

SEARS HOLDINGS CORP
Form 10-Q
August 20, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 31, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 000-51217

SEARS HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

20-1920798
(I.R.S. Employer Identification No.)

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

60179
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

Yes No

As of August 13, 2010, the registrant had 110,648,210 common shares, \$0.01 par value, outstanding.

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SEARS HOLDINGS CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

<i>millions, except per share data</i>	13 Weeks Ended		26 Weeks Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
REVENUES				
Merchandise sales and services	\$ 10,458	\$ 10,551	\$ 20,504	\$ 20,606
COSTS AND EXPENSES				
Cost of sales, buying and occupancy	7,635	7,756	14,851	14,938
Selling and administrative	2,606	2,630	5,161	5,203
Depreciation and amortization	221	228	442	454
Gain on sales of assets	(9)	(5)	(53)	(59)
Total costs and expenses	10,453	10,609	20,401	20,536
Operating income (loss)	5	(58)	103	70
Interest expense	(69)	(63)	(136)	(122)
Interest and investment income	6	14	21	19
Other income (loss)	5	(31)	(9)	(47)
Loss before income taxes	(53)	(138)	(21)	(80)
Income tax benefit	19	52	4	28
Net loss	(34)	(86)	(17)	(52)
Income attributable to noncontrolling interests	(5)	(8)	(6)	(16)
NET LOSS ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS	\$ (39)	\$ (94)	\$ (23)	\$ (68)
LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS SHAREHOLDERS				
Basic and diluted loss per share	\$ (0.35)	\$ (0.79)	\$ (0.20)	\$ (0.57)
Basic and diluted weighted average common shares outstanding	112.6	119.1	113.6	120.0

See accompanying notes.

Table of Contents**SEARS HOLDINGS CORPORATION****Condensed Consolidated Balance Sheets**

	(Unaudited)		
<i>millions</i>	July 31, 2010	August 1, 2009	January 30, 2010
ASSETS			
Current assets			
Cash and cash equivalents	\$ 1,193	\$ 1,189	\$ 1,689
Restricted cash	6	103	11
Accounts receivable	754	896	652
Merchandise inventories	9,430	9,377	8,705
Prepaid expenses and other current assets	350	390	351
Deferred income taxes	28	32	30
Total current assets	11,761	11,987	11,438
Property and equipment, net	7,485	7,867	7,709
Goodwill	1,392	1,392	1,392
Trade names and other intangible assets	3,173	3,244	3,208
Other assets	1,022	1,270	1,061
TOTAL ASSETS	\$ 24,833	\$ 25,760	\$ 24,808
LIABILITIES			
Current liabilities			
Short-term borrowings	\$ 1,218	\$ 1,015	\$ 325
Current portion of long-term debt and capitalized lease obligations	590	283	482
Merchandise payables	3,673	3,361	3,335
Accrued expenses and other current liabilities	3,049	3,088	3,098
Unearned revenues	997	1,029	1,012
Other taxes	551	468	534
Total current liabilities	10,078	9,244	8,786
Long-term debt and capitalized lease obligations	1,378	1,941	1,698
Pension and post-retirement benefits	2,172	2,045	2,271
Other long-term liabilities	2,586	2,883	2,618
Total Liabilities	16,214	16,113	15,373
EQUITY			
Total Equity	8,619	9,647	9,435
TOTAL LIABILITIES AND EQUITY	\$ 24,833	\$ 25,760	\$ 24,808

See accompanying notes.

Table of Contents**SEARS HOLDINGS CORPORATION****Condensed Consolidated Statements of Cash Flows**

(Unaudited)

<i>millions</i>	26 Weeks Ended	
	July 31, 2010	August 1, 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (17)	\$ (52)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	442	454
Gain on sales of assets	(53)	(59)
Pension and post-retirement plan contributions	(122)	(96)
Settlement of Canadian dollar hedges	25	
Change in operating assets and liabilities (net of acquisitions and dispositions):		
Merchandise inventories	(695)	(486)
Merchandise payables	321	307
Deferred income taxes	45	32
Income and other taxes	(119)	(98)
Mark-to-market adjustments and settlements on Sears Canada U.S. dollar option contracts	5	59
Other operating assets	23	45
Other operating liabilities	(45)	(178)
Net cash used in operating activities	(190)	(72)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of property and investments	16	10
Decrease in investments and restricted cash	9	61
Purchases of property and equipment	(168)	(122)
Net cash used in investing activities	(143)	(51)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of long-term debt	(228)	(302)
Increase in short-term borrowings, primarily 90 days or less	893	573
Debt issuance costs		(81)
Additional purchase of noncontrolling interest	(560)	(7)
Sears Canada dividend paid to minority shareholders	(34)	
Purchase of treasury stock	(273)	(134)
Net cash (used in) provided by financing activities	(202)	49
Effect of exchange rate changes on cash and cash equivalents	39	90
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(496)	16
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,689	1,173
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,193	\$ 1,189

SUPPLEMENTAL CASH FLOW DATA:

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Income taxes paid, net of refunds	\$ 126	\$ 120
Cash interest paid	91	85
See accompanying notes.		

Table of Contents**SEARS HOLDINGS CORPORATION****Condensed Consolidated Statements of Equity**

(Unaudited)

<i>millions</i>	Equity Attributable to Holdings Shareholders							
	Number of Shares	Common Stock	Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
Balance at January 31, 2009	122	\$ 1	\$ 10,441	\$ 4,562	\$ (5,012)	\$ (612)	\$ 319	\$ 9,699
Comprehensive income (loss)								
Net income (loss)				(68)			16	(52)
Pension and postretirement adjustments, net of tax						19		19
Cumulative translation adjustment						79	42	121
Total Comprehensive Income								88
Sears Canada shares purchased			(2)				(5)	(7)
Shares repurchased	(3)				(134)			(134)
Other			35		(31)	(3)		1
Balance at August 1, 2009	119	\$ 1	\$ 10,474	\$ 4,494	\$ (5,177)	\$ (517)	\$ 372	\$ 9,647
Balance at January 30, 2010	115	\$ 1	\$ 10,465	\$ 4,797	\$ (5,446)	\$ (721)	\$ 339	\$ 9,435
Comprehensive income (loss)								
Net income (loss)				(23)			6	(17)
Pension and postretirement adjustments, net of tax						25		25
Deferred loss on derivatives						(12)		(12)
Cumulative translation adjustment						41	13	54
Total Comprehensive Income								50
Stock awards			(3)		3			
Sears Canada shares purchased			(269)			(76)	(215)	(560)
Sears Canada dividend paid to minority shareholders							(34)	(34)
Shares repurchased	(4)				(273)			(273)
Other					2		(1)	1
Balance at July 31, 2010	111	\$ 1	\$ 10,193	\$ 4,774	\$ (5,714)	\$ (743)	\$ 108	\$ 8,619

See accompanying notes.

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

Sears Holdings Corporation (Holdings, we, us, our or the Company) is the parent company of Kmart Holding Corporation (Kmart) and Sears Roebuck and Co. (Sears). Holdings was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the Merger), which was completed on March 24, 2005. We are a broadline retailer with 2,206 full-line and 1,335 specialty retail stores in the United States, operating through Kmart and Sears, and 438 full-line and specialty retail stores in Canada operating through Sears Canada Inc. (Sears Canada), a 90%-owned subsidiary.

These interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full fiscal year. The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. These interim financial statements and related notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 30, 2010.

NOTE 2 BORROWINGS

Total borrowings were as follows:

<i>millions</i>	July 31, 2010	August 1, 2009	January 30, 2010
Short-term borrowings:			
Unsecured commercial paper	\$ 396	\$ 20	\$ 206
Secured borrowings	822	995	119
Long-term debt, including current portion:			
Notes and debentures outstanding	1,352	1,560	1,545
Capitalized lease obligations	616	664	635
Total borrowings	\$ 3,186	\$ 3,239	\$ 2,505

The fair value of long-term debt was \$1.4 billion at July 31, 2010, \$1.3 billion at August 1, 2009 and \$1.4 billion at January 30, 2010. The fair value of our debt was estimated based on quoted market prices for the same or similar issues or on current rates offered to us for debt of the same remaining maturities.

Unsecured Commercial Paper

We borrow through the commercial paper markets. At July 31, 2010, we had outstanding commercial paper borrowings of \$396 million, of which \$250 million were held by ESL Investments, Inc. and its affiliates (collectively, ESL), including \$118 million held by Edward S. Lampert. See Note 14 for further discussion of these borrowings.

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Credit Agreement

During the second quarter of 2009, we extended the maturity date of our credit agreement (*Original Credit Agreement*) by entering into an amended credit agreement (the *Amended Credit Agreement*) which has an expiration date of June 22, 2012. The Amended Credit Agreement is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. (*SRAC*) and Kmart Corporation are the borrowers.

The Amended Credit Agreement provided for a bifurcation of the then existing \$4.1 billion credit facility into a \$2.4 billion tranche with a maturity date of June 22, 2012, bearing an interest rate of the London Interbank Offered Rate (*LIBOR*) plus 4.00%, with a *LIBOR* floor of 1.75%, and a \$1.7 billion tranche which matured on March 24, 2010, bearing an initial interest rate of *LIBOR* plus 0.875%. The bifurcation into the Extended Tranche provides Holdings and its subsidiaries more than adequate liquidity for standby letters of credit and working capital needs. The Amended Credit Agreement also gives us the flexibility, subject to certain terms and conditions, to increase the size of the credit facility or add a term loan tranche to the Amended Credit Agreement in an aggregate amount of up to \$1.0 billion. It imposes various requirements, including a requirement that, if availability under the credit facility is beneath a certain threshold, the fixed charge ratio as of the last day of any fiscal quarter be not less than 1.0 to 1.0, a cash dominion requirement if excess availability on the revolver falls below designated levels, and limitations on our ability to make restricted payments, including dividends and share repurchases. In connection with the Amended Credit Agreement, the Company agreed to limit the amount of cash accumulated when borrowings are outstanding under the credit facility. The Amended Credit Agreement has a \$1.5 billion letter of credit sub-limit, is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and determines availability pursuant to a borrowing base formula.

At July 31, 2010, we had \$822 million of borrowings and \$638 million of letters of credit outstanding under the Amended Credit Agreement. Our availability under the agreement, given total outstanding borrowings and letters of credit of \$1.5 billion, was \$981 million at July 31, 2010. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

Orchard Supply Hardware LLC (OSH LLC) Credit Agreement

In November 2005, OSH LLC entered into a five-year, \$130 million senior secured revolving credit facility (the *OSH LLC Facility*), which includes a \$25 million letter of credit sublimit. The OSH LLC Facility was amended and extended in January 2010 and, as a result, available capacity was bifurcated into a \$100 million tranche maturing December 2013 and a \$20 million tranche maturing December 2011. The OSH LLC Facility continues to have a \$25 million letter of credit sublimit. The OSH LLC Facility is available for OSH LLC 's general corporate purposes and is secured by a first lien on substantially all of OSH LLC 's non-real estate assets. Availability under the OSH LLC Facility is determined pursuant to a borrowing base formula based on inventory and account and credit card receivables, subject to certain limitations. As of July 31, 2010, there were no borrowings outstanding under the OSH LLC Facility and \$9 million in outstanding letters of credit.

NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS

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

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Earnings Effects of Derivatives on the Statements of Operations

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

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

Sears Canada Hedges of Merchandise Purchases

As of July 31, 2010, Sears Canada had entered into foreign currency option contracts with a total notional value of \$429 million. As discussed previously, these option contracts are used to hedge Sears Canada's purchase of inventory under U.S. dollar denominated contracts. We record mark-to-market adjustments based on the total notional value of these outstanding option contracts at the end of each quarter. We recorded mark-to-market assets related to these foreign currency option contracts of \$3 million at July 31, 2010, \$15 million at August 1, 2009 and \$9 million at January 30, 2010.

We record the earnings impact of mark-to-market and settlement adjustments for foreign currency option contracts in other income (loss) at the end of each quarter. We recorded mark-to-market and settlement gains of \$8 million and mark-to-market and settlement losses of \$7 million for these contracts in other income (loss) for the 13- and 26- week periods ended July 31, 2010, respectively. We recorded mark-to-market and settlement losses on these contracts of \$43 million and \$66 million in other income (loss) for the 13- and 26- week periods ended August 1, 2009, respectively.

Sears Canada's above noted foreign currency options contracts were entered into as a hedge of merchandise purchase contracts denominated in U.S. currency. We also record mark-to-market adjustments for that portion of the merchandise purchase contracts which are considered to be embedded derivatives under relevant accounting rules at the end of each quarter. We recorded assets of \$1 million and \$10 million at July 31, 2010 and August 1, 2009, respectively, related to these embedded derivatives. These embedded derivatives had a fair value of zero at January 30, 2010.

We record the earnings impact of mark-to-market and settlement adjustments related to the embedded derivative in the merchandise purchase contracts in other income (loss) at the end of each quarter. We recorded mark-to-market and settlement losses of \$3 million and \$2 million for the 13- and 26- week periods ended July 31, 2010, respectively. We recorded mark-to-market and settlement gains of \$10 million and \$15 million for the 13- and 26- week periods ended August 1, 2009, respectively.

At July 31, 2010, we had mark-to-market assets of \$1 million and \$3 million related to the embedded derivative and option contracts, respectively. At August 1, 2009, we had mark-to-market assets of \$10 million and \$15 million related to the embedded derivative and option contracts, respectively. We recorded total mark-to-market and settlement gains of \$5 million and total mark-to-market and settlement losses of \$9 million in other income (loss) for the 13- and 26- week periods ended July 31, 2010, respectively. We recorded total mark-to-market and

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

settlement losses of \$33 million and \$51 million in other income (loss) for the 13- and 26- week periods ended August 1, 2009, respectively. See Note 4 for further information regarding fair value of these option and merchandise purchase contracts and the respective balance sheet classifications as of July 31, 2010, August 1, 2009 and January 30, 2010.

Hedges of Net Investment in Sears Canada

As of July 31, 2010, we had a series of foreign currency forward contracts outstanding with a total Canadian notional value of \$729 million and with a weighted-average remaining life of 0.4 years. These contracts were designated and qualified as hedges of the foreign currency exposure of our net investment in Sears Canada. Accordingly, the aggregate fair value of the forward contracts as of July 31, 2010 of \$7 million was recorded as a liability on our Condensed Consolidated Balance Sheet. The decline in fair value of \$22 million related to these forward contracts, net of tax, was recorded as a component of other comprehensive income for the 26-week period ended July 31, 2010.

We settled certain foreign currency forward contracts during the second quarter of 2010 and received a net amount of \$25 million relative to these contract settlements. As hedge accounting was applied to such contracts, an offsetting amount was recorded as a component of other comprehensive income.

Certain of our currency forward contracts require collateral be posted in the event our liability under such contracts reaches a predetermined threshold. Cash collateral posted under these contracts is recorded as part of our accounts receivable balance. We had \$2 million of cash collateral posted under these contracts as of July 31, 2010. We had an asset related to these contracts of \$15 million recorded as of January 30, 2010. We had no such foreign currency forward contracts outstanding as of August 1, 2009.

Counterparty Credit Risk

We actively manage the risk of nonpayment by our derivative counterparties by limiting our exposure to individual counterparties based on credit ratings, value at risk and maturities. The counterparties to these instruments are major financial institutions with credit ratings of single-A or better as of July 31, 2010.

NOTE 4 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

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

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

Level 3 inputs unobservable inputs for the asset or liability.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Cash and cash equivalents, accounts receivable, merchandise payables, short-term borrowings and accrued liabilities are reflected in the Condensed Consolidated Balance Sheets at cost, which approximates fair value due to the short-term nature of these instruments. Sears Canada invests its cash in short-term treasury bills and bank term deposits, which are marked to fair value at the end of each quarter. The fair value of our debt is disclosed in Note 2 to the Condensed Consolidated Financial Statements. The following table provides the fair value measurement amounts for other financial assets and liabilities recorded on our Condensed Consolidated Balance Sheets at fair value as of July 31, 2010, August 1, 2009 and January 30, 2010:

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

<i>millions</i>	Total Fair Value Amounts at August 1, 2009	Level 1	Level 2	Level 3
Cash equivalents ⁽¹⁾	\$ 721	\$ 721	\$	\$
Restricted cash ⁽²⁾	103	103		
Short-term investments ⁽³⁾	16		16	
Foreign currency derivative assets ⁽³⁾	25		25	
Total	\$ 865	\$ 824	\$ 41	\$

<i>millions</i>	Total Fair Value Amounts at January 30, 2010	Level 1	Level 2	Level 3
Cash equivalents ⁽¹⁾	\$ 1,291	\$ 1,291	\$	\$
Restricted cash ⁽²⁾	11	11		
Foreign currency derivative assets ⁽³⁾	24		24	
Total	\$ 1,326	\$ 1,302	\$ 24	\$

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

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

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

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

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Short-term investments are typically valued at the closing price in the principal active market as of the last business day of the quarter. Short-term investments at August 1, 2009 included \$16 million on deposit with The Reserve Primary Fund, a money market fund that temporarily restricted withdrawals while it liquidated its holdings to generate cash to distribute. The fair value of this investment was determined by using estimates based on the values of similar assets and information obtained from The Reserve Primary Fund.

The fair values of derivative assets and liabilities traded in the over-the-counter market are determined using quantitative models that require the use of multiple inputs including interest rates, prices and indices to generate

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SEARS HOLDINGS CORPORATION

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

pricing and volatility factors. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. Our derivative instruments are valued using Level 2 measurements.

NOTE 5 SEARS CANADA

Acquisition of Noncontrolling Interest

During the first quarter of fiscal 2010, we increased our controlling interest in Sears Canada to 90%, from 73%, by acquiring approximately 19 million additional common shares. We paid a total of \$560 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with accounting standards applicable to noncontrolling interests. Accordingly, we reclassified an accumulated other comprehensive loss from noncontrolling interest to controlling interest in the Condensed Consolidated Statement of Equity at July 31, 2010.

During the first quarter of fiscal 2009, we acquired approximately 0.5 million of Sears Canada's common shares in open market transactions. We paid a total of \$7 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with accounting standards on noncontrolling interests.

Dividends

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

NOTE 6 STORE CLOSINGS

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which the Company no longer intends to receive any economic benefit are accrued for when the Company ceases to use the leased space. During the second quarter of fiscal 2010, we closed 7 stores we previously announced would close and recorded a charge of \$6 million for the related lease obligations. During the second quarter of 2009, we closed 24 stores we previously announced would close during the fourth quarter of fiscal 2008, as well as other small support locations throughout the U.S. We recorded a charge of \$28 million for future rent payments in the second quarter of 2009 when we vacated the retail space at these locations.

We made the decision to close 28 underperforming stores during the second quarter of fiscal 2009. These closings included 22 stores in our Kmart segment and 6 stores in our Sears segment. We recorded charges related to these store closings of \$33 million in the second quarter of 2009. The charges included \$17 million of inventory markdowns recorded in cost of sales and \$16 million recorded in selling and administrative expenses for store closing and severance costs. We did not make a decision to close any stores during the second quarter of 2010.

Total store closing charges recorded during the first half of fiscal 2010 were \$9 million, of which \$2 million was recorded in cost of sales for inventory markdowns and \$7 million was recorded in selling and administrative

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

expenses for store closing, severance and lease costs. Total store closing charges recorded during the first half of fiscal 2009 were \$78 million, of which \$17 million was recorded in cost of sales for inventory markdowns and \$61 million was recorded in selling and administrative expenses for store closing, severance and lease costs.

NOTE 7 EQUITY*Share Repurchase Program*

During the 13- and 26- week periods ended July 31, 2010, we repurchased common shares at a total cost of \$272 million and \$273 million, respectively, under our share repurchase program. Our repurchases for the 13- and 26- week periods ended July 31, 2010 were made at average prices of \$75.57 and \$75.61 per share, respectively. During the first half of fiscal 2010, we repurchased a total of 3.6 million shares. As of July 31, 2010, we had remaining authorization to repurchase \$309 million of common shares under the share repurchase program. The share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods. Timing will be dependent on prevailing market conditions, alternative uses of capital and other factors.

Accumulated Other Comprehensive Loss

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

<i>millions</i>	July 31, 2010	August 1, 2009	January 30, 2010
Pension and postretirement adjustments (net of tax of \$(468), \$(312) and \$(451), respectively)	\$ (713)	\$ (470)	\$ (686)
Cumulative unrealized derivative gain (net of tax of \$(2), \$ and \$6, respectively)	(3)		9
Currency translation adjustments (net of tax of \$(20), \$(31) and \$(29), respectively)	(27)	(47)	(44)
Accumulated other comprehensive loss	\$ (743)	\$ (517)	\$ (721)

Pension and postretirement adjustments relate to the net actuarial gain or loss on our pension and postretirement plans recognized as a component of accumulated other comprehensive income. Accumulated other comprehensive loss attributable to noncontrolling interests at July 31, 2010, August 1, 2009 and January 30, 2010 was \$43 million, \$56 million and \$132 million, respectively.

Additional Treasury Shares related to Kmart Bankruptcy Resolution

On May 6, 2003, Kmart Corporation (the Predecessor Company), a predecessor operating company of Kmart, emerged from reorganization proceedings under Chapter 11 of the federal bankruptcy laws pursuant to the terms of a plan of reorganization (the Plan of Reorganization). The Predecessor Company is an indirect, wholly owned subsidiary of Kmart and an indirect, wholly owned subsidiary of Holdings. As part of the Plan of Reorganization, 31.9 million shares of the Kmart common stock were issued to satisfy the pre-petition claims of unsecured Class 5 creditors. During the second quarter of 2010, we received and recorded as treasury stock 628,513 of these shares which were returned as unclaimed.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 8 BENEFIT PLANS*Pension and Post-retirement Benefit Plans*

We provide benefits to certain associates who are eligible under various defined benefit pension plans, contributory defined benefit pension plans and other post-retirement plans, primarily retiree medical benefits. The following table summarizes the components of total net periodic benefit expense for our retirement plans, which is determined in part by using the fair value of plan assets as the market related value of plan assets:

<i>millions</i>	13 Weeks Ended		26 Weeks Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
Components of net periodic expense:				
Benefits earned during the period	\$ 3	\$ 4	\$ 6	\$ 8
Interest costs	107	105	208	209
Expected return on plan assets	(92)	(72)	(180)	(143)
Amortization of experience gains/losses	23	16	42	31
Net periodic expense	\$ 41	\$ 53	\$ 76	\$ 105

Contributions

During the 13- and 26- week periods ended July 31, 2010, we made total contributions of \$61 million and \$122 million, respectively, to our pension and post-retirement plans. During the 13- and 26- week periods ended August 1, 2009, we made total contributions of \$44 million and \$96 million, respectively, to our pension and post-retirement plans. We anticipate making aggregate contributions to our domestic and Canadian defined benefit plans of approximately \$187 million over the remainder of fiscal 2010.

NOTE 9 INCOME TAXES

At July 31, 2010, we had gross unrecognized tax benefits of \$307 million. Of this amount, \$115 million would, if recognized, impact our effective tax rate, with the remaining amount being comprised of unrecognized tax benefits related to gross temporary differences or any other indirect benefits. During the 13- and 26- week periods ended July 31, 2010, gross unrecognized tax benefits were reduced by \$3 million. We expect that our unrecognized tax benefits could decrease up to \$137 million over the next 12 months for federal and state settlements and for federal and state tax positions related to prior business dispositions due to both the expiration of the statute of limitations for certain jurisdictions, as well as expected related settlements.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. At July 31, 2010, the total amount of interest and penalties recognized on our Condensed Consolidated Balance Sheets was \$79 million (\$51 million net of federal benefit). The total amount of net interest expense recognized in our Condensed Consolidated Statements of Operations for the 13- and 26-week periods ended July 31, 2010 was \$2 million (net of federal tax benefit) and \$5 million (net of federal tax benefit), respectively.

We file income tax returns in the United States, as well as various foreign jurisdictions. The U.S. Internal Revenue Service (IRS) is currently auditing the Holdings' federal income tax returns for the fiscal years 2006 and 2007. The IRS has completed its examination of Sears' federal income tax returns for the fiscal years 2002 - 2005 and Holdings' federal income tax return for the fiscal year 2005. We have resolved with the

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IRS all matters arising from these exams. In addition, Holdings and Sears are under examination by various state, local and foreign income tax jurisdictions for the fiscal years 2001 - 2008, and Kmart is under examination by such jurisdictions for the fiscal years 2003 - 2008.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

At July 31, 2010, we had Federal net operating loss (NOL) carryforwards from the Predecessor Company of approximately \$269 million generating deferred tax assets of approximately \$94 million. Such NOL carryforwards are no longer subject to an annual section 382 limitation. The federal NOL carryforwards will expire in 2021, 2022, 2023, and 2028. We also have credit carryforwards of \$156 million, which will expire between 2015 and 2029.

At the end of fiscal 2009, we had a state NOL deferred tax asset of \$212 million and a valuation allowance of \$131 million. In the first half of fiscal 2010, there were no adjustments to the state NOL deferred tax asset and valuation allowance. The state NOLs will predominantly expire between 2017 and 2029.

NOTE 10 SUMMARY OF SEGMENT DATA

We have three reportable segments: Kmart, Sears Domestic and Sears Canada. These reportable segment classifications are based on our business formats, which are utilized by our chief operating decision maker to make decisions about resource allocation and to assess performance. Each of these segments derives its revenues from the sale of merchandise and related services to customers, primarily in the United States and Canada. We evaluate segment financial performance based on operating income, as presented in the Condensed Consolidated Statements of Operations.

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

<i>millions</i>	For the 13 Weeks Ended August 1, 2009			
	Kmart	Sears Domestic	Sears Canada	Sears Holdings
Merchandise sales and services	\$ 3,756	\$ 5,701	\$ 1,094	\$ 10,551

Costs and expenses

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Cost of sales, buying and occupancy	2,927	4,082	747	7,756
Selling and administrative	845	1,532	253	2,630
Depreciation and amortization	36	167	25	228
Gain on sales of assets	(1)	(3)	(1)	(5)
Total costs and expenses	3,807	5,778	1,024	10,609
Operating income (loss)	\$ (51)	\$ (77)	\$ 70	\$ (58)
Total assets	\$ 6,135	\$ 16,143	\$ 3,482	\$ 25,760
Capital expenditures	\$ 12	\$ 21	\$ 13	\$ 46

Table of Contents**SEARS HOLDINGS CORPORATION**

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

<i>millions</i>	Kmart	For the 26 Weeks Ended August 1, 2009		
		Sears Domestic	Sears Canada	Sears Holdings
Merchandise sales and services	\$ 7,349	\$ 11,273	\$ 1,984	\$ 20,606
Costs and expenses				
Cost of sales, buying and occupancy	5,662	7,907	1,369	14,938
Selling and administrative	1,659	3,060	484	5,203
Depreciation and amortization	72	333	49	454
Gain on sales of assets	(10)	(4)	(45)	(59)
Total costs and expenses	7,383	11,296	1,857	20,536
Operating income (loss)	\$ (34)	\$ (23)	\$ 127	\$ 70
Total assets	\$ 6,135	\$ 16,143	\$ 3,482	\$ 25,760
Capital expenditures	\$ 39	\$ 56	\$ 27	\$ 122

NOTE 11 SUPPLEMENTAL FINANCIAL INFORMATION

Other long-term liabilities as of July 31, 2010, August 1, 2009 and January 30, 2010 consisted of the following:

millions

**July 31,
2010**