kmart) will be the Chairman and a director of Holdings. Alan J. Lacy (current Chairman, Chief Executive Officer and President of Sears) will be the Vice Chairman and Chief Executive Officer and a director of Holdings, and Aylwin B. Lewis (current Chief Executive Officer, President and a director of Kmart) will be the President and a director of Holdings and the Chief Executive Officer of Kmart and Sears Retail.

Regulatory Approvals and Conditions to Completion of the Mergers (see pages 82 and 96)

All regulatory approvals required to be obtained prior to the completion of the mergers have been obtained. However, the mergers are still subject to the receipt of stockholder approvals and the satisfaction or waiver of other conditions. Subject to the satisfaction or waiver of these conditions, we expect to complete the mergers in March 2005.

Termination of the Merger Agreement; Fees Payable (see pages 100 and 101)

We may jointly agree to terminate the merger agreement at any time. Either of us may also terminate the merger agreement in various circumstances, including failure to receive necessary stockholder approvals and if the other party breaches certain of its obligations in the merger agreement.

In several circumstances involving a change in a board's recommendation in favor of the merger agreement or a third party acquisition proposal, Kmart may become obligated to pay up to $380 million in termination fees, and Sears may be obligated to pay up to $400 million in termination fees. In addition, if Sears stockholders do not approve the merger agreement, Sears must reimburse Kmart for all costs and expenses incurred by Kmart in connection with the merger agreement up to $10 million.

SPECIAL MEETINGS

Kmart Special Meeting (see page 27)

The Kmart special meeting will be held at on , 2005, starting at , time.

You may vote at the Kmart special meeting if you owned shares of Kmart common stock at the close of business on January 26, 2005, the Kmart record date. On that date there were 88,642,225 shares of Kmart common stock outstanding and entitled to vote at the Kmart special meeting.

You may cast one vote for each share of Kmart common stock you owned as of the Kmart record date. The affirmative vote of a majority of the outstanding shares of Kmart common stock is required for the adoption of the merger agreement. The affirmative vote of a majority of the shares of Kmart common stock represented at the special meeting and entitled to vote is required to approve each proposal to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings and to approve the grants of restricted shares and options to Aylwin B. Lewis.

As of the record date, Kmart directors and executive officers and their affiliates (other than the ESL Companies and Edward S. Lampert, the Chairman of Kmart) owned and were entitled to vote approximately 1.4% of the outstanding shares of Kmart common stock, and the ESL Companies' beneficial ownership represented the power to vote approximately 47% of the outstanding shares of Kmart common stock.

Sears Special Meeting (see page 27)

The Sears special meeting will be held at the on , 2005, starting at , time.

You may vote at the Sears special meeting if you owned shares of Sears common stock at the close of business on January 26, 2005, the Sears record date. On that date there were 216,931,636 shares of Sears common stock outstanding and entitled to vote at the Sears special meeting. You may cast one vote for each share of Sears common stock you owned as of the Sears record date. The affirmative vote of at least two-thirds of the outstanding shares of Sears common stock is required for the adoption of the merger agreement by the Sears stockholders.

As of the record date, Sears directors and executive officers and their affiliates owned and were entitled to vote less than 1% of the outstanding shares of Sears common stock, and the ESL Companies' beneficial ownership represented the power to vote approximately 14% of the outstanding shares of Sears common stock.

SELECTED HISTORICAL AND PRO FORMA FINANCIAL DATA

The following financial information is to assist you in your analysis of the financial aspects of the mergers. The following tables present (1) selected historical financial data of Kmart, (2) selected historical financial data of Sears, and (3) selected unaudited pro forma condensed consolidated financial data reflecting the mergers. The historical financial data show the financial results actually achieved by Kmart and Sears for the periods indicated. The unaudited pro forma condensed consolidated financial data show financial results as if the mergers had taken place on January 30, 2003, except financial position data which assumes the mergers had taken place on October 27, 2004.

Selected Historical Financial Data of Kmart

The selected historical financial data of Kmart have been derived from the historical consolidated financial statements and related notes of Kmart filed by Kmart with the Securities and Exchange Commission. See "Where You Can Find More Information" beginning on page 145. Interim unaudited data for the 39 weeks ended October 27, 2004 and October 29, 2003 reflect, in the opinion of Kmart's management, all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation of that data. Results for the 39 weeks ended October 27, 2004 do not necessarily indicate results that may be obtained for any other interim period or for the year as a whole.

	Successor Company*			Predecessor Company*				
					Fiscal			
(In millions, except per share data and stores)	39 Weeks Ended October 27, 2004	26 Weeks Ended October 29, 2003	39 Weeks Ended January 28, 2004	13 Weeks Ended April 30, 2003	2002	2001	2000	1999
	(As restated)	(As restated)	(As restated)					
Summary of Operations								
Total sales(1)	$ 13,792	$ 10,744	$ 17,072	$ 6,181	$ 29,352	$ 34,180	$ 35,027	$ 33,960
Comparable sales %(2)	(13.6%)	(6.9%)	(9.5%)	(3.2%)	(10.1%)	(0.1%)	1.1%	4.8%
Income (loss) before interest expense, reorganization items, income taxes and discontinued operations(3)	1,365	2	505	(32)	(2,277)	(2,146)	(65)	1,182
Income (loss) before discontinued operations(3)	797	(36)	234	(852)	(2,771)	(2,377)	(256)	557
Discontinued operations				(10)	(448)	(69)	(12)	(193)
Net income (loss)(3)	797	(36)	234	(862)	(3,219)	(2,446)	(268)	364
Per Common Share								
Basic:								
Continuing (loss) income	$ 8.91	$ (0.40)	$ 2.61	$ (1.63)	$ (5.47)	$ (4.81)	$ (0.51)	$ 1.13
Discontinued operations	$	$	$	$ (0.02)	$ (0.89)	$ (0.14)	$ (0.02)	$ (0.39)
Net (loss) income	$ 8.91	$ (0.40)	$ 2.61	$ (1.65)	$ (6.36)	$ (4.95)	$ (0.53)	$ 0.74
Diluted:(4)								
Continuing (loss) income	$ 7.93	$ (0.40)	$ 2.51	$ (1.63)	$ (5.47)	$ (4.81)	$ (0.51)	$ 1.08
Discontinued operations	$	$	$	$ (0.02)	$ (0.89)	$ (0.14)	$ (0.02)	$ (0.34)
Net (loss) income	$ 7.93	$ (0.40)	$ 2.51	$ (1.65)	$ (6.36)	$ (4.95)	$ (0.53)	$ 0.74

	Successor Company*				Predecessor Company*			
	(As restated)	(As restated)	(As restated)	(As restated)				
Book value per common share	$ 34.45	$ 19.23	$ 24.64	$ 19.45	$ (0.58)	$ 6.42	$ 12.09	$ 12.73
Financial Data								
Total assets	$ 7,665	$ 6,117	$ 6,074	$ 6,660	$ 11,238	$ 14,183	$ 14,815	$ 15,192
Long-term debt(5)	80	24	76	59		330	2,084	1,759
Long-term capital lease obligations	288	419	374	415	623	857	943	1,014
Trust convertible preferred securities					646	889	887	986
Capital expenditures (Predecessor Company for the 13-weeks ended April 30, 2003)	179	61	108	4	252	1,385	1,089	1,277
Number of Stores	1,486	1,511	1,511	1,513	1,829	2,114	2,105	2,171

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* References to "Predecessor Company" refer to Kmart Corporation, which emerged from bankruptcy on May 6, 2003 as a subsidiary of Kmart Holding Corporation, which we refer to as "Successor Company". See "Information about the Companies" on page 25.

(1) Kmart's fiscal year ends on the last Wednesday in January. Fiscal year 2000 consisted of 53 weeks.

(2) Comparable store sales for fiscal year 2000 are based on the 52-week period ended January 24, 2001.

(3) Results include the following non-comparable items: in the 13 weeks ended April 30, 2003, a $47 million charge for accelerated depreciation on unimpaired assets to be disposed of following store closings, a $10 million credit as a result of a change in the estimated expenses for the fiscal year 2002 cost reduction initiatives; in fiscal year 2002, $1,019 million for inventory write-downs in conjunction with accelerated markdowns due to store closings, $533 million for asset impairments, $50 million for cost reduction initiatives, and $33 million for other items; in fiscal year 2001, $827 million for asset impairments, $163 million for supply chain restructuring, $97 million for the restructuring/impairment of Bluelight.com, and $23 million for Voluntary Early Retirement Program/Severance; in fiscal year 2000, $712 million for strategic initiatives; and in fiscal year 1999, $11 million to reflect the cumulative effect of a change in accounting method for layaway sales.

(4) Consistent with the requirements of Statement of Financial Accounting Standards No. 128, "Earnings per Share," options to purchase common stock, restricted stock and trust convertible preferred securities were not included in the calculation of diluted earnings per share for the 13-week period ended April 30, 2003, fiscal years 2002, 2001 or 2000 due to their anti-dilutive effect. Upon emergence from bankruptcy, all then-outstanding equity securities of Kmart Corporation, the predecessor company to Kmart before its emergence from bankruptcy, and the trust convertible preferred securities were cancelled.

(5) For fiscal years 2002 and 2001 long-term debt does not include liabilities classified as subject to compromise.

Selected Historical Financial Data of Sears

The selected historical financial data of Sears have been derived from the historical consolidated financial statements and related notes of Sears, filed by Sears with the Securities and Exchange Commission. Such data have been derived from, and should be read in conjunction with, the audited consolidated financial statements and other financial information contained in the Sears 2003 Form 10-K (as amended), and the unaudited condensed consolidated interim financial information contained in the Sears 2004 Third Quarter Form 10-Q (as amended), including the notes thereto. See "Where You Can Find More Information" beginning on page 145. Interim unaudited data for the 39 weeks ended October 2, 2004 and September 27, 2003 reflect, in the opinion of Sears' management, all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation of that data. Results for the 39 weeks ended October 2, 2004 do not necessarily indicate results that may be obtained for any other interim period or for the year as a whole.

	39 Weeks Ended		Fiscal Year				
(In millions, except per share data and stockholders)	**Oct. 2, 2004**	**Sept. 27, 2003(1)**	**2003(1)(2)**	**2002(3)**	**2001**	**2000**	**1999**
OPERATING RESULTS							
Revenues(4)	$ 24,870	$ 28,870	$ 41,124	$ 41,366	$ 40,990	$ 40,848	$ 39,430
Costs and expenses(3)	24,943	27,830	39,926	39,285	39,812	38,661	37,017
Operating (loss)/income(3)(7)	174	1,891	6,459	3,571	2,614	3,454	3,691
(Loss)/income before income taxes, minority interest and cumulative effect of change in accounting principle	(15)	1,056	5,449	2,453	1,223	2,223	2,419
Income taxes (benefit)/expense	(2)	392	2,007	858	467	831	904
(Loss)/income before cumulative effect of change in accounting principle	(28)	648	3,397	1,584	735	1,343	1,453
Cumulative effect of change in accounting principle(5)	(839)			(208)			
Net (loss)/income	$ (867)	$ 648	$ 3,397	$ 1,376	$ 735	$ 1,343	$ 1,453
FINANCIAL POSITION							
Credit card receivables, net(4)	$ 1,896	$ 29,007	$ 1,956	$ 30,731	$ 28,155	$ 17,317	$ 18,033
Retained interest in transferred credit card receivables						3,105	3,211
Merchandise inventories, net	6,400	6,243	5,335	5,115	4,912	5,618	5,069
Property and equipment, net	6,632	6,660	6,788	6,910	6,824	6,653	6,450
Total assets	22,652	49,090	27,723	50,409	44,317	36,899	36,954
Short-term borrowings(4)	823	6,179	1,033	4,525	3,557	4,280	2,989
Long-term debt, including current portion(4)(6)	4,856	25,117	7,168	26,112	22,078	13,580	15,049
Total debt(4)(6)	5,679	31,296	8,201	30,637	25,635	17,860	18,038
Shareholders' equity	$ 5,418	$ 5,489	$ 6,401	$ 6,753	$ 6,119	$ 6,769	$ 6,839
STOCKHOLDERS AND PER SHARE DATA							
Stockholders	144,414	151,809	150,759	157,378	164,354	209,101	220,749
Average common and equivalent shares outstanding	215	299	286	321	329	346	381
Earnings per common share diluted							
(Loss)/income before cumulative effect of change in accounting principle	$ (0.13)	$ 2.17	$ 11.86	$ 4.94	$ 2.24	$ 3.88	$ 3.81
Cumulative effect of change in accounting principle(4)	(3.90)			(0.65)			
Net (loss)/income	$ (4.03)	$ 2.17	$ 11.86	$ 4.29	$ 2.24	$ 3.88	$ 3.81
Cash dividends declared per common share	$ 0.69	$ 0.69	$ 0.92	$ 0.92	$ 0.92	$ 0.92	$ 0.92

Certain prior year information has been reclassified to conform with current year presentation.

(1) Includes the results of operations for Credit and Financial Products through November 2, 2003 and the results of operations for National Tire and Battery through November 29, 2003, the respective dates prior to their divestiture.

(2) Includes results of operations for 53 weeks.

(3) Includes results of operations for Lands' End effective June 17, 2002, the date of acquisition by Sears.

(4) On November 3, 2003, Sears sold its domestic Credit and Financial Products business to Citibank (USA), N.A. (See Note 2 of the Notes to the Consolidated Financial Statements for fiscal 2003).

(5) During 2004, Sears changed its method of accounting for pension and post-retirement benefits. (See Note 8 of the Notes to the Condensed Consolidated Financial Statements in the Sears Quarterly Report on Form 10-Q for the third quarter of 2004, as amended.)

(6) On November 17, 2003, Sears completed cash tender offers to purchase unsecured public term debt securities maturing after 2003. (See Note 4 of the Notes to the Consolidated Financial Statements for fiscal 2003.)

(7) Certain reclassifications have been made to reflect gains on sales of businesses as a component of operating (loss) income and to exclude interest expense from operating income to conform with the pro forma presentation.

Selected Unaudited Pro Forma Condensed Consolidated Financial Data of Holdings

The following table shows information about the pro forma financial condition and results of operations, including per share data, of Holdings after giving effect to the mergers. The table sets forth selected unaudited pro forma condensed consolidated statement of operations data as if the mergers had become effective on January 30, 2003, and selected unaudited pro forma condensed consolidated balance sheet data as if the mergers had occurred on October 27, 2004. The information presented below should be read together with the historical consolidated financial statements of Kmart and Sears, including the related notes, filed by each of them with the Securities and Exchange Commission and together with the consolidated historical financial data for Kmart and Sears and the other unaudited pro forma financial information, including the related notes, appearing elsewhere in this joint proxy-statement prospectus. See "Where You Can Find More Information" beginning on page 145 and "Unaudited Pro Forma Condensed Consolidated Financial Data" beginning on page 106. The unaudited pro forma financial data are not necessarily indicative of results that actually would have occurred had the mergers been completed on the dates indicated or that may be obtained in the future. See also "Risk Factors" beginning on page 17 and "Information Regarding Forward-Looking Statements" beginning on page 22.

(In millions, except per share data)

(Unaudited)		
FOR THE FISCAL YEAR ENDED JANUARY 28, 2004		
OPERATING RESULTS		
Revenues	$	59,679
Income from continuing operations		89
PER SHARE DATA		
Earnings per common share from continuing operations basic	$	0.61
Earnings per common share from continuing operations diluted		0.59
FOR THE THIRTY-NINE WEEKS ENDED OCTOBER 27, 2004		
OPERATING RESULTS		
Revenues	$	38,662
Income from continuing operations		284
PER SHARE DATA		
Earnings per common share from continuing operations basic	$	1.94
Earnings per common share from continuing operations diluted		1.84
AS OF OCTOBER 27, 2004		
FINANCIAL POSITION		
Merchandise inventories, net	$	10,922
Total assets		34,224
Short-term borrowings		823
Long-term debt, including current portion		5,422
Total debt		6,245

COMPARATIVE PER SHARE DATA
(Unaudited)

The following table sets forth certain historical per share data for Kmart and Sears and combined per share data on an unaudited pro forma condensed consolidated basis. You should read the information below together with the financial statements and related notes of Kmart and Sears that are incorporated by reference in this joint proxy statement-prospectus and with the unaudited pro forma condensed consolidated financial data included under "Unaudited Pro Forma Condensed Consolidated Financial Data" beginning on page 106.

		Fiscal Year 2003	
Kmart Historical Comparative Per Share Data	**39 Weeks Ended October 27, 2004**	**Successor Company 39 Weeks Ended January 28, 2004**	**Predecessor Company 13 Weeks Ended April 30, 2003**
	(As restated)	(As restated)	(As restated)
Basic earnings per common share from continuing operations	$ 8.91	$ 2.61	$ (1.63)
Diluted earnings per common share from continuing operations	$ 7.93	$ 2.51	$ (1.63)
Cash dividends per common share	$	$	$
Book value per common share	$ 34.45	$ 24.64	$ 19.45

Sears Historical Comparative Per Share Data	**39 Weeks Ended October 2, 2004**	**Fiscal Year 2003**
Basic earnings per common share from continuing operations	$ (0.13)	$ 11.95
Diluted earnings per common share from continuing operations	$ (0.13)	$ 11.86
Cash dividends per common share	$ 0.69	$ 0.92
Book value per common share	$ 26.10	$ 27.78

Unaudited Pro Forma Condensed Consolidated Comparative Per Share Data	**39 Weeks Ended October 27, 2004**	**Fiscal Year 2003**
	(As restated)	(As restated)
Basic earnings per common share from continuing operations	$ 1.94	$ 0.61
Diluted earnings per common share from continuing operations	$ 1.84	$ 0.59
Cash dividends per common share	$	$
Book value per common share as of October 27, 2004	$ 61.64	

Unaudited Pro Forma Equivalent Per Share Data for Sears	**39 Weeks Ended October 27, 2004**	**Fiscal Year 2003**
	(As restated)	(As restated)
Basic earnings per common share from continuing operations	$ 0.97	$ 0.31
Diluted earnings per common share from continuing operations	$ 0.92	$ 0.30
Cash dividends per common share	$	$
Book value per common share as of October 27, 2004	$ 30.84	

RISK FACTORS

In addition to the other information contained in or incorporated by reference into this joint proxy statement-prospectus, including the matters addressed under the caption "Information Regarding Forward-Looking Statements" on page 22, you should carefully consider the following risk factors in deciding whether to vote for adoption of the merger agreement.

Sears stockholders may not receive the form of merger consideration that they elect for all of their shares and may receive in part a form of consideration that has a lower value.

The merger agreement contains provisions that are designed to ensure that, in the aggregate, 45% of Sears shares will be converted into cash and 55% of Sears shares will be converted into Holdings common stock. The value of the share consideration at the time of the mergers may be higher than the value of the cash consideration at such time, or vice versa. If elections are made by Sears stockholders to receive more cash or more shares of Holdings than these percentages, either those electing to receive cash or those electing to receive shares of Holdings, respectively, will have the consideration of the type they selected reduced by a pro rata amount, and will receive a portion of their consideration in the form that they did not elect to receive. Accordingly, it is likely that a substantial number of Sears stockholders will not receive a portion of the merger consideration in the form that they elect and that the consideration they do receive will have a lower value than what they elected to receive.

In connection with a support agreement, the ESL Companies have agreed to elect to receive shares of Holdings common stock in the Sears merger even if the value of the share consideration at the time of the mergers is less than the cash consideration. Nonetheless, the ESL Companies will be subject to proration, like all Sears stockholders, if holders of more than 55% of the Sears shares elect shares of Holdings. The ESL Companies as of the record date owned approximately 31.1 million shares of Sears common stock or approximately 14% of the outstanding Sears common stock.

Because the exchange ratios are fixed, the market value of Holdings common stock issued to you may be less than the value of your shares of Kmart common stock or Sears common stock.

Kmart stockholders and Sears stockholders who receive shares in the mergers will receive a fixed number of shares of common stock of Holdings rather than a number of shares with a particular fixed market value. The market values of Kmart and Sears common stock at the time of the mergers may vary significantly from their prices on the date the merger agreement was executed, the date of this joint proxy statement-prospectus or the date on which Kmart and Sears stockholders vote on the mergers. Because the exchange ratio will not be adjusted to reflect any changes in the market value of Kmart or Sears common stock, the market value of the Holdings common stock issued in the mergers and the Kmart and Sears common stock surrendered in the mergers may be higher or lower than the values of such shares on such earlier dates, and may be higher or lower than the $50.00 to be paid to Sears stockholders in the cash portion of the Sears merger. Stock price changes may result from a variety of factors that are beyond the control of Kmart and Sears, including changes in their businesses, operations and prospects, regulatory considerations and general and industry specific market and economic conditions. Neither Kmart nor Sears is permitted to terminate the merger agreement solely because of changes in the market price of either party's common stock.

If you deliver your Sears shares to the exchange agent to make an election, you will not be able to sell those shares unless you revoke your election prior to the election deadline or the merger agreement is terminated.

The deadline for making a cash or share election for Sears shares is 5:00 p.m., New York City time, on   , 2005, the day of the special meeting of Sears stockholders, unless the completion of the Sears merger will occur more than four business days following the date of this

special meeting, in which case the election deadline will be extended until two business days before the completion of the Sears merger. After you submit a form of election, under the terms of the election, you will not be able to sell any Sears shares covered by your form of election, regardless of whether those shares are held in certificated or book entry form, unless you revoke your election before the deadline by providing written notice to the exchange agent. If you do not revoke your election, you will not be able to sell your Sears shares covered by a form of election prior to completion of the Sears merger. In the time between your submission of a form of election and the completion of the Sears merger, the trading price of Sears common stock may change, and you might otherwise want to sell your Sears shares covered by a form of election to gain access to cash, make other investments, or reduce the potential for an adverse change in the value of your investment.

We may fail to realize the anticipated synergies, cost savings and other benefits expected from the mergers, which could adversely affect the value of Holdings stock.

The success of the mergers will depend, in part, on our ability to realize the anticipated growth opportunities and cost savings from combining the businesses of Kmart and Sears. Our managements have conservatively estimated that the combined companies expect to realize approximately $200 million in incremental annual operating profit synergies by the end of 2007 from increased revenues by capitalizing on cross-selling opportunities between Kmart's and Sears' proprietary brands and by converting a substantial number of Kmart stores to the Sears nameplate over time. There can be no assurance, however, that these cross-selling opportunities or conversions will be successful.

Moreover, expanding the offering and distribution of proprietary brands may impact the value of those brands and lead to cannibalization of sales from either Sears or Kmart. There is also the risk that national brands will not sell to the combined companies. In addition, Holdings may be unable to realize the value it expects from the combined real estate portfolio, including being able to differentiate product offerings at its various locations. If these benefits are not achieved, Holdings' results of operations could be materially adversely affected.

Our managements have also conservatively estimated that the combined entities expect to achieve annual cost savings of over $300 million by the end of 2007 principally through improved merchandising and non-merchandising purchasing scale as well as improved supply chain, administrative and other operational efficiencies. However, to realize the anticipated benefits from the mergers, we must successfully combine the businesses of Kmart and Sears in a manner that permits those costs savings and revenue synergies to be realized. In addition, we must achieve these savings without adversely affecting revenues. If we are not able to successfully achieve these objectives, the anticipated benefits of the mergers may not be realized fully or at all or may take longer to realize than expected.

The failure to integrate successfully Kmart's and Sears' businesses and operations in the expected timeframe may adversely affect Holdings' future results.

Kmart and Sears have operated and, until the completion of the mergers, will continue to operate, independently. Kmart and Sears will face significant challenges in consolidating functions, integrating their organizations, procedures and operations in a timely and efficient manner and retaining key Kmart and Sears personnel. The integration of Kmart and Sears will be costly, complex and time consuming, and the managements of Kmart and Sears will have to devote substantial resources and efforts to it.

The integration process and other disruptions from the mergers could result in the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers, suppliers, employees and others with whom we have business dealings or to achieve the anticipated benefits of the mergers.

Directors of Kmart and Sears may have potential conflicts of interest in recommending that you vote in favor of the adoption of the merger agreement.

A number of directors of Kmart and a number of directors of Sears who recommend that you vote in favor of the adoption of the merger agreement have employment or severance agreements, equity compensation and other benefit arrangements or other interests that provide them with interests in the mergers that differ from yours. In addition, a number of directors of Kmart and Sears will continue as directors of Holdings while other directors will not, and in either case Holdings will indemnify and provide insurance for their services as directors of Kmart and Sears prior to the mergers. In particular, Kmart's Chairman and one other director of Kmart have material relationships with the ESL Companies, which are significant stockholders of Kmart and Sears.

The receipt of compensation or other benefits in the mergers, the continuation of indemnification and insurance arrangements for current directors of Kmart and Sears following completion of the mergers, and relationships with significant stockholders of Kmart and Sears may have influenced these directors in making their recommendation that you vote in favor of the adoption of the merger agreement. You should be aware of these interests when you consider your board's recommendation that you vote in favor of the mergers.

Affiliates of the Chairman of Holdings, whose interests may be different than your interests, will have substantial influence over Holdings.

Assuming that Holdings issues approximately 156 million shares pursuant to the mergers and that the ESL Companies exercise their options for approximately 6.5 million shares shortly after the completion of the mergers, and depending upon the elections of Sears stockholders to receive cash or stock consideration, the ESL Companies would be expected to beneficially own between approximately 40% and 44% of the outstanding shares of Holdings common stock immediately after the mergers (including the beneficial ownership of shares of Holdings common stock underlying the options of Kmart currently held by the ESL Companies). The ESL Companies (other than ESL Investment Management, L.L.C.) are controlled, directly or indirectly, by Edward S. Lampert, the current Chairman of Kmart, and the designated Chairman of Holdings. Mr. Lampert directly controls ESL Investment Management, L.L.C. Accordingly, the ESL Companies, and thus Mr. Lampert, would have substantial influence over many if not all actions to be taken by Holdings stockholders after the mergers, including the election of the directors to the Holdings board and transactions involving a change of control.

This substantial influence may have the effect of discouraging offers to acquire Holdings because the consummation of any such acquisition would likely require the consent of the ESL Companies. The interests of the ESL Companies, which have investments in other companies, may from time to time diverge from the interests of other Holdings stockholders, particularly with regard to new investment opportunities.

Following the mergers, Holdings will have significantly less cash on hand than Kmart and Sears prior to the mergers, which could adversely affect its ability to grow and perform.

Following an assumed completion of the mergers in March 2005, after payment of the merger consideration, payment in respect of options to purchase Sears common stock and all other pro forma adjustments relating to the mergers, Holdings is expected to have approximately $700 million in cash and cash equivalents. In addition, Holdings is expected to have approximately $5.1 billion in indebtedness, including $640 million related to obligations under capital leases ($55 million short-term, $585 million long-term) and $600 million of other short-term borrowings. The expected cash on hand in March 2005 assumes a build-up of cash from the seasonal low-point at the end of the third quarter

2004 and first quarter sales consistent with Holdings' business plan. No assurances can be given as to the actual amount of cash and cash equivalents that Holdings will have on hand following the mergers.

Certain rating agencies have assigned Holdings below-investment grade debt ratings, which could adversely affect its ability to access financing on terms acceptable to it and, consequently, its ability to grow and perform.

As a result of Holdings' having significantly less cash on hand than Kmart and Sears have, on a combined basis, prior to the mergers, Holdings will be required to obtain additional financing to meet its liquidity needs. Although Holdings anticipates entering into a five-year $4 billion revolving credit facility prior to the completion of the mergers, Holdings may not be able to satisfy the conditions to borrowing under the credit facility in certain circumstances, and it may not be able to obtain financing from other sources on terms that are acceptable to it. Holdings' ability to obtain financing from other sources will be dependent largely on its operating performance, its credit ratings from the major credit ratings agencies and market conditions. Standard & Poor's has assigned Holdings a "BB-plus" corporate credit rating, and Moody's Investor Service has assigned Holdings a "Ba1" rating for its senior implied debt and senior unsecured issuer ratings. Both of these ratings are one notch below these rating agencies' investment grade ratings and are known as speculative grade or "junk" ratings. Consequently, Holdings' debt ratings will be below the current investment grade ratings for Sears. If Holdings' debt ratings continue to be below investment grade or if Holdings' operating performance were to be worse than expected, its financing costs could be higher than expected and its access to financing could be limited. In particular, it would not expect to have access to the commercial paper market. In such events, Holdings' financial flexibility could be limited, adversely affecting its ability to grow and perform.

Holdings does not expect to pay dividends for the foreseeable future, and you must rely on increases in the trading prices of Holdings stock for returns on your investment.

Although Sears stockholders have historically received quarterly dividends from Sears, Holdings does not expect to pay dividends in the foreseeable future. Former Sears stockholders who become stockholders of Holdings will no longer be able to rely on receiving dividend payments, and instead they (and former Kmart stockholders) must rely on increases in the trading price of Holdings common stock for any return on their investment.

The loss of key personnel may adversely affect Holdings.

Following the mergers, Holdings will be dependent upon the contributions of its senior management team, including Edward S. Lampert (Chairman of Holdings), Alan J. Lacy (Vice Chairman and Chief Executive Officer of Holdings), Aylwin B. Lewis (President of Holdings and Chief Executive Officer of Kmart and Sears Retail), Glenn R. Richter (Executive Vice President and Chief Financial Officer of Holdings), William C. Crowley (Executive Vice President, Finance and Integration of Holdings), and other key employees for its future success. While Messrs. Lacy and Lewis have employment agreements with Holdings, Sears or Kmart, if any of these executives, or other key employees, were to cease to be employed by Holdings, including as a result of the integration of Sears and Kmart following the mergers, Holdings could be adversely affected.

Former Sears stockholders who become stockholders of Holdings will be governed by the restated certificate of incorporation and restated by-laws of Holdings.

Sears stockholders who receive Holdings common stock in the mergers will become Holdings stockholders and their rights as stockholders will be governed by the restated certificate of incorporation and restated by-laws of Holdings and Delaware corporate law. As a result, there will be

material differences between the current rights of Sears stockholders and the rights they can expect to have as Holdings stockholders.

For example, among other differences, Sears provides for a staggered board of directors but Holdings does not, and thus an acquisition or change in control of Holdings by a third party that the board, in its judgment, might not have favored may be easier to effect. Sears provides for the cumulative voting of directors but Holdings does not, and thus a group of controlling stockholders, like the ESL Companies, may be able to elect all of the directors of Holdings.

Moreover, New York corporate law differs in certain respects from Delaware corporate law. For example, among other differences, a stockholder becomes an "interested stockholder" of a Delaware corporation at a lower ownership threshold than a stockholder of a New York corporation but can effect a business combination at an earlier date than an "interested stockholder" of a New York corporation. A merger involving a New York corporation also requires the affirmative vote of at least two-thirds of the outstanding shares instead of just a majority of the outstanding shares of a Delaware corporation. Furthermore, the process for stockholders to perfect appraisal rights differs under New York and Delaware corporate law. For additional information, see "Comparison of Stockholder Rights" beginning on page 122.

We are parties to pending lawsuits in connection with the mergers.

We are parties to several lawsuits filed by third parties seeking monetary damages or injunctive relief, or both, in connection with the mergers. Predicting the outcome of these lawsuits is difficult. An adverse judgment for monetary damages could have a material adverse effect on the operations of Holdings after the mergers. A preliminary injunction could delay or jeopardize the completion of the mergers; and an adverse judgment granting injunctive relief could permanently enjoin the consummation of the mergers.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This joint proxy statement-prospectus contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may be made directly in this joint proxy statement-prospectus or they may be made a part of this joint proxy statement-prospectus by appearing in other documents filed with the Securities and Exchange Commission by Kmart, Sears and Holdings and incorporated by reference in this joint proxy statement-prospectus. These statements may include statements regarding the period following completion of the mergers.

Words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "target," "objective," "goal," "should" and words and terms of similar substance used in connection with any discussion of future operating or financial performance of Kmart, Sears or Holdings or of the mergers identify forward-looking statements. All forward-looking statements are management's present expectations or forecasts of future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to the factors relating to the mergers discussed under the caption "Risk Factors" beginning on page 17 above, the following risks related to the businesses of Kmart, Sears and Holdings, among others, could cause actual results to differ materially from those described in the forward-looking statements:

- competitive conditions in retail and related services industries;
- changes in consumer confidence, tastes, preferences and spending;
- the availability and level of consumer debt;
- anticipated cash flow and the ability of Holdings to maintain sufficient operating cash flow and liquidity;
- the successful execution of, and customer response to, strategic initiatives, including the full-line store strategy and the conversion and integration of the Kmart stores and other new store locations;
- the pace of growth in store locations, which may be higher or lower than anticipated;
- the possibility that new business and strategic options for one or more business segments will be identified, potentially including selective acquisitions, dispositions, restructurings, joint ventures and partnerships;
- trade restrictions, tariffs, and other factors potentially affecting the ability to do business with qualified vendors and access products in an efficient manner;
- the ability to successfully implement initiatives to improve inventory management capabilities;
- changes in interest rates;
- the outcome of pending legal proceedings and bankruptcy claims;
- social and political conditions such as war, political unrest and terrorism or natural disasters;
- the possibility of negative investment returns in pension plans;

volatility in financial markets;

changes in debt ratings, credit spreads and cost of funds;

the possibility of interruptions in systematically accessing the public debt markets;

the impact of seasonal buying patterns, which are difficult to forecast with certainty; and

general economic conditions and normal business uncertainty.

We caution you not to place undue reliance on the forward-looking statements, which speak only as of the date of this joint proxy statement-prospectus in the case of forward-looking statements contained in this joint proxy statement-prospectus, or the dates of the documents incorporated by reference in this joint proxy statement-prospectus in the case of forward-looking statements made in those incorporated documents. Except as may be required by law, none of Kmart, Sears or Holdings has any obligation to update or alter these forward-looking statements, whether as a result of new information, future events or otherwise.

For additional information about factors that could cause actual results to differ materially from those described in the forward-looking statements, please see the annual reports on Form 10-K (as amended) and the quarterly reports on Form 10-Q (as amended) that Kmart and Sears have filed with the Securities and Exchange Commission as described under "Where You Can Find More Information" on page 145.

We expressly qualify in their entirety all forward-looking statements attributable to Kmart, Sears or Holdings or any person acting on our behalf by the cautionary statements contained or referred to in this section.

RECENT DEVELOPMENTS

Sears Fourth Quarter and Fiscal Year 2004 Results

On January 27, 2005, Sears issued a press release announcing its financial results for the fourth quarter and fiscal year ended January 1, 2005. Sears reported net income of $378 million, or $1.76 per share on an average base of 214.3 million common equivalent shares, for the fourth quarter ended January 1, 2005, compared with net income of $2.7 billion, or $10.84 per share on an average base of 253.6 million common equivalent shares, in the fourth quarter of 2003. The prior year results included the results of Sears' domestic Credit and Financial Products and National Tire & Battery businesses divested in the fourth quarter of 2003. Sears' fourth quarter 2003 earnings also included a pretax gain of $4.1 billion, or $10.38 per share, related to the sale of the domestic Credit and Financial Products business, a pretax charge of $791 million, or $1.98 per share, on the early retirement of debt that occurred as a result of the sale of the domestic Credit and Financial Products business and a pretax gain of $81 million, or $0.20 per share, related to the sale of National Tire & Battery.

Sears also reported full-year 2004 net income before the cumulative effect of a change in accounting principle of $350 million, or $1.61 per share on an average base of 216.7 million common equivalent shares, compared with net income of $3.4 billion, or $11.86 per share on an average base of 286.3 million common equivalent shares, for 2003.

Sears' 2004 full-year results include a one-time, non-cash, after-tax charge of $839 million, or $3.87 per share, for the cumulative effect of a change in accounting principle related to its domestic pension and post retirement medical benefit plans. Net loss after the cumulative effect of this accounting change was $489 million, or $2.26 per share, for the full year 2004.

The full press release was filed as an exhibit to Sears' Current Report on Form 8-K with the Securities and Exchange Commission on January 27, 2005, and is incorporated by reference into this joint proxy statement-prospectus.

Holdings Credit Agreement

Prior to the completion of the mergers, Holdings, Kmart Corporation (which is a wholly-owned subsidiary of Kmart) and Sears Roebuck Acceptance Corp. (which is a wholly-owned subsidiary of Sears and which we refer to as SRAC) expect to enter into a Five-Year Credit Agreement with certain financial institutions. The effectiveness of the credit agreement will be contingent upon the occurrence of certain conditions, including the completion of the mergers and the execution of a guarantee and collateral agreement by Holdings and other affiliates of Kmart Corporation and SRAC, which will be guarantors of the borrowings. Kmart Corporation and SRAC will be the borrowers under the credit agreement. This credit agreement will replace an existing credit agreement of Sears.

This credit agreement is expected to provide for a $4 billion revolving credit facility, with a $1.5 billion letter-of-credit sublimit. The revolving credit facility is to be secured by all of the inventory and credit card accounts receivable of Kmart Corporation and SRAC and their affiliates that are party to the guarantee and collateral agreement. At any time after the second anniversary of effectiveness of the credit agreement, however, Holdings can cause the revolving credit facility to become unsecured by achieving a specified leverage ratio for three consecutive fiscal quarters or achieving certain credit ratings. If the collateral were to be released as described in the preceding sentence, Holdings would have to maintain a consolidated leverage ratio and inventory coverage ratio of specified levels. The credit agreement does not, however, otherwise contain financial covenants.

The proceeds of advances under the credit agreement are to be available for general corporate purposes of Holdings and its subsidiaries, including liquidity support for commercial paper, acquisitions, capital expenditures, cash dividends and stock and bond repurchases. Pricing under the revolving credit facility is subject to a leverage ratio-based grid.

INFORMATION ABOUT THE COMPANIES

Kmart Holding Corporation
3100 West Big Beaver Road
Troy, Michigan 48084
(248) 463-1000

Kmart, the nation's third largest discount retailer, is a mass merchandising company that serves America through its 1,480 Kmart and Kmart Supercenter retail outlets in 49 states, Puerto Rico, the U.S. Virgin Islands and Guam and through its e-commerce shopping site, *www.kmart.com*. Kmart Holding Corporation was incorporated in Delaware in April 2003, but the businesses conducted by its predecessors began in 1899. Kmart Corporation (the predecessor company to Kmart Holding Corporation) was incorporated under the laws of the State of Michigan on March 9, 1916, as the successor to the business developed by its founder, S.S. Kresge, who opened his first store in 1899. Kresge was the first retailer to launch a newspaper advertising program to entice shoppers to its stores. After operating Kresge department stores for over 45 years, Kmart's store program commenced with the opening of the first Kmart store in March 1962. In 1977, Kresge Corporation officially changed its name to Kmart Corporation. In 1991, Kmart opened the first Kmart Supercenter in Medina, Ohio, offering a full-service grocery along with general merchandise twenty-four hours a day, seven days a week.

On January 22, 2002, Kmart Corporation and 37 of its U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Northern District of Illinois. Kmart Corporation and its 37 subsidiaries decided to seek bankruptcy reorganization based upon a rapid decline in their liquidity resulting from below-plan sales and earnings performance in the fourth quarter of fiscal 2001, the evaporation of the surety bond market, an erosion of supplier confidence, intense competition, unsuccessful sales and marketing initiatives, the continuing recession and capital market volatility. Kmart Corporation utilized Chapter 11 proceedings to strengthen its balance sheet and reduce debt, focus its store portfolio on the most productive locations and terminate leases for closed stores, develop a more efficient organization and lower overall operating costs.

On May 6, 2003, Kmart Corporation emerged from reorganization proceedings under Chapter 11 pursuant to the terms of an Amended Joint Plan of Reorganization and related amended Disclosure Statement. This plan of reorganization received formal endorsement of the statutory creditors' committee and, as modified, was confirmed by the U.S. Bankruptcy Court on April 23, 2003. Kmart Corporation is presently a wholly-owned subsidiary of Kmart Management Corporation, which is a wholly-owned subsidiary of Kmart Holding Corporation.

For additional information on Kmart, see "Where You Can Find More Information" on page 145.

Sears, Roebuck and Co.

3333 Beverly Road
Hoffman Estates, Illinois 60179
(847) 286-2500

Sears, Roebuck and Co. originated from an enterprise established in 1886 and incorporated in New York in 1906. Sears is a multi-line retailer that offers an array of merchandise and related services. Sears' domestic operations consist of full-line stores, including Sears, Sears Auto Center, Sears Grand and sears.com, and specialty retail stores, including The Great Indoors, Dealer Stores, Hardware Stores, commercial sales and outlet stores. In addition, Sears' direct-to-consumer business includes Lands' End online, catalog and retail operations. Sears also offers a wide variety of home services such as home improvement, delivery, product installation and repair services. Sears makes these products and services available to its customers through a wide network of multiple channels, including 2,300 Sears-branded and affiliated stores in the United States and Canada, a product repair services network with over 10,000 technicians, leading Internet sites including sears.com, sears.ca and landsend.com and direct to customer catalog programs. The Sears Canada segment includes retail, credit and corporate operations conducted by Sears Canada, a 54.3%-owned subsidiary.

For additional information on Sears, see "Where You Can Find More Information" on page 145.

Sears Holdings Corporation

c/o Kmart Holding Corporation
3100 West Big Beaver Road
Troy, Michigan 48084
(248) 463-1000

Sears Holdings Corporation is a newly incorporated Delaware corporation that is currently a wholly-owned subsidiary of Kmart. Upon consummation of the proposed mergers, Holdings will become the holding company of Kmart and Sears, which will essentially continue to operate separately under their respective brand names, although Holdings intends to convert certain Kmart stores to Sears stores and cross-sell Kmart and Sears products in each other's stores. Holdings does not expect to pay dividends in the foreseeable future. After the mergers, Holdings' headquarters will be in Hoffman Estates, Illinois.

Kmart and Sears stockholders who receive Holdings common stock in the mergers will become Holdings stockholders and their rights as stockholders will be governed by the restated certificate of incorporation and restated by-laws of Holdings and Delaware laws. The restated certificate of incorporation and restated by-laws of Holdings upon the completion of the mergers will be in substantially the form set forth in Annex F and Annex G to this joint proxy statement-prospectus, respectively. For information on certain differences between the restated certificate of incorporation and restated by-laws of Holdings and Delaware laws and the certificates of incorporation and by-laws of Kmart and Sears and New York laws, see "Comparison of Stockholder Rights" beginning on page 122.

Holdings has not, to date, conducted any material activities other than those incident to its formation and the matters contemplated by the merger agreement, including the formation of each of Kmart Acquisition Corp. and Sears Acquisition Corp. as wholly-owned subsidiaries, and the preparation of this joint proxy statement-prospectus and the registration statement of which it forms a part.

THE SPECIAL MEETINGS

Joint Proxy Statement-Prospectus

This joint proxy statement-prospectus is being furnished to you in connection with the solicitation of proxies by each of our boards of directors in connection with our respective special meetings of stockholders.

This joint proxy statement-prospectus is first being furnished to Kmart and Sears stockholders on or about , 2005.

Date, Time and Place of the Special Meetings

The special meetings are scheduled to be held as follows:

For Kmart stockholders:	For Sears stockholders:
, 2005	, 2005
, time	, time

Purpose of the Special Meetings

Kmart. At the Kmart special meeting, Kmart's stockholders will be asked to consider and vote upon proposals to adopt the merger agreement, to approve the exclusion of certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings, and to approve the grant of restricted shares and options to Aylwin B. Lewis, and to transact such other business as may properly come before the special meeting or any adjournment or postponement thereof.

Sears. At the Sears special meeting, Sears' stockholders will be asked to consider and vote upon a proposal to adopt the merger agreement and to transact such other business as may properly come before the special meeting or any adjournment or postponement thereof.

Record Date for the Special Meetings

The boards of directors of each of Kmart and Sears have fixed the close of business on January 26, 2005 as the record date for determination of stockholders entitled to notice of and to vote at our respective special meetings of stockholders.

On the record date, there were 88,642,225 shares of Kmart common stock outstanding and entitled to vote at the Kmart special meeting, held by approximately 2,295 holders of record. Shares that are held in Kmart's treasury are not entitled to vote at the Kmart special meeting.

On the record date, there were 216,931,636 shares of Sears common stock outstanding and entitled to vote at the Sears special meeting, held by approximately 141,332 holders of record. Shares that are held in Sears' treasury are not entitled to vote at the Sears special meeting.

Votes Required

Kmart. A majority of the outstanding shares of Kmart common stock must be represented, either in person or by proxy, to constitute a quorum at the Kmart special meeting. The affirmative vote of holders of a majority of the shares of Kmart common stock outstanding on the record date is required to adopt the merger agreement. The affirmative vote of a majority of the shares of Kmart common stock represented at the special meeting and entitled to vote is required to approve each proposal to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings and to approve the grants of restricted shares and options to Mr. Lewis. At the Kmart special meeting, each holder of Kmart common stock is entitled to one vote for each share of Kmart common stock held as of the Kmart record date on all matters properly submitted to the Kmart stockholders.

Completion of the mergers is conditioned on approval of each proposal to exclude certain bankruptcy-related provisions from the certificate of incorporation of Holdings. As a result, a vote against either of such proposals effectively will be a vote against adoption of the merger agreement. However, Kmart and Sears may at any time determine by mutual agreement to waive this condition.

As of the record date, Kmart directors and executive officers and their affiliates (other than the ESL Companies and Edward S. Lampert, the Chairman of Kmart), owned and were entitled to vote approximately 1,200,275 shares of Kmart common stock, representing approximately 1.4% of the outstanding shares of Kmart common stock. We expect that the officers and directors of Kmart will vote their shares of Kmart common stock in favor of adopting the merger agreement, in favor of each proposal to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings and in favor of granting the restricted shares and options to Mr. Lewis, although none of them (other than Mr. Lampert with respect to adoption of the merger agreement and approval of the exclusion of certain bankruptcy-related charter provisions) has entered into any agreement obligating them to do so.

Pursuant to a support agreement, the ESL Companies have agreed to vote their shares of Kmart common stock in favor of the adoption of the merger agreement. As of the record date, the ESL Companies beneficially owned approximately 53% of the outstanding shares of Kmart common stock, which then consisted of approximately 42.0 million shares of Kmart common stock, options to acquire approximately 6.5 million shares of Kmart common stock and notes convertible into approximately 6.3 million shares of Kmart common stock (although since the Kmart record date, all of these convertible notes have been converted into such number of shares of Kmart common stock). This beneficial ownership represents the power to vote approximately 47% of the outstanding shares of Kmart common stock (without giving effect to the exercise of such options and conversion of such convertible notes). The ESL Companies have acknowledged that, as a part of their obligation to vote in favor of the adoption of the merger agreement, they are obligated by the support agreement to vote in favor of the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings. Accordingly, the adoption of the merger agreement and the approval of the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings by the Kmart stockholders are practically assured. Further information concerning the support agreement can be found under "The Mergers The Support Agreement" on page 105.

The support agreement does not require the ESL Companies to vote in favor of approving the grants of restricted shares and options to Mr. Lewis, although it is expected that they will do so. Accordingly, the approval of these equity grants to Mr. Lewis is practically assured.

Sears. The holders of record of one-third of the total number of outstanding shares of Sears common stock entitled to vote must be represented, either in person or by proxy, to constitute a

quorum at the Sears special meeting. The affirmative vote of at least two-thirds of the shares of Sears common stock outstanding on the record date is required to adopt the merger agreement. At the Sears special meeting, each holder of Sears common stock is entitled to one vote for each share of Sears common stock held as of the Sears record date on all matters properly submitted to the Sears stockholders.

As of the record date, Sears directors and executive officers and their affiliates owned and were entitled to vote approximately 545,081 shares of Sears common stock, representing less than 1% of the outstanding shares of Sears common stock. We expect that the officers and directors of Sears will vote their shares of Sears common stock in favor of adopting the merger agreement, although none of them has entered into any agreement obligating them to do so.

Pursuant to a support agreement, the ESL Companies have agreed to vote their shares of Sears common stock in favor of adopting the merger agreement. As of the record date, the ESL Companies beneficially owned approximately 14% of the outstanding shares of Sears common stock, consisting of approximately 31.1 million shares of Sears common stock. This beneficial ownership represents the power to vote approximately 14% of the outstanding shares of Sears common stock. Further information concerning the support agreement can be found under "The Mergers The Support Agreement" on page 105.

Adjournment or Postponement

The Kmart special meeting or the Sears special meeting may be adjourned or postponed, by their respective chairmen and other authorized persons, in order to permit further solicitation of proxies. However, no proxy that is voted against a proposal described in this joint proxy statement-prospectus will be voted in favor of an adjournment.

Proxies

All shares of Kmart common stock and Sears common stock represented by properly executed proxies or voting instructions (including those given through electronic voting through the Internet or by telephone) received before or at the applicable special meeting prior to the closing of the polls will, unless revoked, be voted in accordance with the instructions indicated on those proxies or voting instructions. If no instructions are indicated on a properly executed proxy card, the shares will be voted FOR adoption of the merger agreement. If you are a Kmart stockholder and you respond without voting instructions on the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings, your proxy will be voted FOR the approval of the exclusion of the bankruptcy-related charter provisions. If you are a Kmart stockholder and you respond without voting instructions on the grant of restricted shares and options to Aylwin B. Lewis, your proxy will be voted FOR the approval of the grant. If you return a properly executed proxy card or voting instruction card and have indicated that you have abstained from voting, your Kmart common stock or Sears common stock represented by the proxy will be considered present at the applicable special meeting for purposes of determining a quorum, but will have the same effect as a vote against adopting the merger agreement. If you are a Kmart stockholder and you abstain from voting on the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings or the proposal to grant restricted shares and options to Mr. Lewis, your proxy will be counted as present for the purposes of establishing a quorum, and the abstention will have the same effect as a vote against the relevant proposal. We urge you to mark each applicable box on the proxy card or voting instruction card to indicate how to vote your shares.

If your shares are held in an account at a broker or bank, or through the Sears ASPP, you must instruct the broker, bank or plan administrator on how to vote your shares. If an executed proxy card

returned by a broker, bank or plan administrator holding shares indicates that the broker, bank or plan administrator does not have discretionary authority to vote on a particular matter, the shares will be considered present at the meeting for purposes of determining the presence of a quorum, but will have the same effect as a vote against adopting the merger agreement. This is called a broker non-vote. Your broker, bank or plan administrator will vote your shares over which it does not have discretionary authority only if you provide instructions on how to vote by following the instructions provided to you by your broker, bank or plan administrator. If you hold shares through any Sears Plan, your shares in the plan may be voted even if you do not instruct the trustee how to vote, as explained in your voting instructions.

Because the adoption of the merger agreement requires the affirmative vote of a majority of the outstanding shares of Kmart common stock and two-thirds of the outstanding shares of Sears common stock, abstentions, failures to vote and broker non-votes will have the same effect as votes against adopting the merger agreement. Because the approval of each proposal to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings and the approval of the grants of restricted shares and options to Mr. Lewis require the affirmative vote of a majority of the shares of Kmart common stock represented at the special meeting and entitled to vote, abstentions will have the same effect as a vote against the relevant proposal and failures to vote and broker non-votes will have no effect on the outcome of the proposals to exclude certain bankruptcy-related provisions from the restated certificate of incorporation of Holdings or the proposal to approve the grant of restricted shares and options to Mr. Lewis.

Neither Kmart nor Sears expects that any matter other than the proposal to adopt the merger agreement and, for Kmart stockholders only, the proposals to exclude certain bankruptcy-related provisions that currently exist in the certificate of incorporation of Kmart from the restated certificate of incorporation of Holdings and the proposal to approve the grant of restricted shares and options to Mr. Lewis will be brought before its special meeting. If, however, other matters are properly presented, the persons named as proxies will vote in accordance with their judgment with respect to those matters, unless you withhold authority to do so on the proxy card or voting instruction card.

The persons named as proxies may vote for one or more adjournments of the Kmart or Sears special meeting, as the case may be, to permit further solicitations in favor of the proposals to be considered at those meetings. However, no proxy that is voted against a proposal described in this joint proxy statement-prospectus will be voted in favor of an adjournment.

You may revoke your proxy at any time before it is voted by:

- filing a written notice of revocation with the Secretary, Kmart Holding Corporation, 3100 West Big Beaver Road, Troy, Michigan 48084, if you are a Kmart stockholder;

- filing a written notice of revocation with the Secretary, Sears, Roebuck and Co., 3333 Beverly Road, Hoffman Estates, Chicago, Illinois 60179, if you are a Sears stockholder;

- delivering a subsequently dated proxy; or

- appearing in person and voting at your special meeting if you are a holder of record.

Attendance at a special meeting will not in and of itself constitute revocation of a proxy. If a special meeting is postponed or adjourned, it will not affect the ability of stockholders of record as of the record date to exercise their voting rights or to revoke any previously-granted proxy using the methods described above.

Voting Electronically or by Telephone

Because Delaware and New York, the states in which Kmart and Sears, respectively, are incorporated, both permit electronic submission of proxies through the Internet or by telephone, instead of submitting proxies by mail on the enclosed proxy card or voting instruction card, stockholders of record and many stockholders who hold their shares through a broker or bank will have the option to submit their proxies or voting instructions electronically through the Internet or by telephone. Please note that there are separate arrangements for using the Internet and telephone depending on whether your shares are registered in your company's stock records in your name or in the name of a broker, bank or other holder of record. If you hold your shares through a broker, bank or other holder of record, you should check your proxy card or voting instruction card forwarded by your broker, bank or other holder of record to see which options are available.

Stockholders of record of Kmart common stock at the close of business on January 26, 2005, the Kmart record date, may submit their proxies:

through the Internet by visiting a website established for that purpose at *http://www.eproxyvote.com/kmrt* and following the instructions; or

by telephone by calling the toll-free number (877)-PRX-VOTE (1-877-779-8683) in the United States, Puerto Rico or Canada on a touch-tone phone and following the recorded instructions; stockholders calling from another country may call (201) 536-8073.

Stockholders of record of Sears common stock at the close of business on January 26, 2005, the Sears record date, may submit their proxies:

through the Internet by visiting a website established for that purpose at *http://www.proxyvote.com* and following the instructions; or

by telephone by calling the toll-free number (800) 690-6903 in the United States, Puerto Rico or Canada on a touch-tone phone and following the recorded instructions.

In order to vote via the telephone or the Internet, please have in front of you either your proxy card, or if you have consented to receive your materials electronically, your e-mail notification advising that materials are available on-line. A phone number and an Internet website address are contained on each of the documents. Upon entering either the phone number or the Internet website address, you will be instructed on how to proceed.

Solicitation of Proxies

Kmart and Sears will share equally the expenses incurred in connection with the printing and mailing of this joint proxy statement-prospectus. To assist in the solicitation of proxies, Kmart has retained Innisfree M&A Incorporated for a fee not to exceed $20,000 plus reimbursement of expenses. Sears has retained D.F. King & Co., Inc., for a fee not to exceed $20,000 plus reimbursement of expenses, to assist in the solicitation of proxies. Kmart, Sears and their respective proxy solicitors will also request banks, brokers and other intermediaries holding shares of Kmart or Sears common stock beneficially owned by others to send this joint proxy statement-prospectus to, and obtain proxies from, the beneficial owners and will, if requested, reimburse the record holders for their reasonable out-of-pocket expenses in so doing. Solicitation of proxies by mail may be supplemented by telephone and other electronic means, advertisements and personal solicitation by the directors, officers or employees of Kmart and Sears. No additional compensation will be paid to our directors, officers or employees for solicitation.

Voting and Elections by Participants in the Sears ASPP and Sears Plans

Participants in the Sears Associate Stock Purchase Plan, which we refer to as the "Sears ASPP," and in the Sears 401(k) savings plan, the Sears Puerto Rico savings plan, or the Lands' End Inc. retirement plan, which we collectively refer to as the "Sears Plans," will generally be able to direct how they want both the vested and non-vested Sears shares allocated to their accounts as of the record date to be voted and whether they want to elect cash consideration or share consideration to be allocated to their accounts in exchange for each Sears share in their accounts as of the closing date. All voting instructions submitted by Sears ASPP and Sears Plan participants are confidential and will not be disclosed to Sears' management. After the voting instructions with respect to the Sears Plans are tabulated, the results will be given to an independent investment manager (who has been specially retained in connection with the mergers and is a fiduciary to the Sears Plans) who will, in turn, to the extent not inconsistent with ERISA, direct the trustee as to how to vote on the adoption of the merger agreement and what form of merger consideration to elect. Your instructions on how to vote on the adoption of the merger agreement and to elect the merger consideration will be subject, in the case of all Sears Plans, to the plan trustee's or independent investment manager's (or other applicable fiduciary's) fiduciary duties under ERISA. If you are a participant in the Sears ASPP or in any of the Sears Plans, please follow the instructions that you receive for voting and elections with respect to the shares allocated to your account.

Participants in the Sears ASPP or in any Sears Plan will be able to direct their shares to be voted at the special meeting in one of three ways: vote for adoption of the merger agreement, vote against adoption of the merger agreement or abstain from voting on adoption of the merger agreement. Please note that the independent investment manager will take the following steps with respect to shares in a Sears Plan account, subject to its fiduciary duties under ERISA:

- If you fail to properly provide any instructions as to how you want the shares allocated to your plan account to be voted, your plan shares will be voted ratably for and against the adoption of the merger agreement, in the same proportion as for those plan shares for which specific directions have been received.

- If you return a properly signed voting instruction form but do not specifically indicate how you want your shares to be voted on the adoption of the merger agreement, your plan shares will be voted FOR the adoption of the merger agreement.

- If you indicate you wish to abstain, your shares will not be voted, which will have the same effect as a vote AGAINST the adoption of the merger agreement.

You will be separately provided with an opportunity to elect whether, if the Sears merger is completed, you wish to request either $50.00 in cash or 0.5 of a share of Holdings common stock as consideration for each Sears share allocated to your account, subject to the proration procedures described in this joint proxy statement-prospectus and applicable to all Sears stockholders. You will be provided with separate instructions on how to make such an election.

This will be the only opportunity you will have to choose the form of consideration to be requested in exchange for your plan shares. Accordingly, please note that, if participants in a Sears Plan do not properly provide instructions as to the type of consideration they request for their plan shares, cash and stock will be elected for their plan shares ratably in the same proportion as for those plan shares for which properly completed elections were received. If proper instructions as to the type of consideration participants in the Sears ASPP want are not provided by those participants, their shares will be exchanged for the same cash consideration and/or share consideration received by other holders of Sears shares who fail to provide an election.

KMART PROPOSAL 1 AND SEARS PROPOSAL 1: THE MERGERS

This section of the joint proxy statement-prospectus describes material aspects of the proposed mergers, including the merger agreement. This summary may not contain all of the information that is important to you. You should carefully read this entire joint proxy statement-prospectus, including the full text of the merger agreement, which is attached as Annex A, and the other documents we refer you to for a more complete understanding of the mergers. In addition, we incorporate important business and financial information about each of us into this joint proxy statement-prospectus by reference. You may obtain the information incorporated by reference into this joint proxy statement-prospectus without charge by following the instructions in the section entitled "Where You Can Find More Information" which begins on page 145.

Effect of the Kmart Merger; What You Will Receive in the Kmart Merger

Upon completion of the Kmart merger, Kmart Acquisition Corp., a wholly-owned subsidiary of Holdings newly organized to effect the Kmart merger, will merge with and into Kmart. Kmart will be the surviving corporation in the Kmart merger and will thereby become a wholly-owned subsidiary of Holdings.

In the Kmart merger, each outstanding share of Kmart common stock (other than shares owned by Kmart or Kmart Acquisition Corp.) will be converted into one share of Holdings common stock. The exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the date of the Kmart merger. Each share of Kmart common stock owned by Kmart or Kmart Acquisition Corp. will be cancelled without consideration. Each share of Kmart common stock owned by Sears or any direct or indirect wholly-owned subsidiary of Sears or Kmart will be converted into the right to receive shares of Holdings common stock at the same exchange ratio.

All outstanding Kmart stock options will be converted into options to purchase an equivalent number of shares of Holdings common stock, subject to the same terms and conditions. All restricted shares of Kmart common stock will be exchanged for restricted shares of Holdings common stock at the same exchange ratio applicable to Kmart common stock pursuant to the Kmart merger, subject to the same terms and conditions.

The rights pertaining to Holdings common stock will be the same in all material respects as the rights pertaining to Kmart common stock, because the restated certificate of incorporation and restated by-laws of Holdings in effect immediately after the completion of the mergers will be substantially similar to the current certificate of incorporation and by-laws of Kmart. The rights pertaining to Holdings common stock and Holdings' restated certificate of incorporation and restated by-laws are described under "Description of Holdings Capital Stock Common Stock" on page 121 and "Comparison of Stockholder Rights" on page 122.

Effect of the Sears Merger; What You Will Receive in the Sears Merger

Upon completion of the Sears merger, Sears Acquisition Corp., a wholly-owned subsidiary of Holdings newly organized to effect the Sears merger, will merge with and into Sears. Sears will be the surviving corporation in the Sears merger and will thereby become a wholly-owned subsidiary of Holdings.

In the Sears merger, each outstanding share of Sears common stock (other than restricted shares, dissenting shares and shares owned by Sears, Sears Acquisition Corp., Kmart or any wholly-owned subsidiary of Kmart or Sears) will be converted into the right to receive, at the holder's election, $50.00 in cash per share or 0.5 of a share of Holdings common stock per share, subject to proration. Sears stockholder elections will be subject to proration to ensure that 55% of Sears shares will be exchanged for Holdings shares and 45% of these shares will be exchanged for cash. The exchange ratio and the per share amount of cash to be paid are fixed and will not be adjusted to reflect stock price changes

prior to the date of the Sears merger. Each share of Sears common stock owned by Sears and Sears Acquisition Corp. will be cancelled without consideration. Each share of Sears common stock owned by Kmart or any direct or indirect wholly-owned subsidiary of Sears or Kmart will be converted into the right to receive 0.5 of a share of Holdings common stock. The conversion of these shares is not subject to proration, and these shares will not be taken into consideration when determining the proration calculations.

All outstanding Sears stock options will be exchanged for the right to receive cash in an amount equal to the number of shares of Sears common stock subject to such option times the excess, if any, of the sum of (1) the product of 45% multiplied by $50.00 per share and (2) the product of 55% multiplied by the value of 0.5 of a share of Holdings common stock (based on the closing price of a share of Kmart common stock on the last trading day immediately preceding the effective time of the mergers) over the exercise price of such options.

Upon adoption of the merger agreement by Sears stockholders, a pro rata portion of shares of Sears common stock owned by Sears employees that are currently subject to restrictions and were granted at least six months prior to such adoption will become free of restrictions. As a result, as of the time of the completion of the mergers, these shares will be no different than any other shares of Sears common stock and the holder can make an election with respect to these shares. The restricted shares of Sears stock that do not vest and do not become free of restrictions will be converted into 0.5 of a share of Holdings common stock in the mergers and will continue to be subject to the same restrictions. The exchange of these restricted shares is not subject to proration, and these restricted shares will not be taken into consideration when determining the proration calculations. See "Treatment of Stock Options and Restricted Shares" on page 89.

The rights pertaining to Holdings common stock will be different from the rights pertaining to Sears common stock, because the restated certificate of incorporation and restated by-laws of Holdings in effect immediately after the mergers are completed will be different from those of Sears and because Holdings is a Delaware and not a New York corporation. A further description of the rights pertaining to Holdings common stock and Holdings' restated certificate of incorporation and restated by-laws which will be in effect immediately after the mergers are completed is further described under "Description of Holdings Capital Stock Common Stock" on page 121 and "Comparison of Stockholder Rights" beginning on page 122.

Background of the Mergers

Over the last few years, Sears and Kmart has each independently explored, developed, pursued and implemented a wide range of strategies, as more fully described below, designed to enhance stockholder value.

In January 2002, the predecessor of Kmart filed voluntary petitions for reorganization under Chapter 11 of the federal bankruptcy laws. After Kmart's filing, the ESL Companies accumulated a significant ownership of various pre-petition obligations, joined the Financial Institutions Committee, and made a substantial additional investment in Kmart prior to its emergence from bankruptcy. In connection with the ESL Companies' investment in Kmart and exchange of pre-petition claims, the ESL Companies acquired beneficial ownership of a majority of Kmart's outstanding common stock. The ESL Companies also gained representation on the Kmart board, including Edward S. Lampert's designation as Chairman. The ESL Companies (other than ESL Investment Management, L.L.C.) are controlled, directly or indirectly, by ESL Investments, Inc., which is in turn controlled by Mr. Lampert. Mr. Lampert directly controls ESL Investment Management, L.L.C.

Upon Kmart's emergence from bankruptcy in May 2003, the board of directors of Kmart focused on establishing Kmart's financial strength. The new senior management team sought to generate profitable sales, control costs, streamline overhead and increase asset productivity and customer service.

Kmart also focused on improving the customer store experience by providing quality products at attractive pricing and enhancing its service culture. In that connection, Kmart focused on improving its product offerings by offering better quality products.

Kmart has continued to seek ways to improve its product offering in order to differentiate Kmart from its mass market retail competitors. The mergers represent an extension and acceleration of that strategy.

The board of directors and management of Sears has continually monitored and reviewed Sears' position in light of the changing competitive environment for domestic multi-line retailers, with the objective of determining what alternatives may be available to further enhance value for Sears stockholders. In recent years, the board of directors and management of Sears have continued to explore options designed to improve Sears' competitive position and to increase stockholder value, especially in light of the increasing competitive power of discount, "big-box" and specialty retailers.

In particular, Sears has undertaken a number of steps to refocus on and to improve the performance of its core business, its full-line stores. These steps include:

- an initiative to add off-mall stores in locations closer to where consumers live, generally in urban and dense suburban areas, including through the Sears Grand concept, the first of which opened in 2003 and three more of which have opened to date, and the acquisition of six stores from Wal-Mart Stores, Inc. and 50 stores from Kmart as described below;

- operational initiatives aimed at improving efficiency and effectiveness, such as changes to store operations, supply chain and support activities;

- significant merchandise edits of non-core assortments;

- the June 2002 acquisition of Lands' End, Inc., subsequent roll-out of Lands' End branded merchandise to all full-line Sears stores and the introduction of new proprietary apparel brands such as Covington, Apostrophe, A/Line and Structure;

- substantial improvements of merchandise assortments and the customer shopping experience in key businesses, such as home appliances, electronics, kids apparel and home fashions; and

- the November 2003 sales of Sears' credit and financial products business and National Tire and Battery business.

The ESL Companies first became stockholders of Sears in October 2000 and have been significant stockholders of Sears since 2002 (prior to the time that the ESL Companies invested in Kmart). During the time that the ESL Companies have been significant stockholders of Sears, the ESL Companies have monitored their investment in Sears, including periodic discussions with the management of Sears, primarily through Alan J. Lacy, Chairman, Chief Executive Officer and President of Sears, regarding Sears' performance and strategic direction.

At the end of February 2004, Sears, through Mr. Lacy, approached Mr. Lampert of Kmart to explore the possibility of Kmart and Sears engaging in a mutually beneficial transaction. The types of transactions that were eventually discussed as a result of this meeting varied in terms of size and structure, but included, among others, real estate transactions, working towards entering into licensing agreements with respect to proprietary products, such as Sears' Craftsman tools and Kenmore home appliances, and a potential business combination. In connection with these discussions, on March 16, 2004, Sears entered into a confidentiality agreement with Kmart, pursuant to which Sears agreed to use any confidential information provided to it by Kmart only in connection with its consideration of a possible transaction and to keep all such information confidential. Kmart subsequently provided Sears with various confidential information concerning its business, financial condition and results of operations under the terms of this confidentiality agreement. The confidentiality agreement was

subsequently amended on June 29, 2004 in connection with the 50 store real estate transaction described below.

These discussions continued intermittently throughout the spring of 2004 and related to various aspects of the variety of transactions described above. In particular, with regard to potential real estate transactions, the discussions related to, among other things, the number and location of stores to be purchased, the price to be paid for the stores, the timetables for completing the purchases, the condition and financial performance of the stores to be purchased and similar matters. The discussions regarding working toward entering into licensing agreements related solely to the brands that Kmart wished to license and did not include any discussion of proposed terms. The discussions relating to the potential business combination were exploratory in nature, did not give rise to any understandings as to price and structure and proposals with respect to financial terms were not made by either side. Mr. Lacy regularly apprised the Sears board of directors on the status of these discussions.

Ultimately, the parties' discussions resulted in a transaction announced on June 30, 2004 in which Sears agreed to purchase from Kmart up to 54 stores for a maximum total purchase price of $621 million. The transaction was designed to further Sears' strategy of increasing the number of off-mall full-line stores and to strengthen Kmart's balance sheet and increase its liquidity. At the time, both Sears and Kmart recognized that there could be additional benefits realized by both parties from a continued strategy of repositioning certain Kmart stores to the Sears brand. The parties determined to remain in contact. Messrs. Lampert and Lacy agreed to meet again after the transaction was completed. This transaction was closed on September 27, 2004, at which time Sears purchased 50 stores. Despite the closing of the transaction, Sears did not immediately take possession of each store, which will continue to be operated by Kmart until Sears takes possession of each store, the last of which is expected to be on or before April 2005. At the closing, Sears paid Kmart $172 million, of the total purchase price of $575.9 million, in net cash consideration with the remainder to be paid when Sears takes possession of the stores. Sears and Kmart intend to complete these transactions whether or not the mergers take place. If, however, the mergers take place before these transactions, these transactions will not have any effect on the consolidated financial position of Holdings, as each of Kmart and Sears will be subsidiaries of Holdings.

On October 11, 2004, a regular meeting of the Kmart board of directors was held. At this meeting, the board elected Mr. Lewis as Kmart's Chief Executive Officer and President and also discussed Mr. Lewis' incentive compensation arrangements, including the grant of 50,781 restricted shares of Kmart common stock (which restricted shares had a value of $4.5 million on October 18, 2004, the date of the grant). This grant was made in connection with Mr. Lewis' election as Kmart's Chief Executive Officer and President, not in connection with the proposed combination with Sears.

On October 21, 2004, Sears announced its results of operations for the quarter ended October 2, 2004. After Sears' announcement, a meeting between Kmart and Sears, to be attended by Messrs. Lampert and Lacy, was scheduled to discuss progress at Kmart and Sears since the two men last spoke, as well as potential opportunities for the two companies together. Mr. Lacy apprised his board of directors of the prospective meeting.

On October 31, 2004, Messrs. Lampert and Lacy met and discussed the competitive dynamics affecting the domestic multi-line retail industry, results of their respective businesses and other topics of mutual interest to Kmart and Sears. Mr. Lampert on behalf of Kmart then explored with Mr. Lacy the possibility of a business combination whereby Kmart and Sears would be combined in a transaction in which Sears common stock would be exchanged for Kmart common stock having a value of $45 0.50 of a Kmart share at the time. At the time, this valuation implied a premium of approximately 29% over the last trading day's closing price of Sears common stock. Although Mr. Lampert initially proposed that the consideration in the transaction be all stock, Mr. Lacy indicated that Sears would prefer that a

substantial portion be, at the election of Sears stockholders, in an equivalent amount per share in cash to provide a measure of value assurance for Sears stockholders.

Messrs. Lampert and Lacy also discussed in detail the business rationale for combining the two companies, including the acceleration of Sears' off-mall growth strategy, potential for significant cost-savings and other synergies that could result from a business combination, and expansion of both companies' brand portfolio. They also discussed a number of other issues that would have to be agreed in the context of a business combination, including the structure of the transaction, the consideration to be paid to Sears stockholders (including the maximum percentages of consideration that could be paid in cash and in stock) and the potential composition of the resulting board of directors and management. Messrs. Lampert and Lacy each agreed that, subject to reaching agreement on financial terms and completion of successful due diligence investigations of each other, such a business combination could be a means by which to achieve value for both Kmart and Sears stockholders and decided to speak further after having consulted with their respective boards of directors.

Following this meeting, on November 1, 2004, Mr. Lacy called a special meeting of the Sears board of directors and briefed the board on the substance of the discussions between Kmart and Sears, including his meeting with Mr. Lampert. The Sears board of directors indicated to Mr. Lacy its support for exploring a potential business combination with Kmart. Based on the Sears board's support, Mr. Lacy and the Sears management assembled a team of advisors in connection with consideration of the potential business combination. The Sears board was also supportive of Mr. Lacy having further discussions with Mr. Lampert, with the goals of developing a common understanding of the strategic rationale for the potential transaction and how the new company would be operated and attaining a greater understanding of Kmart's business and strategy. Subsequently, Sears retained Morgan Stanley & Co., Incorporated as its financial advisor as of October 29, 2004 and Wachtell, Lipton, Rosen & Katz as its legal counsel.

During the week of November 1, 2004, members of senior management of Sears and Kmart, including Messrs. Lampert and Lacy, as well as William C. Crowley, Senior Vice President, Finance and a director of Kmart, and Glenn R. Richter, Executive Vice President and Chief Financial Officer of Sears, and others, and representatives of Morgan Stanley had further discussions concerning the strategic rationale for, and the process necessary to implement, the potential business combination. During this period, representatives from Kmart contacted the law firm of Simpson Thacher & Bartlett LLP, which was subsequently engaged, to assist Kmart with respect to legal matters related to a possible business combination transaction.

On November 5, 2004, Vornado Realty Trust announced that it had acquired an approximately 4.3% economic interest in Sears. This announcement caused the price of Sears common stock to rise approximately 21% over the last trading day's closing price, to $45.88 per share at the close of trading on November 5. Following this announcement, the managements of Kmart and Sears had a number of discussions concerning the impact of this announcement on the potential business combination. These discussions were primarily concerned with the trading prices and volatility of Sears and Kmart common stock, the effect of Vornado's announcement on Sears common stock and that of other retailers, and the resulting effect on the consideration to be paid in the mergers. In addition, as a result of Vornado's announcement and other concerns including maintaining confidentiality of the discussions, Sears and Kmart decided to accelerate the timeframe for implementing the proposed business combination to minimize the period during which speculation or additional price volatility could impair the parties' ability to reach an agreement on financial terms.

On November 8, 2004, a special meeting of the Sears board of directors was held. At this special meeting, Messrs. Lacy and Richter and other members of Sears management updated the board of directors on the status of the negotiations with Kmart and reviewed and discussed strategic considerations related to, and the potential merits of, the business combination being considered,

including those described above. In addition, Morgan Stanley discussed with the Sears board of directors various valuation issues regarding Sears and Kmart and a potential transaction.

The Sears board of directors and management determined that the potential business combination had strategic value and believed that stockholder value could be enhanced as a result of such a business combination. As a result, the Sears board of directors indicated its support of management and its advisors continuing to pursue a transaction. The Sears board of directors encouraged management and its advisors to seek to increase the consideration to be paid to Sears stockholders in a potential business combination, while maintaining a significant cash component in the business combination that could be elected by Sears stockholders so that Sears stockholders would have a level of certainty of value in the event the trading price of Kmart common stock were to decrease. The Sears board of directors also directed management and its advisors to continue the analysis of the value that could be created through alternative transactions, such as a leveraged buyout, a leveraged recapitalization or other restructuring alternatives including acquisitions or divestitures, and to use this data in seeking to have Kmart increase the financial consideration offered to Sears stockholders.

On November 9, 2004, Mr. Crowley and representatives of Morgan Stanley briefly discussed the process of implementing the proposed business combination, as well as the financial terms of the proposed business combination, including the consideration and the maximum percentages of consideration that could be paid in cash and in stock.

Also on November 9, 2004, a special meeting of the board of directors of Kmart was held to inform the board concerning the discussions between Kmart and Sears and to determine whether to continue the process. Simpson Thacher & Bartlett LLP reviewed the fiduciary duties of directors in connection with a potential business combination transaction. Mr. Lampert, as Chairman of Kmart, reviewed the background discussions with Sears, the terms that had been discussed and timing considerations related to a potential transaction. He also addressed the strategic rationale for a transaction in light of Kmart's strategy, business and prospects. At the conclusion of this meeting, the Kmart board decided that it was in the best interests of the Kmart stockholders to continue the process and engage a financial advisor.

On November 10, 2004, certain members of the respective management teams of Sears and Kmart met, including Messrs. Lampert, Lacy, Crowley and Richter as well as representatives of Morgan Stanley. At these meetings, Mr. Lacy told Mr. Lampert of the need to increase both the consideration and the maximum percentage of consideration that could be paid in cash. Messrs. Lampert and Lacy ultimately deferred further discussion relating to the consideration to be paid Sears stockholders pending further diligence. The other members of Kmart and Sears management and representatives of Morgan Stanley discussed the possible structure of the business combination and the steps that would have to be undertaken to fully explore the business combination, including mutual due diligence investigations. Sears and Kmart also discussed the tax and other benefits of structuring the business combination as a "top-hat" transaction, whereby both Kmart and Sears would become subsidiaries of a newly-formed holding company as contemplated by the mergers described in this joint proxy statement-prospectus. The parties also continued to discuss the business rationale for the mergers, including the potential for significant revenue growth, cost-savings and other synergies from the mergers, as well as the terms of the mergers.

Also on November 10, 2004, Kmart and Sears executed a confidentiality agreement, substantially in the form of that executed by Kmart and Sears in March 2004, pursuant to which Kmart agreed to use any confidential information provided to it by Sears only in connection with its consideration of a possible transaction and to keep all such information confidential.

On November 11 and 12, 2004, the parties continued to have discussions concerning the proposed mergers and began exchanging due diligence information regarding each company's businesses, strategies, structure and management team, and the parties' financial and legal advisors commenced

discussions regarding the drafting of the legal documentation of the mergers. Also on November 11, Kmart agreed to retain Lehman Brothers Inc. as its financial advisor in connection with the mergers.

In the morning of November 13, 2004, Messrs. Lampert and Lacy again met. At this meeting, they agreed to discuss with their respective boards that, subject to reaching agreement on the financial terms of the mergers and successful completion of the mutual due diligence investigations:

- the name of the newly-formed holding company would be Sears Holdings Corporation;
- the headquarters of Holdings would be located in Hoffman Estates, Illinois;
- Mr. Lacy would be the Vice Chairman and Chief Executive Officer of Holdings;
- Mr. Lewis would be the President of Holdings and Chief Executive Officer of Kmart and Sears Retail;
- there would be an "Office of the Chairman" of Holdings, consisting of Messrs. Lampert, Lacy and Lewis; and
- the board of directors of Holdings would be composed of representatives from both boards (including Messrs. Lampert, Lacy and Lewis) with a significant majority being from the Kmart board.

On November 13 and 14, 2004, representatives of Kmart and Sears, led by Messrs. Crowley and Richter, and including, among others, the following Sears personnel: Steven M. Cook, Vice President and Deputy General Counsel, Michael Coyne, Vice President and Treasurer, James di Stefano, Vice President, Tax, Michael Graham, Vice President and Controller, Matthew T. Myren, Associate General Counsel and William Phelan, Assistant Controller, and the following Kmart personnel: Julian C. Day, director, James E. Defebaugh, then Senior Vice President, Deputy General Counsel, and Chief Compliance Officer, James F. Gooch, Vice President, Controller, Harold W. Lueken, then Senior Vice President, General Counsel and Secretary, Allen R. Ravas, Vice President, Treasurer, Financial Planning & Analysis, and David Whipple, Senior Vice President, Associate Resources, met to undertake mutual confidential due diligence and management discussions and for the negotiation of legal documentation. Kmart and Sears were assisted in these discussions and negotiations by their respective financial and legal advisors, and, in the case of Sears, Deloitte & Touche LLP. Due diligence continued over the next several days, and the parties and their legal counsel continued to negotiate the terms of a definitive merger agreement, a draft of which had been exchanged on November 11, 2004. During the course of November 14, 2004, the parties and their advisors had numerous discussions concerning possible structures for the transaction and pricing terms, including the exchange ratio and the per share cash consideration, the maximum percentages of consideration that could be paid in cash and stock, and whether a collar would be used. In the course of these discussions, the parties noted the significant increase in the prices of both the Kmart and Sears stock subsequent to October 31, 2004, including the significant increase in their respective stock prices following the Vornado announcement. In particular, the parties discussed their beliefs as to the reasons for these increases, the likely trading prices of Sears and Kmart common stock in the future absent further third party developments and how these increases affected each party's views as to the appropriateness of the pricing terms that had previously been discussed. Kmart also noted to Sears that the premium that the offer represented to the Sears share price after the Vornado announcement was not the most relevant comparison to premiums to the unaffected stock price of other companies and that absent the Vornado announcement and speculation regarding Sears, the Sears stock price would likely have been in the same range as it was prior to the announcement. The parties were not able to reach a tentative agreement.

On November 15, 2004, following additional discussions, Messrs. Lacy and Lampert agreed to recommend to their respective boards the financial terms of the mergers, in which each share of Sears common stock would be converted into the right to receive, at the election of the holder, either (1) 0.50 of a share of Holdings common stock or (2) $50 in cash. The stockholder elections would be subject to proration to ensure that 55% of the shares of Sears common stock would be converted into stock and 45% into cash. Mr. Lampert made clear to Mr. Lacy that this was the best and final offer that he was prepared to recommend to the Kmart board. Messrs. Lacy and Lampert also agreed to recommend to their respective boards the ultimate composition of the board of directors of the newly formed holding company consisting of seven members of the current Kmart board of directors (including Messrs. Lampert and Lewis) and three members of the current Sears board of directors (including Mr. Lacy). As part of their negotiations, they also agreed to recommend the termination fee payable by each of the parties as well as the requirement that each party would submit the merger agreement to a vote of its stockholders.

A special meeting of the board of directors of Sears was held later during the day of November 15, 2004, at which Messrs. Lacy and Richter and Sears' advisors updated the board of directors on the status of the negotiations with Kmart, including the tentative financial terms, the status of the legal documentation and the results of the due diligence investigation of Kmart. Final approval for the mergers was not sought, but the Sears board of directors indicated its support for Sears management and its advisors proceeding to resolve all issues necessary to finalize a transaction on the terms that had been discussed, and determined to reconvene on November 16, 2004, to formally consider the mergers.

Negotiation of the terms of the legal documentation for the mergers and the due diligence process, as well as discussions concerning the support agreement with the ESL Companies and the terms of the post-closing employment arrangements with Mr. Lacy, continued during the remainder of the day. Drafts of the support agreement and the employment agreement for Mr. Lacy had been exchanged by the parties' legal counsel during the afternoon of November 15.

At 8:00 a.m. on November 16, 2004, the Kmart board of directors held a regular meeting to consider the proposed mergers, which was also attended by members of Kmart's senior management and Kmart's financial and legal advisors. At this meeting, Kmart's senior management reviewed with the board of directors strategic considerations related to the mergers and the progress and status of the negotiations and apprised the board of directors of the results of the due diligence conducted. They also summarized the proposed employment agreement with Mr. Lacy. In addition, Kmart's legal advisors discussed with the board of directors the legal standards applicable to its decisions with respect to the proposed mergers, presented the results of its legal due diligence, reviewed the legal terms of the proposed definitive merger agreement and the proposed support agreement, and responded to questions from directors. Lehman Brothers presented its financial analysis relating to the proposed mergers, responded to questions and indicated that it was prepared to deliver its opinion that, as of that date and based on and subject to the considerations, assumptions and limitations set forth in its opinion, the consideration to be paid to Sears stockholders pursuant to the mergers was fair, from a financial point of view, to Kmart and, accordingly, its stockholders. During these discussions, the Kmart board discussed the proposed mergers and related agreements, and the risks and benefits of proceeding with the proposed transaction. The Kmart board asked questions of Kmart's senior management, legal counsel and financial advisor. The Kmart board then met in executive session (without Mr. Lewis). The Kmart board discussed various governance and management issues. The Kmart board also discussed the benefits of granting an additional $1 million of restricted shares of Kmart to Mr. Lewis in recognition of the broader managerial responsibilities that Mr. Lewis would assume as a result of the mergers. The Kmart board of directors then met in executive session (without Messrs. Lampert, Crowley and Lewis) to discuss the proposed mergers. Following the executive session of the board, the full Kmart board of directors reconvened and agreed to adjourn until later that evening.

In the afternoon of November 16, 2004, the Sears board of directors held a special meeting to consider the proposed mergers, which was also attended by Mr. Richter and other members of Sears' senior management and Sears' legal counsel and financial advisors. At this meeting, Messrs. Lacy and Richter and other Sears senior management reviewed with the Sears board of directors strategic considerations relating to the mergers and the progress and status of negotiations regarding the terms of the mergers and apprised the board of the results of its due diligence review of Kmart. Morgan Stanley reviewed its financial analyses relating to the proposed mergers, responded to questions posed by directors, and delivered its opinion that, as of that date and based on and subject to the considerations in its opinion, the consideration to be paid pursuant to the merger agreement was fair, from a financial point of view, to holders of Sears common stock (other than the ESL Companies). In addition, Sears' legal counsel discussed with the board of directors the legal standards applicable to its decisions with respect to the proposed mergers, reviewed the legal terms of the proposed definitive merger agreement, the proposed support agreement and the proposed employment agreement with Mr. Lacy, and responded to questions from directors. During these discussions, the Sears board discussed the proposed mergers and related agreements and asked questions of Sears' senior management and Sears' legal counsel and financial advisor. Following further review and discussion among the members of the Sears board of directors, the board of directors voted unanimously to approve the merger agreement and related agreements and resolved to recommend that its stockholders vote to adopt the merger agreement.

At 8:00 p.m. on November 16, 2004, the Kmart board of directors reconvened to review the terms of the merger agreement and to consider whether to approve the proposed mergers. Representatives of Simpson Thacher & Bartlett LLP updated the Kmart board on any final changes in the definitive documentation since its previous review by the Kmart board. Lehman Brothers delivered its oral opinion, which was subsequently confirmed by delivery of a written opinion dated November 16, 2004, that as of that date and based on and subject to the considerations, assumptions and limitations set forth in its opinion, the consideration to be paid to Sears stockholders pursuant to the mergers was fair, from a financial point of view, to Kmart and, accordingly, its stockholders. Following deliberations, the Kmart board of directors, by unanimous vote of all directors, approved the merger agreement and the support agreement, declared advisable the transactions contemplated by the merger agreement and resolved to recommend that Kmart stockholders vote to adopt the merger agreement.

Following approval of each board of directors, proper officers of each of Kmart and Sears executed and delivered the merger agreement. Concurrently, the ESL Companies, Sears and Kmart executed the support agreement, and Mr. Lacy, Sears and Kmart executed Mr. Lacy's employment agreement.

Prior to the opening of trading on the Nasdaq National Market and the New York Stock Exchange on November 17, 2004, Kmart and Sears issued a joint press release announcing the execution of the merger agreement.

Kmart's Reasons for the Kmart Merger; Recommendation of the Kmart Merger by the Kmart Board of Directors

At its meeting on November 16, 2004, the Kmart board of directors consulted with Kmart management and its financial and legal advisors and unanimously determined to approve the merger agreement and recommended that Kmart stockholders vote for adoption of the merger agreement. In reaching its conclusion to approve the Kmart merger and the related transactions and to recommend that the Kmart stockholders adopt the merger agreement, the Kmart board considered the following factors as generally supporting its decision to enter into the merger agreement.

Strategic Considerations. Kmart's board believes that the business combination with Sears will provide a number of significant strategic opportunities and benefits, including the following factors, all of which it viewed as generally supporting its decision to approve the business combination with Sears:

Enhanced Position in Retail Market. The transaction is expected to create the third largest retailer in the United States with $55 billion in annual revenues and would provide a broader retail presence with 3,800 full-line and specialty retail stores in the United States and Canada.

Winning Real Estate Strategy. The combination will significantly expand the points of distribution for Sears' and Kmart's products in key markets, especially in Kmart's urban and high-density suburban locations where Kmart believes the combined companies have competitive advantages relative to other retailers, which advantages include, but are not limited to, Kmart's and Sears' name recognition in these locations and the mix and price point of the merchandise carried in their stores which should be attractive to the potential customer base given the demographics of these locations. The combined companies should be able to rapidly grow in stand-alone stores outside of malls (or off-mall) in locations closer and more convenient to customers, which Kmart believes should result in greater sales. The combined companies should also have the opportunity to sell non-strategic real estate assets and redeploy the proceeds into the business.

Combines Wealth of Leading Proprietary Brands to Further Differentiate Stores from Competition. The business combination with Sears provides the combined companies with additional unique and differentiated products that should enable the combined companies to better differentiate themselves from other mass market retailers. Sears has a strong list of private label brands, which include Craftsman, Kenmore, Lands' End, DieHard, Covington and Apostrophe, which complement Kmart's private label brands, which include Martha Stewart Everyday, Joe Boxer, Jaclyn Smith, Sesame Street, Route 66 and Thalia Sodi.

Strengthened Financial Position. The combined companies should have increased earnings and cash flows with a net cash position as a result of combined retail sales that provide scale and a strong foundation for growth. The combined companies should also be able to negotiate and obtain better terms from vendors.

Generates Significant Synergies. The Kmart board also considered management's view that the combined companies should produce incremental operating income for the full year 2007 of $500 million, consisting of $200 million in operating profit synergies, a substantial portion of which would be derived from increased revenues from converting certain Kmart stores to Sears stores and the remainder from cross-selling Sears and Kmart products in each other's stores, $200 million in purchasing cost reductions as a result of increased purchasing scale in both merchandise and non-merchandise procurement, and $100 million from other cost reductions, particularly with respect to the consolidation of corporate services and headquarters functions. While these synergies reflect management's conservative estimates, the Kmart board recognized there could be no assurance that they would be achieved. While these benefits are expected to be realized by the end of the third year of combined operations, the mergers are expected to be accretive to Kmart in year one, excluding one-time costs. Further, the Kmart board considered management's estimates that the combined companies have preliminarily identified opportunities to achieve an additional $250 million to $750 million of combined operating profit synergies from increased revenues and cost savings. The identified incremental operating profit synergy from increased revenues opportunities (including opportunities from converting Kmart stores to the Sears format and incremental sales in cross-selling brands) range from $100 to $250 million, while the identified incremental cost savings opportunities (including opportunities from lowered merchandise and non-merchandise purchasing costs, improved transportation logistics, network integration, and consolidation of shared services and support) range from $150 to $500 million.

While the conservative estimates have a greater likelihood of achievement, the potential to realize greater synergies represents an additional factor considered by the board.

Creation of Strong Management Team. The Kmart board considered that the combined companies will be able to select the most capable managers from both companies. Kmart's board and management also expects that the combined companies' management will be willing to create a positive and winning culture, to maintain a disciplined investment strategy and to strive for operational excellence.

The Kmart board also considered the corporate governance arrangements established for the transaction, including the board composition and the designation of key senior management, which are designed to promote the continuity of management from each company and smooth integration of the businesses.

The Kmart board also considered the benefits of granting certain equity compensation to Aylwin B. Lewis, in particular the effect of these grants in retaining and incentivizing Mr. Lewis as an executive officer of the combined companies.

Support from Controlling Stockholders. The ESL Companies, as Kmart's controlling stockholders, indicated their approval of the mergers and agreed to enter into the support agreement, which includes their agreement to elect irrevocably to receive Holdings common stock for all of their Sears common stock. In that connection, the Kmart board recognized that the affirmative vote of Kmart stockholders was practically assured.

Other Factors Considered by the Kmart Board. In addition to considering the strategic factors outlined above, the Kmart board considered the following additional factors, all of which it viewed as generally supporting its decision to approve the business combination with Sears:

- historical information concerning Kmart's and Sears' respective businesses, financial performance and condition, operations, management, competitive positions and stock performance, which comparisons generally informed the board's determination as to the relative values of Kmart, Sears and the combined companies;

- the results of the due diligence review of Sears' businesses and operations;

- management's assessment that the proposed business combination was likely to meet certain criteria they deemed necessary for a successful merger strategic fit, acceptable execution risk, and financial benefits to Kmart and Kmart's stockholders;

- the current and prospective competitive environment in which retailers such as Kmart operate;

- the financial analyses and presentations of Kmart's financial advisor and its opinion that the consideration to be paid to the stockholders of Sears in the mergers was fair, from a financial point of view, to Kmart and, accordingly, its stockholders (the written opinion of Lehman Brothers is attached as Annex C to this joint proxy statement-prospectus and discussed in detail under " Opinion of Kmart's Financial Advisor" beginning on page 50);

- the terms and conditions of the merger agreement, including:

  - the fact that the merger agreement is not subject to termination solely as a result of any change in the trading prices of either company's stock between signing of the merger agreement and closing;

  - the limited number and nature of the conditions to Sears' obligation to consummate the mergers and the limited risk of non-satisfaction of such conditions;

  - the restrictions on the ability of the parties to entertain third party acquisition proposals, and the payment of termination fees under certain circumstances; and

- the conclusion of Kmart's board of directors that the $380 million termination fee, and the circumstances when such fee may be payable, were reasonable in light of the benefits of the mergers and commercial practice;

- the nontaxable treatment of the exchange of Kmart common stock for Holdings common stock;

- the determination that an exchange ratio that is fixed and not subject to adjustment is appropriate to reflect the strategic purpose of the mergers and consistent with market practice for mergers of this type and that a fixed exchange ratio avoids fluctuations caused by near-term market volatility; and

- the likelihood that the mergers will be completed on a timely basis, including the likelihood that the mergers will receive all necessary regulatory antitrust approvals without unacceptable conditions.

Kmart's board of directors also considered the potential risks of the mergers and potential conflicts of interest, including the following:

- the challenges of combining the operations of two major retail businesses and effecting certain cultural changes;

- the possible disruptions from anticipated workforce reductions to be implemented as part of the merger integration plan;

- the possibility that expanding product offerings may adversely impact Sears' private label brands and that national brands may not sell to the combined companies;

- the risk that anticipated operating profit synergies and cost savings will not be achieved (or the risk that certain cost savings will adversely affect operating profits);

- the potential dilution to Kmart's stockholders;

- interests of Kmart directors, including the interests of Edward S. Lampert and William C. Crowley in the ESL Companies (which are the beneficial owners of a substantial stake in Sears) in connection with the Kmart merger (see " Interests of Directors and Executive Officers in the Mergers" beginning on page 68); and

- the risk of diverting management's attention from other strategic priorities to implement merger integration efforts.

In view of the wide variety of factors considered in connection with its evaluation of the mergers and the complexity of these matters, the Kmart board did not find it useful, and did not attempt, to quantify, rank or otherwise assign relative weights to these factors. In considering the factors described above, individual members of the Kmart board may have given different weight to different factors. The Kmart board conducted an overall analysis of the factors described above, including thorough discussions with, and questioning of, Kmart's management and Kmart's legal and financial advisors, and considered the factors overall to be favorable to, and to support, its determination. The Kmart board also considered the experience and expertise of Lehman Brothers, its financial advisor, in reviewing quantitative analyses of the financial terms of the mergers. See " Opinion of Kmart's Financial Advisor" beginning on page 50.

The Kmart board of directors unanimously approved the merger agreement. The Kmart board unanimously recommends that Kmart stockholders vote "FOR" adoption of the merger agreement.

Sears' Reasons for the Sears Merger; Recommendation of the Sears Merger by the Sears Board of Directors

At its meeting on November 16, 2004, as well as the other meetings at which it considered the mergers, the Sears board of directors consulted with Sears management as well as its financial and legal advisors and, at its November 16, 2004 meeting, unanimously determined to approve the merger agreement and recommended that Sears stockholders vote for adoption of the merger agreement. In reaching its conclusion to approve the Sears merger and the related transactions and to recommend that the stockholders of Sears adopt the merger agreement, the Sears board considered the following factors as generally supporting its decision to enter into the merger agreement and related agreements:

The Sears board of directors considered the following positive factors relating to the mergers:

- the mergers will create the third largest retailer in the United States, with over $55 billion in annual revenues and 3,800 full-line and specialty retail stores in the United States and Canada, as compared with Sears' current position as the fourth largest retailer in the United States;

- the expectation that the mergers will accelerate Sears' strategy for stand-alone stores located outside of malls, with Kmart's real estate adding important urban and high-density suburban locations, resulting in a more rapid and lower-cost growth in store base than Sears would be able to accomplish on its own;

- anticipated synergies from the transaction by the third year after the mergers estimated at $500 million per year, comprising $200 million in operating profit synergies from increased revenue through cross-selling proprietary brands and converting a substantial number of off-mall Kmart locations to the Sears nameplate and $300 million from cost savings through improved merchandising and non-merchandising procurement, improved logistics and supply chain management and consolidation of shared headquarter functions and corporate services, all of which should positively impact the combined companies' earnings and create value for stockholders, as well as other preliminarily identified opportunities for additional synergies and cost savings;

- the opportunity for Sears stockholders to elect cash or stock consideration, which will enable many to receive immediate cash value while those stockholders who wish to continue to participate in the combined companies will have the chance to do so, and will provide Sears stockholders with a measure of value assurance in the event of a decline in the price of Kmart common stock;

- the fact that the ESL Companies have agreed in the support agreement to elect irrevocably to receive stock consideration for their shares of Sears common stock (subject to proration, if necessary) evidencing the ESL Companies' belief in the benefits of the transaction and enhancing the opportunity of other Sears stockholders to receive cash;

- the fact that Sears stockholders will receive consideration for shares of Sears common stock at a premium to the trading price of Sears common stock prior to the announcement of the transaction and at a 36.5% premium to the trading price on the trading day prior to Vornado's announcement;

- the expectation that the mergers will create a combined company with strong and stable earnings and cash flow as a result of combined retail sales that provide a scale greater than Sears alone and a stronger foundation for growth;

- the combination of leading proprietary brands owned by Sears and Kmart which should enable the retail operations of the combined companies to further distinguish themselves from competitors and significantly expand the points of distribution for Sears' products in key markets;

consideration of the alternatives available to Sears if it were not to engage in the business combination with Kmart that was being considered and the value that such alternatives could be expected to deliver to Sears shareholders, including growth through acquisitions, a leveraged buyout or a leveraged recapitalization, all of which involve meaningful risks and uncertainties and none of which had been discussed with third parties, including Kmart and the ESL Companies, or provided the same potential for growth provided by the business combination with Kmart as more fully described below;

the proposed composition of the Holdings board of directors and management which is expected to facilitate the integration, and assist the continuation of the best practices and traditions of the two companies following completion of the mergers by providing the combined companies with the expertise and the leadership of both companies. In this regard, Sears' board considered that Alan J. Lacy, Chairman, Chief Executive Officer and President of Sears, would be Vice Chairman and Chief Executive Officer of Holdings, Edward S. Lampert, Chairman of Kmart, would be the Chairman of the Holdings board of directors, and Aylwin B. Lewis, director, President and Chief Executive Officer of Kmart would be President of Holdings and Chief Executive Officer of Kmart and Sears Retail;

the limited closing conditions in the merger agreement and the low risk of nonsatisfaction of those conditions;

the expectation that the exchange of Sears common stock for Holdings common stock would be nontaxable to Sears stockholders who receive Holdings common stock;

the analysis, presentation and oral opinion of Morgan Stanley delivered on November 16, 2004, and subsequently confirmed in writing as of that day, to the effect that, as of the date of such opinion, and based upon and subject to the various considerations, assumptions and limitations set forth in the opinion, the merger consideration to be provided to Sears stockholders pursuant to the merger agreement is fair from a financial point of view to the holders of Sears common stock (other than the ESL Companies) (the written opinion of Morgan Stanley is attached as Annex D to this joint proxy statement-prospectus and discussed in detail under " Opinion of Sears' Financial Advisor" beginning on page 60), taking into account the contingent nature of Morgan Stanley's compensation and fees previously paid to Morgan Stanley;

the potential benefits to Sears' employees from the expanded opportunities available as part of a larger organization, including increased advancement opportunities in a larger and more diverse enterprise;

the fact that the holding company following the merger, Holdings, will retain the Sears name, which the Sears board considered important in light of Sears' history and strong customer relationships; and

the fact that the headquarters of Holdings will be in Hoffman Estates, Illinois, which the Sears board considered important in light of Sears' importance to the Chicago area and the effect on employees.

The Sears board of directors considered the following negative factors relating to the mergers:

the problems inherent in merging the operations of two large companies, including the possibility that management may be distracted from regular business concerns by (1) unforeseen difficulties in integrating operations and systems, (2) possible employee uncertainty in the face of potential workforce reductions and difficulties in assimilating employees, and (3) potential adverse short-term effects on operating results of the combined companies;

the likelihood of realizing and the risks of not realizing the expected operating profit synergies and cost savings;

- certain risks related to expanding product offerings, including the impact on Sears private label brands of being available at a discount retailer and the risk that national brands will not sell to the combined companies; and

- the fact that the value of the transaction will fluctuate with the value of Kmart stock and would decrease if the trading value of Kmart common stock decreases, though this is partially offset by the significant cash component of the compensation offered to Sears stockholders in the Sears merger.

The Sears board of directors also considered the following factors relating to the mergers:

- the review and analysis of each of Kmart's and Sears' business, financial condition, earnings, risks and prospects, including the results of the due diligence investigation of Kmart;

- the historical market prices and trading information with respect to the shares of Sears common stock and Kmart common stock;

- the comparisons of historical financial measures for Sears and Kmart, including earnings and comparisons of historical operational measures for Sears and Kmart;

- current industry, economic and market conditions, including the size of Sears' primary competitors, and the prospect of further restructuring and consolidation in the domestic retail industry;

- the fact that the ESL Companies then beneficially owned approximately 15% of the outstanding shares of Sears common stock and that, following the mergers, the ESL Companies, the interests of which may from time to time diverge from those of other Holdings stockholders, were then expected to own between approximately 39% and 43% of the outstanding shares of Holdings common stock, depending on proration, and thus have substantial influence over actions to be taken by Holdings stockholders after completion of the business combination, including the election of directors to the Holdings board and transactions involving a change of control;

- the interests that certain Sears executive officers and directors may have with respect to the merger in addition to their interests as Sears stockholders. See " Interests of Sears Directors and Executive Officers" on page 71;

- the fact that stockholder approval of the transaction would be required from both Kmart and Sears; and

- the terms and conditions of the merger agreement, including the possible payment of a termination fee and expenses to Kmart under certain circumstances and the restrictions on the ability of Sears to entertain third party acquisition proposals, which the board of directors considered reasonable in light of the context of the entire transaction and commercial practice.

The Sears board of directors believed that, overall, the potential benefits of the mergers to Sears and Sears stockholders outweighed the risks which are mentioned above.

The Sears board of directors also considered the feasibility and desirability of pursuing alternative strategies, such as pursuing growth and increased stockholder value through acquisitions of assets or companies, such as the acquisition of additional real estate in off-mall, stand alone locations, a leveraged buyout and a leveraged recapitalization. The Sears board of directors reviewed a number of potential alternative transactions and other strategic business opportunities. The board concluded that the alternatives presented significantly greater execution risks and uncertainties, and would involve lengthy execution periods. None of the alternatives considered offered comparable synergies, was as financially attractive or offered the potential opportunities for growth or as comprehensive and complementary a fit for Sears as a business combination with Kmart.

This discussion of the information and factors considered by the Sears board of directors in making its decision is not intended to be exhaustive but includes all material factors considered by the Sears board of directors. In view of the wide variety of factors considered in connection with its evaluation of the merger and the complexity of these matters, the Sears board of directors did not find it useful to, and did not attempt to, quantify, rank or otherwise assign relative weights to these factors. In addition, individual members of the Sears board of directors may have given different weight to different factors.

The Sears board of directors unanimously approved the merger agreement. The Sears board unanimously recommends that holders of Sears common stock vote "FOR" adoption of the merger agreement.

Certain officers of Sears, including Mr. Lacy, will receive substantial financial and other benefits in connection with the Sears merger. For a discussion of the interests of directors and officers that are different from or in addition to the interests of other stockholders, see " Interests of Sears Directors and Executive Officers" beginning on page 71.

Certain Kmart Projections

Kmart does not as a matter of course publicly disclose detailed forecasts or internal projections as to future revenues, earnings or financial condition. However, in the course of its discussions with Sears, as discussed under " Background of the Mergers" beginning on page 34, Kmart provided Sears with certain business and financial information which Kmart and Sears believe was not publicly available. Such information included the following information:

Kmart Holding Corporation
Projected Statement of Operations Data
(in millions, except per share data and store count)

	For the fiscal year ended	
	January 26, 2005	**January 25, 2006**
Sales	$ 19,758	$ 19,576
Gross margin	5,074	5,208
Earnings before interest and income taxes	907(a)	1,154
Net income	500(a)	709(b)
Earnings before interest, income taxes, depreciation and amortization	931(a)	1,197
Diluted earnings per share	$ 4.95(a)	$ 7.00(b)
Store count(c):		
Beginning of year	1,511	1,482
End of year	1,482	1,433
Capital expenditures	262	272

(a) Excludes $837 million ($521 million after-tax or $5.13 per share) of gains from the sale of property and leasehold interests partially offset by continuing expenses related to Kmart's bankruptcy proceedings.

(b)

Net income and Diluted earnings per share reflect $65 million ($41 million after-tax or $0.40 per share) of interest income on short-term investments assuming a weighted investment rate of 1.9% and an average invested balance of $3,470 million, and interest expense of $88 million ($55 million after-tax or $0.54 per share). Included in interest expense is $50 million of non-cash interest expense related to the accretion of obligations at net present value.

(c)

Represents the assumed store count included in the Projected Statement of Operations Data.

See cautionary statements regarding forward looking information under "Information Regarding Forward-Looking Statements" beginning on page 22.

While such projections were prepared in good faith by Kmart management, no assurance can be made regarding future events. Therefore, such projections cannot be considered a reliable predictor of future operating results, and this information should not be relied on as such. The information in this section was not prepared with a view toward public disclosure or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, published guidelines of the Securities and Exchange Commission regarding forward-looking statements, or U.S. generally accepted accounting principles. In the view of Kmart management, the information was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best of Kmart management's knowledge and belief, the expected course of action and the expected future financial performance of Kmart. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this joint proxy statement-prospectus are cautioned not to place undue reliance on this information.

The prospective financial information included in this prospectus has been prepared by, and is the responsibility of, Kmart management. BDO Seidman, LLP and PricewaterhouseCoopers LLP have neither examined nor compiled the accompanying prospective financial information and, accordingly, BDO Seidman, LLP and PricewaterhouseCoopers LLP do not express an o text-align: left; font-family: Times New Roman, Times, Serif">$- $1,752,554 $1,752,554

The Company’s financial assets that were measured at fair value on a recurring basis as of June 30, 2017, were as follows:

	Level 1	Level 2	Level 3	Total Assets
Revenues in excess of billing - long term	$ -	$ -	$5,173,538	$5,173,538
Total	$ -	$ -	$5,173,538	$5,173,538

The reconciliation from June 30, 2017 to March 31, 2018 is as follows:

	Revenues in excess of billing - long term	Fair value discount	Total
Balance at June 30, 2017	$5,483,869	$(310,331)	$5,173,538
Additions	2,432,244	$(180,526)	2,251,718
Transfers to short term	(5,850,000)	$-	(5,850,000)
Amortization during the period	-	177,298	177,298
Balance at March 31, 2018	$2,066,113	$(313,559)	$1,752,554

The Company applied the discounted cash flow method to calculate the fair value and used NetSol PK's weighted average borrowing rate, ranging from 3.87% to 4.43%.

Management analyzes all financial instruments with features of both liabilities and equity under ASC 480, *"Distinguishing Liabilities From Equity"* and ASC 815, *"Derivatives and Hedging."* Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant and option derivatives are valued using the Black-Scholes model.

New Accounting Pronouncements

Recent Accounting Standards Adopted by the Company:

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ("ASU") 2015-17, *Balance Sheet Classification of Deferred Taxes* (ASU 2015-17), which changes how deferred taxes are classified on the balance sheet and is effective for financial statements issued for annual periods beginning after December 15, 2016, with early adoption permitted. ASU 2015-17 requires all deferred tax assets and liabilities to be classified as non-current. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The guidance simplifies accounting for share-based payments, most notably by requiring all excess tax benefits and tax deficiencies to be recorded as income tax benefits or expense in the income statement and by allowing entities to recognize forfeitures of awards when they occur. This new guidance is effective for annual reporting periods beginning after December 15, 2016 and may be adopted prospectively or retroactively. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

Accounting Standards Recently Issued but Not Yet Adopted by the Company:

In May 2014, the ("FASB") issued ASU 2014-09, *Revenue from Contracts with Customers*, which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most current revenue recognition guidance. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB deferred the effective date of the new revenue standard by one year, which will make it effective for the Company in the first quarter of its fiscal year ending June 30, 2019. The Company is currently in the process of evaluating the impact of adoption of this ASU on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01), which requires equity investments that are not accounted for under the equity method of accounting to be measured at fair value with changes recognized in net income and updates certain presentation and disclosure requirements. ASU 2016-01 is effective beginning after December 15, 2017. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to recognize right-of-use assets and lease liabilities, for all leases, with the exception of short-term leases, at the commencement date of each lease. This ASU requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. This ASU is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted. The amendments of this update should be applied using a modified retrospective approach, which requires lessees and lessors to recognize and measure leases at the beginning of the earliest period presented. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Clarification of Certain Cash Receipts and Cash Payments*, which eliminates the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows, by adding or clarifying guidance on eight specific cash flow issues. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The amendments in this update should be applied retrospectively to all periods presented, unless deemed impracticable, in which case, prospective application is permitted. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

On November 17, 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash.* It is intended to reduce diversity in the presentation of restricted cash and restricted cash equivalents in the statement of cash flows. The new standard requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Earlier adoption is permitted. The Company maintains restricted cash balances and will show restricted cash as part of cash and restricted cash equivalents in the statement of cash flows.

In January 2017, the FASB issued ASU 2017-01, *Clarifying the Definition of a Business*, which clarifies and provides a more robust framework to use in determining when a set of assets and activities is a business. The amendments in this update should be applied prospectively on or after the effective date. This update is effective for annual periods beginning after December 15, 2017, and interim periods within those periods. Early adoption is permitted for acquisition or deconsolidation transactions occurring before the issuance date or effective date and only when the transactions have not been reported in issued or made available for issuance financial statements. The Company does not expect the adoption to have any significant impact on its results of operations, financial position or disclosures.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*. Under the new standard, goodwill impairment would be measured as the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying value of goodwill. This ASU eliminates existing guidance that requires an entity to determine goodwill impairment by calculating the implied fair value of goodwill by hypothetically assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. This update is effective for annual periods beginning after December 15, 2019, and interim periods within those periods. Early adoption is permitted for interim or annual goodwill impairment test performed on testing dates after January 1, 2017. The Company will apply this guidance to applicable impairment tests after the adoption date.

In May 2017, the FASB issued ASU 2017-09, *Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting,* which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance will reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as a modification. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The new standard will be effective prospectively for the Company for the fiscal year beginning July 1, 2018. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of the new standard on its results of operations, financial position or disclosures.

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception.* The ASU was issued to address the complexity associated with applying generally accepted accounting principles (GAAP) for certain financial instruments with characteristics of liabilities and equity. The ASU, among other things, eliminates the need to consider the effects of down round features when analyzing convertible debt, warrants and other financing instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. The amendments are effective for fiscal years beginning after December 15, 2018, and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company is currently in the process of evaluating the impact of the adoption of this standard on its consolidated financial statements.

All other newly issued accounting pronouncements not yet effective have been deemed either immaterial or not applicable.

NOTE 3 – EARNINGS PER SHARE

Basic earnings per share are computed based on the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

The components of basic and diluted earnings per share were as follows:

	For the three months ended March 31, 2018			For the nine months ended March 31, 2018		
	Net Income	Shares	Per Share	Net Income	Shares	Per Share
Basic income per share:						
Net income available to common shareholders	$2,864,445	11,190,048	$0.26	$3,129,368	11,118,529	$0.28
Effect of dilutive securities						
Stock options	-	78,794	-	-	33,836	-
Diluted income per share	$2,864,445	11,268,842	$0.25	$3,129,368	11,152,365	$0.28

	For the three months ended March 31, 2017			For the nine months ended March 31, 2017		
	Net Income	Shares	Per Share	Net Loss	Shares	Per Share
Basic income (loss) per share:						
Net income (loss) available to common shareholders	$699,968	10,987,214	$0.06	$(1,854,537)	10,850,538	$(0.17)
Effect of dilutive securities						
Stock options	-	134,406	-	-	-	-
Diluted income (loss) per share	$699,968	11,121,620	$0.06	$(1,854,537)	10,850,538	$(0.17)

The following potential dilutive shares were excluded from the shares used to calculate diluted earnings per share as their inclusion would be anti-dilutive.

For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
2018	2017	2018	2017

Stock Options	-	-	-	480,133
Share Grants	243,684	542,361	243,684	542,361
	243,684	542,361	243,684	1,022,494

NOTE 4 – OTHER COMPREHENSIVE INCOME AND FOREIGN CURRENCY:

The accounts of NTE, VLSH and VLS use the British Pound; VLSIL and NTG use the Euro; NetSol PK, Connect, and NetSol Innovation use the Pakistan Rupee; NTPK Thailand and NetSol Thai use the Thai Baht; Australia uses the Australian dollar; and NetSol Beijing uses the Chinese Yuan as the functional currencies. NetSol Technologies, Inc., and its subsidiary, NTA, use the U.S. dollar as the functional currency. Assets and liabilities are translated at the exchange rate on the balance sheet date, and operating results are translated at the average exchange rate throughout the period. Accumulated translation losses classified as an item of accumulated other comprehensive loss in the stockholders' equity section of the consolidated balance sheet were $22,005,245 and $18,074,570 as of March 31, 2018 and June 30, 2017, respectively. During the three and nine months ended March 31, 2018, comprehensive income (loss) in the consolidated statements of comprehensive income (loss) included a translation loss attributable to NetSol of $1,729,215 and $3,930,675, respectively. During the three and nine months ended March 31, 2017, comprehensive income (loss) in the consolidated statements of comprehensive income (loss) included a translation loss attributable to NetSol of $169,101 and $67,002, respectively.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

NOTE 5 – RELATED PARTY TRANSACTIONS

NetSol-Innovation

In November 2004, the Company entered into a joint venture with 1insurer, formerly *Innovation Group,* called NetSol-Innovation. NetSol-Innovation provides support services to 1insurer. During the three and nine months ended March 31, 2018, NetSol Innovation provided services of $774,393 and $2,702,906, respectively. During the three and nine months ended March 31, 2017, NetSol Innovation provided services of $1,446,749 and $4,403,368, respectively. Accounts receivable at March 31, 2018 and June 30, 2017 were $2,919,233 and $1,462,078, respectively.

Investec Asset Finance

In October 2011, NTE entered into an agreement with Investec Asset Finance to acquire VLS. NTE and VLS provide support services to Investec. During the three and nine months ended March 31, 2018, NTE and VLS provided license, maintenance and services of $464,976 and $1,508,867, respectively. During the three and nine months ended March 31, 2017, NTE and VLS provided license, maintenance and services of $229,081 and $1,080,868, respectively. Accounts receivable at March 31, 2018 and June 30, 2017 were $229,061 and $133,218, respectively.

NOTE 6 – MAJOR CUSTOMERS

The Company is a strategic business partner for Daimler Financial Services (which consists of a group of many companies in different countries), which accounts for approximately 36.65% and 44.83% of revenue for the nine months ended March 31, 2018 and 2017, respectively. The revenue from this customer is shown in the Asia – Pacific segment. Accounts receivable at March 31, 2018 and June 30, 2017, were $17,368,246 and $1,620,717, respectively. Revenues in excess of billing at March 31, 2018 was $10,686,363, which included $1,752,554 shown as long term.

Revenues in excess of billing at June 30, 2017 was $18,579,540, which included $5,173,538 shown as long term.

On December 21, 2015, the Company entered into a 10-year contract with Daimler Financial Services to provide license, maintenance and services for 12 countries in the Asia Pacific Region. The implementation phase is expected to be over a five-year period with maintenance and support over 10 years. The contract is a fixed fee arrangement with total license and maintenance fees of approximately €71,000,000 (approximately $87,654,000) with services to be separately agreed upon and billed as they are performed. The customer will make fixed annual payments of €5,850,000 (approximately $7,222,000) for years 1-5 and €8,350,000 (approximately $10,309,000) for years 6-10. Under the terms of the contract, the customer has the right to withdraw from certain modules and terminate the agreement as to certain countries based on good cause or business reasons prior to the beginning of implementation.

On September 4, 2017, the Company amended the agreement which provided for an additional €7,700,000 (approximately $9,506,000) to be earned over the remaining life of the contract. The amended agreement provides for €7,000,000 (approximately $8,642,000) to be paid in the current fiscal year with €100,000 (approximately $123,000) to be paid each year over the remaining seven years.

NOTE 7 – CONVERTIBLE NOTE RECEIVABLE – RELATED PARTY

The Company entered into an agreement with WRLD3D, whereby the Company was issued a Convertible Promissory Note (the “Convertible Note”) which was fully executed on May 25, 2017. The maximum principal amount of the Convertible Note is $750,000, and as of March 31, 2018, the Company had disbursed the full amount. The Convertible Note bears interest at 5% per annum and all unpaid interest and principal is due and payable upon the Company’s request on or after February 1, 2018. The Convertible Note is convertible into Series BB Preferred shares at the lesser of (i) the price paid per share for the equity security by the investors in the qualified financing and (ii) $0.6788 per share (adjusted for any stock dividends, combinations, splits, recapitalizations or the like with respect to WRLD3D’s Series BB Preferred Stock after the date of the Convertible Note). The Convertible Note is convertible upon the occurrence of the following events:

1. Upon a qualified financing which is an equity financing of at least $2,000,000.
2. Optionally, upon an equity financing less than $2,000,000.
3. Optionally after the maturity date.
4. Upon a change of control.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

NOTE 8 - OTHER CURRENT ASSETS

Other current assets consisted of the following:

	As of March 31, 2018	As of June 30, 2017
Prepaid Expenses	$ 721,110	$ 597,687
Advance Income Tax	986,589	1,052,935
Employee Advances	115,699	128,100
Security Deposits	89,900	103,255
Other Receivables	485,112	252,590
Other Receivables - related party	300,000	-
Other Assets	406,506	329,319
Total	$ 3,104,916	$ 2,463,886

During the quarter ended March 31, 2018, NetSol PK advanced $300,000 to WRLD3D, which is recorded as other receivables – related party in other current assets.

NOTE 9 – REVENUES IN EXCESS OF BILLINGS – LONG TERM

Revenues in excess of billings, net consisted of the following:

	As of March 31, 2018	As of June 30, 2017

Revenues in excess of billing - long term	$2,066,113	$5,483,869
Present value discount	(313,559)	(310,331)
Net Balance	$1,752,554	$5,173,538

Pursuant to revenue recognition for contract accounting, the Company has recorded revenues in excess of billings long-term for amounts billable after one year. During the three and nine months ended March 31, 2018, the Company accreted $66,304 and $177,298, respectively, which is recorded in interest income for the period. The Company used the discounted cash flow method with interest rates ranging from 3.87% to 4.43%.

NOTE 10 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	As of March 31, 2018	As of June 30, 2017
Office Furniture and Equipment	$3,844,617	$3,755,710
Computer Equipment	25,142,979	26,693,730
Assets Under Capital Leases	1,571,110	1,965,650
Building	8,421,016	9,243,866
Land	2,199,399	2,428,626
Autos	1,312,148	1,270,339
Improvements	525,118	592,652
Subtotal	43,016,387	45,950,573
Accumulated Depreciation	(25,490,160)	(25,579,870)
Property and Equipment, Net	$17,526,227	$20,370,703

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

For the three and nine months ended March 31, 2018, depreciation expense totaled $705,429 and $2,141,756, respectively. Of these amounts, $474,121 and $1,441,790, respectively, are reflected in cost of revenues. For the three and nine months ended March 31, 2017, depreciation expense totaled $930,712 and $2,732,693, respectively. Of these amounts, $646,070 and $1,907,469, respectively, are reflected in cost of revenues.

Following is a summary of fixed assets held under capital leases as of March 31, 2018 and June 30, 2017:

	As of March 31, 2018	As of June 30, 2017
Computers and Other Equipment	$249,262	$309,863
Furniture and Fixtures	65,084	227,914
Vehicles	1,256,764	1,427,873
Total	1,571,110	1,965,650
Less: Accumulated Depreciation - Net	(568,816)	(711,622)
	$1,002,294	$1,254,028

NOTE 11 – OTHER LONG-TERM ASSETS

		As of March 31, 2018	As of June 30, 2017
Investment	(1)	$ 3,174,314	$ 3,057,020
Long Term Security Deposits		105,154	154,275
Total		$ 3,279,468	$ 3,211,295

(1) Investment in WRLD3D – Related party

On March 2, 2016, the Company purchased a 4.9% interest in WRLD3D, a non-public company, for $1,111,111. The Company paid $555,556 at the initial closing and $555,555 on September 1, 2016. NetSol PK, a subsidiary of the Company, purchased a 12.2% investment in WRLD3D, for $2,777,778 which will be earned over future periods by providing IT and enterprise software solutions. Per the agreement, NetSol PK is to provide a minimum of $200,000 of services in each three-month period and the entire balance is required to be provided within three years of the date of the agreement. If NetSol PK fails to provide the future services, it may be required to forfeit the unearned shares back to WRLD3D. As of March 31, 2018, the investment earned by NetSol PK is $2,597,778.

In connection with the investment, the Company and NetSol PK received a warrant to purchase preferred stock of WRLD3D which included the following key terms and features:

- The warrants are exercisable into shares of the “Next Round Preferred”, only if and when the Next Round Preferred is issued by WRLD3D in a “Qualified Financing”.
- The warrants expire on March 2, 2020.
- “Next Round Preferred” is defined as occurring if WRLD3D’s preferred stock (or securities convertible into preferred stock) are issued in a Qualified Financing that occurs after March 2, 2016.
- “Qualified Financing” is defined as financing with total proceeds of at least $2 million.
- The total number of common stock shares to be issued is equal to $1,250,000 divided by the per share price of the Next Round Preferred.
- The exercise price of the warrants is equal to the greater of
  - a) 70% of the per share price of the Next Round Preferred sold in a Qualified Financing, or
  - b) 25,000,000 divided by the total number of shares of common stock outstanding immediately prior to the Qualified Financing (on a fully-diluted basis, excluding the number of common stock shares issuable upon the exercise of any given warrant).

Page 16

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

During the three and nine months ended March 31, 2018, NetSol PK provided services valued at $150,373 and $734,081, respectively. During the three and nine months ended March 31, 2017, NetSol PK provided services valued at $334,963 and $950,471, respectively. This revenue is recorded as services-related party. These services are recorded as accounts receivable until approved by WRLD3D after which the shares are released from restriction. Accounts receivable at March 31, 2018 and June 30, 2017 were $264,052 and $49,646, respectively. Revenues in excess of billing at March 31, 2018 and June 30, 2017 were $153,135 and $80,705, respectively. During the three and nine months ended March 31, 2018, NetSol PK services valued at $48,191 and $601,869, respectively, were released from restriction. During the three and nine months ended March 31, 2017, NetSol PK services valued at $286,449 and $836,070, respectively, were released from restriction. Under the equity method of accounting, the Company recorded its share of net loss of $263,678 and $534,576 for the three and nine months ended March 31, 2018, respectively.

NOTE 12 - INTANGIBLE ASSETS

Intangible assets consisted of the following:

	As of March 31, 2018	As of June 30, 2017
Product Licenses - Cost	$47,244,997	$47,244,997
Effect of Translation Adjustment	(6,141,253)	(3,134,488)
Accumulated Amortization	(27,570,124)	(27,067,358)
Net Balance	$13,533,620	$17,043,151

(A) Product Licenses

Product licenses include internally developed original license issues, renewals, enhancements, copyrights, trademarks, and trade names. Product licenses are amortized on a straight-line basis over their respective lives, and the

unamortized amount of $13,533,620 will be amortized over the next 5.25 years. Amortization expense for the three and nine months ended March 31, 2018 was $652,956 and $2,026,503, respectively. Amortization expense for the three and nine months ended March 31, 2017 was $694,118 and $2,082,355, respectively.

(B) Future Amortization

Estimated amortization expense of intangible assets over the next five years is as follows:

Year ended:	
March 31, 2019	$2,516,328
March 31, 2020	2,516,328
March 31, 2021	2,516,328
March 31, 2022	2,516,328
March 31, 2023	2,516,328
Thereafter	951,980
	$13,533,620

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

NOTE 13 - ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following:

	As of March 31, 2018	As of June 30, 2017
Accounts Payable	$1,658,929	$1,466,265
Accrued Liabilities	5,260,927	4,498,958
Accrued Payroll & Taxes	430,135	520,719
Taxes Payable	249,906	174,485
Other Payable	165,748	219,767
Total	$7,765,645	$6,880,194

NOTE 14 – DEBTS

Notes payable and capital leases consisted of the following:

		As of March 31, 2018		
Name		Total	Current Maturities	Long-Term Maturities
D&O Insurance	(1)	$128,415	$128,415	$ -
Bank Overdraft Facility	(2)	-	-	-
Loan Payable Bank - Export Refinance	(3)	4,325,634	4,325,634	-
Loan Payable Bank - Running Finance	(4)	-	-	-
Loan Payable Bank - Export Refinance II	(5)	3,027,943	3,027,943	-

Loan Payable Bank - Running Finance II	(6)	1,297,690	1,297,690	-
		8,779,682	8,779,682	-
Subsidiary Capital Leases	(7)	616,351	320,140	296,211
		$9,396,033	$9,099,822	$ 296,211

		As of June 30, 2017		
			Current	Long-Term
Name		Total	Maturities	Maturities
D&O Insurance	(1)	$87,485	$87,485	$ -
Bank Overdraft Facility	(2)	221,379	221,379	-
Loan Payable Bank - Export Refinance	(3)	4,776,461	4,776,461	-
Loan Payable Bank - Export Refinance II	(5)	1,910,585	1,910,585	-
Loan Payable Bank - Running Finance II	(6)	2,865,877	2,865,877	-
		9,861,787	9,861,787	-
Subsidiary Capital Leases	(7)	727,770	361,008	366,762
		$10,589,557	$10,222,795	$ 366,762

(1) The Company finances Directors' and Officers' ("D&O") liability insurance and Errors and Omissions ("E&O") liability insurance, for which the D&O and E&O balances are renewed on an annual basis and, as such, are recorded in current maturities. The interest rate on these financings were ranging from 4.8% to 7.69% as of March 31, 2018 and June 30, 2017.

(2) The Company's subsidiary, NTE, has an overdraft facility with HSBC Bank plc whereby the bank would cover any overdrafts up to £300,000, or approximately $422,535. The annual interest rate was 4.75% as of March 31, 2018. Total outstanding balance as of March 31, 2018 was £Nil. Interest expense for the three and nine months ended March 31, 2018, was $5,122 and $13,167, respectively. Interest expense for the three and nine months ended March 31, 2017, was $4,501.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

This overdraft facility requires that the aggregate amount of invoiced trade debtors (net of provisions for bad and doubtful debts and excluding intra-group debtors) of NTE, not exceeding 90 days old, will not be less than an amount equal to 200% of the facility. As of March 31, 2018, NTE was in compliance with this covenant.

(3) The Company's subsidiary, NetSol PK, has an export refinance facility with Askari Bank Limited, secured by NetSol PK's assets. This is a revolving loan that matures every six months. Total facility amount is Rs. 500,000,000 or $4,325,634 at March 31, 2018 and June 30, 2017. The interest rate for the loan was 3% at March 31, 2018 and June 30, 2017. Interest expense for the three and nine months ended March 31, 2018 was $24,441 and $94,710, respectively. Interest expense for the three and nine months ended March 31, 2017 was $28,012 and $85,604, respectively.

(4) The Company's subsidiary, NetSol PK, has a running finance facility with Askari Bank Limited, secured by NetSol PK's assets. Total facility amount is Rs. 75,000,000 or $648,845, at March 31, 2018. NetSol PK used Rs. Nil or $Nil, at March 31, 2018. The interest rate for the loan was 8.16% at March 31, 2018.

This facility requires NetSol PK to maintain a long-term debt equity ratio of 60:40 and the current ratio of 1:1. As of March 31, 2018, NetSol PK was in compliance with this covenant.

(5) The Company's subsidiary, NetSol PK, has an export refinance facility with Samba Bank Limited, secured by NetSol PK's assets. This is a revolving loan that matures every six months. Total facility amount is Rs. 350,000,000 or $3,027,643 and Rs. 200,000,000 or $1,910,585, at March 31, 2018 and June 30, 2017, respectively. The interest rate for the loan was 3% at March 31, 2018 and June 30, 2017. Interest expense for the three and nine months ended March 31, 2018 was $30,095 and $69,873, respectively. Interest expense for three and nine months ended March 31, 2017, was $nil.

(6) The Company's subsidiary, NetSol PK, has a running finance facility with Samba Bank Limited, secured by NetSol PK's assets. Total facility amount is Rs. 150,000,000 or $1,297,690 and Rs. 300,000,000 or $2,865,877, at March 31,

2018 and June 30, 2017, respectively. The interest rate for the loan was 8.14% and 8.13% at March 31, 2018 and June 30, 2017, respectively. Interest expense for the three and nine months ended March 31, 2018 was $19,997 and $99,718, respectively. Interest expense for the three and nine months ended March 31, 2017, was $nil.

During the tenure of loan, the facilities from Samba Bank Limited require NetSol PK to maintain at a minimum a current ratio of 1:1, an interest coverage ratio of 4 times, a leverage ratio of 2 times, and a debt service coverage ratio of 4 times. As of March 31, 2018, NetSol PK was in compliance with these covenants.

(6) The Company leases various fixed assets under capital lease arrangements expiring in various years through 2022. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are secured by the assets themselves. Depreciation of assets under capital leases is included in depreciation expense for the three months and nine months ended March 31, 2018 and 2017.

Following is the aggregate minimum future lease payments under capital leases as of March 31, 2018:

	Amount
Minimum Lease Payments	
Due FYE 3/31/19	$354,639
Due FYE 3/31/20	241,087
Due FYE 3/31/21	66,911
Due FYE 3/31/22	3,474
Total Minimum Lease Payments	666,111
Interest Expense relating to future periods	(49,760)
Present Value of minimum lease payments	616,351
Less: Current portion	(320,140)
Non-Current portion	$296,211

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

NOTE 15 - STOCKHOLDERS' EQUITY

During the nine months ended March 31, 2018, the Company issued 39,204 shares of common stock for services rendered by officers of the Company. These shares were valued at the fair market value of $245,025.

During the nine months ended March 31, 2018, the Company issued 9,699 shares of common stock for services rendered by the independent members of the Board of Directors as part of their board compensation. These shares were valued at the fair market value of $55,080.

During the nine months ended March 31, 2018, the Company issued 147,612 shares of its common stock to employees pursuant to the terms of their employment agreements valued at $907,661.

During the nine months ended March 31, 2018, the Company collected subscription receivable of $76,511 related to the exercise of stock options in previous years.

During the nine months ended March 31, 2018, the Company received $138,800 pursuant to a stock option agreement for the exercise of 35,773 shares of common stock at price of $3.88 per share.

During the nine months ended March 31, 2018, the Company paid $750,714 to purchase 171,074 of shares of its common stock from the open market at an average price of $4.39 per share.

NOTE 16 - INCENTIVE AND NON-STATUTORY STOCK OPTION PLAN

Common stock purchase options consisted of the following:

OPTIONS:

	# of shares	Weighted Ave Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregated Intrinsic Value
Outstanding and exercisable, June 30, 2016	610,133	$ 4.90	0.99	$ 799,030
Granted	79,838	$ 4.53		
Exercised	(84,838)	$ 4.49		
Expired / Cancelled	(130,000)	$ 7.50		
Outstanding and exercisable, June 30, 2017	475,133	$ 4.20	1.05	$ 8,413
Granted	-	-		
Exercised	(35,773)	$ 3.88		
Expired / Cancelled	(1,000)	$ 16.00		
Outstanding and exercisable, March 31, 2018	438,360	$ 4.20	0.32	$ 319,465

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

The following table summarizes information about stock options outstanding and exercisable at March 31, 2018.

Exercise Price	Number Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Ave Exercise Price
OPTIONS:			
$ 3.88	384,898	0.25	$ 3.88
$ 6.50	53,462	0.85	$ 6.50
Totals	438,360	0.32	$ 4.20

The following table summarizes stock grants awarded as compensation:

	# of shares	Weighted Average Grant Date Fair Value ($)
Unvested, June 30, 2016	630,228	$ 6.07
Granted	222,146	$ 5.92
Forfeited / Cancelled	(5,000)	$ 5.55
Vested	(427,175)	$ 5.90
Unvested, June 30, 2017	420,199	$ 6.07
Granted	20,000	$ 4.25
Vested	(196,515)	$ 6.15
Unvested, March 31, 2018	243,684	$ 6.02

For the three and nine months ended March 31, 2018, the Company recorded compensation expense of $448,221 and $1,281,751, respectively. For the three and nine months ended March 31, 2017, the Company recorded compensation expense of $449,743 and $2,047,839, respectively. The compensation expense related to the unvested stock grants as of March 31, 2018 was $1,368,687 which will be recognized during the fiscal years 2018 through 2022.

NOTE 17 – TAXES

U.S. Tax Reform

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act significantly revises the future ongoing U.S. corporate income tax by, among other things, lowering U. S. corporate income tax rates and implementing a territorial tax system. As the Company has a June 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a U.S. statutory federal rate of approximately 28% for our fiscal year ending June 30, 2018, and 21% for subsequent fiscal years.

There are also certain transitional impacts of the Tax Act. As part of the transition to the new territorial tax system, the Tax Act imposes a one-time repatriation tax on deemed repatriation of historical earnings of foreign subsidiaries. As of December 31, 2017, the provisional undistributed earnings of foreign subsidiaries were $22.8 million which the Company anticipates being able to offset fully with net operating loss carry forwards. In addition, the modified territorial tax system includes a new anti-deferral provision, referred to as global intangible low taxed income (“GILTI”), which subjects certain foreign income to current U.S. tax.

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

The changes included in the Tax Act are broad and complex. The final transition impacts of the Tax Act may differ from the above estimate, possibly materially, due to, among other things, changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the company has utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and foreign exchange rates of foreign subsidiaries.

In December 2017, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act" ("SAB 118"), which provides guidance on accounting for the tax effects of the Tax Reform Act. Under SAB 118, companies are able to record a reasonable estimate of the impacts of the Tax Reform Act if one is able to be determined and report it as a provisional amount during the measurement period. The measurement period is not to extend beyond one year from the enactment date. Impacts of the Tax Reform Act that a company is not able to make a reasonable estimate for should not be recorded until a reasonable estimate can be made during the measurement period.

We currently anticipate finalizing and recording any resulting adjustments by the end of our current fiscal year ending June 30, 2018.

NOTE 18 – CONTINGENCIES

On April 7, 2017, Conister Bank Limited filed a complaint in the High Court of Justice Chancery Division, as claim no. HC-2017-001045 against our subsidiary, Virtual Lease Services Limited ("VLS"). The complaint alleges that VLS was in willful default of their agreements with Conister Bank Limited by failing to fulfill its obligations under the agreements with Conister. The complaint was settled and dismissed on March 19, 2018, for £300,000 (approximately $421,000) of which insurance covered £209,000 (approximately $293,000).

NOTE 19 – OPERATING SEGMENTS

The Company has identified three segments for its products and services; North America, Europe and Asia-Pacific. Our reportable segments are business units located in different global regions. Each business unit provides similar products and services; license fees for leasing and asset-based software, related maintenance fees, and implementation and IT consulting services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies due to their particular regional location. The Company accounts for intra-company sales and expenses as if the sales or expenses were to third parties and eliminates them in the consolidation.

The following table presents a summary of identifiable assets as of March 31, 2018 and June 30, 2017:

	As of March 31, 2018	As of June 30, 2017
Identifiable assets:		
Corporate headquarters	$3,034,938	$2,922,514
North America	5,237,144	6,717,366
Europe	6,860,909	6,056,514
Asia - Pacific	88,769,527	83,980,936
Consolidated	$103,902,518	$99,677,330

The following table presents a summary of investment under equity method as of March 31, 2018 and June 30, 2017:

	As of March 31, 2018	As of June 30, 2017
Investment in WRLD3D:		
Corporate headquarters	$957,929	$1,111,111
Asia - Pacific	2,216,385	1,945,909
Consolidated	$3,174,314	$3,057,020

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

The following table presents a summary of operating information for the three and nine months ended March 31:

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2018	2017	2018	2017
Revenues from unaffiliated customers:				
North America	$998,403	$1,111,897	$3,134,113	$4,467,325
Europe	1,764,651	1,579,486	4,873,688	3,133,101
Asia - Pacific	12,891,024	13,247,144	31,355,376	35,898,971
	15,654,078	15,938,527	39,363,177	43,499,397
Revenue from affiliated customers				
Europe	464,976	229,081	1,508,867	2,031,339
Asia - Pacific	924,766	1,781,712	3,436,987	5,353,839
	1,389,742	2,010,793	4,945,854	7,385,178
Consolidated	$17,043,820	$17,949,320	$44,309,031	$50,884,575
Intercompany revenue				
Europe	$137,864	$112,419	$379,567	$343,599
Asia - Pacific	338,201	292,839	1,483,569	2,215,393
Eliminated	$476,065	$405,258	$1,863,136	$2,558,992
Net income (loss) after taxes and before non-controlling interest:				
Corporate headquarters	$(529,048)	$(1,147,068)	$(2,825,689)	$(3,326,500)
North America	(11,777)	(302,353)	(242,229)	(569,170)
Europe	265,831	(199,215)	545,876	(1,492,986)
Asia - Pacific	5,134,308	3,786,853	8,862,093	6,533,246
Consolidated	$4,859,314	$2,138,217	$6,340,051	$1,144,590

The following table presents a summary of capital expenditures for the nine months ended March 31:

	For the Nine Months Ended March 31,	
	2018	2017
Capital expenditures:		
North America	$3,556	$41,340
Europe	254,548	422,024
Asia - Pacific	849,628	852,558
Consolidated	$1,107,732	$1,315,922

Page 23

NETSOL TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018

(UNAUDITED)

NOTE 20 – NON-CONTROLLING INTEREST IN SUBSIDIARY

The Company had non-controlling interests in several of its subsidiaries. The balance of non-controlling interest was as follows:

SUBSIDIARY	Non-Controlling Interest %		Non-Controlling Interest at March 31, 2018	
NetSol PK	33.79	%	$ 13,181,663	
NetSol-Innovation	49.90	%	1,850,342	
VLS, VLSH & VLSIL Combined	49.00	%	534,232	
NetSol Thai	0.006	%	(76	)
Total			$ 15,566,161	

SUBSIDIARY	Non-Controlling Interest %		Non-Controlling Interest at June 30, 2017	
NetSol PK	33.80	%	$ 12,887,938	
NetSol-Innovation	49.90	%	1,599,734	
VLS, VLHS & VLSIL Combined	49.00	%	311,502	
NetSol Thai	0.006	%	(92	)
Total			$ 14,799,082	

<u>NetSol PK</u>

During the nine months ended March 31, 2018, employees of NetSol PK exercised 67,000 options of common stock and NetSol PK received cash of $10,349. The Company purchased 55,500 shares of common stock of NetSol PK from

the open market for $33,987. Due to the exercise of options and the shares purchase, the non-controlling interest decreased from 33.80% to 33.79%.

During the nine months ended March 31, 2018, NetSol PK paid a cash dividend of $1,234,991.

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

The following discussion is intended to assist in an understanding of the Company's financial position and results of operations for the three and nine months ended March 31, 2018. The following discussion should be read in conjunction with the information included within our Annual Report on Form 10-K for the year ended June 30, 2017, and the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

Forward-Looking Information

This report contains certain forward-looking statements and information relating to the Company that is based on the beliefs of its management as well as assumptions made by and information currently available to its management. When used in this report, the words "anticipate", "believe", "estimate", "expect", "intend", "plan", and similar expressions relate to the Company or its management, are intended to identify forward-looking statements. These statements reflect management's current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should any of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this report as anticipated, estimated or expected. The Company's realization of its business aims could be materially and adversely affected by any technical or other problems in, or difficulties with, planned funding and technologies, third party technologies which render the Company's technologies obsolete, the unavailability of required third party technology licenses on commercially reasonable terms, the loss of key research and development personnel, the inability or failure to recruit and retain qualified research and development personnel, or the adoption of technology standards which are different from technologies around which the Company's business ultimately is built. The Company does not intend to update these forward-looking statements.

Business Overview

NetSol Technologies, Inc. (NasdaqCM: NTWK) is a worldwide provider of IT and enterprise software solutions. We believe that our solutions constitute mission critical applications for clients, as they encapsulate end-to-end business processes, facilitating faster processing and increased transactions.

The Company's primary source of revenue is the licensing, customization, enhancement and maintenance of its suite of financial applications under the brand name NFS™ (NetSol Financial Suite) and NFS Ascent™ for leading businesses in the global lease and finance industry.

NetSol's clients include Dow-Jones 30 Industrials and Fortune 500 manufacturers and financial institutions, global vehicle manufacturers, and enterprise technology providers, all of which are serviced by NetSol delivery locations around the globe.

Founded in 1997, NetSol is headquartered in Calabasas, California. While the Company follows a global strategy for sales and delivery of its portfolio of solutions and services, it continues to maintain regional offices in the following locations:

North America	Los Angeles Area
Europe	London Metropolitan area
Asia Pacific	Lahore, Karachi, Bangkok, Beijing, Jakarta and Sydney

NetSol's offerings include its flagship global solution, NFS™. A robust suite of five software applications, it is an end-to-end solution for the lease and finance industry covering the complete leasing and financing cycle, starting from quotation origination through end of contract transactions. The five software applications under NFS™ have been designed and developed for a highly flexible setting and are capable of dealing with multinational, multi-company, multi-asset, multi-lingual, multi-distributor and multi-manufacturer environments. Each application is a complete system in itself and can be used independently to address specific sub-domains of the leasing/financing cycle. When used together, they fully automate the entire leasing/financing cycle for any size company, including those with multi-billion-dollar portfolios.

NFS Ascent™

NFS Ascent™ is the Company's next-generation platform, offering a technologically advanced solution for the auto and equipment finance and leasing industry. NFS Ascent's™ architecture and user interfaces were designed based on the Company's collective experience with global Fortune 500 companies over the past 30 years. The platform's framework allows auto captive and asset finance companies to rapidly transform legacy driven technology into a state-of-the-art IT and business process environment. At the core of the NFS Ascent™ platform is a lease accounting and contract processing engine, which allows for an array of interest calculation methods, as well as robust accounting of multibillion dollar lease portfolios under various generally accepted accounting principles (GAAP), as well as international financial reporting standards (IFRS). NFS Ascent™, with its distributed and clustered deployment across parallel application and high-volume data servers, enables finance companies to process voluminous data in a hyper speed environment. NFS Ascent™ has been developed using the latest tools and technologies and its n-tier SOA architecture allows the system to greatly improve a myriad of areas including, but not limited to, scalability, performance, fault tolerance and security.

NFS Digital

NetSol launched NFS digital in 2014. It enables a sales force for the finance and leasing company across different channels such as point of sale, field investigation and auditing, and allows end customers to access their contract details through a self-service mobile application. NFS digital includes mAccount, mPOS, mDealer, mAuditor, and Mobile Field Investigator (mFI).

LeasePak

In North America, NTA has and continues to develop the LeasePak CMS product. LeasePak streamlines the lease management lifecycle, enabling superior lease and loan portfolio management, flexible financial products (lease or loan terms) and sophisticated financial analysis and management to reducing operating costs and improve profits. It is scalable from a basic offering to a collection of highly specialized add on modules for systems, portfolios and accrual methods for virtually all sizes and varying complexity of operations. It is part of the vehicle leasing infrastructure at leading Fortune 500 banks and manufacturers, as well as for some of the industry's leading independent lessors. It handles every aspect of the lease or loan lifecycle, including credit application origination, credit adjudication, pricing, documentation, booking, payments, customer service, collections, midterm adjustments, and end-of-term options and asset disposition. It is also integrated with important partners in the asset-finance ecosystem, such as Vertex Series O.

LeasePak-SaaS

NTA also offers the LeasePak Software-as-a-Service ("SaaS") business line, which provides high performance with a reduced total cost of ownership. SaaS offers a proven deployment option whereby customers only require access to the internet to use the software. With an elastic cloud price, revenue stream predictability and improved return on investment for customers, management believes that its SaaS customers will experience the performance, the reliability and the speed usually associated with a highly scalable private cloud. LeasePak-SaaS targets small and mid-sized leasing and finance companies.

LeaseSoft

In addition to offering NFS Ascent™ to the European market, NTE has some regional offerings, including LeaseSoft and LoanSoft. LeaseSoft is a full lifecycle lease and finance system aimed predominantly at the UK funder market, including modules to support web portals and an electronic data interchange manager to facilitate integration between funders and introducers. LoanSoft is similar to LeaseSoft, but optimized for the consumer loan market.

Highlights

Listed below are a few of NetSol's major successes achieved in the nine months ended March 31, 2018:

We amended the 12 country NFS Ascent™ contract securing €7.7 million Euros (approximately $9.5 million) in future revenues in addition to what was previously projected from the customer. The revenue will be recognized over the contract term as the support services are performed.
Pursuant to the 12 country NFS Ascent™ contract, we successfully implemented the Loan Origination System and the Wholesale Financial System in Thailand and Korea, respectively.
Pursuant to the 12 country NFS Ascent™ contract, we delivered the first major release of NFS Ascent™ to China.

An increase in software modification requests from some of our existing customers spread across the various regions contributed reasonably to the revenues for the quarter. A trend which is believed will be continued in the following quarters.
We signed a chargeable proof of concept agreement with one of the oldest and largest banks in Australia. The proof of concept project will add to our revenues and assist us in making further progress in the selection process for our NFS Ascent™ product.
Mizhou Balimore, a Japanese bank in Indonesia, went live with the first phase of its NFS Ascent™ digital solution.
Our existing customer, an auto finance company of a leading bank in Indonesia, kicked off its leasing project. We believe that this is likely to help increase revenues in the following quarters. This kick off has further strengthened our relationship with this Indonesian business partner paving the way for further success in the market. Additionally, all the branches of the same business partner successfully went live with NFS Ascent™ during the first quarter of the current fiscal year culminating into a maturing and long-standing delivery commitment.
We signed a new agreement to deploy our mobility applications with an existing customer valued at approximately $3 million.
A current Chinese customer purchased $1 million of additional licenses due to the increase in its business.
NFS Ascent™ and Ascent Digital continue to generate interest across all major regions and industries as some significant new prospects have come through the pipeline, further strengthening projections and forecasts. Revenue could also be boosted as customization requests grow in addition to new business volume.
The launch of “innovation lab” to explore and focus on new technologies such as blockchain, artificial intelligence, and big data to complement our core business.

Our success, in the near term, will depend, in large part, on the Company’s ability to continue to grow revenues and improve profits, adequately capitalize for growth in various markets and verticals, make progress in the North American and European markets and, continue to streamline sales and marketing efforts in every market we operate. However, management’s outlook for the continuing operations, which has been consolidated and has been streamlined, remains optimistic.

Management has identified the following material trends affecting NetSol.

Positive trends:

Improving U.S. economy generally, and particularly auto and banking markets.
According to Automotive World December 2017 publication, global demand for light weight trucks is expected to reach an all-time high in 2018.
Total industry sales of more than 20 million vehicles annually by 2018, according to John Murphy, an analyst for Bank of America Merrill Lynch annual industry outlook.
Robust Chinese markets as asset based leasing and finance sector are far from maturity levels.
The inflation rate in Pakistan reached a low of 3.25% in March 2018.
China investment or CPEC (China Pakistan Economic Corridor) has exceeded $50 billion from originally $46 billion in Pakistan on energy and infrastructure projects.

- New emerging markets and IT destinations in Thailand, Malaysia, Indonesia, China and Australia.
- Continued interest from Fortune 500 multinational auto captives and global companies in NetSol Ascent™.
- Continuing interest from existing clients in the NFS™ legacy systems in emerging and developing markets.
- Growing demand and traction for upgrading to NFS Ascent™ by existing tier one auto captive clients.
- Increased visits to NTPK by senior executives of existing clients and potential new customers.

Negative trends:

- Continued Global terrorism and extremism threats in European countries.
- Geopolitical unrest in the Middle East and potential terrorism and the disruption risk it creates.
- Restricted liquidity and financial burden due to tighter internal processes and limited budgets might cause delays in the receivables from some clients.
- The threats of conflict between in the Middle Eastern countries could potentially create volatility in oil prices, causing readjustments of corporate budgets and consumer spending slowing global auto sales.
- Industry trend towards autonomous cars and its effect on the automotive industry.

CHANGES IN FINANCIAL CONDITION

Quarter Ended March 31, 2018 Compared to the Quarter Ended March 31, 2017

The following table sets forth the items in our unaudited condensed consolidated statement of operations for the quarter ended March 31, 2018 and 2017 as a percentage of revenues.

	For the Three Months Ended March 31,			
	2018	%	2017	%
Net Revenues:				
License fees	$2,648,870	15.54 %	$5,730,222	31.92 %
Maintenance fees	3,659,998	21.47 %	3,538,996	19.72 %
Services	9,345,210	54.83 %	6,669,309	37.16 %
Maintenance fees - related party	105,325	0.62 %	51,698	0.29 %
Services - related party	1,284,417	7.54 %	1,959,095	10.91 %
Total net revenues	17,043,820	100.00%	17,949,320	100.00%
Cost of revenues:				
Salaries and consultants	5,418,067	31.79 %	6,161,110	34.33 %
Travel	425,060	2.49 %	764,867	4.26 %
Depreciation and amortization	1,127,077	6.61 %	1,340,188	7.47 %
Other	880,897	5.17 %	686,950	3.83 %
Total cost of revenues	7,851,101	46.06 %	8,953,115	49.88 %
Gross profit	9,192,719	53.94 %	8,996,205	50.12 %
Operating expenses:				
Selling and marketing	1,962,402	11.51 %	2,439,948	13.59 %
Depreciation and amortization	231,308	1.36 %	284,642	1.59 %
General and administrative	4,048,271	23.75 %	4,329,798	24.12 %
Research and development cost	197,643	1.16 %	101,193	0.56 %
Total operating expenses	6,439,624	37.78 %	7,155,581	39.87 %
Income from operations	2,753,095	16.15 %	1,840,624	10.25 %
Other income and (expenses)				
Gain on sale of assets	40,537	0.24 %	1,647	0.01 %
Interest expense	(102,522)	-0.60 %	(60,357)	-0.34 %
Interest income	142,356	0.84 %	27,229	0.15 %
Gain (loss) on foreign currency exchange transactions	2,550,394	14.96 %	390,897	2.18 %
Share of net loss from equity investment	(263,678)	-1.55 %	-	0.00 %
Other income	314	0.00 %	(219)	0.00 %

Total other income (expenses)	2,367,401	13.89 %	359,197	2.00 %
Net income (loss) before income taxes	5,120,496	30.04 %	2,199,821	12.26 %
Income tax provision	(261,182)	-1.53 %	(61,604)	-0.34 %
Net income (loss)	4,859,314	28.51 %	2,138,217	11.91 %
Non-controlling interest	(1,994,869)	-11.70 %	(1,438,249)	-8.01 %
Net income (loss) attributable to NetSol	$2,864,445	16.81 %	$699,968	3.90 %

Page 28

A significant portion of our business is conducted in currencies other than the U.S. dollar. We operate in several geographical regions as described in Note 19 "Operating Segments" within the Notes to the Condensed Consolidated Financial Statements. Weakening of the value of the U.S. dollar compared to foreign currency exchange rates generally has the effect of increasing our revenues but also increasing our expenses denominated in currencies other than the U.S. dollar. Similarly, strengthening of the U.S. dollar compared to foreign currency exchange rates generally has the effect of reducing our revenues but also reducing our expenses denominated in currencies other than the U.S. dollar. We plan our business accordingly by deploying additional resources to areas of expansion, while continuing to monitor our overall expenditures given the economic uncertainties of our target markets. In order to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency fluctuations, we compare the changes in results from one period to another period using constant currency. In order to calculate our constant currency results, we apply the current period results to the prior period foreign currency exchange rates. In the table below, we present the change based on actual results in reported currency and in constant currency.

	For the Three Months Ended March 31, 2018	%	2017	%	Favorable (Unfavorable) Change in Constant Currency	Favorable (Unfavorable) Change due to Currency Fluctuation	Total Favorable (Unfavorable) Change as Reported
Net Revenues:	17,043,820	100.00%	17,949,320	100.00%	(425,759)	(479,741)	(905,500)
Cost of revenues:	7,851,101	46.06%	8,953,115	49.88%	864,576	237,438	1,102,014
Gross profit	9,192,719	53.94%	8,996,205	50.12%	438,817	(242,303)	196,514
Operating expenses:	6,439,624	37.78%	7,155,581	39.87%	169,300	546,657	715,957
Income (loss) from operations	2,753,095	16.15%	1,840,624	10.25%	608,117	304,354	912,471

Net revenues for the quarter ended March 31, 2018 and 2017 are broken out among the segments as follows:

	2018 Revenue	%	2017 Revenue	%
North America	998,403	5.86%	1,111,897	6.19%
Europe	2,229,627	13.08%	1,808,567	10.08%
Asia-Pacific	13,815,790	81.06%	15,028,856	83.73%
Total	$17,043,820	100.00%	$17,949,320	100.00%

Revenues

License fees

License fees for the three months ended March 31, 2018 were $2,648,870 compared to $5,730,222 for the three months ended March 31, 2017, reflecting a decrease of $3,081,352 with a change in constant currency of $2,914,611. The decrease in license revenue for the fiscal three months ended March 31, 2018 compared to 2017 is primarily due to the decrease of license revenue recognized for the 12 country NFS Ascent™ contract offset by new license sales of approximately $1,400,000 and $1,200,000 for our legacy products and our mobility products, respectively.

Page 29

Maintenance fees

Maintenance fees for the three months ended March 31, 2018 were $3,659,998 compared to $3,538,996 for the three months ended March 31, 2017 reflecting an increase of $121,002 with a change in constant currency of $145,167. Maintenance fees begin once a customer has "gone live" with our product. The increase was due to the fluctuation in usage of active users. We anticipate maintenance fees to gradually increase as we implement both our NFS legacy product and NFS Ascent™.

Maintenance fees – related party

Maintenance fees from related party for the three months ended March 31, 2018 were $105,325 compared to $51,698 for the three months ended March 31, 2017 reflecting an increase of $53,627 with a change in constant currency of $43,190. The increase was due to the fluctuation in usage of active users.

Services

Services income for the three months ended March 31, 2018 was $9,345,210 compared to $6,669,309 for the three months ended March 31, 2017 reflecting an increase of $2,675,901 with a change in constant currency of $2,954,472. The services revenue increase was due to an increase in services revenue associated with new implementations and change requests. Services revenue is derived from services provided to both current customers as well as services provided to new customers as part of the implementation process.

Services – related party

Services income from related party for the three months ended March 31, 2018 was $1,284,417 compared to $1,959,095 for the three months ended March 31, 2017 reflecting a decrease of $674,678 with a change in constant currency of $653,977. The decrease in related party service revenue is due to a decrease in revenue from our joint venture with 1insurer.

Gross Profit

The gross profit was $9,192,719, for the three months ended March 31, 2018 as compared with $8,996,205 for the three months ended March 31, 2017. This is an increase of $196,514 with an increase in constant currency of $438,817. The gross profit percentage for the three months ended March 31, 2018 increased to 53.94% from 50.12% for the three months ended March 31, 2017. The cost of sales was $7,851,101 for the three months ended March 31, 2018 compared to $8,953,115 for the three months ended March 31, 2017 for a decrease of $1,102,014 and on a constant currency basis a decrease of $864,576. As a percentage of sales, cost of sales decreased from 49.88% for the three months ended March 31, 2017 to 46.06% for the three months ended March 31, 2018.

Salaries and consultant fees decreased by $743,043 from $6,161,110 for the three months ended March 31, 2017 to $5,418,067 for the three months ended March 31, 2018 and on a constant currency basis decreased $568,807. The decrease in salaries and consultant fees is due to the right sizing of technical employees at key locations including Pakistan, Thailand, China, UK and North America. As a percentage of sales, salaries and consultant expense decreased from 34.33% for the three months ended March 31, 2017 to 31.79% for the three months ended March 31, 2018.

Depreciation and amortization expense decreased to $1,127,077 compared to $1,340,188 for the three months ended March 31, 2017 or a decrease of $213,111 and on a constant currency basis a decrease of $143,596. Depreciation and amortization expense decreased as some products became fully amortized.

Operating Expenses

Operating expenses were $6,439,624 for the three months ended March 31, 2018 compared to $7,155,581, for the three months ended March 31, 2017 for a decrease of 10.01% or $715,957 and on a constant currency basis a decrease of 2.37% or $169,300. As a percentage of sales, it decreased from 39.87% to 37.78%. The decrease in operating expenses was primarily due to decreases in selling and marketing expenses, professional services, general and administrative expenses and depreciation.

Selling and marketing expenses decreased by $477,546 or 19.57% and on a constant currency basis a decrease of $45,387 or 1.86%. The decrease in selling and marketing expenses is due to reduction in staff, decrease in our salaries and commissions, travel expenses, and business development costs to market and sell NFS Ascent™ globally.

General and administrative expenses were $4,048,271 for the three months ended March 31, 2018 compared to $4,329,798 at March 31, 2017 or a decrease of $281,527 or 6.50% and on a constant currency basis a decrease of $176,589 or 4.08%. During the three months ended March 31, 2018, salaries increased by approximately $230,665 or $236,537 on a constant currency basis due to the annual raises, offset by a decrease in professional services of $175,233 or $180,818 on a constant currency basis and other general and administrative expenses of approximately $336,959 or $232,308 on a constant currency basis.

Income from Operations

Income from operations was $2,753,095 for the three months ended March 31, 2018 compared to $1,840,624 for the three months ended March 31, 2017. This represents an increase of $912,471 with an increase of $608,117 on a constant currency basis for the three months ended March 31, 2018 compared with the three months ended March 31, 2017. As a percentage of sales, income from operations was 16.15% for the three months ended March 31, 2018 compared to 10.25% for the three months ended March 31, 2017.

Other income and expense

Other income was $2,367,401 for the three months ended March 31, 2018 compared with $359,197 for the three months ended March 31, 2017. This represents an increase of $2,008,204 with an increase of $2,131,878 on a constant currency basis. The increase is primarily due to the foreign currency exchange transactions. The majority of the contracts with NetSol PK are either in U.S. dollars or Euros; therefore, the currency fluctuations will lead to foreign currency exchange gains or losses depending on the value of the Pakistan Rupee (“PKR”) compared to the U.S. dollar and the Euro. In December 2017, Pakistan’s central bank withdrew its support of the PKR, which caused the PKR to drop in value. During the three months ended March 31, 2018, we recognized a gain of $2,550,394 in foreign currency exchange transactions compared to $390,897 for the three months ended March 31, 2017. During the three months ended March 31, 2018, the value of the U.S. dollar and the Euro increased 4.5% and 7.54%, respectively, compared to the PKR. During the three months ended March 31, 2017, the value of the U.S. dollar and the Euro increased 0.4% and 1.9%, respectively, compared to the PKR.

Non-controlling Interest

For the three months ended March 31, 2018 and 2017, the net income attributable to non-controlling interest was $1,994,869 and $1,438,249, respectively. The increase in non-controlling interest is primarily due to the increase in net income of NetSol PK offset by a decrease in net income of NetSol Innovation.

Net Income / Loss attributable to NetSol

Net income was $2,864,445 for the three months ended March 31, 2018 compared $699,968 for the three months ended March 31, 2017. This is an increase of $2,164,477 with an increase of $1,872,983 on a constant currency basis, compared to the prior year. For the three months ended March 31, 2018, net income per share was $0.26 and $0.25 for

basic and diluted shares, respectively, compared to $0.06 for basic and diluted shares for the three months ended March 31, 2017.

Nine Months Ended March 31, 2018 Compared to the Nine Months Ended March 31, 2017

The following table sets forth the items in our unaudited condensed consolidated statement of operations for the nine months ended March 31, 2018 and 2017 as a percentage of revenues.

	For the Nine Months Ended March 31,			
	2018	%	2017	%
Net Revenues:				
License fees	$3,210,868	7.25 %	$14,953,574	29.39 %
Maintenance fees	10,702,171	24.15 %	10,651,692	20.93 %
Services	25,450,138	57.44 %	18,844,602	37.03 %
License fees - related party	261,513	0.59 %	246,957	0.49 %
Maintenance fees - related party	309,539	0.70 %	233,674	0.46 %
Services - related party	4,374,802	9.87 %	5,954,076	11.70 %
Total net revenues	44,309,031	100.00 %	50,884,575	100.00 %
Cost of revenues:				
Salaries and consultants	16,244,319	36.66 %	18,034,263	35.44 %
Travel	1,226,073	2.77 %	2,313,002	4.55 %
Depreciation and amortization	3,468,293	7.83 %	3,989,824	7.84 %
Other	2,677,465	6.04 %	2,725,015	5.36 %
Total cost of revenues	23,616,150	53.30 %	27,062,104	53.18 %
Gross profit	20,692,881	46.70 %	23,822,471	46.82 %
Operating expenses:				
Selling and marketing	5,605,838	12.65 %	7,497,464	14.73 %
Depreciation and amortization	699,966	1.58 %	825,224	1.62 %
General and administrative	11,862,535	26.77 %	12,882,407	25.32 %
Research and development cost	572,619	1.29 %	285,732	0.56 %
Total operating expenses	18,740,958	42.30 %	21,490,827	42.23 %
Income from operations	1,951,923	4.41 %	2,331,644	4.58 %
Other income and (expenses)				
Gain (loss) on sale of assets	24,468	0.06 %	(33,095)	-0.07 %
Interest expense	(330,268)	-0.75 %	(176,959)	-0.35 %
Interest income	394,837	0.89 %	81,085	0.16 %
Gain (loss) on foreign currency exchange transactions	5,304,723	11.97 %	(645,886)	-1.27 %
Share of net loss from equity investment	(534,576)	-1.21 %	-	0.00 %
Other income	15,924	0.04 %	28,164	0.06 %
Total other income (expenses)	4,875,108	11.00 %	(746,691)	-1.47 %
Net income before income taxes	6,827,031	15.41 %	1,584,953	3.11 %

Income tax provision	(486,980)	-1.10 %	(440,363)	-0.87 %
Net income	6,340,051	14.31 %	1,144,590	2.25 %
Non-controlling interest	(3,210,683)	-7.25 %	(2,999,127)	-5.89 %
Net income (loss) attributable to NetSol	$3,129,368	7.06 %	$(1,854,537)	-3.64 %

A significant portion of our business is conducted in currencies other than the U.S. dollar. We operate in several geographical regions as described in Note 19 "Operating Segments" within the Notes to the Condensed Consolidated Financial Statements. Weakening of the value of the U.S. dollar compared to foreign currency exchange rates generally has the effect of increasing our revenues but also increasing our expenses denominated in currencies other than the U.S. dollar. Similarly, strengthening of the U.S. dollar compared to foreign currency exchange rates generally has the effect of reducing our revenues but also reducing our expenses denominated in currencies other than the U.S. dollar. We plan our business accordingly by deploying additional resources to areas of expansion, while continuing to monitor our overall expenditures given the economic uncertainties of our target markets. In order to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency fluctuations, we compare the changes in results from one period to another period using constant currency. In order to calculate our constant currency results, we apply the current period results to the prior period foreign currency exchange rates. In the table below, we present the change based on actual results in reported currency and in constant currency.

	For the Nine Months Ended March 31, 2018	%	2017	%	Favorable (Unfavorable) Change in Constant Currency	Favorable (Unfavorable) Change due to Currency Fluctuation	Total Favorable (Unfavorable) Change as Reported
Net Revenues:	44,309,031	100.00%	50,884,575	100.00%	(6,076,003)	(499,541)	(6,575,544)
Cost of revenues:	23,616,150	53.30%	27,062,104	53.18%	3,134,346	311,608	3,445,954
Gross profit	20,692,881	46.70%	23,822,471	46.82%	(2,941,657)	(187,933)	(3,129,590)
Operating expenses:	18,740,958	42.30%	21,490,827	42.23%	2,267,248	482,621	2,749,869
Income (loss) from operations	1,951,923	4.41%	2,331,644	4.58%	(674,409)	294,688	(379,721)

Net revenues for the nine months ended March 31, 2018 and 2017 are broken out among the segments as follows:

	2018 Revenue	%	2017 Revenue	%
North America	$3,134,113	7.07%	$4,467,325	8.78%
Europe	6,382,555	14.40%	5,164,440	10.15%
Asia-Pacific	34,792,363	78.52%	41,252,810	81.07%
Total	$44,309,031	100.00%	$50,884,575	100.00%

Revenues

License fees

License fees for the nine months ended March 31, 2018 were $3,210,868 compared to $14,953,574 for the nine months ended March 31, 2017, reflecting a decrease of $11,742,706 with a change in constant currency of $11,597,815. The decrease in license revenue for the fiscal nine months ended March 31, 2018 compared to 2017 is primarily due to the decrease of license revenue recognized for the 12 country NFS Ascent™ contract offset by new license sales of approximately $2,000,000 and $1,200,000 for our legacy products and our mobility products, respectively.

License fees – related party

License fees from related party for the nine months ended March 31, 2018 were $261,513 compared to $246,957 for the nine months ended March 31, 2017 reflecting an increase of $14,556 with a change in constant currency of $7,851.

Maintenance fees

Maintenance fees for the nine months ended March 31, 2018 were $10,702,171 compared to $10,651,692 for the nine months ended March 31, 2017 reflecting an increase of $50,479 with a change in constant currency of $64,915. Maintenance fees begin once a customer has "gone live" with our product. The increase was due to the fluctuation in usage of active users. We anticipate maintenance fees to gradually increase as we implement both our NFS legacy product and NFS Ascent™.

Maintenance fees – related party

Maintenance fees from related party for the nine months ended March 31, 2018 were $309,539 compared to $233,674 for the nine months ended March 31, 2017 reflecting an increase of $75,865 with a change in constant currency of $60,192. The increase was due to the fluctuation in usage of active users.

Services

Services income for the nine months ended March 31, 2018 was $25,450,138 compared to $18,844,602 for the nine months ended March 31, 2017 reflecting an increase of $6,605,536 with a change in constant currency of $6,941,815. The services revenue increase was due to an increase in services revenue associated with new implementations and change requests. Services revenue is derived from services provided to both current customers as well as services provided to new customers as part of the implementation process.

Services – related party

Services income from related party for the nine months ended March 31, 2018 was $4,374,802 compared to $5,954,076 for the nine months ended March 31, 2017 reflecting a decrease of $1,579,274 with a change in constant currency of $1,552,961. The decrease in related party service revenue is due to a decrease in revenue from our joint venture with 1insurer.

Gross Profit

The gross profit was $20,692,881, for the nine months ended March 31, 2018 as compared with $23,822,471 for the nine months ended March 31, 2017. This is a decrease of $3,129,590 with a change in constant currency of $2,941,657. The gross profit percentage for the nine months ended March 31, 2018 decreased to 46.70% from 46.82% for the nine months ended March 31, 2017. The cost of sales was $23,616,150 for the nine months ended March 31, 2018 compared to $27,062,104 for the nine months ended March 31, 2017 for a decrease of $3,445,954 and on a constant currency basis a decrease of $3,134,346. As a percentage of sales, cost of sales increased from 53.18% for the nine months ended March 31, 2017 to 53.30% for the nine months ended March 31, 2018.

Salaries and consultant fees decreased by $1,789,944 from $18,034,263 for the nine months ended March 31, 2017 to $16,244,319 for the nine months ended March 31, 2018 and on a constant currency basis decreased $1,541,008. The decrease in salaries and consultant fees is due to the right sizing of technical employees at key locations including Pakistan, Thailand, China, UK and North America. As a percentage of sales, salaries and consultant expense increased from 35.44% for the nine months ended March 31, 2017 to 36.66% for the nine months ended March 31, 2018.

Depreciation and amortization expense decreased to $3,468,293 compared to $3,989,824 for the nine months ended March 31, 2017 or a decrease of $521,531 and on a constant currency basis a decrease of $427,379. Depreciation and amortization expense decreased as some products became fully amortized.

Operating Expenses

Operating expenses were $18,740,958 for the nine months ended March 31, 2018 compared to $21,490,827, for the nine months ended March 31, 2017 for a decrease of 12.80% or $2,749,869 and on a constant currency basis a decrease of 10.55% or $2,267,248. As a percentage of sales, it increased from 42.23% to 42.30%. The decrease in operating expenses was primarily due to decreases in selling and marketing expenses, salaries and wages and depreciation.

Selling and marketing expenses decreased by $1,891,626 or 25.23% and on a constant currency basis a decrease of $1,491,024 or 19.89%. The decrease in selling and marketing expenses is due to reduction in staff, decrease in our salaries and commissions, travel expenses, and business development costs to market and sell NFS Ascent™ globally.

General and administrative expenses were $11,862,535 for the nine months ended March 31, 2018 compared to $12,882,407 at March 31, 2017 or a decrease of $1,019,872 or 7.92% and on a constant currency basis a decrease of $945,325 or 7.34%. During the nine months ended March 31, 2018, salaries decreased by $821,691 or $806,610 on a constant currency basis due to the decrease in the number of employees, minimal annual raises, less issue of share grants and options. Other general and administrative expenses decreased by $88,603 or $19,877 on a constant currency basis and professional services decreased by $109,578 or $118,838 on constant currency bases.

Income from Operations

Income from operations was $1,951,923 for the nine months ended March 31, 2018 compared to income of $2,331,644 for the nine months ended March 31, 2017. This represents a decrease of $379,721 with a decrease of $674,409 on a constant currency basis for the nine months ended March 31, 2018 compared with the nine months ended March 31, 2017. As a percentage of sales, income from operations was 4.41% for the nine months ended March 31, 2018 compared to 4.58% for the nine months ended March 31, 2017.

Other Income and Expense

Other income was $4,875,108 for the nine months ended March 31, 2018 compared with a loss of $746,691 for the nine months ended March 31, 2017. This represents an increase of $5,621,799 with an increase of $5,778,863 on a constant currency basis. The increase is primarily due to the foreign currency exchange transactions. The majority of the contracts with NetSol PK are either in U.S. dollars or Euros; therefore, the currency fluctuations will lead to foreign currency exchange gains or losses depending on the value of the PKR compared to the U.S. dollar and the Euro. In December 2017, Pakistan's central bank withdrew its support of the PKR, which caused the PKR to drop in value. During the nine months ended March 31, 2018, we recognized a gain of $5,304,723 in foreign currency exchange transactions compared to a loss of $645,886 for the nine months ended March 31, 2017. During the nine months ended March 31, 2018, the value of the U.S. dollar and the Euro increased 10.42% and 19.13%, respectively, compared to the PKR. During the nine months ended March 31, 2017, the value of the U.S. dollar and the Euro decreased 0.14% and 4.55%, respectively, compared to the PKR.

Non-controlling Interest

For the nine months ended March 31, 2018 and 2017, the net income attributable to non-controlling interest was $3,210,683 and $2,999,127, respectively. The increase in non-controlling interest is primarily due to the increase in net income of NetSol PK offset by a decrease in net income of NetSol Innovation.

Net Income / Loss attributable to NetSol

Net income was $3,129,368 for the nine months ended March 31, 2018 compared to a loss of $1,854,537 for the nine months ended March 31, 2017. This is an increase of $4,983,905 with an increase of $4,730,820 on a constant currency basis, compared to the prior year. For the nine months ended March 31, 2018, net income per share was $0.28 for basic and diluted shares compared to a loss of $0.17 for basic and diluted shares for the nine months ended March 31, 2017.

Non-GAAP Financial Measures

Regulation S-K Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings," defines and prescribes the conditions for use of non-GAAP financial information. Our measures of adjusted EBITDA and adjusted EBITDA per basic and diluted share meet the definition of a non-GAAP financial measure.

We define the non-GAAP measures as follows:

EBITDA is GAAP net income or loss before net interest expense, income tax expense, depreciation and amortization.
Non-GAAP adjusted EBITDA is EBITDA less stock-based compensation expense.
Adjusted EBITDA per basic and diluted share – Adjusted EBITDA allocated to common stock divided by the weighted average shares outstanding and diluted shares outstanding.

We use non-GAAP measures internally to evaluate the business and believe that presenting non-GAAP measures provides useful information to investors regarding the underlying business trends and performance of our ongoing operations as well as useful metrics for monitoring our performance and evaluating it against industry peers. The non-GAAP financial measures presented should be used in addition to, and in conjunction with, results presented in accordance with GAAP, and should not be relied upon to the exclusion of GAAP financial measures. Management strongly encourages investors to review our consolidated financial statements in their entirety and not to rely on any single financial measure in evaluating the Company.

The non-GAAP measures reflect adjustments based on the following items:

EBITDA: We report EBITDA as a non-GAAP metric by excluding the effect of net interest expense, income tax expense, depreciation and amortization from net income or loss because doing so makes internal comparisons to our historical operating results more consistent. In addition, we believe providing an EBITDA calculation is a more useful comparison of our operating results to the operating results of our peers.

Stock-based compensation expense: We have excluded the effect of stock-based compensation expense from the non-GAAP adjusted EBITDA and non-GAAP adjusted EBITDA per basic and diluted share calculations. Although stock-based compensation expense is calculated in accordance with current GAAP and constitutes an ongoing and recurring expense, such expense is excluded from non-GAAP results because it is not an expense which generally requires cash settlement by NetSol, and therefore is not used by us to assess the profitability of our operations. We also believe the exclusion of stock-based compensation expense provides a more useful comparison of our operating results to the operating results of our peers.

Non-controlling interest: We add back the non-controlling interest in calculating gross adjusted EBITDA and then subtract out the income taxes, depreciation and amortization and net interest expense attributable to the non-controlling interest to arrive at a net adjusted EBITDA.

Our reconciliation of the non-GAAP financial measures of adjusted EBITDA and non-GAAP earnings per basic and diluted share to the most comparable GAAP measures for the three and nine months ended March 31, 2018 and 2017 are as follows:

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017	Nine Months Ended March 31, 2018	Nine Months Ended March 31, 2017
Net Income (loss) before preferred dividend, per GAAP	$2,864,445	$699,968	$3,129,368	$(1,854,537)
Non-controlling interest	1,994,869	1,438,249	3,210,683	2,999,127
Income taxes	261,182	61,604	486,980	440,363
Depreciation and amortization	1,358,385	1,624,830	4,168,259	4,815,048
Interest expense	102,522	60,357	330,268	176,959
Interest (income)	(142,356)	(27,229)	(394,837)	(81,085)
EBITDA	$6,439,047	$3,857,779	$10,930,721	$6,495,875
Add back:				
Non-cash stock-based compensation	448,233	478,345	1,281,763	2,025,924
Adjusted EBITDA, gross	$6,887,280	$4,336,124	$12,212,484	$8,521,799
Less non-controlling interest (a)	(2,540,702)	(2,317,246)	(4,804,869)	(5,501,218)
Adjusted EBITDA, net	$4,346,578	$2,018,878	$7,407,615	$3,020,581
Weighted Average number of shares outstanding				
Basic	11,190,048	10,987,214	11,118,529	10,850,538
Diluted	11,268,842	11,121,620	11,152,365	10,984,944
Basic adjusted EBITDA	$0.39	$0.18	$0.67	$0.28
Diluted adjusted EBITDA	$0.39	$0.18	$0.66	$0.27
(a)The reconciliation of adjusted EBITDA of non-controlling interest to net income attributable to non-controlling interest is as follows				
Net Income attributable to non-controlling interest	$1,994,869	$1,438,249	$3,210,683	$2,999,127
Income Taxes	65,798	36,569	106,221	74,350
Depreciation and amortization	449,828	790,065	1,382,148	2,346,603
Interest expense	31,865	9,416	105,400	40,749
Interest (income)	(43,702)	(31,715)	(125,777)	(83,112)
EBITDA	$2,498,658	$2,242,584	$4,678,675	$5,377,717
Add back:				
Non-cash stock-based compensation	42,044	74,662	126,194	123,501
Adjusted EBITDA of non-controlling interest	$2,540,702	$2,317,246	$4,804,869	$5,501,218

LIQUIDITY AND CAPITAL RESOURCES

Our cash position was $12,711,983 at March 31, 2018, compared to $14,172,954 at June 30, 2017.

Net cash provided by operating activities was $2,252,005 for the nine months ended March 31, 2018 compared to net cash used in operating activities of $2,018,592 for the nine months ended March 31, 2017. At March 31, 2018, we had current assets of $58,294,081 and current liabilities of $24,794,887. We had accounts receivable of $26,287,212 at March 31, 2018 compared to $8,228,141 at June 30, 2017. The increase in accounts receivable includes $4,313,306 due to billing for the code split per the amended DFS contract. We had revenues in excess of billings of $17,192,524 at March 31, 2018 compared to $24,380,632 at June 30, 2017 of which $1,752,554 and $5,173,538 is shown as long term as of March 31, 2018 and June 30, 2017, respectively.

The long-term portion is discounted by $313,559 and $310,331 at March 31, 2018 and June 30, 2017, respectively, using the discounted cash flow method with interest rates ranging from 3.87% to 4.43% which is NetSol PK's weighted average borrowing rate. During the nine months ended March 31, 2018, our revenues in excess of billings were reclassified to accounts receivable pursuant to billing requirements detailed in each contract. The combined totals for accounts receivable and revenues in excess of billings increased by $10,870,963 from $32,608,773 at June 30, 2017 to $43,479,736 at March 31, 2018. The increase is due to recognition of revenue according to progress of contracts and billing for the amended DFS contract. Accounts payable and accrued expenses, and current portions of loans and lease obligations amounted to $7,765,645 and $9,099,822, respectively at March 31, 2018. Accounts payable and accrued expenses, and current portions of loans and lease obligations amounted to $6,880,194 and $10,222,795, respectively at June 30, 2017.

The average days sales outstanding for the nine months ended March 31, 2018 and 2017 were 274 and 165 days, respectively, for each period. The days sales outstanding have been calculated by taking into consideration the average combined balances of accounts receivable and revenues in excess of billings.

Net cash used in investing activities was $1,392,957 for the nine months ended March 31, 2018, compared to $2,072,047 for the nine months ended March 31, 2017. We had purchases of property and equipment of $1,107,732 compared to $1,315,922 for the nine months ended March 31, 2017. For the nine months ended March 31, 2018, we invested $550,000 in a short-term convertible note receivable from WRLD3D. For the nine months ended March 31, 2018, we invested $50,000 in WRLD3D compared to $905,555 for the nine months ended March 31, 2017.

Net cash used in financing activities was $1,117,872 for the nine months ended March 31, 2018, compared to $1,065,436 provided by financing activities for the nine months ended March 31, 2017. The nine months ended March 31, 2018 included the cash inflow of $215,311 from the exercising of stock options compared to $785,479 for the same period last year. During the nine months ended March 31, 2018, we purchased 171,074 shares of our common stock from the open market for $750,714 compared to 7,500 shares of common stock for $38,885 for the same period last year. The nine months ended March 31, 2018 included the cash inflow of $696,936 from bank proceeds compared to $1,484,162 for the same period last year. During the nine months ended March 31, 2018, we had net payments for bank loans and capital leases of $961,901 compared to $251,040 for the nine months ended March 31, 2017. We are operating in various geographical regions of the world through our various subsidiaries. Those subsidiaries have financial arrangements from various financial institutions to meet both their short and long-term funding requirements. These loans will become due at different maturity dates as described in Note 14 of the financial statements. We are in compliance with the covenants of the financial arrangements and there is no default, which may lead to early payment of these obligations. We anticipate paying back all these obligations on their respective due dates from its own sources.

We typically fund the cash requirements for our operations in the U.S. through our license, services, and maintenance agreements, intercompany charges for corporate services, and through the exercise of options and warrants. As of March 31, 2018, we had approximately $12.7 million of cash, cash equivalents and marketable securities of which

approximately $11.6 million is held by our foreign subsidiaries. As of June 30, 2017, we had approximately $14.2 million of cash, cash equivalents and marketable securities of which approximately $11.6 million is held by our foreign subsidiaries. The Tax Act, which was passed on December 22, 2017, imposes a one-time repatriation tax on deemed repatriation of historical earnings of foreign subsidiaries. As of December 31, 2017, the provisional undistributed earnings of foreign subsidiaries were $22.8 million which we anticipate being able to offset fully with net operating loss carry forwards.

We remain open to strategic relationships that would provide value added benefits. The focus will remain on continuously improving cash reserves internally and reduced reliance on external capital raise.

As a growing company, we have on-going capital expenditure needs based on our short term and long-term business plans. Although our requirements for capital expenses vary from time to time, for the next 12 months, we anticipate needing $2 million for APAC, U.S. and Europe new business development activities and infrastructure enhancements, which we expect to provide from current operations.

While there is no guarantee that any of these methods will result in raising sufficient funds to meet our capital needs or that even if available will be on terms acceptable to us, we will be very cautious and prudent about any new capital raise given the global market uncertainties. However, we are very conscious of the dilutive effect and price pressures in raising equity-based capital.

Financial Covenants

Our UK based subsidiary, NTE, has an approved overdraft facility of £300,000 ($422,535) which requires that the aggregate amount of invoiced trade debtors (net of provisions for bad and doubtful debts and excluding intra-group debtors) of NTE, not exceeding 90 days old, will not be less than an amount equal to 200% of the facility. The Pakistani subsidiary, NetSol PK has an approved facility for export refinance from Askari Bank Limited amounting to Rupees 500 million ($4,325,634) and a running finance facility of Rupees 75 million ($648,845) which requires NetSol PK to maintain a long-term debt equity ratio of 60:40 and the current ratio of 1:1. NetSol PK also has an approved export refinance facility of Rs. 350 million ($3,027,643) and a running finance facility of Rs. 150 million ($1,297,690) from Samba Bank Limited. During the tenure of loan, these two facilities require NetSol PK to maintain at a minimum a current ratio of 1:1, an interest coverage ratio of 4 times, a leverage ratio of 2 times, and a debt service coverage ratio of 4 times.

As of the date of this report, we are in compliance with the financial covenants associated with our borrowings. The maturity dates of the borrowings of respective subsidiaries may accelerate if they do not comply with these covenants. In case of any change in control in subsidiaries, they may have to repay their respective credit facilities.

CRITICAL ACCOUNTING POLICIES

Our financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management’s application of accounting policies. Critical accounting policies for us include revenue recognition and multiple element arrangements, intangible assets, software development costs, and goodwill.

REVENUE RECOGNITION

The Company derives revenues from the following sources: (1) software licenses, (2) services, which include implementation and consulting services, and (3) maintenance, which includes post contract support.

The Company recognizes revenue from license contracts without major customization when a non-cancelable, non-contingent license agreement has been signed, delivery of the software has occurred, the fee is fixed or

determinable, and collectability is probable. Delivery is considered to have occurred upon electronic transfer of the license key that provides immediate availability of the product to the purchaser. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue the Company reports.

If an arrangement does not qualify for separate accounting of the software license and consulting transactions, then new software license revenue is generally recognized together with the consulting services based on contract accounting using either the percentage-of-completion or completed contract method. Contract accounting is applied to any arrangements: (1) that include milestones or customer specific acceptance criteria that may affect collection of the software license fees; (2) where services include significant modification or customization of the software; (3) where significant consulting services are provided for in the software license contract without additional charge or are substantially discounted; or (4) where the software license payment is tied to the performance of consulting services.

Revenue from consulting services is recognized as the services are performed for time-and-materials contracts. Revenue from training and development services is recognized as the services are performed.

Revenue from maintenance agreements is recognized ratably over the term of the maintenance agreement, typically one year.

Multiple Element Arrangements

The Company may enter into multiple element revenue arrangements in which a customer may purchase a number of different combinations of software licenses, consulting services, maintenance and support, as well as training and development.

Vendor specific objective evidence ("VSOE") of fair value for each element is based on the price for which the element is sold separately. The Company determines the VSOE of fair value of each element based on historical evidence of the Company's stand-alone sales of these elements to third-parties or from the stated renewal rate for the elements contained in the initial software license arrangement. When VSOE of fair value does not exist for any undelivered element, revenue is deferred until the earlier of the point at which such VSOE of fair value exists or until all elements of the arrangement have been delivered. The only exception to this guidance is when the only undelivered element is maintenance and support or other services, then the entire arrangement fee is recognized ratably over the performance period.

INTANGIBLE ASSETS

Intangible assets consist of product licenses, renewals, enhancements, copyrights, trademarks, trade names, and customer lists. Intangible assets with finite lives are amortized over the estimated useful life and are evaluated for impairment at least on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

SOFTWARE DEVELOPMENT COSTS

Costs incurred to internally develop computer software products or to enhance an existing product are recorded as research and development costs and expensed when incurred until technological feasibility for the respective product is established. Thereafter, all software development costs are capitalized and reported at the lower of unamortized cost or net realizable value. Capitalization ceases when the product or enhancement is available for general release to customers.

The Company makes on-going evaluations of the recoverability of its capitalized software projects by comparing the amount capitalized for each product to the estimated net realizable value of the product. If such evaluations indicate that the unamortized software development costs exceed the net realizable value, the Company writes off the amount which the unamortized software development costs exceed net realizable value. Capitalized and purchased computer software development costs are being amortized ratably based on the projected revenue associated with the related software or on a straight-line basis.

STOCK-BASED COMPENSATION

Our stock-based compensation expense is estimated at the grant date based on the award's fair value as calculated by the Black-Scholes-Merton (BSM) option pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including expected volatility and expected term. If any of the assumptions used in the BSM model changes significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience and our expectations regarding future pre-vesting termination behavior of employees. To the extent our actual forfeiture rate is different from our estimate; stock-based compensation expense is adjusted

accordingly.

GOODWILL

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a purchase businesses combination. Goodwill is reviewed for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the carrying amount of goodwill may be impaired. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

RECENT ACCOUNTING PRONOUNCEMENTS

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2 of Notes to Condensed Consolidated Financial Statements included elsewhere in this Quarterly Report.

Item 3. Quantitative and Qualitative Disclosures about Market Risks.

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act, as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, the Chief Financial Officer and Chief Executive Officer concluded that our disclosure controls and procedures were ineffective.

The material weakness relates to the lack of qualified Internal Audit resources dedicated to documenting and testing legacy accounting systems and Corporate functions.

The Company is in the process of remediating the material weakness, including, but not limited to, by continuing the implementation of a leading cloud-based global ERP system, as approved by the Company's Board in fiscal year 2016, which is already live in certain locations, and is expected to be completed by June 30, 2018. Further, the Company engaged an internal audit consulting firm to advise and assist with the remediation and internal control improvements, including to assist with the expansion and training of the Company's internal audit function, and to augment corporate oversight and internal audit coverage.

Changes in Internal Control over Financial Reporting

Except for progress made in the remediation actions described above, there were no changes in our internal controls over financial reporting during the three months ended March 31, 2018, that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)).

PART II OTHER INFORMATION

Item 1. Legal Proceedings

On April 7, 2017, Conister Bank Limited filed a complaint in the High Court of Justice Chancery Division, as claim no. HC-2017-001045 against our subsidiary, Virtual Lease Services Limited ("VLS"). The complaint alleges that VLS was in willful default of their agreements with Conister Bank Limited by failing to fulfill its obligations under the agreements with Conister. The complaint was settled and dismissed on March 19, 2018, for £300,000 (approximately $421,000) of which insurance covered £209,000 (approximately $293,000).

Item 1A. Risk Factors

None.

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

On February 27, 2018, the Company announced that it had continued the stock repurchase program permitting the Company to repurchase up to 500,000 of its shares of common stock commencing February 27, 2018 and continuing through June 30, 2018. The following table provides the repurchases made from February 27, 2017 through March 31, 2018.

Issuer Purchases of Equity Securities

Month	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may be Purchased Under the Plans or Programs
Mar-18	31,799	$ 4.71	31,799	500,000

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CEO)
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CFO)
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CEO)
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CFO)

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NETSOL TECHNOLOGIES, INC.

Date:	May 14, 2018	*/s/ Najeeb U. Ghauri*
		NAJEEB U. GHAURI
		Chief Executive Officer
Date:	May 14, 2018	*/s/Roger K. Almond*
		ROGER K. ALMOND
		Chief Financial Officer
		Principal Accounting Officer