

SEARS HOLDINGS CORP
Form 10-K
March 21, 2017

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended January 28, 2017

or
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 000-51217, 001-36693

SEARS HOLDINGS CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Delaware 20-1920798
(State of Incorporation) (I.R.S. Employer Identification No.)

3333 Beverly Road, Hoffman Estates, Illinois 60179
(Address of principal executive offices) (Zip Code)
Registrant's Telephone Number, Including Area Code: (847) 286-2500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of Each Exchange on Which Registered
Common Shares, par value \$0.01 per share	The NASDAQ Stock Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such response) 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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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

On March 16, 2017, the registrant had 107,151,038 common shares outstanding. The aggregate market value (based on the closing price of the Registrant's common shares for stocks quoted on the NASDAQ Global Select Market) of the Registrant's common shares owned by non-affiliates as of the last business day of the Registrant's most recently completed second fiscal quarter, was approximately \$357 million.

Documents Incorporated By Reference

Part III of this Form 10-K incorporates by reference certain information from the Registrant's definitive proxy statement relating to our Annual Meeting of Stockholders to be held on May 10, 2017 (the "2016 Proxy Statement"), which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Form 10-K relates.

PART I

Item 1. Business

General

Sears Holdings Corporation ("Holdings") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings (together with its subsidiaries, "we," "us," "our," or the "Company") was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger") on March 24, 2005. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We operate a national network of stores with 1,430 full-line and specialty retail stores in the United States operating through Kmart and Sears. Further, we operate a number of websites under the sears.com and kmart.com banners which offer millions of products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way[®], a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way connects all of the ways members shop - in store, at home, online and by phone. The Company is a leading home appliance retailer, as well as a leader in tools, lawn and garden, fitness equipment, automotive repair and maintenance, and is a significant player in the rapidly emerging Connected Solutions market. We offer key proprietary brands including Kenmore[®] and DieHard[®], as well as Craftsman[®] branded product offerings. We also maintain a broad apparel and home offering including such well-known labels as Jaclyn Smith[®], Joe Boxer[®], Route 66[®], Cannon[®], Adam Levine[®] and Levi's[®] and also offer Lands' End[®] merchandise in some of our Full-line stores. We are the nation's No. 1 provider of appliance and product repair services, with nearly seven million service calls made annually.

The retail industry is changing rapidly. The progression of the Internet, mobile technology, social networking and social media is fundamentally reshaping the way we interact with our core customers and members. As a result, we are transitioning to a member-centric company. Our focus continues to be on our core customers, our members, and finding ways to provide them value and convenience through Integrated Retail and our Shop Your Way membership platform. We have invested significantly in our online ecommerce platforms, our membership program and the technology needed to support these initiatives.

Business Segments

Through the third quarter of 2014, we operated three reportable segments: Kmart, Sears Domestic and Sears Canada. Since the de-consolidation of Sears Canada in October 2014, we have operated in two segments, Kmart and Sears Domestic. Financial information, including revenues, operating loss, total assets and capital expenditures for each of these business segments is contained in Note 17 of Notes to Consolidated Financial Statements. Information regarding the components of revenue for Holdings is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations as well as Note 17 of Notes to Consolidated Financial Statements.

Kmart

At January 28, 2017, the Company operated a total of 735 Kmart stores across 49 states, Guam, Puerto Rico and the U.S. Virgin Islands. This store count consists of 734 discount stores, averaging 95,000 square feet, and one Super Center, approximately 185,000 square feet. Most Kmart stores are one-floor, free-standing units that carry a wide array of products across many merchandise categories, including consumer electronics, seasonal merchandise, outdoor living, toys, lawn and garden equipment, food and consumables and apparel, including products sold under such well-known labels as Craftsman, Jaclyn Smith, Joe Boxer, and certain proprietary Sears branded products (such as Kenmore and DieHard) and services. We also offer an assortment of major appliances, including Kenmore-branded products, in all of our locations. There are 451 Kmart stores that also operate in-store pharmacies. The Super Center combines a full-service grocery along with the merchandise selection of a discount store. There are also six Sears Auto Centers operating in Kmart stores, offering a variety of professional automotive repair and maintenance services, as well as a full assortment of automotive accessories. Kmart offers a layaway program, which allows members and customers to cost-effectively finance their purchases both in-store and online. In addition, our members and customers have the ability to buy online and pick up in store. This service is now

available in over 700 Kmart stores via mygofer.com, kmart.com or shopyourway.com. Kmart also sells its products through its kmart.com website and provides members and customers enhanced cross-channel options such as buying through a mobile app or online and picking up merchandise in one of our Kmart or Sears Full-line stores.

Sears Domestic

At January 28, 2017, Sears Domestic operations consisted of the following:

Full-line Stores—670 stores located across all 50 states and Puerto Rico, primarily mall-based locations averaging 139,000 square feet. Full-line stores offer a wide array of products and service offerings across many merchandise categories, including appliances, consumer electronics/connected solutions, tools, sporting goods, outdoor living, lawn and garden equipment, certain automotive services and products, such as tires and batteries, home fashion products, as well as apparel, footwear, jewelry and accessories for the whole family. Our product offerings include our proprietary Kenmore, DieHard, Bongo, Covington, Simply Styled, Everlast, Metaphor, Roebuck & Co., Outdoor Life and Structure brand merchandise, and other brand merchandise such as Craftsman, Roadhandler, Levi's and WallyHome. Lands' End, Inc. continues to operate 215 "store within a store" departments inside Sears Domestic Full-line locations. We also have 588 Sears Auto Centers operating in association with Full-line stores. In addition, there are 23 free-standing Sears Auto Centers that operate independently of Full-line stores. Sears extends the availability of its product selection through the use of its sears.com and shopyourway.com website, which offers an assortment of home, apparel and accessory merchandise and provides members and customers the option of buying through a mobile app or online and picking up their merchandise in one of our Sears Full-line or Kmart stores.

Specialty Stores—25 specialty stores (primarily consisting of the 23 free-standing Sears Auto Centers noted above) located in free-standing, off-mall locations or high-traffic neighborhood shopping centers. Specialty stores also include a Sears Appliances store in Ft. Collins, Colorado.

Commercial Sales—We sell Sears merchandise, parts and services to commercial customers through our business-to-business Sears Commercial Sales, which includes California Builder Appliances, Inc. (d/b/a Monark Premium Appliance Co. of California), Florida Builder Appliances, Inc. (d/b/a Monark Premium Appliance Co.) and Starwest, LLC. (d/b/a Monark Premium Appliance Co. of Arizona).

Home Services—Product Repair Services, the nation's No. 1 provider of appliance and product repair services, is a key element in our active relationship with nearly 35 million households. With approximately 6,400 service technicians making nearly seven million service calls annually, this business delivers a broad range of retail-related residential and commercial services across all 50 states, Puerto Rico, Guam and the Virgin Islands under either the Sears Parts & Repair Services or A&E Factory Service trade names. Commercial and residential customers can obtain parts and repair services for all major brands of products within the appliances, lawn and garden equipment, consumer electronics, floor care products, and heating and cooling systems categories. We also provide repair parts with supporting instructions for "do-it-yourself" members and customers through our searspartsdirect.com website. This business also offers protection agreements, home warranties and Kenmore and Carrier brand residential heating and cooling systems. Home Services also includes home improvement services (primarily siding, windows, cabinet refacing, kitchen remodeling, roofing, carpet and upholstery cleaning, air duct cleaning, and garage door installation and repair) provided through Sears Home Improvement Services and Sears Home & Business Franchises.

Delivery and Installation—Provides both home delivery and retail installation services for Holdings' retail operations with over four million deliveries and installation calls made annually. Also includes Innovel Solutions, which provides delivery services for third party customers.

Craftsman Brand Sale

On January 5, 2017, Holdings announced that it had entered into a definitive agreement under which Stanley Black & Decker would purchase the Craftsman brand from Holdings (the "Craftsman Sale"). On March 8, 2017, the Company closed its sale of the Craftsman brand to Stanley Black & Decker. The transaction provides Stanley Black & Decker with the right to develop, manufacture and sell Craftsman-branded products outside of Holdings and Sears

Hometown & Outlet Stores, Inc. distribution channels. As part of the agreement, Holdings will continue to offer Craftsman-branded products, sourced from existing suppliers, through its current retail channels via a perpetual license from Stanley Black & Decker, which will be royalty-free for the first 15 years after closing and royalty-bearing thereafter.

The Company received an initial upfront payment of \$525 million, subject to closing costs and an adjustment for working capital changes, at closing. In addition, Stanley Black & Decker will pay a further \$250 million in cash in three years and Holdings will receive payments of between 2.5% and 3.5% on new Stanley Black & Decker sales of Craftsman products for the 15 year period following the closing of the transaction. See Note 1 of Notes to Consolidated Financial Statements for further information.

Sears Canada Rights Offering

On October 2, 2014, the Company announced that its Board of Directors had approved a rights offering of up to 40 million shares of Sears Canada Inc. ("Sears Canada"). The operating results for Sears Canada through October 16, 2014 are presented within the consolidated operations of Holdings and the Sears Canada segment in the accompanying Consolidated Financial Statements. The Company de-consolidated Sears Canada on October 16, 2014. See Note 2 of Notes to Consolidated Financial Statements for further information.

Separation of Lands' End, Inc.

On April 4, 2014, we completed the separation of our Lands' End business through a spin-off transaction. The operating results for Lands' End through the date of the spin-off are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Consolidated Financial Statements. See Note 1 of Notes to Consolidated Financial Statements for further information.

Real Estate Transactions

In the normal course of business, we consider opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash. In addition, we review leases that will expire in the short term in order to determine the appropriate action to take with respect to them.

Further information concerning our real estate transactions is contained in Note 11 of Notes to Consolidated Financial Statements.

Trademarks and Trade Names

The KMART® and SEARS® trade names, service marks and trademarks, used by us both in the United States and internationally, are material to our retail and other related businesses.

We sell proprietary branded merchandise under a number of brand names that are important to our operations. Our KENMORE® and DIEHARD® brands are among the most recognized proprietary brands in retailing. These marks are the subject of numerous United States and foreign trademark registrations. Other well recognized Company trademarks and service marks include BLUELIGHT®, CANYON RIVER BLUES®, COVINGTON®, SHOP YOUR WAY®, SMART SENSE®, STRUCTURE®, THOM MCAN®, TOUGHSKINS®, and WALLY®, which also are registered or are the subject of pending registration applications in the United States. Generally, our rights in our trade names and marks continue so long as we use them.

Seasonality

The retail business is seasonal in nature, and we generate a high proportion of our revenues, operating income and operating cash flows during the fourth quarter of our year, which includes the holiday season. As a result, our overall profitability is heavily impacted by our fourth quarter operating results. Additionally, in preparation for the fourth quarter holiday season, we significantly increase our merchandise inventory levels, which are financed from operating cash flows, credit terms received from vendors and borrowings under our domestic credit agreement (described in the "Uses and Sources of Liquidity" section below). Fourth quarter reported revenues accounted for approximately 27% of total reported revenues in 2016, 29% of total reported revenues in 2015 and 28% of total

reported revenues in 2014, excluding the impact of transactions related to Sears Canada and Lands' End. See Note 19 of Notes to Consolidated Financial Statements for further information on revenues earned by quarter in 2016 and 2015.

Competition

Our business is subject to highly competitive conditions. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, consumer electronics dealers, auto service providers, specialty retailers, wholesale clubs, as well as many other retailers operating on a national, regional or local level in the U.S. and Canada. Online and catalog businesses, which handle similar lines of merchandise, also compete with us. Walmart, Target, Kohl's, J.C. Penney, Macy's, The Home Depot, Lowe's, Best Buy and Amazon are some of the national retailers and businesses with which we compete. The Home Depot and Lowe's are major competitors in relation to our home appliance business, which accounted for approximately 15% of our 2016, 15% of our 2015 and 15% of our 2014 reported revenues. Success in these competitive marketplaces is based on factors such as price, product assortment and quality, service and convenience, including availability of retail-related services such as access to credit, product delivery, repair and installation. Additionally, we are influenced by a number of factors, including, but not limited to, the cost of goods, consumer debt availability and buying patterns, economic conditions, customer preferences, inflation, currency exchange fluctuations, weather patterns, and catastrophic events. Item 1A in this Annual Report on Form 10-K contains further information regarding risks to our business.

Employees

At January 28, 2017, subsidiaries of Holdings had approximately 140,000 employees in the United States and U.S. territories. This employee count includes part-time employees.

Our Website; Availability of SEC Reports and Other Information

Our corporate website is located at searsholdings.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports are available, free of charge, through the "SEC Filings" portion of the Investor Information section of our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC").

The Corporate Governance Guidelines of our Board of Directors, the charters of the Audit, Compensation, Finance and Nominating and Corporate Governance Committees of the Board of Directors, our Code of Conduct and the Board of Directors Code of Conduct are available in the Corporate Governance section of searsholdings.com.

References to our website address do not constitute incorporation by reference of the information contained on such website, and the information contained on the website is not part of this document.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, results of operations and financial condition.

If we are unable to compete effectively in the highly competitive retail industry, our business and results of operations could be materially adversely affected.

The retail industry is highly competitive with few barriers to entry. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, appliances and consumer electronics retailers, auto service providers, specialty retailers, wholesale clubs, online and catalog retailers and many other competitors operating on a national, regional or local level. Some of our competitors are actively engaged in new store expansion. Online and catalog businesses, which handle similar lines of merchandise, and some of which are not required to collect sales taxes on purchases made by their customers, also compete with us. Competition may intensify as competitors enter into business combinations or alliances. We also experience significant competition from promotional activities of our competitors, and some competitors may be able to devote greater resources to sourcing, promoting and selling their products. In this competitive marketplace, success is based on factors such as price, advertising, product assortment, quality, service, reputation and convenience.

Our success depends on our ability to differentiate ourselves from our competitors with respect to shopping convenience, a quality assortment of available merchandise, functionality of digital channels, and superior customer service and experience. We must also successfully respond to our members' and customers' changing tastes and expectations. The performance of our competitors, as well as changes in their pricing policies, marketing activities, new store openings and other business strategies, could have a material adverse effect on our business, financial condition and results of operations.

If we fail to offer merchandise and services that our members and customers want, our sales may be limited, which would reduce our revenues and profits.

In order for our business to be successful, we must identify, obtain supplies of, and offer to our members and customers, attractive, innovative and high-quality merchandise. Our products and services must satisfy the desires of our members and customers, whose preferences may change in the future. Our sales and operating results depend in part on our ability to predict consumer demand for products and services we sell, availability of merchandise, product trends, and our members' and customers' purchasing habits, tastes and preferences. If we misjudge these predictions, our relationship with our members and customers may be negatively impacted, and we may be faced with excess inventories of some products, which may impact our sales or require us to sell the merchandise we have obtained at lower prices, and missed opportunities for products and services we chose not to offer. In addition, merchandise misjudgments may adversely impact the perception or reputation of our company, which could result in declines in member and customer loyalty and vendor relationships. These factors could have a negative effect on our business, financial condition and results of operations.

If our integrated retail strategy to transform into a member-centric retailer is not successful, our business and results of operations could be adversely affected.

We are seeking to transform into a member-centric retailer through our integrated retail strategy, which is based on a number of initiatives, including our Shop Your Way program, that depend on, among other things, on our ability to respond quickly to ongoing technology developments and implement new ways to understand and rely on the data to interact with our members and customers and our ability to provide attractive, convenient and consistent online and mobile experiences for our members. We must anticipate and meet our members' and customers' evolving expectations, while counteracting developments by our competitors and striving to deliver a seamless experience across all of our sales channels. We may need to adjust our strategic initiatives depending on our members' and customers' reactions to and level of engagement with our initiatives. Failure to execute these initiatives or provide our members with positive experiences may result in a loss of active members, failure to attract new members and lower than anticipated sales. There is no assurance that our initiatives and strategies will improve our operating results.

If we do not successfully manage our inventory levels, our operating results will be adversely affected. We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory as we seek to minimize out-of-stock levels across all product categories and to maintain in-stock levels. We obtain a significant portion of our inventory from vendors located outside the United States. Some of these vendors require lengthy advance notice of our requirements in order to be able to supply products in the quantities we request. This usually requires us to order merchandise, and enter into purchase order contracts for the purchase and manufacture of such merchandise, well in advance of the time these products will be offered for sale. As a result, we may experience difficulty in responding quickly to a changing retail environment, which makes us vulnerable to changes in price and demand. If we do not accurately anticipate the future demand for a particular product or the time it will take to obtain new inventory, our inventory levels will not be appropriate and our results of operations may be negatively impacted.

Our business has been and will continue to be affected by worldwide economic conditions; an economic downturn, a renewed decline in consumer-spending levels and other conditions, including inflation and changing prices of energy, could lead to reduced revenues and gross margins, and negatively impact our liquidity.

Many economic and other factors are outside of our control, including consumer and commercial credit availability, consumer confidence and spending levels, as well as the impact of payroll tax and medical cost increases on U.S. consumers, recession, inflation, deflation, employment levels, housing sales and remodels, interest rates, tax rates, rates of economic growth, fiscal and monetary government policies, consumer debt levels, consumer debt payment behaviors, fuel costs and other challenges currently affecting the global economy, the full impact of which on our business, results of operations and financial condition cannot be predicted with certainty. These economic conditions adversely affect the disposable income levels of, and the credit available to, our members and customers, which could lead to reduced demand for our merchandise. Although fuel and energy costs have decreased in recent months, future increases may have a significant impact on our operations. We require significant quantities of fuel for the vehicles used by technicians in our home services business, and we are exposed to the risk associated with variations in the market price for petroleum products. We could experience a disruption in energy supplies, including our supply of gasoline, as a result of factors that are beyond our control, which could have an adverse effect on our business. Certain of our vendors also could experience increases in the cost of various raw materials, such as cotton, oil-related materials, steel and rubber, which could result in increases in the prices that we pay for merchandise, particularly apparel, appliances and tires. Domestic and international political events also affect consumer confidence. The threat, outbreak or escalation of terrorism, civil unrest, military conflicts or other hostilities could lead to a decrease in consumer spending. Any of these events and conditions could inhibit sales or cause us to increase inventory markdowns and promotional expenses, thereby reducing our gross margins.

The lack of willingness of our vendors to do business with us or to provide acceptable payment terms could negatively impact our liquidity and/or reduce the availability of products or services we seek to procure.

We depend on our vendors to provide us with financing on our purchases of inventory and services. Our vendors could seek to limit the availability of vendor credit to us or modify the other terms under which they sell to us, or both, which could negatively impact our liquidity. In addition, the inability of vendors to access liquidity, or the insolvency of vendors, could lead to their failure to deliver inventory or other services. Certain of our vendors finance their operations and/or reduce the risk associated with collecting accounts receivable from us by selling or "factoring" the receivables or by purchasing credit insurance or other forms of protection from loss associated with our credit risks. The ability of our vendors to do so is subject to the perceived credit quality of the Company. Such vendors could be limited in their ability to factor receivables or obtain credit protection in the future because of our perceived financial position and creditworthiness, which could reduce the availability of products or services we seek to procure, increase the cost to us of those products and services, or both.

We have ongoing discussions concerning our liquidity and financial position with the vendor community and third parties that offer various credit protection services to our vendors. The topics discussed have included such areas as pricing, payment terms and ongoing business arrangements. As of the date of this report, we have not experienced any significant disruption in our access to merchandise or our operations; however, there can be no assurance that one or more of our vendors may not slow or cease merchandise shipments or require or condition the sale or shipment of merchandise on new payment terms or other assurances. Such circumstances could have a negative effect on our business, financial condition and results of operations.

Certain factors, including changes in market conditions and our credit ratings, may limit our access to capital markets and other financing sources and materially increase our borrowing costs.

In addition to credit terms from vendors, our liquidity needs are funded by our operating cash flows and, to the extent necessary, borrowings under our credit agreements and commercial paper program, asset sales and access to capital markets. The availability of financing depends on numerous factors, including economic and market conditions, our operating performance, our credit ratings, and lenders' assessments of our prospects and the prospects of the retail industry in general. Changes in these factors may affect our cost of financing, liquidity and our ability to access financing sources, including our commercial paper program and possible second lien indebtedness that is permitted under the domestic revolving credit facility, with respect to each of which we have no lender commitments. Rating agencies revise their ratings for the companies that they follow from time to time. Several ratings agencies have downgraded the credit rating on certain of our outstanding debt instruments during the six months preceding the date of this report, and our ratings may be further revised or withdrawn in their entirety at any time.

The Company's domestic credit facility currently provides up to \$2.8 billion of lender commitments, \$1.5 billion of which are revolving commitments. Our ability to borrow funds under this facility is limited by a borrowing base determined by the value, from time to time, of eligible inventory, accounts receivable and certain other assets. If, through asset sales or other means, the value of these eligible assets is not sufficient to support borrowings of up to the full amount of the commitments under this facility, we will not have full access to the facility, but rather will have access to a lesser amount determined by the borrowing base. A decline in the value of eligible assets also could result in our inability to borrow up to the full amount of second lien indebtedness permitted by the domestic credit facility as our second-lien borrowings are limited by a borrowing base requirement under the indenture that governs our senior secured notes due 2018. The domestic revolving credit facility imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement. The domestic credit facility also effectively limits full access to the facility if our fixed charge ratio at the last day of any quarter is less than 1.0 to 1.0. As of January 28, 2017, our fixed charge ratio was less than 1.0 to 1.0. If availability under the domestic revolving credit facility were to fall below 10%, the Company would be required to test the fixed charge coverage ratio, and would not comply with the facility, and the lenders under the facility could demand immediate payment in full of all amounts outstanding and terminate their obligations under the facility. In addition, the domestic credit facility provides that in the event we make certain prepayments of indebtedness, for a period of one year thereafter we must maintain availability under the facility of at least 12.5%, and it prohibits certain other prepayments of indebtedness.

The lenders under our various credit facilities may not be able to meet their commitments if they experience shortages of capital and liquidity. Disruptions or turmoil in the financial markets could reduce our ability to meet our capital requirements. There can be no assurance that our ability to otherwise access the credit markets will not be adversely affected by changes in the financial markets and the global economy.

We cannot predict whether our plans to enhance our financial flexibility and liquidity to fund our transformation will be successful.

We are continuing to pursue a transformation strategy and to explore potential initiatives to enhance our financial flexibility and liquidity. We have incurred significant losses and experienced negative operating cash flows for the past several years, and accordingly we have taken a number of actions to fund our continued transformation and meet our obligations, including the amendment and extension of our revolving credit facility, the first lien term loan facility due 2018, the entrance into the first lien term loan facility due 2020, the second lien term loan facility due 2020, the amendment of the senior secured letter of credit facility, the real estate term loan facility due July

2017 and the real estate term loan facility due 2020, the sale of the Craftsman brand, the rights offering and sale-leaseback transaction with Seritage Growth Properties, the separation of our Lands' End subsidiary, the Sears Canada rights offering, the rights offering for senior unsecured notes with warrants, and various real estate transactions. We also expect to pursue other near-term actions to bolster liquidity. If we continue to incur losses, additional actions may be required to further enhance our financial flexibility and liquidity. The success of our initiatives is subject to risks and uncertainties with respect to market conditions and other factors that may cause our actual results, performance or achievements to differ materially from our plans. We cannot assure that cash flows and other internal and external sources of liquidity will at all times be sufficient for our cash requirements. If necessary, we may need to consider actions and steps to improve our cash position, mitigate any potential liquidity shortfall, pursue additional sources of liquidity, and reduce costs. There can be no assurance that these actions would be successful. In addition, there can be no assurance that the evaluation and/or completion of any potential transactions will not have a negative impact on our other businesses.

We cannot predict the outcome of any actions to generate liquidity, whether such actions would generate the expected liquidity as currently planned, or the availability of additional debt financing. The specific actions taken or assets involved, the timing, and the overall amount will depend on a variety of factors, including market conditions, interest in specific assets, valuations of those assets and our underlying operating performance.

If we continue to experience operating losses and we are not able to generate additional liquidity through the mechanisms described above or through some combination of other actions, we may not be able to access additional funds under our domestic credit facility and we might need to secure additional sources of funds, which may or may not be available to us. Additionally, a failure to generate additional liquidity could negatively impact our access to inventory or services that are important to the operation of our business. Moreover, if the borrowing base (as calculated pursuant to the indenture) falls below the principal amount of the notes plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for the notes on the last day of any two consecutive quarters, it could trigger an obligation to repurchase notes in an amount equal to such deficiency. Our business results and ability to fund our transformation depend on our ability to achieve cost savings initiatives and complete our previously announced restructuring program.

In February 2017, we initiated a restructuring program targeted to deliver at least \$1.0 billion in annualized cost savings. Under the restructuring program, we plan to reduce our corporate overhead, more closely integrate our Sears and Kmart operations and improve our merchandising, supply chain and inventory management. The anticipated savings also include cost reductions from the previously announced closure of 108 Kmart and 42 Sears stores. If we are unable to deliver the expected cost reductions or complete the restructuring program as planned, while continuing to invest in business growth, our financial results could be adversely impacted. Our ability to successfully manage and execute these initiatives and realize expected savings and benefits in the amounts and at the times anticipated is important to our business success, and any failure to do so, which could result from our inability to successfully execute plans, changes in global or regional economic conditions, competition, changes in the industries in which we compete, unanticipated costs or charges and other factors described herein, could adversely affect our business, financial condition and results of operations. As part of our overhead reduction, we have reduced our corporate and operations headcount, including management level, distribution and field employees. These reductions, as well as attrition could result in the potential loss of specific knowledge relating to our company, operations and industry that could be difficult to replace. Also, we now operate with fewer employees, who have assumed additional duties and responsibilities. The restructuring program and workforce changes may negatively impact communication, morale, management cohesiveness and effective decision-making, which could have an adverse impact on our business operations, customer experience, sales and results of operations.

Our business results may be negatively impacted as a result of the recapture rights included in the Master Leases in connection with the Seritage transaction and JV transactions.

In 2015, we entered into various sale-lease back transactions with respect to certain of our real properties with Seritage Growth Properties ("Seritage") and certain joint ventures we formed with affiliates of Simon Property Group, Inc., General Growth Properties, Inc. and the Macerich Company (collectively, the "JVs"). In connection with the Seritage transaction and JV transactions, Holdings entered into agreements with Seritage and the JVs pursuant to which Holdings leased 255 of the properties (the "Master Leases"). The Master Leases include recapture provisions that allow Seritage or the JVs, as applicable, to reclaim approximately 50% of the space within these properties (subject to certain exceptions, including reclamation rights as to 100% of the space at 21 properties, and further subject to a lease termination payment by Seritage), in addition to all of the automotive care centers which are free-standing or attached as "appendages," and all outparcels or outlots, as well as certain portions of parking areas and common areas. While we believe these provisions are generally beneficial for Holdings as they facilitate the transformation of our physical stores, potentially enable us to rationalize our footprint by reducing the space we occupy in a given location, and provide us with substantial flexibility in how we manage our store network moving forward, if we are unable to successfully manage and execute our plans to operate our stores in the smaller footprint, our business, financial condition and results of operations could be adversely impacted. Additionally, the recapture rights are within the control of Seritage and the JVs and we cannot predict the timing on which the recapture rights may be exercised, if at all, or whether the timing of any such exercise of these rights will align well with the timing of our transformation, which could create disruptions in our operations.

Potential liabilities in connection with the separation of Lands' End or other asset transactions may arise under fraudulent conveyance and transfer laws and legal capital requirements.

With respect to the separation of our Lands' End, Inc. subsidiary, the sale of real estate assets to real estate investment trusts and other third parties, the sale of the Craftsman brand, and any future dispositions of other similar assets, if the Company, Lands' End, or any asset purchaser subsequently fails to pay its creditors or enters insolvency proceedings, the transaction may be challenged under U.S. federal, U.S. state and foreign fraudulent conveyance and transfer laws, as well as legal capital requirements governing distributions and similar transactions. If a court were to determine under these laws that, (a) at the time of the transaction, the entity in question: (1) was insolvent; (2) was rendered insolvent by reason of the transaction; (3) had remaining assets constituting unreasonably small capital; (4) intended to incur, or believed it would incur, debts beyond its ability to pay these debts as they matured; or (b) the transaction in question failed to satisfy applicable legal capital requirements, the court could determine that the transaction was voidable, in whole or in part. Subject to various defenses, the court could then require the Company, Lands' End, the respective purchaser, or other recipients of value in connection with any such transaction, as the case may be, to turn over value to other entities involved in the transaction and contemplated transactions for the benefit of unpaid creditors. The measure of insolvency and applicable legal capital requirements will vary depending upon the jurisdiction whose law is being applied.

We rely extensively on computer systems to implement our integrated retail strategy, process transactions, summarize results and otherwise manage our business. Disruptions in these systems could harm our ability to run our business. Given the significance of our online and mobile capabilities, our collection and use of data to create personalized experiences, and the number of individual transactions we have each year, including in our stores, it is critical that we maintain uninterrupted operation of our computer and communications hardware and software systems, some of which are based on end-of-life or legacy technology, operate with minimal or no vendor support and are otherwise difficult to maintain. Our systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, worms, other malicious computer programs, denial-of-service attacks, security breaches, catastrophic events such as fires, tornadoes, hurricanes, acts of terrorism and usage errors by our employees. If our systems are damaged, breached or cease to function properly, we may have to make a significant investment to repair or replace them, and we may suffer loss of critical data and interruptions or delays in our operations. Operating legacy systems subjects us to inherent costs and risks associated with maintaining, upgrading and replacing these systems and retaining sufficiently skilled personnel to maintain and operate the systems, demands on management time, and other risks and costs. Any material interruption in our

computer operations may have a material adverse effect on our business or results of operations, including on our Shop Your Way program and participation in or engagement with that program. We are pursuing initiatives to transform our information technology processes and systems. These initiatives are highly complex and include replacing legacy systems, upgrading existing systems, and acquiring new systems and hardware with updated functionality. The risk of disruption is increased in periods when such complex and significant systems changes are undertaken.

If we do not maintain the security of our member and customer, associate or company information, we could damage our reputation, incur substantial additional costs and become subject to litigation.

The protection of member, customer, employee, and company data is critical to the Company. We have systems and processes in place that are designed to protect information and protect against security and data breaches as well as fraudulent transactions and other activities. Nevertheless, cyber-security risks such as malicious software and attempts to gain unauthorized access to data are rapidly evolving and becoming increasingly sophisticated. Techniques or software used to gain unauthorized access, and/or disable, degrade or harm our systems may be difficult to detect or scope for prolonged periods of time, and we may be unable to anticipate these techniques or put in place protective or preventive measures. These attempts to gain unauthorized access could lead to disruptions in our systems, unauthorized release of confidential or otherwise protected information or corruption of data. If individuals are successful in infiltrating, breaking into, disrupting, damaging or otherwise stealing from the computer systems of the Company or its third-party providers we may have to make a significant investment to fix or replace them, we may suffer interruptions in our operations in the interim, we may face costly litigation, government investigations, government enforcement actions, fines and/or lawsuits, the ability for our members to earn or redeem points in our Shop Your Way program may be impacted or halted, and our reputation with our members and customers may be significantly harmed. There is no guarantee that the procedures that we have implemented to protect against unauthorized access to secured data are adequate to safeguard against all data security breaches. A data security breach or any failure by us to comply with applicable privacy and information security laws and regulations could result in a loss of customer or member confidence and negatively impact our business, including our Shop Your Way program, and our results of operations. Moreover, a data security breach could require us to devote significant management resources to address the problems created by the breach and to expend significant additional resources to upgrade further the security measures that we employ to guard against such breaches, which could disrupt our business, operations and financial condition. As publicly announced on October 10, 2014, Kmart's information technology team detected on October 9, 2014 that the Kmart store payment data system had been criminally breached beginning in early September 2014, that the payment data systems at Kmart stores were purposely infected with a new form of malware, and that debit and credit card numbers were potentially compromised. The Company has settled a class-action lawsuit in the Northern District of Illinois alleging violations relating to, and harm resulting from this incident and is awaiting final court approval of the settlement.

We are subject to payment-related risks that could increase our operating costs, expose us to fraud or theft, subject us to potential liability and potentially disrupt our business operations.

As a retailer who accepts payments using a variety of methods, including credit and debit cards, PayPal, and gift cards, the Company is subject to rules, regulations, contractual obligations and compliance requirements, including payment network rules and operating guidelines, data security standards and certification requirements, and rules governing electronic funds transfers. The regulatory environment related to information security and privacy is increasingly rigorous, with new and constantly changing requirements applicable to our business, and compliance with those requirements could result in additional costs or accelerate these costs. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which could increase over time and raise our operating costs. We rely on third parties to provide payment processing services, including the processing of credit cards, debit cards, and other forms of electronic payment. If these companies become unable to provide these services to us, or if their systems are compromised, it could disrupt our business.

The Payment Card Industry (PCI) has established standards for securing payment card data through the PCI Data Security Standards (DSS). The Company is required to conduct an annual assessment with a PCI Qualified Security Assessor to assess compliance with the PCI DSS. Based on the 2016 assessment, the Company was determined to be non-compliant with PCI DSS. The Company presently expects to address areas of non-compliance

prior to the deadline for the 2017 annual assessment in September 2017. A failure to achieve compliance with PCI DSS could result in the incurrence of fines, penalties or other liabilities by the Company.

Due to the seasonality of our business, our annual operating results would be adversely affected if our business performs poorly in the fourth quarter.

Due to the seasonality of our business, our operating results vary considerably from quarter to quarter. We generate a high proportion of revenues, operating income and operating cash flows during the fourth quarter of our year, which includes the holiday season. In addition, our Company incurs significant additional expenses for inventory, advertising and employees in the period leading up to the months of November and December in anticipation of higher sales volume in the fourth quarter. As a result, our fourth quarter operating results significantly impact our annual operating results. Our fourth quarter operating results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions.

Our sales may fluctuate for a variety of reasons, which could adversely affect our results of operations.

Our business is sensitive to customers' spending patterns, which in turn are subject to prevailing economic conditions.

Our sales and results of operations have fluctuated in the past, and we expect them to continue to fluctuate in the future. A variety of other factors affect our sales and financial performance, including:

- actions by our competitors, including opening of new stores in our existing markets or changes to the way these competitors go to market online;

- seasonal fluctuations due to weather conditions;

- changes in our merchandise strategy and mix;

- changes in population and other demographics; and

- timing of our promotional events.

Accordingly, our results for any one quarter are not necessarily indicative of the results to be expected for any other quarter, and comparable store sales for any particular future period may increase or decrease. For more information on our results of operations, see Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Annual Report on Form 10-K.

We rely on foreign sources for significant amounts of our merchandise, and our business may therefore be negatively affected by the risks associated with international trade.

We depend on a large number of products produced in foreign markets. We face risks, including reputational risks, associated with sourcing, purchasing, and the delivery of merchandise originating outside the United States, including:

- potential economic and political instability in countries where our suppliers are located;

- increases in shipping costs;

- manufacturing and transportation delays and interruptions, including without limitation, delays and interruptions resulting from labor slowdowns, strikes, or other disruptions at any port where merchandise we purchase enters the U.S.;

- the availability of raw materials to suppliers;

- supplier financial instability;

- supplier compliance with applicable laws, including labor and environmental laws, and with our global compliance program for suppliers and factories;

- merchandise safety and quality issues, adverse fluctuations in currency exchange rates; and

- changes in U.S. and foreign laws affecting the importation and taxation of goods, including duties, tariffs and quotas, or changes in the enforcement of those laws.

U.S. foreign trade policies, trade restrictions, other impositions on imported goods, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries, and other factors relating to foreign trade are beyond our control. These and other factors affecting our suppliers and our access to products could adversely affect our results of operations.

We rely on third parties to provide us with services in connection with the administration of certain aspects of our business.

We have entered into agreements with third-party service providers (both domestic and overseas) to provide processing and administrative functions over a broad range of areas, and we may continue to do so in the future. These areas include finance and accounting, information technology, including IT development, call center, human resources and procurement functions. Services provided by third parties could be interrupted as a result of many factors, such as acts of God or contract disputes, and any failure by third parties to provide us with these services on a timely basis or within our service level expectations and performance standards could result in a disruption of our business. In addition, to the extent we are unable to maintain our outsourcing arrangements, we could incur substantial costs, including costs associated with hiring new employees or finding an alternative outsourced solution. Moreover, the Company cannot make any assurances that it would be able to arrange for alternate or replacement outsourcing arrangements on terms as favorable as the Company's existing agreements, if at all. Any inability on the part of the Company to do so could negatively affect our results of operations. These outsourcing arrangements also carry the risk that the Company will fail to adequately retain the significant internal historical knowledge of our business and systems that is transferred to the service providers as the employment of the Company's personnel who possess such knowledge ends.

We could incur charges due to impairment of goodwill, intangible and long-lived assets.

At January 28, 2017, we had goodwill and intangible asset balances of \$1.8 billion, which are subject to periodic testing for impairment. Our long-lived assets, primarily stores, also are subject to periodic testing for impairment. A significant amount of judgment is involved in the periodic testing. Failure to achieve sufficient levels of cash flow within our reporting unit, or sales of our branded products or cash flow generated from operations at individual store locations could result in impairment charges for goodwill and intangible assets or fixed asset impairment for long-lived assets, which could have a material adverse effect on our reported results of operations. Impairment charges, if any, resulting from the periodic testing are non-cash. A significant decline in the property fair values could result in long-lived asset impairment charges. A significant and sustained decline in our stock price could result in goodwill and intangible asset impairment charges. During times of financial market volatility, significant judgment is used to determine the underlying cause of the decline and whether stock price declines are short-term in nature or indicative of an event or change in circumstances. See Notes 12 and 13 of Notes to Consolidated Financial Statements for further information.

Our failure to attract or retain employees, including key personnel, may disrupt our business and adversely affect our financial results.

Our business is dependent on our ability to attract, develop, and retain qualified employees, many of whom are entry-level or part-time positions with historically high turnover rates. Our ability to meet our labor needs and control labor costs is subject to external factors such as unemployment levels, prevailing wage rates, collective bargaining efforts, health care and other benefit costs, changing demographics, and our reputation within the labor market. If we are unable to attract and retain adequate numbers and an appropriate mix of qualified employees, the quality of service we provide to our customers may decrease and our financial performance may be adversely affected. Further, we depend on the contributions of key personnel, including Edward S. Lampert, our Chairman and Chief Executive Officer, and other key employees, for our future success. Although certain executives have employment agreements with us, changes in our senior management and any future departures of key employees may disrupt our business and materially adversely affect our results of operations.

Affiliates of our Chairman and Chief Executive Officer, whose interests may be different than your interests, exert substantial influence over our Company.

Affiliates of Edward S. Lampert, our Chairman and Chief Executive Officer, collectively own approximately 48% of the outstanding shares of our common stock at January 28, 2017. These affiliates are controlled, directly or indirectly, by Mr. Lampert. Accordingly, these affiliates, and thus Mr. Lampert, have substantial influence over many, if not all, actions to be taken or approved by our stockholders, including the election of directors and any transactions involving a change of control.

The interests of these affiliates, which have investments in other companies, including Seritage and our former subsidiaries, Sears Hometown and Outlet Stores, Inc., Lands' End, Inc. and Sears Canada, may from time to time diverge from the interests of our other stockholders, particularly with regard to new investment opportunities. This substantial influence may also have the effect of discouraging offers to acquire our Company because the consummation of any such acquisition would likely require the consent of these affiliates.

We may be unable to protect or preserve the image of our brands and our intellectual property rights, which could have a negative impact on our business.

We regard our copyrights, service marks, trademarks, trade dress, trade secrets, patents and similar intellectual property as critical to our success, particularly those that relate to our private branded merchandise. As such, we rely on trademark and copyright law, patent law, trade secret protection and confidentiality agreements with our associates, consultants, vendors, and others to protect our proprietary rights. Nevertheless, the steps we take to protect our proprietary rights may be inadequate. If we are unable to protect or preserve the value of our trademarks, copyrights, trade secrets, patents or other proprietary rights for any reason, or if we fail to maintain the image of our brands due to merchandise and service quality issues, actual or perceived, adverse publicity, governmental investigations or litigation, or other reasons, our brands and reputation could be damaged and we could lose members and customers.

Our sales and operating results could be adversely affected by product safety concerns or claims concerning the services we offer.

If our merchandise offerings do not meet applicable safety standards or consumer expectations regarding safety, we could experience decreased sales, increased costs, and exposure to reputational risk and personal injury, death, or property damage claims related to such merchandise. Such matters may require us to take actions such as product recalls and could give rise to government enforcement actions. We also provide various services to our members and customers, which could also give rise to such claims and government actions. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. Reputational damage caused by and claims arising from real or perceived product safety concerns or from the services we offer could negatively affect our business and results of operations.

We may be subject to periodic litigation and other regulatory proceedings. These proceedings may be affected by changes in laws and government regulations or changes in the enforcement thereof.

From time to time, we may be involved in lawsuits and regulatory actions relating to our business, certain of which may be in jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants. Some of these actions have the potential for significant statutory penalties, and compensatory, treble or punitive damages. Our pharmacy, home services and grocery businesses, in particular, are subject to numerous federal, state and local regulations, and a significant change in, or noncompliance with, these regulations could have a material adverse effect on our compliance costs and results of operations. We are impacted by trends in litigation, including class-action allegations brought under various consumer protection and employment laws, including wage and hour laws, patent infringement claims, and investigations and actions that are based on allegations of untimely compliance or noncompliance with applicable regulations or statutes. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition, and results of operations. In addition, regardless of the outcome of any litigation or regulatory proceedings, these proceedings could result in substantial costs and may require that we devote substantial resources to defend our Company. Further, changes in governmental regulations both in the United States and in the other countries where we operate could have adverse effects on our business and subject us to additional regulatory actions. For a description of current legal proceedings, see Item 3, Legal Proceedings, as well as Note 18 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K.

Our pension and postretirement benefit plan obligations are currently underfunded, and we may have to make significant cash payments to some or all of these plans, which would reduce the cash available for our businesses. We have unfunded obligations under our domestic pension and postretirement benefit plans. The funded status of our pension plans is dependent upon many factors, including returns on invested assets, the level of certain market interest rates and the discount rate used to determine pension obligations. Unfavorable returns on the plan assets or unfavorable changes in applicable laws or regulations could materially change the timing and amount of required plan funding, which would reduce the cash available for our businesses. In addition, a decrease in the discount rate used to determine pension obligations could result in an increase in the valuation of pension obligations, which could affect the reported funding status of our pension plans and future contributions, as well as the periodic pension cost in subsequent years. Moreover, unfavorable regulatory action could materially change the timing and amount of required plan funding and negatively impact our business operations and impair our business strategy.

On March 18, 2016, we entered into a five-year pension plan protection and forbearance agreement with the Pension Benefit Guaranty Corporation ("PBGC"), pursuant to which the Company has agreed to continue to protect, or "ring-fence," pursuant to customary covenants, the assets of certain special purpose subsidiaries (the "Relevant Subsidiaries") holding real estate and/or intellectual property assets. Also under the agreement, the Relevant Subsidiaries granted PBGC a springing lien on the ring-fenced assets, which lien will be triggered only by (a) failure to make required contributions to the Company's pension plans (the "Plans"), (b) prohibited transfers of ownership interests in the Relevant Subsidiaries, (c) termination events with respect to the Plans, or (d) bankruptcy events with respect to the Company or certain of its material subsidiaries.

The Company will continue to make required contributions to the Plans, the scheduled amounts of which are not affected by the arrangement. Under the agreement, the PBGC has agreed to forbear from initiating an involuntary termination of the Plans, except upon the occurrence of specified conditions, one of which is based on the aggregate market value of the Company's issued and outstanding stock. As of the date of this report, the Company's stock price is such that the PBGC would be permitted to cease forbearance. The PBGC has been given notice in accordance with the terms of the agreement and has not communicated any intention to cease its forbearance; however, if the PBGC were to initiate an involuntary termination of the Plans, our financial condition could be materially and adversely affected. We may not realize the full anticipated benefits of the recently closed Craftsman Sale transaction.

We may not realize the full anticipated benefits of the recently closed Craftsman Sale transaction (the "Craftsman Sale"), in which case our business, financial results or operations could be adversely affected. Under the Purchase Agreement, during the 15-year period following the closing of the Craftsman Sale, Holdings is entitled to receive additional contingent payments based on a specified percentage of aggregate worldwide net sales (as defined in the Purchase Agreement) of Stanley Black & Decker and its affiliates of Craftsman-branded products. These contingent payments are dependent upon Stanley successfully maintaining and increasing market demand for, and sales of, Craftsman-branded products, and there can be no assurance regarding the amount or timing of any such contingent payments. In addition, following the closing of the Craftsman Sale, we will have the right to continue to use the Licensed IP and sell Craftsman-branded products in certain distribution channels pursuant to a license agreement with Stanley. If the license is terminated, or if the terms of the license agreement are otherwise modified, we may not be able to continue to market, procure or sell Craftsman-branded products on favorable terms or at all, and our business may be adversely affected.

Our failure to comply with federal, state, local and international laws, or changes in these laws could adversely affect our results of operations.

Our business is subject to a wide array of laws and regulations. If we fail to comply with applicable laws and regulations, we could be subject to legal risk, including government enforcement action and class action civil litigation that could increase our cost of doing business. Changes in the regulatory environment regarding topics such as privacy and information security, product safety, environmental protection, payment methods and related fees, responsible sourcing, supply chain transparency, wage and hour laws, health care mandates and other

applicable laws and regulations could also cause our compliance costs to increase and adversely affect our results of operations.

Our performance could further be impacted by changes in legislation, trade policies and agreements, energy and environmental standards, and tax laws and regulations. The current U.S. Administration has signaled that it may alter trade agreements and terms with foreign countries, including limiting trade and/or imposing a tariff on imports from certain foreign countries. If any such restrictions or tariffs are imposed on products that we import, we may be required to raise our prices, which could result in decreased sales. Further, changes in environmental and energy efficiency standards and regulations applicable to products that we develop and/or sell, and potential changes in the size and availability of tax incentives applicable to such products, may impact the types, characteristics, and consumer interest in such products, which may negatively impact our results of operations. Moreover, future legislation or regulations, including environmental matters, product certification, product liability, tariffs, duties, taxes, tax incentives and other matters, may impact our results. Major developments in tax policy or trade relations, such as the disallowance of tax deductions for imported merchandise or the imposition of unilateral tariffs on imported products, could have a material adverse effect on our business, results of operations and liquidity. In addition, various corporate tax reform proposals being discussed on Capitol Hill and in the U.S. Administration could impact our Company. A reduction in corporate income tax rates at the Federal level could be favorable to our financial position, while other ideas such as a border tax could dramatically increase our tax burden and raise the costs of goods for our consumers. Weather conditions and natural disasters may impact consumer shopping patterns and could adversely affect our results of operations.

Significant weather conditions where our stores are located could negatively affect the Company's business and results of operations. Heavy snowfall, ice storms, rainstorms or other extreme weather conditions over a prolonged period could make it difficult for our members and customers to travel to our stores, thus leading to decreased sales. Our business is also susceptible to unseasonable weather conditions, such as unseasonably warm temperatures during the winter season or cool weather during the summer season, which could reduce demand for certain inventory and compromise our efforts to predict and manage inventory levels effectively. In addition, extreme weather conditions could result in disruption or delay of production and delivery of materials and products in our supply chain. In addition, natural disasters such as hurricanes, tornadoes and earthquakes, or a combination of these or other factors, could damage or destroy our facilities or make it difficult for members and customers to travel to our stores, thereby negatively affecting our business and results of operations as well as causing us to incur significant expenses to repair or replace such facilities.

Our stock price has been and may continue to be volatile.

The market price of our common stock has fluctuated substantially and may continue to fluctuate significantly. Future announcements or disclosures concerning us or any of our competitors, our strategic initiatives, our sales and profitability, any quarterly variations in actual or anticipated operating results or comparable sales, any failure to meet analysts' expectations and sales of large blocks of our common stock, among other factors, could cause the market price of our common stock to fluctuate substantially.

Increases in the cost of employee benefits could impact our financial results and cash flow.

Our expenses relating to employee health benefits are significant. Unfavorable changes in the cost of such benefits could negatively affect our financial results and cash flow. Healthcare costs have risen significantly in recent years, and recent legislative and private sector initiatives regarding healthcare reform have resulted, and could continue to result in significant changes to the U.S. healthcare system. Due to the breadth and complexity of the healthcare reform legislation, and the potential for change in this regard under the current U.S. Administration, we are unable at this time to fully determine the impact that further healthcare reform will have on our employee health benefit plans.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The following table summarizes the locations of our Kmart and Sears Domestic stores at January 28, 2017:

State / Territory	Kmart	Sears Domestic	
		Full-line Stores	Specialty Stores
Alabama	8	5	—
Alaska	—	3	—
Arizona	9	13	—
Arkansas	3	5	—
California	72	75	4
Colorado	8	10	1
Connecticut	5	7	—
Delaware	4	3	—
Florida	39	48	1
Georgia	18	18	—
Hawaii	5	4	—
Idaho	5	4	—
Illinois	19	24	5
Indiana	17	13	1
Iowa	15	5	1
Kansas	6	5	1
Kentucky	18	6	—
Louisiana	6	11	1
Maine	5	4	—
Maryland	16	18	—
Massachusetts	14	20	—
Michigan	38	19	—
Minnesota	7	10	—
Mississippi	2	4	—
Missouri	15	11	—
Montana	7	1	—
Nebraska	2	4	—
Nevada	10	5	1
New Hampshire	4	6	—
New Jersey	25	20	1
New Mexico	9	7	—
New York	42	35	4
North Carolina	21	18	—
North Dakota	5	4	—
Ohio	33	30	—
Oklahoma	6	6	—
Oregon	7	6	1
Pennsylvania	72	31	—
Rhode Island	1	2	—
South Carolina	14	9	—
South Dakota	3	2	—
Tennessee	14	14	—
Texas	11	56	1
Utah	5	5	1
Vermont	2	1	—

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Virginia	19	19	—
Washington	9	17	1
West Virginia	14	6	—
Wisconsin	13	10	—
Wyoming	7	2	—
Puerto Rico	21	9	—
U.S. Virgin Islands	4	—	—
Guam	1	—	—
Totals	735	670	25

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	Kmart	Sears Domestic Full-line Stores	Specialty Stores
Owned	67	293	20
Leased	668	377	5
January 28, 2017	735	670	25

In addition, at January 28, 2017, we had 31 domestic supply chain distribution centers, of which 12 were owned and 19 were leased with remaining lease terms ranging up to 10 years. Of the total, six primarily support Kmart stores, 21 primarily support Sears stores and four support both Sears and Kmart stores. We also had 429 domestic store warehouses, customer call centers and service facilities (including 19 facilities related to our Monark Premium Appliance Co. of California, Monark Premium Appliance Co., and Monark Premium Appliance Co. of Arizona businesses), most of which are leased for terms ranging from one to six years or are part of other facilities included in the above table. Many of our facilities are also used to support our online channels.

Our principal executive offices are located on a 200-acre site owned by us at the Prairie Stone office park in Hoffman Estates, Illinois. The complex consists of six interconnected office buildings totaling approximately two million gross square feet of office space. We also own an 86,000 square foot office building in Troy, Michigan. We operate numerous buying offices throughout the world that procure product internationally, as well as an information technology center in Pune, India.

A description of our leasing arrangements and commitments appears in Note 14 of Notes to Consolidated Financial Statements.

Item 3. Legal Proceedings

See Part II, Item 8, Financial Statements—Notes to Consolidated Financial Statements, Note 18—Legal Proceedings, for additional information regarding legal proceedings, which information is incorporated herein by this reference.

Item 4. Mine Safety Disclosures

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table and information sets forth the names of our executive officers, their current positions and offices with the Company, the date they first became executive officers of the Company, their current ages, and their principal employment during the past five years.

Name	Position	Date First Became an Executive Officer	Age
Edward S. Lampert	Chairman of the Board and Chief Executive Officer	2013	54
Jason M. Hollar	Chief Financial Officer	2016	43
Eric D. Jaffe	Senior Vice President, Shop Your Way	2016	29
Girish Lakshman	President, Fulfillment - Supply Chain and Sourcing	2015	52
Leena Munjal	Senior Vice President, Customer Experience and Integrated Retail	2013	40
David Pastrana	President, Apparel	2016	40
James Politeski	President, Home Appliances and Consumer Electronics	2016	49
Robert A. Riecker	Controller and Head of Capital Markets Activities	2012	52
Sean Skelley	President, Home Services	2016	50
Stephan Zoll	President, Online	2016	46

Mr. Lampert has served as Chairman of the Company's Board of Directors since 2004 and as our Chief Executive Officer since February 2013. He also is the Chairman and Chief Executive Officer of ESL Investments, Inc., which he founded in April 1988.

Mr. Hollar was appointed to his current position in October 2016, and had served as Senior Vice President, Finance of the Company since October 2014. Prior to joining the Company, he worked for Delphi Automotive PLC, serving from December 2013 to September 2014 as Vice President and Corporate Controller and from April 2011 to November 2013 as CFO, Powertrain Systems and Delphi Europe, Middle East and Africa.

Mr. Jaffe has served in his current position, as Senior Vice President, Shop Your Way, since January 2013. Prior to joining the Company, he served as an Investment Analyst at Rand Group from 2012-2013, and as an Investment Analyst at ESL Investments from 2010-2012.

Mr. Lakshman joined the Company as President, Fulfillment - Supply Chain and Sourcing in September 2015. Prior to joining the Company, he served in a variety of roles with Amazon.com, Inc. since July 1999, most recently as Vice President of Worldwide Transportation Strategy, Technology and Customer Returns. Mr. Lakshman serves as a director of Grubhub, Inc.

Ms. Munjal was appointed to her current position in October 2012. She was appointed as Divisional Vice President, Integrated Retail and Member Experience, in July 2011 and was promoted to Vice President in June 2012. From October 2009 to June 2011, she served as Divisional Vice President, and Chief of Staff, Office of the Chairman, and served as Chief of Staff, Office of the CEO, from November 2007 to November 2009. Ms. Munjal joined Sears as Director, Information Technology, in March 2003.

Mr. Pastrana was appointed to his current position in May 2015. He joined the Company as Chief of Staff in February 2014. Prior to joining the Company, he served as President, North America Region at Topshop USA from 2013-2014, and as Managing Director at Inditex USA from 2010-2013.

Mr. Politeski joined the Company as President, Home Appliances and Consumer Electronics in September 2016. Prior to joining the Company, he served as President of Samsung Electronics Canada from 2011-2015, and Senior Vice President of Samsung USA from 2009-2011.

Mr. Riecker was appointed to his current position in October 2016. He joined the Company as Assistant Controller in October 2005 and served as Vice President and Assistant Controller from May 2007 to October 2011. From October 2011 until his election as Vice President, Controller and Chief Accounting Officer in January 2012, he served as the Company's Vice President, Internal Audit.

Mr. Skelley joined the Company in October 2015 in his current role as President, Home Services. Prior to joining the Company, he served as Senior Vice President of Service Solutions at Asurion from 2011-2013.

Dr. Zoll joined the Company as President, Online in June 2016. Prior to joining the Company he held several positions at Ebay Germany, including Vice President from 2013-2016, and Senior Director prior to 2013.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Holdings' common stock is quoted on The NASDAQ Stock Market under the ticker symbol SHLD. There were 10,361 shareholders of record at March 16, 2017. The quarterly high and low sales prices for Holdings' common stock are set forth below.

	Fiscal Year 2016			
	Sears Holdings			
	First	Second	Third	Fourth
	Quarter	Quarter	Quarter	Quarter
Common stock price				
High	\$19.12	\$16.55	\$18.18	\$13.84
Low	\$14.05	\$10.52	\$10.50	\$7.08

	Fiscal Year 2015			
	Sears Holdings			
	First	Second	Third	Fourth
	Quarter	Quarter	Quarter	Quarter
Common stock price				
High	\$46.23	\$44.72	\$28.31	\$25.24
Low	\$31.35	\$20.86	\$19.08	\$16.27

Holdings has not paid cash dividends over the two most recent fiscal years and does not expect to pay cash dividends in the foreseeable future.

Equity Compensation Plan Information

The following table reflects information about securities authorized for issuance under our equity compensation plans at January 28, 2017.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans*
Equity compensation plans approved by security holders	—	—	4,375,623
Equity compensation plans not approved by security holders	—	—	—
Total	—	—	4,375,623

Represents shares of common stock that may be issued pursuant to our 2013 Stock Plan (our 2006 Stock Plan has been closed). Awards under the 2013 Stock Plan may be restricted stock, stock unit awards, incentive stock options, nonqualified stock options, stock appreciation rights, or certain other stock-based awards. The 2013 Stock Plan also allows common stock of Holdings to be awarded in settlement of an incentive award under the Sears Holdings Corporation Umbrella Incentive Program (and any incentive program established thereunder). The shares shown exclude shares covered by an outstanding plan award that, subsequent to January 28, 2017, ultimately are not delivered on an unrestricted basis (for example, because the award is forfeited, canceled, settled in cash or used to satisfy tax withholding obligations).

Stock Performance Graph

Comparison of Five-Year Cumulative Stockholder Return

The following graph compares the cumulative total return to stockholders on Holdings' common stock from January 27, 2012 through January 27, 2017, the last trading day before the end of fiscal year 2016, based on the market prices at the last trading day before the end of each fiscal year through and including fiscal year 2016, with the return on the S&P 500 Index, the S&P 500 Retailing Index and the S&P 500 Department Stores Index for the same period. The graph assumes an initial investment of \$100 on January 27, 2012 in each of our common stock, the S&P 500 Index, the S&P Retailing Index and the S&P 500 Department Stores Index. The graph further assumes reinvestment of the value of: (i) subscription rights to purchase shares of common stock of Sears Hometown and Outlet Stores, Inc. on September 13, 2012, the ex-distribution date of the distribution of such rights to Holdings' shareholders; (ii) common shares of Sears Canada on November 13, 2012, the distribution date of such shares to Holdings' shareholders; (iii) shares of Lands' End on April 7, 2014, the ex-distribution date of the distribution of such shares to Holdings' shareholders; (iv) subscription rights to purchase shares of common stock of Sears Canada on October 17, 2014, the ex-distribution date of the distribution of such rights to Holdings' shareholders; (v) subscription rights to purchase up to \$625 million in aggregate principal amount of 8% senior unsecured notes due 2019 and warrants to purchase shares of Holdings' common stock on November 3, 2014, the ex-distribution date of the distribution of such rights to Holdings' shareholders; and (vi) subscription rights to purchase shares of common stock of Seritage Growth Properties on June 12, 2015, the distribution date of such rights to Holdings' shareholders.

The S&P 500 Retailing Index consists of companies included in the S&P 500 Index in the broadly defined retail sector, which includes competing retailers of softlines (apparel and domestics) and hardlines (appliances, electronics and home improvement products), as well as food and drug retailers. The S&P 500 Department Stores Index consists primarily of department stores that compete with our full-line stores.

	Jan 27, 2012	Feb 1, 2013	Jan 31, 2014	Jan 30, 2015	Jan 29, 2016	Jan 27, 2017
Sears Holdings	\$100.00	\$121.49	\$92.93	\$107.82	\$68.95	\$30.18
S&P 500 Index	\$100.00	\$117.59	\$141.45	\$161.56	\$160.47	\$193.94
S&P 500 Retailing Index	\$100.00	\$127.09	\$159.26	\$191.26	\$223.38	\$264.82
S&P 500 Department Stores Index	\$100.00	\$103.09	\$119.64	\$149.27	\$107.64	\$86.82

Purchase of Equity Securities

During the quarter ended January 28, 2017, we did not repurchase any shares of our common stock under our common share repurchase program. At January 28, 2017, we had approximately \$504 million of remaining authorization under the program.

	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program ⁽²⁾	Average Price Paid per Share for Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
October 30, 2016 to November 26, 2016	—	\$ —	—	\$ —	—
November 27, 2016 to December 31, 2016	—	—	—	—	—
January 1, 2017 to January 28, 2017	—	—	—	—	—
Total	—	\$ —	—	\$ —	—\$ 503,907,832

(1) Consists entirely of 0 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock.

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

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

Item 6. Selected Financial Data

The table below summarizes our recent financial information. The data set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our Consolidated Financial Statements and notes thereto in Item 8.

dollars in millions, except per share and store data	Fiscal				
	2016	2015	2014	2013	2012
Summary of Operations					
Revenues ⁽¹⁾	\$22,138	\$25,146	\$31,198	\$36,188	\$39,854
Domestic comparable store sales %	(7.4)%	(9.2)%	(1.8)%	(3.8)%	(2.5)%
Net loss from continuing operations attributable to Holdings' shareholders ⁽²⁾	(2,221)	(1,129)	(1,682)	(1,365)	(930)
Per Common Share					
Basic:					
Net loss from continuing operations attributable to Holdings' shareholders	\$(20.78)	\$(10.59)	\$(15.82)	\$(12.87)	\$(8.78)
Diluted:					
Net loss from continuing operations attributable to Holdings' shareholders	\$(20.78)	\$(10.59)	\$(15.82)	\$(12.87)	\$(8.78)
Holdings' book value per common share	\$(35.71)	\$(18.40)	\$(8.93)	\$16.34	\$25.89
Financial Data					
Total assets	\$9,362	\$11,337	\$13,185	\$18,234	\$19,320
Long-term debt	3,470	1,971	2,878	2,531	1,560
Long-term capital lease obligations	103	137	210	275	364
Capital expenditures	142	211	270	329	378
Adjusted EBITDA ⁽³⁾	(808)	(836)	(718)	(487)	428
Domestic Adjusted EBITDA ⁽³⁾	(808)	(836)	(647)	(490)	359
Number of stores	1,430	1,672	1,725	2,429	2,548

(1) We follow a retail-based financial reporting calendar. Accordingly, the fiscal year ended February 2, 2013 contained 53 weeks, while all other years presented contained 52 weeks.

The periods presented were impacted by certain significant items, which affected the comparability of amounts reflected in the above selected financial data. For 2016, 2015 and 2014, these significant items are discussed within Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." 2013 results include the impact of domestic pension expense of \$102 million, domestic store closings and severance of \$180 million, domestic gain on the sales of assets of \$41 million and the results of Lands' End and Sears Canada that were included in the results of our operations prior to the separations of \$79 million and \$244 million, respectively. 2012 results include the impact of non-cash charges of domestic pension settlements of \$452 million, domestic pension expense of \$103 million, domestic store closings and severance of \$109 million, domestic transaction costs of \$6 million, domestic gain on the sales of assets of \$160 million and the results of the Lands' End, Sears Canada and Sears Hometown and Outlet businesses that were included in the results of our operations prior to the separations of \$50 million, \$(51) million and \$51 million, respectively.

(3) See Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 for a reconciliation of this measure to GAAP and a discussion of management's reasoning for using such measure.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

We have divided our Management's Discussion and Analysis of Financial Condition and Results of Operations into the following six sections:

Overview of Holdings

Results of Operations:

Fiscal Year

Holdings' Consolidated Results

Business Segment Results

Analysis of Consolidated Financial Condition

Contractual Obligations and Off-Balance Sheet Arrangements

Application of Critical Accounting Policies and Estimates

Cautionary Statement Regarding Forward-Looking Information

The discussion that follows should be read in conjunction with the Consolidated Financial Statements and notes thereto included in Item 8.

OVERVIEW OF HOLDINGS

Holdings, the parent company of Kmart and Sears, was formed in connection with the March 24, 2005 Merger of these two companies. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We operate a national network of stores, with 1,430 full-line and specialty retail stores in the United States, operating as Kmart and Sears. Further, we operate a number of websites under the Sears.com and Kmart.com banners which offer millions of products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way, a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way connects all of the ways members shop - in store, at home, online and by phone.

Through the third quarter of 2014, we conducted our operations in three business segments: Kmart, Sears Domestic and Sears Canada. As a result of the de-consolidation of Sears Canada as described in Note 2 of Notes to the Consolidated Financial Statements, Sears Canada is no longer an operating or reportable segment. We now conduct our operations in two business segments: Kmart and Sears Domestic. The nature of operations conducted within each of these segments is discussed within the Business Segments section of Item 1 in this Annual Report on Form 10-K. Our business segments have been determined in accordance with accounting standards regarding the determination, and reporting, of business segments.

RESULTS OF OPERATIONS

Fiscal Year

Our fiscal year end is the Saturday closest to January 31 each year. Fiscal years 2016, 2015 and 2014 consisted of 52 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Holdings' Consolidated Results

Holdings' consolidated results of operations for 2016, 2015 and 2014 are summarized as follows:

millions, except per share data	2016	2015	2014
REVENUES			
Merchandise sales and services	\$22,138	\$25,146	\$31,198
COSTS AND EXPENSES			
Cost of sales, buying and occupancy	17,452	19,336	24,049
Gross margin dollars	4,686	5,810	7,149
Gross margin rate	21.2	% 23.1	% 22.9
Selling and administrative	6,109	6,857	8,220
Selling and administrative expense as a percentage of revenues	27.6	% 27.3	% 26.3
Depreciation and amortization	375	422	581
Impairment charges	427	274	63
Gain on sales of assets	(247)	(743)	(207)
Total costs and expenses	24,116	26,146	32,706
Operating loss	(1,978)	(1,000)	(1,508)
Interest expense	(404)	(323)	(313)
Interest and investment income (loss)	(26)	(62)	132
Other income	13	—	4
Loss before income taxes	(2,395)	(1,385)	(1,685)
Income tax (expense) benefit	174	257	(125)
Net loss	(2,221)	(1,128)	(1,810)
(Income) loss attributable to noncontrolling interests	—	(1)	128
NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	\$(2,221)	\$(1,129)	\$(1,682)
NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS			
Diluted loss per share	\$(20.78)	\$(10.59)	\$(15.82)
Diluted weighted average common shares outstanding	106.9	106.6	106.3

References to comparable store sales amounts within the following discussion include sales for all stores operating for a period of at least 12 full months, including remodeled and expanded stores, but excluding store relocations and stores that have undergone format changes. Comparable store sales amounts include sales from sears.com and kmart.com shipped directly to customers. These online sales resulted in a negative impact to our comparable store sales results of approximately 20 basis points and 10 basis points for 2016 and 2015, respectively. In addition, comparable store sales have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period, which did not have any impact in 2016 and resulted in a negative impact of 10 basis points for 2015. Comparable store sales results for 2016 were calculated based on the 52-week period ended January 28, 2017 as compared to the comparable 52-week period in the prior year, while comparable store sales results for 2015 were calculated based on the 52-week period ended January 30, 2016 as compared to the comparable 52-week period in the prior year.

2016 Compared to 2015

Net Loss Attributable to Holdings' Shareholders

We recorded a net loss attributable to Holdings' shareholders of \$2.2 billion (\$20.78 loss per diluted share) and \$1.1 billion (\$10.59 loss per diluted share) for 2016 and 2015, respectively. Our results for 2016 and 2015 were affected by a number of significant items. Our net loss as adjusted for these significant items, which are further discussed below, was \$887 million (\$8.30 loss per diluted share) for 2016 and \$953 million (\$8.94 loss per diluted share) for 2015. The decrease in adjusted net loss for the year primarily reflected a decrease in selling and administrative expenses, partially offset by a decline in gross margin, which was driven by the decline in revenues and a decline in gross margin rate.

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

Adjusted EBITDA and Domestic Adjusted EBITDA were determined as follows:

millions	2016	2015	2014
Net loss attributable to Holdings per statement of operations	\$(2,221)	\$(1,129)	\$(1,682)
Income (loss) attributable to noncontrolling interests	—	1	(128)
Income tax expense (benefit)	(174)	(257)	125
Interest expense	404	323	313
Interest and investment (income) loss	26	62	(132)
Other income	(13)	—	(4)
Operating loss	(1,978)	(1,000)	(1,508)
Depreciation and amortization	375	422	581
Gain on sales of assets	(247)	(743)	(207)
Before excluded items	(1,850)	(1,321)	(1,134)
Closed store reserve and severance	384	98	224
Domestic pension expense	288	229	89
Other ⁽¹⁾	31	(64)	50
Amortization of deferred Seritage gain	(88)	(52)	—
Impairment charges	427	274	63
Adjusted EBITDA	(808)	(836)	(708)
Lands' End	—	—	(10)
Adjusted EBITDA as defined ⁽²⁾	\$(808)	\$(836)	\$(718)
Sears Canada	—	—	71
Domestic Adjusted EBITDA as defined ⁽²⁾	\$(808)	\$(836)	\$(647)

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

⁽²⁾ Adjusted to reflect the results of the Lands' End and Sears Canada businesses that were included in our results of operations prior to the separation/disposition.

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Adjusted EBITDA for our segments was as follows:

	2016			2015			2014			
millions	Kmart	Sears Domestic	Sears Holdings	Kmart	Sears Domestic	Sears Holdings	Kmart	Sears Domestic	Sears Canada	Sears Holdings
Operating loss per statement of operations	\$(530)	\$(1,448)	\$(1,978)	\$(292)	\$(708)	\$(1,000)	\$(422)	\$(920)	\$(166)	\$(1,508)
Depreciation and amortization	71	304	375	72	350	422	95	437	49	581
(Gain) loss on sales of assets	(181)	(66)	(247)	(185)	(558)	(743)	(103)	(105)	1	(207)
Before excluded items	(640)	(1,210)	(1,850)	(405)	(916)	(1,321)	(430)	(588)	(116)	(1,134)
Closed store reserve, severance and other	318	66	384	86	12	98	142	55	27	224
Domestic pension expense	—	288	288	—	229	229	—	89	—	89
Other ⁽¹⁾	15	16	31	43	(107)	(64)	43	4	3	50
Amortization of deferred Seritage gain	(17)	(71)	(88)	(11)	(41)	(52)	—	—	—	—
Impairment charges	22	405	427	14	260	274	29	19	15	63
Adjusted EBITDA	(302)	(506)	(808)	(273)	(563)	(836)	(216)	(421)	(71)	(708)
Lands' End separation	—	—	—	—	—	—	—	(10)	—	(10)
Adjusted EBITDA as defined ⁽²⁾	\$(302)	\$(506)	\$(808)	\$(273)	\$(563)	\$(836)	\$(216)	\$(431)	\$(71)	\$(718)
% to revenues ⁽³⁾	(3.5)%	(3.8)%	(3.6)%	(2.7)%	(3.8)%	(3.3)%	(1.8)%	(2.6)%	(3.4)%	(2.3)%

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

(2) Adjusted to reflect the results of the Lands' End business that were included in our results of operations prior to the separation.

(3) Excludes revenues of the Lands' End business that were included in our results of operations prior to the separation.

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The following tables set forth results of operations on a GAAP and "As Adjusted" basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Consolidated Statements of Operations during the years 2016, 2015 and 2014.

Year Ended January 28, 2017										
Adjustments										
millions, except per share data	GAAP	Domestic Pension Expense	Closed Store Reserve, Store Impairments and Severance	Trade name Impairment	Gain on Sales Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other ⁽¹⁾	Tax Matters	As Adjusted
Gross margin impact	\$4,686	\$—	\$ 226	\$ —	\$—	\$ —	\$ (88)	\$(33)	\$—	\$4,791
Selling and administrative impact	6,109	(288)	(158)	—	—	—	—	(64)	—	5,599
Depreciation and amortization impact	375	—	(20)	—	—	—	—	—	—	355
Impairment charges impact	427	—	(46)	(381)	—	—	—	—	—	—
Gain on sales of assets impact	(247)	—	—	—	109	—	—	—	—	(138)
Operating loss impact	(1,978)	288	450	381	(109)	—	(88)	31	—	(1,025)
Interest and investment loss impact	(26)	—	—	—	—	35	—	—	—	9
Other income impact	13	—	—	—	—	—	—	(13)	—	—
Income tax benefit impact	174	(108)	(169)	(143)	41	(13)	33	(7)	725	533
After tax and noncontrolling interests impact	(2,221)	180	281	238	(68)	22	(55)	11	725	(887)
Diluted loss per share impact	\$(20.78)	\$1.68	\$ 2.63	\$ 2.23	\$(0.64)	\$ 0.21	\$ (0.51)	\$0.10	\$ 6.78	\$(8.30)
Year Ended January 30, 2016										
Adjustments										
millions, except per share data	GAAP	Domestic Pension Expense	Closed Store Reserve, Store Impairments and Severance	Trade name Impairment	Gain on Sales Assets	Mark-to-Market Adjustments	Amortization of Deferred Seritage Gain	Other ⁽²⁾	Tax Matters	As Adjusted
Gross margin impact	\$5,810	\$—	\$ 44	\$ —	\$—	\$ —	\$ (52)	\$(146)	\$—	\$5,656
Selling and administrative impact	6,857	(229)	(54)	—	—	—	—	(82)	—	6,492
Depreciation and amortization impact	422	—	(3)	—	—	—	—	—	—	419
Impairment charges impact	274	—	(94)	(180)	—	—	—	—	—	—
Gain on sales of assets impact	(743)	—	—	—	687	—	—	—	—	(56)
Operating loss impact	(1,000)	229	195	180	(687)	—	(52)	(64)	—	(1,199)
Interest and investment loss impact	(62)	—	—	—	—	59	—	—	—	(3)
Income tax benefit impact	257	(86)	(73)	(68)	258	(22)	20	24	263	573
After tax and noncontrolling interests	(1,129)	143	122	112	(429)	37	(32)	(40)	263	(953)

impact

Diluted loss per share \$(10.59)\$1.34 \$ 1.14 \$ 1.05 \$(4.02)\$ 0.35 \$ (0.30) \$(0.38)\$ 2.47 \$(8.94)
impact

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

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

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millions, except per share data	Year Ended January 31, 2015										
	GAAP	Adjustments									
		Domestic Pension Expense	Closed Store Reserve, Store Impairments and Severance			Domestic Gain on Sales of Assets	Other Expense	Gain on Sears Canada Disposition	Domestic Tax Matters	Sears Canada Segment	Lands' End Separation
			As Adjusted ⁽¹⁾								
Gross margin impact	\$7,149	\$—	\$ 68	\$—	\$—	\$—	\$—	\$ (502)	\$(87)	\$ 6,628	
Selling and administrative impact	8,220	(89)	(129)	—	(47)	—	—	(603)	(77)	7,275	
Depreciation and amortization impact	581	—	(8)	—	—	—	—	(49)	(3)	521	
Impairment charges impact	63	—	(48)	—	—	—	—	(15)	—	—	
Gain on sales of assets impact	(207)	—	—	87	—	—	—	(1)	—	(121)	
Operating loss impact	(1,508)	89	253	(87)	47	—	—	166	(7)	(1,047)	
Interest expense impact	(313)	—	—	—	—	—	—	5	—	(308)	
Interest and investment income impact	132	—	—	—	—	(70)	—	(38)	—	24	
Other income impact	4	—	—	—	—	—	—	(4)	—	—	
Income tax expense impact	(125)	(33)	(95)	33	(18)	26	574	136	3	501	
Income attributable to noncontrolling interests impact	128	—	—	—	—	—	—	(128)	—	—	
After tax and noncontrolling interests impact	(1,682)	56	158	(54)	29	(44)	574	137	(4)	(830)	
Diluted loss per share impact	\$(15.82)	\$0.53	\$ 1.48	\$(0.51)	\$ 0.27	\$(0.41)	\$ 5.40	\$ 1.29	\$(0.04)	\$(7.81)	

⁽¹⁾ Adjusted to reflect the results of the Lands' End and Sears Canada businesses that were included in our results of operations prior to the separation/disposition.

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

• EBITDA excludes the effects of financings and investing activities by eliminating the effects of interest and depreciation costs;

• Management considers gains/(losses) on the sale of assets to result from investing decisions rather than ongoing operations; and

• Other significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, which affects comparability of results. We have adjusted our results for these items to make our statements more comparable and therefore more useful to investors as the items are not representative of our ongoing operations and reflect past investment decisions.

We also believe that our use of Adjusted EPS provides an appropriate measure for investors to use in assessing our performance across periods, given that this measure provides an adjustment for certain significant items which may

vary significantly from period to period, improving the comparability of year-to-year results and is therefore

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representative of our ongoing performance. Therefore, we have adjusted our results for significant items to make our statements more useful and comparable. However, we do not, and do not recommend that you, solely use Adjusted EPS to assess our financial and earnings performance. We also use, and recommend that you use, diluted earnings per share in addition to Adjusted EPS in assessing our earnings performance.

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

Domestic pension expense – Contributions to our pension plans remain a significant use of our cash on an annual basis. Cash contributions to our pension and postretirement plans are separately disclosed on the cash flow statement. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, we have a legacy pension obligation for past service performed by Kmart and Sears associates. The annual pension expense included in our statement of operations related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, and the resulting abnormally low interest rates, which continue to persist, our domestic pension expense was \$288 million in 2016, \$229 million in 2015 and \$89 million in 2014. Pension expense is comprised of interest cost, expected return on plan assets and recognized net loss and other. This adjustment eliminates the entire pension expense from the statement of operations to improve comparability. Pension expense is included in the determination of net loss.

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

millions	2016	2015	2014
Components of net periodic expense:			
Interest cost	\$227	\$210	\$221
Expected return on plan assets	(202)	(249)	(247)
Recognized net loss and other	263	268	115
Net periodic expense	\$288	\$229	\$89

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

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

Closed store reserve and severance – We are transforming our Company to a less asset-intensive business model.

Throughout this transformation, we continue to make choices related to our stores, which could result in sales, closures, lease terminations or a variety of other decisions.

Impairment charges – Accounting standards require the Company to evaluate the carrying value of fixed assets, goodwill and intangible assets for impairment. As a result of the Company's analysis, we have recorded impairment charges related to certain fixed asset and indefinite-lived intangible asset balances.

Domestic gains on sales of assets – We have recorded significant gains on sales of assets, as well as gains on sales of joint venture interests, which were primarily attributable to several real estate transactions. Management considers these gains on sales of assets to result from investing decisions rather than ongoing operations.

Mark-to-market adjustments – We elected the fair value option for the equity method investment in Sears Canada, and the change in fair value is recorded in interest and investment income in the Consolidated Statements of Operations. Management considers activity related to our retained investment in Sears Canada to result from investing decisions rather than ongoing operations. Furthermore, we do not consider the short term fluctuations in Sears Canada's stock price useful in assessing our operating performance.

Amortization of deferred Seritage gain – A portion of the gain on the Seritage transaction was deferred and will be recognized in proportion to the related rent expense, which is a component of cost of sales, buying and occupancy in the Consolidated Statements of Operations, over the lease term. Management considers the amortization of the deferred Seritage gain to result from investing decisions rather than ongoing operations.

Other – Consists of one-time credits from vendors, transaction costs associated with strategic initiatives, expenses associated with legal matters, other expenses and other income.

Domestic tax matters – In 2011, we recorded a non-cash charge to establish a valuation allowance against substantially all of our domestic deferred tax assets. Accounting rules generally require that a valuation reserve be established when income has not been generated over a three-year cumulative period to support the deferred tax asset. While an accounting loss was recorded, we believe no economic loss has occurred as these net operating losses and tax benefits remain available to reduce future taxes as income is generated in subsequent periods. As this valuation allowance has a significant impact on the effective tax rate, we have adjusted our results to reflect a standard effective tax rate for the Company beginning in fiscal 2011 when the valuation allowance was first established.

Gain on Sears Canada disposition – We recognized a gain upon de-consolidation of Sears Canada. Management considers the gain to result from investing decisions rather than ongoing operations.

Sears Canada segment – Reflects the results of the Sears Canada business that were included in our results of operations prior to the disposition. The adjustment also includes the valuation allowance that was recorded in the third quarter of 2014 prior to the de-consolidation of Sears Canada.

Lands' End separation – Reflects the results of the Lands' End business that were included in our results of operations prior to the separation.

Revenues and Comparable Store Sales

Revenues decreased \$3.0 billion, or 12.0%, to \$22.1 billion in 2016, as compared to revenues of \$25.1 billion in 2015. The decline in revenues included a decrease of \$1.3 billion as a result of having fewer Kmart and Sears Full-line stores in operation. For the full year, comparable store sales declined 7.4%, which contributed to \$1.4 billion of the revenue decline relative to the prior year. In addition, we also experienced a decline in revenues from Sears Hometown and Outlet Stores, Inc. ("SHO") of approximately \$238 million during 2016 as compared to 2015.

Kmart comparable store sales declined 5.3% for the full year primarily driven by declines in the grocery & household, consumer electronics and pharmacy categories. Sears Domestic comparable store sales for the year declined 9.3% primarily driven by decreases in the home appliances, apparel and consumer electronics categories.

Gross Margin

Gross margin declined \$1.1 billion to \$4.7 billion in 2016 from \$5.8 billion in 2015 as a result of the above noted decline in sales, as well as a decline in gross margin rate. Gross margin for 2016 included one-time vendor credits of \$33 million, as well as a credit of \$88 million related to the amortization of the deferred gain on sale of

assets associated with the Seritage transaction, while 2015 included one-time vendor credits of \$146 million, as well as a credit of \$52 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction. Gross margin for 2016 and 2015 also included charges of \$226 million and \$44 million, respectively, related to store closures.

As compared to the prior year, Kmart's gross margin rate for 2016 declined 310 basis points. Excluding the impact of significant items primarily related to store closures as noted in our Adjusted Earnings Per Share tables, Kmart's gross margin rate would have declined 130 basis points with margin rate declines experienced across most categories, most notably in the apparel, grocery & household, drugstore, home and pharmacy categories. Sears Domestic's gross margin rate for 2016 decreased 130 basis points. Excluding the impact of significant items in both years primarily related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, one-time vendor credits and store closures, Sears Domestic's gross margin rate declined 60 basis points, with the most notable decreases experienced in the apparel, home appliances and footwear categories. The decline in margin rate experienced in both Kmart and Sears Domestic is primarily attributable to increased markdowns, including an increase in Shop Your Way points expense.

In addition, as a result of the Seritage and JV transactions, 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately \$197 million and \$133 million, respectively. Due to the structure of the leases, we expect that our cash rent obligations to Seritage and the joint venture partners will decline, over time, as space in these stores is recaptured. From the inception of the Seritage transaction to date, we have received recapture notices on 25 properties, which is estimated to reduce the rent expense by approximately \$14 million on an annual basis. We have also exercised our right to terminate the lease on 36 properties, which is estimated to reduce rent expense by approximately \$12 million on an annual basis.

Selling and Administrative Expenses

Selling and administrative expenses decreased \$748 million to \$6.1 billion in 2016 from \$6.9 billion in 2015 and included significant items which aggregated to an expense of \$510 million and \$365 million for 2016 and 2015, respectively. Excluding these items, selling and administrative expenses declined \$893 million, primarily due to a decrease in payroll expense. In addition, advertising expense also declined as we continued to shift away from traditional advertising to use of Shop Your Way points expense, which is included within gross margin.

Selling and administrative expenses as a percentage of revenues ("selling and administrative expense rate") were 27.6% and 27.3% for 2016 and 2015, respectively, as the decreases in overall selling and administrative expenses were more than offset by the above noted decline in revenues.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$47 million during 2016 to \$375 million, as compared to 2015, primarily due to having fewer assets to depreciate.

Impairment Charges

We recorded impairment charges of \$427 million in 2016, which consisted of impairment of \$381 million related to the Sears trade name, as well as \$46 million related to the impairment of long-lived assets. We recorded impairment charges of \$274 million in 2015, which consisted of impairment of \$180 million related to the Sears trade name, as well as \$94 million related to the impairment of long-lived assets. Impairment charges recorded in both years are described further in Notes 1 and 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets of \$247 million in 2016 and \$743 million in 2015, which were primarily attributable to several significant real estate transactions. The gains recorded in 2015 included \$508 million recognized in connection with the joint venture transactions and the sale-leaseback transaction with Seritage. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

We recorded an operating loss of \$2.0 billion and \$1.0 billion in 2016 and 2015, respectively. The operating loss for 2016 included significant items which aggregated to operating expense of \$953 million, while operating loss for 2015 included significant items which aggregated to operating income of \$199 million. Excluding these items, we would have reported an adjusted operating loss of \$1.0 billion and \$1.2 billion in 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was primarily driven by the decrease in selling and administrative expenses, partially offset by the decline in gross margin noted above.

Interest Expense

We incurred \$404 million and \$323 million in interest expense during 2016 and 2015, respectively. The increase is due to an increase in average outstanding borrowings in 2016.

Interest and Investment Loss

We recorded interest and investment loss of \$26 million during 2016 compared to interest and investment loss of \$62 million during 2015. Interest and investment income loss is described further in Note 6 of Notes to Consolidated Financial Statements.

Income Taxes

We recorded an income tax benefit of \$174 million in 2016 compared with an income tax benefit of \$257 million in 2015. Our effective tax rate for 2016 was a benefit of 7.3% compared to a benefit of 18.6% for 2015. During 2016, the Company realized a significant tax benefit on the deferred taxes related to the partial impairment of the Sears trade name. In addition, the Company recorded a tax benefit related to the net gain on pension and other postretirement benefits in continuing operations and a corresponding tax expense of the same amount in other comprehensive income. Also, the application of the requirements for accounting for income taxes, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2016 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. In addition, 2016 was negatively impacted by foreign branch taxes and state income taxes.

The 2015 rate was favorably impacted by the significant tax benefit realized on the deferred taxes related to indefinite-life assets associated with the property sold in the transaction with Seritage and the tax benefit realized on the deferred taxes related to the partial impairment of the Sears trade name. These items were partially offset by foreign branch taxes and state income taxes.

2015 Compared to 2014

Net Loss Attributable to Holdings' Shareholders

We recorded a net loss attributable to Holdings' shareholders of \$1.1 billion (\$10.59 loss per diluted share) and \$1.7 billion (\$15.82 loss per diluted share) for 2015 and 2014, respectively. Our results for 2015 and 2014 were affected by a number of significant items. Our net loss as adjusted for these significant items, which are further discussed below, was \$953 million (\$8.94 loss per diluted share) for 2015 and \$830 million (\$7.81 loss per diluted share) for 2014. The increase in net loss as adjusted for the year primarily reflected a decline in gross margin, which was driven by the decline in revenues, partially offset by a decrease in selling and administrative expenses.

Revenues and Comparable Store Sales

Revenues decreased \$6.1 billion, or 19.4%, to \$25.1 billion in 2015, as compared to revenues of \$31.2 billion in 2014. Much of the decline related to actions we took during 2014 to streamline our operations and focus on our transformation into a member-centric retailer. The decrease in revenue included a decrease of \$2.1 billion associated with Sears Canada, which was de-consolidated in October 2014, \$222 million from the separation of the Lands' End business, which was completed on April 4, 2014, and \$1.5 billion from fewer Kmart and Sears Full-line stores. In addition, domestic comparable store sales declined 9.2%, which contributed to \$2.0 billion of the decline. The decline in comparable store sales was driven by reduced, but more highly targeted promotional and marketing spend to better align with member needs and a shift away from low margin categories, such as consumer electronics. Comparable store sales in the latter part of the year, particularly in the apparel and softlines businesses, were negatively impacted by unseasonably warm weather and a highly promotional environment.

Kmart comparable store sales declined 7.3% with increases in the home appliances, mattresses and seasonal categories, which were more than offset by declines in the consumer electronics, apparel, grocery & household and drugstore categories. Excluding the impact of the consumer electronics business, which is a business we continue to alter to meet our members' needs, Kmart comparable store sales would have decreased 5.5%. Sears Domestic comparable store sales decreased 11.1%, and were also negatively impacted by consumer electronics. Excluding the impact of consumer electronics, Sears Domestic comparable store sales would have decreased 9.5%, primarily driven by decreases in apparel, home appliances, lawn & garden and Sears Auto Centers, which were partially offset by an increase in the mattresses category.

Gross Margin

Gross margin declined \$1.3 billion to \$5.8 billion in 2015 from \$7.1 billion in 2014 as the above noted decline in sales was partially offset by an improvement in gross margin rate. Gross margin for 2015 included one-time vendor credits of \$146 million, as well as a credit of \$52 million related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction, while 2014 included gross margin of \$502 million from Sears Canada and \$87 million from the Lands' End business. Gross margin for 2015 and 2014 also included charges of \$44 million and \$68 million, respectively, related to store closures.

As compared to the prior year, Kmart's gross margin rate for 2015 declined 10 basis points, as increases experienced in a majority of categories, most notably consumer electronics, grocery & household, drugstore and toys, were more than offset by decreases in the apparel and pharmacy categories. Sears Domestic's gross margin rate for 2015 improved 50 basis points. Excluding the impact of significant items, Sears Domestic's gross margin rate declined 60 basis points, with the most notable decreases experienced in the apparel and home appliances categories driven by an increase in promotional activities, particularly during the fourth quarter of 2015 as a result of the highly competitive promotional environment.

In addition, as a result of the Seritage and JV transactions, 2015 included additional rent expense and assigned sub-tenant income of approximately \$133 million.

Selling and Administrative Expenses

Selling and administrative expenses decreased \$1.4 billion to \$6.9 billion in 2015 from \$8.2 billion in 2014 and included significant items which aggregated to expense of \$365 million and \$945 million for 2015 and 2014, respectively, with 2014 including expenses of \$603 million from Sears Canada and \$77 million from the Lands' End business. Excluding these items, selling and administrative expenses declined \$783 million, primarily due to decreases in payroll and advertising expenses.

Selling and administrative expenses as a percentage of revenues ("selling and administrative expense rate") were 27.3% and 26.3% for 2015 and 2014, respectively, as the decreases in overall selling and administrative expenses were more than offset by the above noted decline in revenues.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$159 million during 2015 to \$422 million, primarily due to having fewer assets to depreciate. Depreciation and amortization expense during 2014 included expense of \$52 million related to Sears Canada and the Lands' End business.

Impairment Charges

We recorded impairment charges of \$274 million in 2015, which consisted of impairment of \$180 million related to the Sears trade name, as well as \$94 million related to the impairment of long-lived assets. We recorded impairment charges of \$63 million in 2014, which were related to the impairment of long-lived assets. Impairment charges recorded in both years are described further in Notes 1 and 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets of \$743 million in 2015 and \$207 million in 2014, which were primarily attributable to several significant real estate transactions. The gains recorded in 2015 included \$508 million recognized in connection with the joint venture transactions and the sale-leaseback transaction with Seritage. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

We recorded an operating loss of \$1.0 billion and \$1.5 billion in 2015 and 2014, respectively. The operating loss for 2015 included significant items which aggregated to operating income of \$199 million, while operating loss for 2014 included significant items which aggregated to operating expense of \$461 million. Excluding these items, we would have reported an adjusted operating loss of \$1.2 billion and \$1.0 billion in 2015 and 2014, respectively. The increase in adjusted operating loss in 2015 was primarily driven by the decrease in gross margin, partially offset by the decline in selling and administrative expenses.

Interest Expense

We incurred \$323 million and \$313 million in interest expense during 2015 and 2014, respectively. The increase is due to an increase in average outstanding borrowings in 2015.

Interest and Investment Income (Loss)

We recorded interest and investment loss of \$62 million during 2015 compared to interest and investment income of \$132 million during 2014. Interest and investment income (loss) is described further in Note 6 of Notes to Consolidated Financial Statements.

Income Taxes

We recorded an income tax benefit of \$257 million in 2015 compared with income tax expense of \$125 million in 2014. During 2015, the Company realized a significant tax benefit on the deferred taxes related to indefinite-life assets associated with the property sold in the transaction with Seritage. As a result, our effective tax rate for 2015 was a benefit of 18.6% compared to expense of 7.4% for 2014. Also, the application of the requirements for accounting for income taxes, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2015 continued to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. In addition, 2015 was negatively impacted by foreign branch taxes and state income taxes.

The 2014 rate was negatively impacted by a valuation allowance established on Sears Canada's deferred tax assets in the third quarter, prior to de-consolidation, and increased foreign taxes in Puerto Rico resulting from a new tax law change, which became effective during the second quarter of 2014. These items were partially offset by state

audit settlements and statute expirations. In addition, the 2014 rate was favorably impacted by the book to tax difference for the original issue discount relating to the \$625 million 8% senior unsecured notes issued in November 2014, which resulted in the creation of a deferred tax liability through additional paid-in capital and a valuation allowance reversal through continuing operations.

Business Segment Results

Kmart

Kmart results and key statistics were as follows:

millions, except number of stores	2016	2015	2014
Merchandise sales and services	\$8,650	\$10,188	\$12,074
Comparable store sales %	(5.3)%	(7.3)%	(1.4)%
Cost of sales, buying and occupancy	7,093	8,042	9,513
Gross margin dollars	1,557	2,146	2,561
Gross margin rate	18.0 %	21.1 %	21.2 %
Selling and administrative	2,175	2,537	2,962
Selling and administrative expense as a percentage of total revenues	25.1 %	24.9 %	24.5 %
Depreciation and amortization	71	72	95
Impairment charges	22	14	29
Gain on sales of assets	(181)	(185)	(103)
Total costs and expenses	9,180	10,480	12,496
Operating loss	\$(530)	\$(292)	\$(422)
Adjusted EBITDA	\$(302)	\$(273)	\$(216)
Total Kmart stores	735	941	979

2016 Compared to 2015

Revenues and Comparable Store Sales

Kmart's revenues decreased by \$1.5 billion to \$8.7 billion in 2016, primarily due to the effect of having fewer stores in operation, which accounted for approximately \$1.0 billion of the decline. Revenues were also impacted by a decrease in comparable store sales of 5.3%, which accounted for approximately \$477 million of the decline. The decline in comparable store sales was primarily driven by declines in the grocery & household, consumer electronics and pharmacy categories.

Gross Margin

Kmart generated \$1.6 billion in gross margin in 2016 compared to \$2.1 billion in 2015. The decrease in Kmart's gross margin is due to the above noted decrease in sales, as well as a decline in gross margin rate. Gross margin included significant items which aggregated to expense of \$170 million and \$28 million for 2016 and 2015, respectively.

Kmart's gross margin rate declined 310 basis points to 18.0% in 2016 from 21.1% in 2015. Excluding the impact of significant items primarily related to store closures as noted in our Adjusted Earnings Per Share tables, Kmart's gross margin rate would have declined 130 basis points due to margin rate declines experienced across most categories, most notably in the apparel, grocery & household, drugstore, home and pharmacy categories driven by increased markdowns, including an increase in Shop Your Way points expense.

In addition, as a result of the Seritage and JV transactions, 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately \$35 million and \$25 million, respectively.

Selling and Administrative Expenses

Kmart's selling and administrative expenses decreased \$362 million in 2016. Selling and administrative expenses included significant items which aggregated to expense of \$146 million and \$90 million for 2016 and 2015, respectively. Excluding these items, selling and administrative expenses decreased \$418 million primarily due to decreases in payroll and advertising expenses.

Kmart's selling and administrative expense rate was 25.1% in 2016 and 24.9% in 2015 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

Impairment charges

Kmart recorded impairment charges of \$22 million and \$14 million in 2016 and 2015, respectively, related to the impairment of long-lived assets. Impairment charges recorded during 2016 and 2015 are further described in Note 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Kmart recorded total gains on sales of assets of \$181 million and \$185 million in 2016 and 2015, respectively. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

Kmart recorded an operating loss of \$530 million in 2016 as compared to \$292 million in 2015. Operating loss for 2016 included significant items which aggregated to operating expense of \$280 million, while operating loss for 2015 included significant items which aggregated to operating income of \$14 million. Excluding these items, Kmart would have reported an adjusted operating loss of \$250 million and \$306 million for 2016 and 2015, respectively. The decrease in Kmart's adjusted operating loss was primarily driven by the decrease in selling and administrative expenses, partially offset by a decline in gross margin.

2015 Compared to 2014

Revenues and Comparable Store Sales

Kmart's revenues decreased by \$1.9 billion to \$10.2 billion in 2015, primarily due to the effect of having fewer stores in operation, which accounted for approximately \$1.1 billion of the decline. Revenues were also impacted by a decrease in comparable store sales of 7.3%, which accounted for approximately \$787 million of the decline.

The decline in comparable store sales was primarily driven by declines in the consumer electronics, apparel, grocery & household and drugstore categories, partially offset by increases in the home appliances, mattresses and seasonal categories. Excluding the impact of the consumer electronics business, which is a business we continue to alter to meet our members' needs, Kmart comparable store sales would have decreased 5.5%.

Gross Margin

Kmart generated \$2.1 billion in gross margin in 2015 compared to \$2.6 billion in 2014. The decrease in Kmart's gross margin is due to the above noted decrease in sales, as well as a slight decrease in gross margin rate. Gross margin included significant items which aggregated to \$28 million and \$54 million for 2015 and 2014, respectively.

Excluding these items, gross margin decreased \$441 million.

Kmart's gross margin rate declined 10 basis points to 21.1% in 2015 from 21.2% in 2014, as increases experienced in a majority of categories, most notably grocery & household, consumer electronics, drugstore and toys, were more than offset by decreases in the apparel and pharmacy categories.

In addition, as a result of the Seritage and JV transactions, 2015 included additional rent expense and assigned sub-tenant rental income of approximately \$25 million.

Selling and Administrative Expenses

Kmart's selling and administrative expenses decreased \$425 million in 2015. Selling and administrative expenses included significant items which aggregated to expense of \$90 million and \$131 million for 2015 and 2014, respectively. Excluding these items, selling and administrative expenses decreased \$384 million primarily due to decreases in payroll and advertising expenses.

Kmart's selling and administrative expense rate was 24.9% in 2015 and 24.5% in 2014 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$23 million during 2015 to \$72 million, as compared to 2014, primarily due to having fewer assets to depreciate.

Impairment charges

Kmart recorded impairment charges of \$14 million and \$29 million in 2015 and 2014, respectively, related to the impairment of long-lived assets. Impairment charges recorded during 2015 and 2014 are further described in Note 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Kmart recorded total gains on sales of assets of \$185 million and \$103 million in 2015 and 2014, respectively. Gains recorded in 2015 included gains of \$137 million recognized in connection with the sale-leaseback transaction with Seritage. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

Kmart recorded an operating loss of \$292 million in 2015 as compared to \$422 million in 2014. Operating loss for 2015 included significant items which aggregated to operating income of \$14 million, while operating loss for 2014 included significant items which aggregated to operating expense of \$208 million. Excluding these items, Kmart would have reported an adjusted operating loss of \$306 million and \$214 million for 2015 and 2014, respectively. The increase in Kmart's adjusted operating loss was primarily driven by the decrease in gross margin, partially offset by the decrease in selling and administrative expenses.

Sears Domestic

Sears Domestic results and key statistics were as follows:

millions, except number of stores	2016	2015	2014
Merchandise sales and services	\$13,488	\$14,958	\$17,036
Comparable store sales %	(9.3)%	(11.1)%	(2.1)%
Cost of sales, buying and occupancy	10,359	11,294	12,950
Gross margin dollars	3,129	3,664	4,086
Gross margin rate	23.2 %	24.5 %	24.0 %
Selling and administrative	3,934	4,320	4,655
Selling and administrative expense as a percentage of total revenues	29.2 %	28.9 %	27.3 %
Depreciation and amortization	304	350	437
Impairment charges	405	260	19
Gain on sales of assets	(66)	(558)	(105)
Total costs and expenses	14,936	15,666	17,956
Operating loss	\$(1,448)	\$(708)	\$(920)
Adjusted EBITDA	\$(506)	\$(563)	\$(421)
Lands' End separation	—	—	(10)
Adjusted EBITDA as defined ⁽¹⁾	\$(506)	\$(563)	\$(431)
Number of:			
Full-line stores	670	705	717
Specialty stores	25	26	29
Total Sears Stores	695	731	746

⁽¹⁾ Adjusted to reflect the results of the Lands' End business that were included in our results of operations prior to the separation.

2016 Compared to 2015

Revenues and Comparable Store Sales

Sears Domestic's revenues decreased by \$1.5 billion to \$13.5 billion in 2016 as compared to 2015. This decline in revenues was primarily driven by a decrease in comparable store sales of 9.3%, which accounted for \$890 million of the decline, and the effect of having fewer Full-line stores in operation, which accounted for \$241 million of the decline. The decline in Sears Domestic comparable store sales was primarily driven by decreases in the home appliances, apparel and consumer electronics categories. In addition, we also experienced a decline in revenues from SHO of approximately \$238 million during 2016 as compared to 2015.

Gross Margin

Sears Domestic generated gross margin of \$3.1 billion and \$3.7 billion in 2016 and 2015, respectively, and included significant items which aggregated to additional gross margin of \$65 million and \$182 million for 2016 and 2015, respectively.

Sears Domestic's gross margin rate for the year declined 130 basis points to 23.2% in 2016 from 24.5% in 2015.

Excluding the impact of significant items in both years primarily related to the amortization of the deferred gain on sales of assets associated with the Seritage transaction, one-time vendor credits and store closures, Sears Domestic's gross margin rate declined 60 basis points, with the most notable decreases experienced in the apparel, home appliances and footwear categories driven by increased markdowns, including an increase in Shop Your Way points expense.

In addition, as a result of the Seritage and JV transactions, 2016 and 2015 included additional rent expense and assigned sub-tenant rental income of approximately \$162 million and \$108 million, respectively.

Selling and Administrative Expenses

Sears Domestic's selling and administrative expenses decreased \$386 million in 2016 as compared to 2015 and included significant items which aggregated to \$364 million and \$275 million for 2016 and 2015, respectively. Excluding these items, selling and administrative expenses decreased \$475 million, primarily due to decreases in payroll and advertising expenses.

Sears Domestic's selling and administrative expense rate was 29.2% in 2016 and 28.9% in 2015 and increased as the above noted expense reduction was more than offset by the decline in sales noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$46 million during 2016 to \$304 million, as compared to 2015, primarily due to having fewer assets to depreciate.

Impairment Charges

Sears Domestic recorded impairment charges of \$405 million in 2016 which consisted of impairment of \$381 million related to the Sears trade name, as well as \$24 million related to the impairment of long-lived assets. We recorded impairment charges of \$260 million in 2015 which consisted of impairment of \$180 million related to the Sears trade name, as well as \$80 million related to the impairment of long-lived assets. Impairment charges recorded in both years are described further in Notes 1 and 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Sears Domestic recorded total gains on sales of assets of \$66 million and \$558 million in 2016 and 2015, respectively. The gains recorded in 2015 included \$371 million recognized in connection with the joint venture transactions and the sale-leaseback transaction with Seritage. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

Sears Domestic reported an operating loss of \$1.4 billion in 2016 compared to \$708 million in 2015. Sears Domestic's operating loss in 2016 included significant items which aggregated to expense of \$673 million, while Sears Domestic's operating loss for 2015 included significant items which aggregated to operating income of \$185 million. Excluding these items, we would have reported an adjusted operating loss of \$775 million and \$893 million for 2016 and 2015, respectively. The decrease in adjusted operating loss in 2016 was driven by the decrease in selling and administrative expenses, partially offset by the above noted decline in gross margin.

2015 Compared to 2014

Revenues and Comparable Store Sales

Sears Domestic's revenues decreased by \$2.1 billion to \$15.0 billion in 2015 as compared to 2014. This decline in revenues was primarily driven by a decrease in comparable store sales of 11.1%, which accounted for \$1.2 billion of the decline, and the effect of having fewer Full-line stores in operation, which accounted for \$433 million of the decline. The revenue decline also included \$222 million lower revenue as a result of the separation of the Lands' End business, which occurred in the first quarter of 2014, as well as lower revenues from our Home Services business of approximately \$110 million. The decline in comparable store sales was driven by reduced, but more highly targeted promotional and marketing spend to better align with member needs and a shift away from low margin categories, such as consumer electronics. Comparable store sales in the latter part of the year, particularly in the apparel and softlines businesses, were negatively impacted by unseasonably warm weather and a highly promotional environment.

Sears Domestic comparable store sales were also negatively impacted by consumer electronics. Excluding the impact of consumer electronics, Sears Domestic comparable store sales would have decreased 9.5%, primarily driven by decreases in apparel, home appliances, lawn & garden and Sears Auto Centers, which were partially offset by an increase in the mattresses category.

Gross Margin

Sears Domestic generated gross margin of \$3.7 billion and \$4.1 billion in 2015 and 2014, respectively, and included significant items which aggregated to additional gross margin of \$182 million and \$73 million for 2015 and 2014, respectively. Excluding these items, gross margin decreased \$531 million.

Sears Domestic's gross margin rate for the year improved 50 basis points to 24.5% in 2015 from 24.0% in 2014. Excluding the impact of significant items recorded in gross margin during the year, Sears Domestic's gross margin rate declined 60 basis points, with the most notable decreases experienced in the apparel and home appliances categories, primarily driven by increased promotional activities, particularly during the fourth quarter of 2015 as a result of the highly competitive promotional environment.

In addition, as a result of the Seritage and JV transactions, 2015 includes additional rent expense and assigned sub-tenant rental income of approximately \$108 million.

Selling and Administrative Expenses

Sears Domestic's selling and administrative expenses decreased \$335 million in 2015 as compared to 2014 and included significant items which aggregated to \$275 million and \$211 million for 2015 and 2014, respectively. Excluding these items, selling and administrative expenses decreased \$399 million, primarily due to a decrease in payroll expense.

Sears Domestic's selling and administrative expense rate was 28.9% in 2015 and 27.3% in 2014 and increased as the above noted expense reduction was more than offset by the decline in sales noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$87 million during 2015 to \$350 million, primarily due to having fewer assets to depreciate.

Impairment Charges

Sears Domestic recorded impairment charges of \$260 million which consisted of impairment of \$180 million related to the Sears trade name, as well as \$80 million related to the impairment of long-lived assets. We recorded impairment charges of \$19 million in 2014 related to the impairment of long-lived assets. Impairment charges recorded in both years are described further in Notes 1 and 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Sears Domestic recorded total gains on sales of assets of \$558 million and \$105 million in 2015 and 2014, respectively. The gains recorded in 2015 included \$371 million recognized in connection with the joint venture transactions and the sale-leaseback transaction with Seritage. Gains on sales of assets recorded in both years are described further in Note 11 of Notes to Consolidated Financial Statements.

Operating Loss

Sears Domestic reported an operating loss of \$708 million in 2015 compared to \$920 million in 2014. Sears Domestic's operating loss in 2015 included significant items which aggregated to operating income of \$185 million, while Sears Domestic's operating loss for 2014 included significant items which aggregated to operating expense of \$87 million. Excluding these items, we would have reported an adjusted operating loss of \$893 million and \$833 million for 2015 and 2014, respectively. The increase in adjusted operating loss in 2015 was driven by the above noted decrease in gross margin, partially offset by the decline in selling and administrative expenses.

Sears Canada

Sears Canada conducts similar retail operations as Sears Domestic. As previously noted, the Company completed a rights offering for a portion of its interest in Sears Canada in the third quarter of 2014. As such, the Company no longer maintained control of Sears Canada resulting in the de-consolidation of Sears Canada on October 16, 2014. Sears Canada results and key statistics through the date of de-consolidation were as follows:

millions	2014	
Merchandise sales and services	\$2,088	
Comparable sales %	(8.0)%	
Cost of sales, buying and occupancy	1,586	
Gross margin dollars	502	
Gross margin rate	24.0 %	
Selling and administrative	603	
Selling and administrative expense as a percentage of total revenues	28.9 %	
Depreciation and amortization	49	
Impairment charges	15	
Loss on sales of assets	1	
Total costs and expenses	2,254	
Operating loss	\$(166)	
Adjusted EBITDA	\$(71)	

ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION

Cash Balances

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. Our cash balances as of January 28, 2017 and January 30, 2016 are detailed in the following table.

millions	January 28, January 30,	
	2017	2016
Cash and equivalents	\$ 196	\$ 141
Cash posted as collateral	3	2
Credit card deposits in transit	87	95
Total cash balances	\$ 286	\$ 238

We had total cash balances of \$286 million and \$238 million at January 28, 2017 and January 30, 2016, respectively. During 2016, the Company received net proceeds from various financing transactions of \$2.0 billion, which included approximately \$722 million from the 2016 Term Loan, approximately \$485 million from the 2016 Secured Loan Facility, approximately \$291 million from the Second Lien Term Loan and approximately \$486 million from the 2017 Secured Loan Facility. In addition, the Company generated approximately \$386 million from the sale of properties and investments. These proceeds were primarily used for general corporate purposes and to reduce outstanding borrowings under the Company's asset-based revolving credit facility.

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

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

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

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash balances when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit were \$29 million and \$59 million as of January 28, 2017 and January 30, 2016, respectively.

Operating Activities

The Company used \$1.4 billion of cash in its operations during 2016, \$2.2 billion during 2015 and \$1.4 billion during 2014. Our primary source of operating cash flows is the sale of goods and services to customers, while the primary use of cash in operations is the purchase of merchandise inventories and the payment of operating expenses. We used less cash in operations in 2016 compared to the prior year primarily due to a decrease in our net inventory. We used more cash in operations in 2015 compared to 2014 primarily driven by the increase in inventory balances experienced in 2015 as compared to the significant decrease in inventory balances experienced during 2014.

Merchandise inventories were \$4.0 billion and \$5.2 billion, respectively, at January 28, 2017 and January 30, 2016, while merchandise payables were approximately \$1.0 billion and \$1.6 billion, respectively, at January 28, 2017 and January 30, 2016. Our inventory balances decreased approximately \$1.2 billion primarily due to both improved productivity and store closures. Sears Domestic inventory decreased in virtually all categories, with the most notable decreases in the home appliances, apparel and consumer electronics. Kmart inventory also decreased in virtually all categories with the most notable decreases in the apparel, grocery & household goods, drugstore and home categories.

Investing Activities

We generated net cash flows from investing activities of \$244 million in 2016, \$2.5 billion in 2015 and \$327 million in 2014.

For 2016, net cash flows from investing activities primarily consisted of cash proceeds from the sale of properties and investments of \$386 million, partially offset by cash used for capital expenditures of \$142 million. For 2015, net cash flows from investing activities primarily consisted of cash proceeds from the sale of properties and investments of \$2.7 billion, partially offset by cash used for capital expenditures of \$211 million. Proceeds from the sales of properties and investments included approximately \$2.6 billion of net proceeds from the Seritage transaction. For 2014, net cash flows generated from investing activities primarily consisted of cash proceeds from the sale of properties and investments of \$424 million, partially offset by cash used for capital expenditures of \$270 million. Additionally, 2014 included proceeds from the Sears Canada rights offering of \$380 million, partially offset by \$207 million resulting from the de-consolidation of Sears Canada cash.

We spent \$142 million, \$211 million and \$270 million during 2016, 2015 and 2014, respectively, for capital expenditures. Capital expenditures during 2014 included expenditures by Sears Canada of \$32 million. Capital expenditures during all three years primarily included investments in online and mobile shopping capabilities, enhancements to the Shop Your Way platform, information technology infrastructure and store maintenance.

We anticipate 2017 capital expenditure levels to be similar to 2016 levels. In the normal course of business, we consider opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash and cause our capital expenditure levels to vary from period to period. In addition, we review leases that will expire in the short term in order to determine the appropriate action to take with respect to them.

Financing Activities

During 2016, we generated net cash flows from financing activities of \$1.2 billion, which consisted of proceeds from debt issuances of \$2.0 billion and \$71 million of net cash proceeds received during the fourth quarter

of 2016 from a sale-leaseback financing transaction for five Sears Full-line stores and two Sears Auto Centers that have continuing involvement, partially offset by a decrease in short-term borrowings of \$797 million, debt repayments of \$66 million and the payment of debt issuance costs of \$51 million.

During 2015, the Company used net cash flows in financing activities of \$364 million, which consisted of debt repayments of \$1.4 billion, of which \$927 million was the purchase of Senior Secured Notes pursuant to the tender offer and \$400 million was the repayment of the secured short-term loan, the payment of debt issuance costs of \$50 million related to the amendment and extension of our Domestic Credit Facility and fees related to the tender offer related to our Senior Secured Notes. These uses of cash were partially offset by an increase in short-term borrowings of \$583 million and \$508 million of net cash proceeds from sale-leaseback financing, which consisted of \$426 million of proceeds from the JV transactions received during 2015 and \$82 million of proceeds received in 2015 related to four joint venture properties that have continuing involvement.

During 2014, the Company generated net cash from financing activities of \$285 million, which primarily consisted of Lands' End pre-separation funding of \$515 million and proceeds from debt issuances of \$1.0 billion, consisting of \$400 million from the secured short-term loan entered into in September 2014 and \$625 million from the 8% senior unsecured notes due 2019 issued in November 2014. For further information, see Note 3 of Notes to Consolidated Financial Statements. The cash generated from financing activities was primarily used to pay down existing revolver borrowings.

During 2016, 2015 and 2014, we did not repurchase any of our common shares under our share repurchase program. The common share repurchase program was initially announced in 2005 and had a total authorization since inception of the program of \$6.5 billion. At January 28, 2017, we had approximately \$504 million of remaining authorization under the program. The common share repurchase program has no stated expiration date and share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods.

Uses and Sources of Liquidity

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

During 2015, we undertook actions to monetize the value of certain of our real estate assets, which included entering into three different real estate joint ventures with General Growth Properties, Inc., Simon Property Group, Inc. and The Macerich Company, in which we contributed a total of 31 properties to the joint ventures in exchange for a 50% interest in each of the joint ventures and \$429 million in gross cash proceeds, as well as the completion of the rights offering and sale-leaseback transaction with Seritage in which we received aggregate gross proceeds of \$2.7 billion. Also during 2015, the Company completed an amendment and extension of the \$3.275 billion revolving portion of our domestic credit facility, with approximately \$2.0 billion maturing in 2020 and the remaining approximately \$1.3 billion of the existing domestic credit facility expiring on the original maturity date in April 2016. Finally, during 2015, the Company completed a tender offer (the "Tender Offer") to purchase for cash up to \$1.0 billion principal amount of its outstanding 6 5/8% Senior Secured Notes Due 2018 (the "Senior Secured Notes"). Approximately \$936 million principal amount of the Senior Secured Notes were validly tendered in the Tender Offer.

During 2016, the Company completed various financing transactions, including the closing of the \$750 million Senior Secured Term Loan under its domestic credit facility (the "2016 Term Loan") maturing in July 2020, which generated net proceeds of approximately \$722 million, the completion of a \$500 million real estate loan facility in April 2016 (the "2016 Secured Loan Facility") maturing in July 2017 which generated net proceeds of approximately \$485 million, the completion of an additional \$500 million real estate loan facility in January 2017 (the "2017 Secured Loan Facility") maturing in July 2020 which generated net proceeds of approximately \$486 million, and also entering into a \$300 million Second Lien Credit Agreement in September 2016 (the "Second Lien Term Loan") maturing in 2020 which generated net proceeds of approximately \$291 million. Additionally, the

Company generated nearly \$460 million in cash proceeds from the sale of real estate and other asset sales, including \$71 million from a sale-leaseback transaction for five Sears Full-line stores and two Sears Auto Centers. Other actions announced during the fourth quarter of 2016 included a new Letter of Credit and Reimbursement Agreement (the "LC Facility Agreement") providing for up to a \$500 million (of which \$200 million is presently committed) secured standby letter of credit facility (the "LC Facility") from certain affiliates of ESL Investments, Inc., and the establishment of a Special Committee of the Board of Directors to market certain real estate properties targeting at least \$1.0 billion of asset sales. The specific assets involved, the timing and the overall amount will depend on a variety of factors, including market conditions, interest in specific assets, valuations of those assets and our underlying operating performance. A portion of the cash proceeds generated from these asset sales will be utilized to repay amounts outstanding under both the 2016 Secured Loan Facility and 2017 Secured Loan Facility. In addition, in February 2017, the Company entered into an amendment to our existing domestic credit facility. The amendment reduced the aggregate revolver commitments from \$1.971 billion to \$1.5 billion, but also implemented other modifications to covenants and reserves against the domestic credit facility borrowing base that improved net liquidity. The amended credit facility is smaller in size, reflecting the Company's reduced needs consistent with lower inventory levels associated with our transforming business model, which has fewer physical stores and a greater online presence. The amendment also provides additional flexibility in the form of a \$250 million increase in the general debt basket from \$750 million to \$1.0 billion. Our domestic credit facility permits us up to \$500 million of FILO loan capacity under the credit agreement and up to \$2.0 billion of second lien loan capacity (of which \$604 million is currently utilized) outside the credit agreement, all depending on the applicable and available borrowing base as defined in our applicable debt agreements, as well as our ability to secure commitments from lenders. We also have the ability to obtain longer-term secured financing maturing outside of the domestic credit facility maturity date which would not be subject to borrowing base limitations (see Note 3 of Notes to Consolidated Financial Statements). The options available to us include securitizing assets and real estate loans, which we have successfully executed in the past. Further, in February and March 2017, the Company issued commercial paper to meet short-term liquidity needs, with the maximum amount outstanding during this time of \$100 million, of which all has been repaid. Also in February 2017, the Company initiated a restructuring program targeted to deliver at least \$1.0 billion in annualized cost savings in 2017, which includes cost reductions from the previously announced store closures. Under the restructuring program, we intend to simplify Holdings' organizational structure, including greater consolidation of the Sears and Kmart corporate and support functions, as well as implement a streamlined operating model to drive greater accountability and profitability. We also intend to transition to an integrated value chain model to drive efficiencies in pricing, sourcing, supply chain and inventory management, optimize product assortment at Sears and Kmart stores to better align with preferences of our Best Members focusing on profitable, high-return Best Categories and actively manage our real estate portfolio to identify additional opportunities for reconfiguration and reduction of capital obligations. We are primarily focusing on profitability instead of revenues, market share and other metrics each of which relate to, but do not necessarily drive profit. This approach may negatively impact our sales, however, it is aimed at returning the Company to profitability. Finally, in March 2017, the Company closed its previously-announced sale of the Craftsman brand to Stanley Black & Decker. The Company received an initial upfront payment of \$525 million, subject to closing costs and an adjustment for working capital changes, at closing. A portion of these proceeds were used to reduce outstanding borrowings under both the Company's domestic credit facility and term loans outstanding, as well as for general corporate purposes. In addition, Stanley Black & Decker will pay a further \$250 million in cash in three years and Holdings will receive payments of between 2.5% and 3.5% on new Stanley Black & Decker sales of Craftsman products for the next 15 years. As described in Note 1 of Notes to Consolidated Financial Statements, the Pension Benefit Guaranty Corporation ("PBGC") consented to the sale of the Craftsman-related assets that had been "ring-fenced" under the pension plan protection and forbearance agreement (the "PPPFA") with the PBGC. We acknowledge that we continue to face a challenging competitive environment and while we continue to focus on our overall profitability, including managing expenses, we reported a loss in 2016 and were required to fund cash used in operating activities with cash from investing and financing activities. We expect that the actions taken in 2016 and early 2017 will enhance our liquidity and financial flexibility. In addition, as previously discussed, we expect to generate additional liquidity through the monetization of our real estate and additional debt financing actions. We

expect that these actions will be executed in alignment with the anticipated timing of our liquidity needs.

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We also continue to explore ways to unlock value across a range of assets, including exploring ways to maximize the value of our Home Services and Sears Auto Centers businesses, as well as our Kenmore and DieHard brands through partnerships or other means of externalization that could expand distribution of our brands and service offerings to realize significant growth. We expect to continue to right-size, redeploy and highlight the value of our assets, including our real estate portfolio, in our transition from an asset intensive, historically "store-only" based retailer to a more asset light, integrated membership-focused company.

Our historical operating results indicate substantial doubt exists related to the Company's ability to continue as a going concern. We believe that the actions discussed above are probable of occurring and mitigating the substantial doubt raised by our historical operating results and satisfying our estimated liquidity needs 12 months from the issuance of the financial statements. However, we cannot predict, with certainty, the outcome of our actions to generate liquidity, including the availability of additional debt financing, or whether such actions would generate the expected liquidity as currently planned. In addition, the PPPFA, contains certain limitations on our ability to sell assets, which could impact our ability to complete asset sale transactions or our ability to use proceeds from those transactions to fund our operations. Therefore, the planned actions take into account the applicable restrictions under the PPPFA.

If we continue to experience operating losses, and we are not able to generate additional liquidity through the mechanisms described above or through some combination of other actions, while not expected, we may not be able to access additional funds under our amended Domestic Credit Agreement and we might need to secure additional sources of funds, which may or may not be available to us. Additionally, a failure to generate additional liquidity could negatively impact our access to inventory or services that are important to the operation of our business. Moreover, if the borrowing base (as calculated pursuant to the indenture) falls below the principal amount of the notes plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for the notes on the last day of any two consecutive quarters, it could trigger an obligation to repurchase notes in an amount equal to such deficiency.

Our outstanding borrowings at January 28, 2017 and January 30, 2016 were as follows:

millions	January 28, January 30, 2017 2016	
Short-term borrowings:		
Secured borrowings	\$ —	\$ 797
Long-term debt, including current portion:		
Notes, term loan and debentures outstanding	4,018	1,984
Capitalized lease obligations	145	195
Total borrowings	\$ 4,163	\$ 2,976

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

millions	2016	2015
Secured borrowings:		
Maximum daily amount outstanding during the period	\$1,150	\$876
Average amount outstanding during the period	334	416
Amount outstanding at period-end	—	797
Weighted average interest rate	4.6	% 3.2 %

Unsecured commercial paper:

Maximum daily amount outstanding during the period	\$250	\$104
Average amount outstanding during the period	106	15
Amount outstanding at period-end	—	—
Weighted average interest rate	7.9	% 4.1 %

Secured short-term loan:

Maximum daily amount outstanding during the period	\$—	\$400
Average amount outstanding during the period	—	84
Amount outstanding at period-end	—	—
Weighted average interest rate	—	% 5.0 %

Information about our Domestic Credit Agreement, Senior Secured Notes, Senior Unsecured Notes, Debt Repurchase Authorization, Unsecured Commercial Paper, Secured Short-Term Loan, and Wholly-owned Insurance Subsidiary and Intercompany Securities is included in Note 3 of Notes to Consolidated Financial Statements.

Domestic Pension Plans Funding

Contributions to our pension plans remain a significant use of our cash on an annual basis. While the Company's pension plans are frozen, and thus associates do not currently earn pension benefits, the Company has a legacy pension obligation for past service performed by Kmart and Sears associates. During 2016, we contributed \$314 million to our domestic pension plans. We estimate that the domestic pension contributions will be approximately \$312 million in 2017 and approximately \$297 million in 2018. As previously noted, the Company agreed to grant the PBGC a lien on, and subsequently contribute to the Company's pension plans, the value of the \$250 million cash payment payable to the Company on the third anniversary of the Craftsman closing with the value of such payment being fully credited against the Company's minimum pension funding obligations in 2017, 2018 and 2019. The Company also agreed to grant a lien to the PBGC on the 15-year income stream relating to new Stanley Black & Decker sales of Craftsman products, and agreed to contribute the payments from Stanley Black & Decker under such income stream to the Company's pension plans, with such payments to be credited against the Company's minimum pension funding obligations starting no later than five years from the closing date. The Company also agreed to grant the PBGC a lien on \$100 million of real estate assets to secure the Company's minimum pension obligations through the end of 2019. The ultimate amount of pension contributions could be affected by changes in applicable regulations, as well as financial market and investment performance.

Contractual Obligations and Off-Balance Sheet Arrangements

Information concerning our obligations and commitments to make future payments under contracts such as debt and lease agreements, and under contingent commitments, is aggregated in the following tables.

Contractual Obligations	Total	Payments Due by Period				Other
		Within 1 Year	1-3 Years	3-5 Years	After 5 Years	
millions						
Operating leases	\$3,675	\$650	\$ 997	\$ 697	\$1,331	\$—
Capital lease obligations	198	52	62	22	62	—
Royalty license fees ⁽¹⁾	83	39	35	9	—	—
Other	14	14	—	—	—	—
Pension funding obligations	1,777	312	568	446	451	—
Long-term debt including current portion and interest	5,399	876	2,337	1,653	533	—
Liability and interest related to uncertain tax positions ⁽²⁾	203	—	—	—	—	203
Total contractual obligations	\$11,349	\$1,943	\$ 3,999	\$ 2,827	\$2,377	\$203

We pay royalties under various merchandise license agreements, which are generally based on sales of products covered under these agreements. We currently have license agreements for which we pay royalties, including those to use Joe Boxer and Everlast. Royalty license fees represent the minimum the Company is obligated to pay, regardless of sales, as guaranteed royalties under these license agreements.

At January 28, 2017, our uncertain tax position liability and gross interest payable were \$142 million and \$61 million, respectively. We are unable to reasonably estimate the timing of liabilities and interest payments arising from uncertain tax positions in individual years due to the uncertainties in the timing of the effective settlement of tax positions.

Other Commercial Commitments

We issue various types of guarantees in the normal course of business. We had the following guarantees outstanding at January 28, 2017:

millions	Bank Issued	SRAC Issued	Other	Total
Standby letters of credit	\$ 665	\$ 7	\$ —	—\$672
Commercial letters of credit	—	54	—	54
Secondary lease obligations and performance guarantee	—	—	122	122

The secondary lease obligations relate to certain store leases that have been assigned and previously divested Sears businesses. The secondary lease obligations represent the maximum potential amount of future payments, including renewal option periods pursuant to the lease agreements. We remain secondarily liable if the primary obligor defaults.

Application of Critical Accounting Policies and Estimates

In preparing the financial statements, certain accounting policies require considerable judgment to select the appropriate assumptions to calculate financial estimates. These estimates are complex and subject to an inherent degree of uncertainty. We base our estimates on historical experience, terms of existing contracts, evaluation of trends and other assumptions that we believe to be reasonable under the circumstances. We continually evaluate the information used to make these estimates as our business and the economic environment change. Although the use of estimates is pervasive throughout the financial statements, we consider an accounting estimate to be critical if:

- it requires assumptions to be made about matters that were highly uncertain at the time the estimate was made; and
- changes in the estimate that are reasonably likely to occur from period to period or different estimates that could have been selected would have a material effect on our financial condition, cash flows or results of operations.

Management believes the current assumptions and other considerations used to estimate amounts reflected in the financial statements are appropriate. However, if actual experience differs from the assumptions and the considerations used in estimating amounts, the resulting changes could have a material adverse effect on our consolidated results of operations, and in certain situations, could have a material adverse effect on our financial condition.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the disclosure presented below relating to the selection of these estimates.

The following is a summary of our most critical policies and estimates. See Note 1 of Notes to Consolidated Financial Statements for a listing of our other significant accounting policies.

Valuation of Inventory

Our inventory is valued at the lower of cost or market determined primarily using the retail inventory method ("RIM"). RIM is an averaging method that is commonly used in the retail industry. To determine inventory cost under RIM, inventory at its retail selling value is segregated into groupings of merchandise having similar characteristics, which are then converted to a cost basis by applying specific average cost factors for each grouping of merchandise. Cost factors represent the average cost-to-retail ratio for each merchandise group based upon the year purchasing activity for each store location. Accordingly, a significant assumption under the retail method is that inventory in each group is similar in terms of its cost-to-retail relationship and has similar turnover rates. Management monitors the content of merchandise in these groupings to prevent distortions that would have a material effect on inventory valuation.

RIM inherently requires management judgment and certain estimates that may significantly affect the ending inventory valuation, as well as gross margin. Among others, two significant estimates used in inventory valuation are the level and timing of permanent markdowns (clearance markdowns used to clear unproductive or slow-moving inventory) and shrinkage. Amounts are charged to cost of sales, buying and occupancy at the time the retail value of inventory is reduced through the use of permanent markdowns.

Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise, fashion trends and weather conditions. In addition, inventory is also evaluated against corporate pre-determined historical markdown cadences. When a decision is made to permanently markdown merchandise, the resulting gross margin reduction is recognized in the period the markdown is recorded. The timing of the decision, particularly surrounding the balance sheet date, can have a significant effect on the results of operations. Shrinkage is estimated as a percentage of sales for the period from the date of the last physical inventory to the end of the year. Physical inventories are taken annually for all stores and inventory records are adjusted accordingly. The shrinkage rate from the most recent physical inventory, in combination with historical experience, is used as the basis for the shrinkage accrual following the physical inventory.

Self-insurance Reserves

We use a combination of third-party insurance and/or self-insurance for a number of risks including workers' compensation, asbestos, environmental, automobile, warranty, product and general liability claims. General liability costs relate primarily to litigation that arises from store operations. Self-insurance reserves include actuarial estimates of both claims filed and carried at their expected ultimate settlement value and claims incurred but not yet reported. Our estimated claim amounts are discounted using a rate with a duration that approximates the duration of our self-insurance reserve portfolio. Our liability reflected in the Consolidated Balance Sheets represents an estimate of the ultimate cost of claims incurred at the balance sheet date. In estimating this liability, we utilize loss development factors based on Company-specific data to project the future development of incurred losses. Loss estimates are adjusted based upon actual claims settlements and reported claims. These projections are subject to a high degree of variability based upon future inflation rates, litigation trends, legal interpretations, benefit level changes and claim settlement patterns. Although we do not expect the amounts ultimately paid to differ significantly from our estimates, self-insurance reserves could be affected if future claim experience differs significantly from the historical trends and the actuarial assumptions. A 10% change in our self-insurance reserves would have impacted net loss by approximately \$72 million.

Defined Benefit Pension Plans

The fundamental components of accounting for defined benefit pension plans consist of the compensation cost of the benefits earned, the interest cost from deferring payment of those benefits into the future and the results of investing any assets set aside to fund the obligation. Such retirement benefits were earned by associates ratably over their service careers. Therefore, the amounts reported in the income statement for these retirement plans have historically followed the same pattern. Accordingly, changes in the obligations or the value of assets to fund them have been recognized systematically and gradually over the associate's estimated period of service. The largest drivers of losses or charges in recent years have been the discount rate used to determine the present value of the obligation and the actual return on pension assets. We recognize the changes by amortizing experience gains/losses in excess of the 10% corridor into expense over the associated service period.

The Company's actuarial valuations utilize key assumptions including discount rates and expected returns on plan assets. We are required to consider current market conditions, including changes in interest rates and plan asset investment returns, in determining these assumptions. The determination of our obligations and expense for pension benefits is dependent upon certain assumptions used in calculating such amounts. Key assumptions used in the actuarial valuations include the discount rate, expected long-term rate of return on plan assets and mortality rate assumptions. To determine the discount rate used in the development of the benefit obligation and net periodic benefit cost, a cash flow matching analysis of the expected future benefit payments is performed. In addition to considering the results that cash flow matching produces, the Company gives consideration to changes in industry benchmark yield curve rates. Actuarial assumptions may differ materially from actual results due to changing market and economic conditions, changes in investment strategies, higher or lower withdrawal rates, and longer or shorter life spans of participants. For further information, see Note 7 of Notes to Consolidated Financial Statements.

The actual and expected return on plan assets for 2016, 2015 and 2014 were as follows:

	2016	2015	2014
Actual return on plan assets	16.08 %	(7.35) %	1.49 %
Expected return on plan assets	6.50 %	7.00 %	7.00 %

The Sears Holdings Corporation Investment Committee is responsible for the investment of the assets of Holdings' domestic pension plans. The Investment Committee, made up primarily of select members of senior management, has appointed a non-affiliated third party professional to advise the Investment Committee with respect to the assets of Holdings' domestic pension plans. The plans' overall investment objective is to provide a long-term return that, along with Company contributions, is expected to meet future benefit payment requirements. A long-term horizon has been adopted in establishing investment policy such that the likelihood and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets. The plans' investment policies require investments to be diversified across individual securities, industries, market

capitalization and valuation characteristics. In addition, various techniques are utilized to monitor, measure and manage risk.

For purposes of determining the periodic expense of our defined benefit plans, we use the fair value of plan assets as the market related value. A one-percentage-point change in the assumed discount rate would have the following effects on the pension liabilities:

millions	1 percentage-point Increase	1 percentage-point Decrease
Effect on interest cost component	\$ 24	\$ (31)
Effect on pension benefit obligation	\$ (487)	\$ 583

Income Taxes

We account for income taxes according to accounting standards for such taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the book basis and tax basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If future utilization of deferred tax assets is uncertain, the Company may record a valuation allowance against its deferred tax assets. Our accounting policies related to the valuation allowance are further described in Note 1 of Notes to Consolidated Financial Statements. After consideration of evidence regarding the ability to realize our deferred tax assets, we established a valuation allowance against deferred income tax assets in 2016, 2015 and 2014. For the year ended January 28, 2017, the valuation allowance increased by \$762 million of which a decrease of \$3 million was recorded through other comprehensive income. The Company continues to monitor its operating performance and evaluate the likelihood of the future realization of these deferred tax assets.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and the valuation allowance recorded against our net deferred tax assets, if any. Management considers estimates of the amount and character of future taxable income in assessing the likelihood of realization of deferred tax assets. Our actual effective tax rate and income tax expense could vary from estimated amounts due to the future impacts of various items, including changes in income tax laws, tax planning and the Company's forecasted financial condition and results of operations in future periods. Although management believes current estimates are reasonable, actual results could differ from these estimates.

Domestic and foreign tax authorities periodically audit our income tax returns. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposures associated with our various tax filing positions, we record reserves in accordance with accounting standards for uncertain tax positions. A number of years may elapse before a particular matter, for which we have established a reserve, is audited and fully resolved. Management's estimates at the date of the financial statements reflect our best judgment, giving consideration to all currently available facts and circumstances. As such, these estimates may require adjustment in the future, as additional facts become known or as circumstances change. For further information, see Note 10 of Notes to Consolidated Financial Statements.

Goodwill and Intangible Asset Impairment Assessments

At both January 28, 2017 and January 30, 2016, we had goodwill balances of \$269 million, and intangible asset balances of \$1.5 billion and \$1.9 billion, respectively. The Company evaluates the carrying value of goodwill and intangible assets for possible impairment under accounting standards governing goodwill and other intangible assets. Our accounting policies related to goodwill and intangible asset impairment assessments are further described in Note 1 of Notes to Consolidated Financial Statements.

Goodwill Impairment Assessments

Our goodwill balance relates to our Home Services business. We did not record any goodwill impairment charges in 2016, 2015 or 2014.

The use of different assumptions, estimates or judgments in either step of the goodwill impairment testing process, such as the estimated future cash flows of the reporting unit, the discount rate used to discount such cash flows, or the estimated fair value of the reporting unit's tangible and intangible assets and liabilities, could significantly increase or decrease the estimated fair value of the reporting unit or its net assets. At the 2016 annual impairment test date, the conclusion that no indication of goodwill impairment existed for the reporting unit would not have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of the reporting unit to its net present value in determining their estimated fair values; and/or (2) a 100 basis point decrease in the estimated sales growth rate and/or terminal period growth rate.

Based on our sensitivity analysis, we do not believe that the remaining recorded goodwill balance is at risk of impairment at the reporting unit at the end of the year because the fair value is in excess of the carrying value and not at risk of failing step one. However, goodwill impairment charges may be recognized in future periods in the reporting unit to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry or in the equity markets, which includes the market value of our common shares, deterioration in our performance or our future projections, or changes in our plans for the reporting unit.

Intangible Asset Impairment Assessments

The majority of our indefinite-lived intangible assets relate to the Sears, Kenmore, Craftsman and DieHard trade names. In 2016 and 2015, we recorded impairment related to the Sears trade name of \$381 million and \$180 million, respectively, which reduced the carrying value to \$431 million at January 28, 2017. We did not record any intangible asset impairment charges in 2014.

The use of different assumptions, estimates or judgments in our intangible asset impairment testing process, such as the estimated future cash flows of assets and the discount rate used to discount such cash flows, could significantly increase or decrease the estimated fair value of an asset, and therefore, impact the related impairment charge. At the 2016 annual impairment test date, the above-noted conclusion that no indication of intangible asset impairment existed at the test date for the Kenmore, Craftsman and DieHard trade names would have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of our assets to their net present value in determining their estimated fair values (without any change in the aggregate estimated cash flows of our intangibles); (2) a 100 basis point decrease in the terminal period growth rate; (3) a 10% decrease in the revenue growth rate for fiscal year 2017; or (4) a 10 basis point decrease in the royalty rate applied to the forecasted net sales stream of our assets and would have resulted in a potential impairment of up to \$163 million under any combination of those scenarios. Also, the above-noted impairment related to the Sears trade name would have changed under any combination of those scenarios and would have resulted in potential incremental impairment of up to \$125 million.

We believe the impairment charges of \$381 million and \$180 million in 2016 and 2015, respectively, are appropriate based on the judgments and estimates used in our analysis. We do not believe that the other indefinite-lived intangible balances are impaired at the end of the year because the fair values are in excess of the carrying values based on our analysis. However, further indefinite-lived intangible impairment charges may be recognized in future periods to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry, deterioration in our performance or our future projections, if actual results are not consistent with our estimates and assumptions used in the analysis, or changes in our plans for one or more indefinite-lived intangible assets. We will continue to monitor for such changes in facts or circumstances, which may be indicators of potential impairment triggers, and may result in impairment charges in the future, which could be material to our results of operations.

Impairment of Long-Lived Assets

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Our accounting policies related to long-lived asset impairment assessments are further described in Note 1 of Notes to Consolidated Financial Statements. As a result of this impairment testing, the

Company recorded impairment charges of \$46 million, \$94 million and \$34 million during 2016, 2015 and 2014, respectively. Our impairment testing includes uncertainty because it requires management to make assumptions and to apply judgment to estimate future cash flows and asset fair values. If actual results are not consistent with our estimates and assumptions used in estimating future cash flows and asset fair values, we may be exposed to additional impairment charges in the future, which could be material to our results of operations.

New Accounting Pronouncements

See Note 1 of Notes to Consolidated Financial Statements for information regarding new accounting pronouncements.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements made in this Annual Report on Form 10-K and in other public announcements by us contain forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995.

Forward-looking statements include information concerning our future financial performance, business strategy, plans, goals and objectives. Statements preceded or followed by, or that otherwise include, the words "believes," "expects," "anticipates," "intends," "estimates," "plans," "forecast," "is likely to" and similar expressions or future or conditional verbs such as "will," "may" and "could" are generally forward-looking in nature and not historical facts. Such statements are based upon the current beliefs and expectations of the Company's management and are subject to significant risks and uncertainties, many of which are beyond the Company's control, that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Actual results may differ materially from those set forth in the forward-looking statements.

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

Certain of these and other factors are discussed in more detail in Part I, Item 1A of this Annual Report on Form 10-K. While we believe that our forecasts and assumptions are reasonable, we caution that actual results may

differ materially. We intend the forward-looking statements to speak only as of the time made and do not undertake to update or revise them as more information becomes available, except as required by law.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding. All debt securities are considered non-trading. At January 28, 2017, 49% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at January 28, 2017, which totaled approximately \$2.0 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by \$20 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

Item 8. Financial Statements and Supplementary Data

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SEARS HOLDINGS CORPORATION

Consolidated Statements of Operations

millions, except per share data

	2016	2015	2014
REVENUES			
Merchandise sales and services ⁽¹⁾⁽²⁾	\$22,138	\$25,146	\$31,198
COSTS AND EXPENSES			
Cost of sales, buying and occupancy ⁽¹⁾⁽³⁾	17,452	19,336	24,049
Selling and administrative	6,109	6,857	8,220
Depreciation and amortization	375	422	581
Impairment charges	427	274	63
Gain on sales of assets	(247)	(743)	(207)
Total costs and expenses	24,116	26,146	32,706
Operating loss	(1,978)	(1,000)	(1,508)
Interest expense	(404)	(323)	(313)
Interest and investment income (loss)	(26)	(62)	132
Other income	13	—	4
Loss before income taxes	(2,395)	(1,385)	(1,685)
Income tax (expense) benefit	174	257	(125)
Net loss	(2,221)	(1,128)	(1,810)
(Income) loss attributable to noncontrolling interests	—	(1)	128
NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	\$(2,221)	\$(1,129)	\$(1,682)
NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS			
Basic loss per share	\$(20.78)	\$(10.59)	\$(15.82)
Diluted loss per share	\$(20.78)	\$(10.59)	\$(15.82)
Basic weighted average common shares outstanding	106.9	106.6	106.3
Diluted weighted average common shares outstanding	106.9	106.6	106.3

Includes merchandise sales to Sears Hometown and Outlet Stores, Inc. ("SHO") of \$1.1 billion, \$1.3 billion and (1) \$1.4 billion in 2016, 2015 and 2014, respectively. Pursuant to the terms of the separation, merchandise is sold to SHO at cost.

(2) Includes revenue from Lands' End, Inc. ("Lands' End") for retail services and rent for Lands' End Shops at Sears, participation in the Shop Your Way program and corporate shared services of \$52 million, \$59 million and \$59 million in 2016, 2015 and 2014, respectively.

(3) Includes rent expense (consisting of straight-line rent expense offset by amortization of a deferred gain on sale-leaseback) of \$83 million and \$49 million in 2016 and 2015, respectively, and installment expenses of \$64 million and \$40 million in 2016 and 2015, respectively, pursuant to the master lease with Seritage Growth Properties ("Seritage"). There were no such rent or installment expenses paid to Seritage in 2014.

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Consolidated Statements of Comprehensive Loss

millions	2016	2015	2014
Net loss	\$(2,221)	\$(1,128)	\$(1,810)
Other comprehensive income (loss)			
Pension and postretirement adjustments, net of tax	366	113	(1,040)
Deferred loss on derivatives, net of tax	—	—	(2)
Currency translation adjustments, net of tax	—	(1)	3
Sears Canada de-consolidation	—	—	(186)
Dissolution of noncontrolling interest	(7)	—	—
Total other comprehensive income (loss)	359	112	(1,225)
Comprehensive loss	(1,862)	(1,016)	(3,035)
Comprehensive (income) loss attributable to noncontrolling interests	7	(1)	438
Comprehensive loss attributable to Holdings' shareholders	\$(1,855)	\$(1,017)	\$(2,597)

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION

Consolidated Balance Sheets

millions	January 28, 2017	January 30, 2016
ASSETS		
Current assets		
Cash and cash equivalents	\$ 286	\$ 238
Accounts receivable ⁽¹⁾	466	419
Merchandise inventories	3,959	5,172
Prepaid expenses and other current assets ⁽²⁾	285	216
Total current assets	4,996	6,045
Property and equipment		
Land	770	827
Buildings and improvements	2,954	3,140
Furniture, fixtures and equipment	1,133	1,352
Capital leases	224	272
Gross property and equipment	5,081	5,591
Less accumulated depreciation and amortization	(2,841)	(2,960)
Total property and equipment, net	2,240	2,631
Goodwill	269	269
Trade names and other intangible assets	1,521	1,909
Other assets	336	483
TOTAL ASSETS	\$ 9,362	\$ 11,337
LIABILITIES		
Current liabilities		
Short-term borrowings	\$ —	\$ 797
Current portion of long-term debt and capitalized lease obligations ⁽³⁾	590	71
Merchandise payables	1,048	1,574
Other current liabilities ⁽⁴⁾	1,956	1,925
Unearned revenues	748	787
Other taxes	339	284
Total current liabilities	4,681	5,438
Long-term debt and capitalized lease obligations ⁽⁵⁾	3,573	2,108
Pension and postretirement benefits	1,750	2,206
Deferred gain on sale-leaseback	563	753
Sale-leaseback financing obligation	235	164
Other long-term liabilities	1,641	1,731
Long-term deferred tax liabilities	743	893
Total Liabilities	13,186	13,293
Commitments and contingencies		
DEFICIT		
Sears Holdings Corporation deficit		
Preferred stock, 20 shares authorized; no shares outstanding	—	—
Common stock \$0.01 par value; 500 shares authorized; 107 and 107 shares outstanding, respectively	1	1
Treasury stock—at cost	(5,891)	(5,928)
Capital in excess of par value	9,130	9,173
Retained deficit	(5,512)	(3,291)

Accumulated other comprehensive loss	(1,552)	(1,918)
Total Sears Holdings Corporation deficit	(3,824)	(1,963)
Noncontrolling interest	—	7
Total Deficit	(3,824)	(1,956)
TOTAL LIABILITIES AND DEFICIT	\$ 9,362	\$ 11,337

Includes \$81 million and \$51 million at January 28, 2017 and January 30, 2016, respectively, of net amounts

(1) receivable from SHO, and \$14 million and \$7 million of amounts receivable from Seritage at January 28, 2017 and January 30, 2016, respectively.

(2) Includes \$9 million of prepaid rent to Seritage at January 30, 2016.

(3) Includes balances held by related parties of \$216 million at January 28, 2017 related to our 2016 Secured Loan Facility.

(4) Includes \$1 million and \$1 million of net amounts payable to Lands' End at January 28, 2017 and January 30, 2016, respectively, and \$11 million of amounts payable to Seritage at January 28, 2017.

(5) Includes balances held by related parties of \$1.7 billion and \$603 million at January 28, 2017 and January 30, 2016, respectively, related to our Senior Secured Notes, Subsidiary Notes, Senior Unsecured Notes, Second Lien Term Loan, 2016 Term Loan and 2017 Secured Loan Facility. See Note 15 for further information.

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION

Consolidated Statements of Cash Flows

millions	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	(2,221)	(1,128)	(1,810)
Adjustments to reconcile net loss to net cash used in operating activities:			
Deferred tax valuation allowance	836	217	835
Tax benefit resulting from Other Comprehensive Income allocation	(71)	—	—
Depreciation and amortization	375	422	581
Impairment charges	427	274	63
Gain on sales of assets	(247)	(743)	(207)
Gain on sales of investments	—	—	(105)
Pension and postretirement plan contributions	(334)	(311)	(450)
Mark-to-market adjustments of financial instruments	15	66	(3)
Amortization of deferred gain on sale-leaseback	(88)	(52)	—
Amortization of debt issuance costs and accretion of debt discount	81	60	38
Settlement of Canadian dollar hedges	—	—	8
Change in operating assets and liabilities (net of acquisitions and dispositions):			
Deferred income taxes	(987)	(519)	(719)
Merchandise inventories	1,213	(229)	1,091
Merchandise payables	(526)	(47)	(528)
Income and other taxes	80	(95)	(110)
Other operating assets	(52)	54	(66)
Other operating liabilities	118	(136)	(5)
Net cash used in operating activities	(1,381)	(2,167)	(1,387)
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of property and investments ⁽¹⁾	386	2,730	424
Purchases of property and equipment	(142)	(211)	(270)
De-consolidation of Sears Canada cash	—	—	(207)
Proceeds from Sears Canada rights offering ⁽²⁾	—	—	380
Net cash provided by investing activities	244	2,519	327
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from debt issuances ⁽³⁾	2,028	—	1,025
Repayments of debt ⁽⁴⁾	(66)	(1,405)	(80)
Increase (decrease) in short-term borrowings, primarily 90 days or less	(797)	583	(1,117)
Proceeds from sale-leaseback financing ⁽¹⁾	71	508	—
Lands' End, Inc. pre-separation funding	—	—	515
Separation of Lands' End, Inc.	—	—	(31)
Debt issuance costs	(51)	(50)	(27)
Net cash provided by (used in) financing activities	1,185	(364)	285
Effect of exchange rate changes on cash and cash equivalents	—	—	(3)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	48	(12)	(778)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	238	250	1,028
CASH AND CASH EQUIVALENTS, END OF YEAR	\$286	\$238	\$250

SUPPLEMENTAL INFORMATION:

Capital lease obligation incurred	\$25	\$6	\$45
Supplemental Cash Flow Data:			

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Income taxes paid, net of refunds	\$23	\$45	\$119
Cash interest paid ⁽⁵⁾	275	252	230
Unpaid liability to acquire equipment and software	18	27	25

⁽¹⁾ Holdings received cash proceeds of \$2.7 billion (\$2.6 billion, net of closing costs) from the Seritage transaction (including \$745 million and \$297 million, respectively, received from ESL Investments, Inc. and its affiliates ("ESL") and Fairholme Capital Management, LLC and its affiliates ("Fairholme")), and \$429 million (\$426 million, net of closing costs) from the JV transactions. Proceeds from the Seritage transaction are included in proceeds from sales of property and investments (\$2.6 billion), and proceeds from sale-leaseback financing (\$82 million) for 2015. Proceeds from the JV transactions are included in proceeds from sale-leaseback financing (\$426 million) for 2015. See Note 11 for further information and defined terms.

⁽²⁾ Includes proceeds of \$212 million received from ESL and its affiliates and \$93 million received from Fairholme and its affiliates.

⁽³⁾ Proceeds in 2016 and 2014, respectively, include amounts from related parties of \$1.3 billion received from the 2017 Secured Loan Facility, 2016 Secured Loan Facility, 2016 Term Loan and Second Lien Term Loan, and \$878 million received from the Secured Short-Term Loan and Senior Unsecured Notes. See Notes 3 and 15 for further information and defined terms.

⁽⁴⁾ Repayments in 2015 include \$400 million of the Secured Short-Term Loan with related parties and \$482 million of Senior Secured Notes tendered by related parties, respectively. See Notes 3 and 15 for further information and defined terms.

⁽⁵⁾ Cash interest paid includes \$94 million, \$83 million and \$30 million interest paid to related parties related to our borrowings in 2016, 2015 and 2014, respectively. See Notes 3 and 15 for further information.

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Consolidated Statements of Deficit

dollars and shares in millions	Deficit Attributable to Holdings' Shareholders							Total
	Number of Shares	Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	
Balance at February 1, 2014	106	\$ 1	\$(5,963)	\$9,298	\$(480)	\$(1,117)	\$ 444	\$2,183
Comprehensive loss								
Net loss	—	—	—	—	(1,682)	—	(128)	(1,810)
Pension and postretirement adjustments, net of tax	—	—	—	—	—	(1,045)	5	(1,040)
Deferred loss on derivatives, net of tax	—	—	—	—	—	(2)	—	(2)
Currency translation adjustments, net of tax	—	—	—	—	—	4	(1)	3
Sears Canada de-consolidation	—	—	—	—	—	128	(314)	(186)
Total Comprehensive Loss								(3,035)
Stock awards	1	—	9	(5)	—	—	—	4
Separation of Lands' End, Inc.	—	—	—	(323)	—	2	—	(321)
Issuance of warrants	—	—	—	219	—	—	—	219
Associate stock purchase	—	—	5	—	—	—	—	5
Balance at January 31, 2015	107	\$ 1	\$(5,949)	\$9,189	\$(2,162)	\$(2,030)	\$ 6	\$(945)
Comprehensive loss								
Net loss	—	—	—	—	(1,129)	—	1	(1,128)
Pension and postretirement adjustments, net of tax	—	—	—	—	—	113	—	113
Currency translation adjustments, net of tax	—	—	—	—	—	(1)	—	(1)
Total Comprehensive Loss								(1,016)
Stock awards	—	—	16	(16)	—	—	—	—
Associate stock purchase	—	—	5	—	—	—	—	5
Balance at January 30, 2016	107	\$ 1	\$(5,928)	\$9,173	\$(3,291)	\$(1,918)	\$ 7	\$(1,956)
Comprehensive loss								
Net loss	—	—	—	—	(2,221)	—	—	(2,221)
Pension and postretirement adjustments, net of tax	—	—	—	—	—	366	—	366
Dissolution of noncontrolling interest	—	—	—	—	—	—	(7)	(7)
Total Comprehensive Loss								(1,862)
Stock awards	—	—	29	(30)	—	—	—	(1)
Reclassification of warrants	—	—	—	(13)	—	—	—	(13)
Associate stock purchase	—	—	8	—	—	—	—	8
Balance at January 28, 2017	107	\$ 1	\$(5,891)	\$9,130	\$(5,512)	\$(1,552)	\$ —	\$(3,824)

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Notes to Consolidated Financial Statements

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations, Consolidation and Basis of Presentation

Sears Holdings Corporation ("Holdings") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings (together with its subsidiaries, "we," "us," "our," or the "Company") was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger"), on March 24, 2005. We are an integrated retailer with 1,430 full-line and specialty retail stores in the United States, operating through Kmart and Sears. Through the third quarter of 2014, we conducted our operations under three reportable segments: Kmart, Sears Domestic and Sears Canada. Following the de-consolidation of Sears Canada discussed in Note 2, we have operated under two reportable segments: Kmart and Sears Domestic.

The consolidated financial statements include all majority-owned subsidiaries in which Holdings exercises control. Investments in companies in which Holdings exercises significant influence, but which we do not control (generally 20% to 50% ownership interest), are accounted for under the equity method of accounting. Investments in companies in which we have less than a 20% ownership interest and do not exercise significant influence are accounted for at cost. All intercompany transactions and balances have been eliminated.

Fiscal Year

Our fiscal year ends on the Saturday closest to January 31 each year. Fiscal years 2016, 2015 and 2014 consisted of 52 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Separation of Lands' End, Inc.

On April 4, 2014, we completed the separation of our Lands' End business through a spin-off transaction. The separation was structured to be tax free to our U.S. shareholders for U.S. federal income tax purposes. Prior to the separation, Lands' End, Inc. ("Lands' End") entered into an asset-based senior secured revolving credit facility, which provided for maximum borrowings of approximately \$175 million with a letter of credit sub-limit, and a senior secured term loan facility of approximately \$515 million. The proceeds of the term loan facility were used to fund a \$500 million dividend to Holdings and pay fees and expenses associated with the foregoing facilities. We accounted for this spin-off in accordance with accounting standards applicable to spin-off transactions. Accordingly, we classified the carrying value of net assets of \$323 million contributed to Lands' End as a reduction of capital in excess of par value in the Consolidated Statement of Equity (Deficit) for the year ended January 31, 2015.

Additionally, as a result of Mr. Lampert's role as our Chairman and Chief Executive Officer, and Chairman and Chief Executive Officer of ESL Investments, Inc. (together with its affiliated fund, "ESL"), and the continuing arrangements between Holdings and Lands' End (as further described in Note 15), Holdings has determined that it has significant influence over Lands' End. Accordingly, the operating results for Lands' End through the date of the spin-off are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Consolidated Financial Statements.

In connection with the separation, Holdings and certain of its subsidiaries entered into various agreements with Lands' End under the terms described in Note 15.

Pension Benefit Guaranty Corporation Agreement

On March 18, 2016, we entered into a five-year pension plan protection and forbearance agreement with the Pension Benefit Guaranty Corporation ("PBGC") (the "PPPFA"), pursuant to which the Company has agreed to continue to protect, or "ring-fence," pursuant to customary covenants, the assets of certain special purpose subsidiaries (the "Relevant Subsidiaries") holding real estate and/or intellectual property assets. Also under the agreement, the Relevant Subsidiaries granted the PBGC a springing lien on the ring-fenced assets, which lien will be triggered only by (a) failure to make required contributions to the Company's pension plans (the "Plans"), (b) prohibited transfers of ownership interests in the Relevant Subsidiaries, (c) termination events with respect to the Plans, or (d) bankruptcy events with respect to the Company or certain of its material subsidiaries. Under the

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agreement, the PBGC has agreed to forbear from initiating an involuntary termination of the Plans, except upon the occurrence of specified conditions, one of which is based on the aggregate market value of the Company's issued and outstanding stock. As of the date of this report, the Company's stock price is such that the PBGC would be permitted to cease forbearance. The PBGC has been given notice in accordance with the terms of the agreement and has not communicated any intention to cease its forbearance.

Craftsman Brand Sale

On January 5, 2017, Holdings announced that it had entered into a definitive agreement under which Stanley Black & Decker would purchase the Craftsman brand from Holdings (the "Craftsman Sale"). On March 8, 2017, the Company closed its sale of the Craftsman brand to Stanley Black & Decker. The transaction provides Stanley Black & Decker with the right to develop, manufacture and sell Craftsman-branded products outside of Holdings and Sears Hometown & Outlet Stores, Inc. distribution channels. As part of the agreement, Holdings will continue to offer Craftsman-branded products, sourced from existing suppliers, through its current retail channels via a perpetual license from Stanley Black & Decker, which will be royalty-free for the first 15 years after closing and royalty-bearing thereafter.

The Company received an initial upfront payment of \$525 million, subject to closing costs and an adjustment for working capital changes, at closing. In addition, Stanley Black & Decker will pay a further \$250 million in cash in three years and Holdings will receive payments of between 2.5% and 3.5% on new Stanley Black & Decker sales of Craftsman products for the 15 years following the closing.

In connection with the closing of the Craftsman transaction, Holdings reached an agreement with the PBGC pursuant to which the PBGC has consented to the sale of the Craftsman-related assets that had been "ring-fenced" under the PPPFA and certain related transactions. As a condition to obtaining this consent, the Company agreed to grant the PBGC a lien on, and subsequently contribute to the Company's pension plans, the value of the \$250 million cash payment payable to the Company on the third anniversary of the Craftsman closing with the value of such payment being fully credited against certain of the Company's minimum pension funding obligations in 2017, 2018 and 2019. The Company also granted a lien to the PBGC on the 15-year income stream relating to new Stanley Black & Decker sales of Craftsman products, and agreed to contribute the payments from Stanley Black & Decker under such income stream to the Company's pension plans, with such payments to be credited against the Company's minimum pension funding obligations starting no later than five years from the closing date. The Company also agreed to grant the PBGC a lien on \$100 million of real estate assets to secure the Company's minimum pension funding obligations through the end of 2019, and agreed to certain other amendments to the PPPFA.

Uses and Sources of Liquidity

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

During 2015, the Company completed its previously announced rights offering and sale-leaseback transaction with Seritage Growth Properties and received aggregate gross proceeds from the transaction of \$2.7 billion. In addition, as discussed in Note 3, the Company completed an amendment and extension of its existing domestic credit facility in which the maturity date for \$1.971 billion of the revolving tranche of our domestic credit facility has been extended to July 2020, while \$1.304 billion retained the existing maturity date of April 2016. Finally, as also discussed in Note 3, the Company completed a tender offer for \$936 million principal amount of its outstanding 6 5/8% Senior Secured Notes Due 2018.

During 2016, the Company completed various financing transactions, including the closing of the \$750 million Senior Secured Term Loan under its domestic credit facility (the "2016 Term Loan") maturing in July 2020, which generated net proceeds of approximately \$722 million, the completion of a \$500 million real estate loan facility in April 2016 (the "2016 Secured Loan Facility") maturing in July 2017 which generated net proceeds of approximately \$485

million, the completion of an additional \$500 million real estate loan facility in January 2017 (the "2017 Secured Loan Facility") maturing in July 2020 which generated net proceeds of approximately \$486 million, and also entering into a \$300 million Second Lien Credit Agreement in September 2016 (the "Second Lien

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Term Loan”) maturing in 2020 which generated net proceeds of approximately \$291 million. Additionally, the Company generated nearly \$460 million in cash proceeds from the sale of real estate and other asset sales, including \$71 million from a sale-leaseback transaction for five Sears Full-line stores and two Sears Auto Centers. The funds received from these actions were used to reduce outstanding borrowings under the Company's domestic credit facility and for general corporate purposes.

Other actions announced in 2016 included a new Letter of Credit and Reimbursement Agreement (the "LC Facility Agreement") providing for up to a \$500 million secured standby letter of credit facility (the "LC Facility") from certain affiliates of ESL Investments, Inc., and the establishment of a Special Committee of the Board of Directors to market certain real estate properties targeting at least \$1.0 billion of asset sales. The specific assets involved, the timing and the overall amount will depend on a variety of factors, including market conditions, interest in specific assets, valuations of those assets and our underlying operating performance. A portion of the cash proceeds generated from these asset sales will be utilized to repay amounts outstanding under both the 2016 Secured Loan Facility and 2017 Secured Loan Facility.

In addition, in February 2017, the Company entered into an amendment to our existing domestic credit facility. The amendment reduced the aggregate revolver commitments from \$1.971 billion to \$1.5 billion, but also implemented other modifications to covenants and reserves against the domestic credit facility borrowing base that improved net liquidity. The amendment also provides additional flexibility in the form of a \$250 million increase in the general debt basket from \$750 million to \$1.0 billion. Our domestic credit facility permits us up to \$500 million of FILO loan capacity under the credit agreement and up to \$2.0 billion of second lien loan capacity (of which \$604 million is currently utilized) outside the credit agreement, all depending on the applicable and available borrowing base as defined in our applicable debt agreements, as well as our ability to secure commitments from lenders. We also have the ability to obtain longer-term secured financing maturing outside of the domestic credit facility maturity date which would not be subject to borrowing base limitations (see Note 3). The options available to us include securitizing assets and real estate loans, which we have successfully executed in the past. Further, in February and March 2017, the Company issued commercial paper to meet short-term liquidity needs, with the maximum amount outstanding during this time of \$100 million, of which all has been repaid.

Also in February 2017, the Company initiated a restructuring program targeted to deliver cost savings in 2017 and beyond. Under the restructuring program, the Company intends to simplify its organizational structure, including greater consolidation of the Sears and Kmart corporate and support functions, as well as transition to an integrated value chain model to drive efficiencies in pricing, sourcing, supply chain and inventory management, optimize product assortment at Sears and Kmart stores to better align with preferences of our Best Members focusing on profitable, high-return Best Categories and actively manage our real estate portfolio to identify additional opportunities for reconfiguration and reduction of capital obligations. We are primarily focusing on profitability instead of revenues, market share and other metrics each of which relate to, but do not necessarily drive profit. This approach may negatively impact our sales, however, it is aimed at returning the Company to profitability.

Finally, in March 2017, the Company closed its previously-announced sale of the Craftsman brand to Stanley Black & Decker. The Company received an initial upfront payment of \$525 million, subject to closing costs and an adjustment for working capital changes, at closing. A portion of these proceeds were used to reduce outstanding borrowings under both the Company's domestic credit facility and term loans outstanding, as well as for general corporate purposes. In addition, Stanley Black & Decker will pay a further \$250 million in cash on the third anniversary of the closing of the transaction and Holdings will receive payments of between 2.5% and 3.5% on new Stanley Black & Decker sales of Craftsman products for the 15 years following the closing.

As described above, the PBGC consented to the sale of the Craftsman-related assets that had been "ring-fenced" under the PPPFA. As a condition to obtaining this consent, the Company agreed to grant the PBGC a lien on, and subsequently contribute to the Company's pension plans, the value of the \$250 million cash payment payable to the Company on the third anniversary of the Craftsman closing, with the value of such payment being fully credited

against certain of the Company's minimum pension funding obligations in 2017, 2018 and 2019. The Company also granted a lien to the PBGC on the 15-year income stream relating to new Stanley Black & Decker sales of Craftsman products, and agreed to contribute such payments from Stanley Black & Decker under such income stream to the Company's pension plans, with such payments being credited against the Company's minimum pension funding obligations starting no later than five years from the closing of the transaction. The Company also

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agreed to grant the PBGC a lien on \$100 million of real estate assets to secure the Company's minimum pension funding obligations through the end of 2019.

We acknowledge that we continue to face a challenging competitive environment and while we continue to focus on our overall profitability, including managing expenses, we reported a loss in 2016 and were required to fund cash used in operating activities with cash from investing and financing activities. We expect that the actions taken in 2016 and early 2017 will enhance our liquidity and financial flexibility. In addition, as previously discussed, we expect to generate additional liquidity through the monetization of our real estate and additional debt financing actions. We expect that these actions will be executed in alignment with the anticipated timing of our liquidity needs. We also continue to explore ways to unlock value across a range of assets, including exploring ways to maximize the value of our Home Services and Sears Auto Centers businesses, as well as our Kenmore and DieHard brands through partnerships or other means of externalization that could expand distribution of our brands and service offerings to realize significant growth. We expect to continue to right-size, redeploy and highlight the value of our assets, including our real estate portfolio, in our transition from an asset intensive, historically "store-only" based retailer to a more asset light, integrated membership-focused company.

Our historical operating results indicate substantial doubt exists related to the Company's ability to continue as a going concern. We believe that the actions discussed above are probable of occurring and mitigating the substantial doubt raised by our historical operating results and satisfying our estimated liquidity needs 12 months from the issuance of the financial statements. However, we cannot predict, with certainty, the outcome of our actions to generate liquidity, including the availability of additional debt financing, or whether such actions would generate the expected liquidity as currently planned. In addition, the PPPFA contains certain limitations on our ability to sell assets, which could impact our ability to complete asset sale transactions or our ability to use proceeds from those transactions to fund our operations. Therefore, the planned actions take into account the applicable restrictions under the PPPFA.

If we continue to experience operating losses, and we are not able to generate additional liquidity through the mechanisms described above or through some combination of other actions, while not expected, we may not be able to access additional funds under our amended Domestic Credit Agreement and we might need to secure additional sources of funds, which may or may not be available to us. Additionally, a failure to generate additional liquidity could negatively impact our access to inventory or services that are important to the operation of our business. Moreover, if the borrowing base (as calculated pursuant to the indenture) falls below the principal amount of the notes plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for the notes on the last day of any two consecutive quarters, it could trigger an obligation to repurchase notes in an amount equal to such deficiency.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events. The estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances. Adjustments to estimates and assumptions are made when facts and circumstances dictate. As future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying consolidated financial statements. Significant estimates and assumptions are required as part of determining inventory and accounts receivable valuation, estimating depreciation, amortization and recoverability of long-lived assets, establishing self-insurance, warranty, legal and other reserves, performing goodwill and intangible impairment analyses, and in establishing valuation allowances on deferred income tax assets and reserves for tax examination exposures, and calculating retirement benefits.

Cash and Cash Equivalents

Cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. We also include deposits in-transit from banks for payments related to third-party credit card and

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debit card transactions within cash equivalents. The deposits in-transit balances included within cash equivalents were \$87 million and \$95 million at January 28, 2017 and January 30, 2016, respectively.

We classify outstanding checks in excess of funds on deposit within other current liabilities and reduce cash and cash equivalents when these checks clear the bank on which they were drawn. Outstanding checks in excess of funds on deposit included in other current liabilities were \$29 million and \$59 million at January 28, 2017 and January 30, 2016, respectively.

Allowance for Doubtful Accounts

We provide an allowance for doubtful accounts based on both historical experience and a specific identification basis. Allowances for doubtful accounts on accounts receivable balances were \$37 million and \$34 million at January 28, 2017 and January 30, 2016, respectively. Our accounts receivable balance on our Consolidated Balance Sheet is presented net of our allowance for doubtful accounts and is comprised of various vendor-related and customer-related accounts receivable, including receivables related to our pharmacy operations.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market. For Kmart and Sears Domestic, cost is primarily determined using the retail inventory method ("RIM"). Kmart merchandise inventories are valued under the RIM using primarily a first-in, first-out ("FIFO") cost flow assumption. Sears Domestic merchandise inventories are valued under the RIM using primarily a last-in, first-out ("LIFO") cost flow assumption.

Inherent in the RIM calculation are certain significant management judgments and estimates including, among others, merchandise markons, markups, markdowns and shrinkage, which significantly impact the ending inventory valuation at cost, as well as resulting gross margins. The methodologies utilized by us in our application of the RIM are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogenous classes of merchandise, the development of shrinkage and obsolescence reserves, the accounting for price changes and the computations inherent in the LIFO adjustment (where applicable). Management believes that the RIM provides an inventory valuation that reasonably approximates cost and results in carrying inventory at the lower of cost or market.

Approximately 54% of consolidated merchandise inventories are valued using LIFO. To estimate the effects of inflation on inventories, we utilize external price indices determined by an outside source, the Bureau of Labor Statistics. If the FIFO method of inventory valuation had been used instead of the LIFO method, merchandise inventories would have been \$33 million higher at January 28, 2017 and \$35 million higher at January 30, 2016. During 2016 and 2015, a reduction in inventory quantities resulted in a liquidation of applicable LIFO inventory quantities carried at lower costs in prior years. This LIFO liquidation resulted in a decrease in cost of sales of approximately \$12 million and \$2 million in 2016 and 2015, respectively.

Vendor Rebates and Allowances

We receive rebates and allowances from certain vendors through a variety of programs and arrangements intended to offset our costs of promoting and selling certain vendor products. These vendor payments are recognized and recorded as a reduction to the cost of merchandise inventories when earned and, thereafter, as a reduction of cost of sales, buying and occupancy as the merchandise is sold. Upfront consideration received from vendors linked to purchases or other commitments is initially deferred and amortized ratably to cost of sales, buying and occupancy over the life of the contract or as performance of the activities specified by the vendor to earn the fee is completed.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Additions and substantial improvements are capitalized and include expenditures that materially extend the useful lives of existing facilities and equipment. Maintenance and repairs that do not materially improve or extend the lives of the respective assets are expensed as incurred.

Depreciation expense, which includes depreciation on assets under capital leases, is recorded over the estimated useful lives of the respective assets using the straight-line method for financial statement purposes, and

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accelerated methods for tax purposes. The range of lives are generally 20 to 50 years for buildings, 3 to 10 years for furniture, fixtures and equipment, and 3 to 5 years for computer systems and computer equipment. Leasehold improvements are depreciated over the shorter of the associated lease term or the estimated useful life of the asset. Depreciation expense included within depreciation and amortization expense reported in the Consolidated Statements of Operations was \$370 million, \$415 million and \$563 million for the years ended January 28, 2017, January 30, 2016 and January 31, 2015, respectively.

Primarily as a result of store closing actions, certain property and equipment are considered held for sale. The value of assets held for sale was \$96 million and \$31 million at January 28, 2017 and January 30, 2016, respectively. These assets were included in prepaid expenses and other current assets in the Consolidated Balance Sheets at January 28, 2017 and January 30, 2016 at the lower of their historical net book value or their estimated fair value, less estimated costs to sell. We expect to sell the properties within a year and we continually remarket them. The majority of assets held for sale are held within the Sears Domestic segment.

Impairment of Long-Lived Assets and Costs Associated with Exit Activities

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses, current cash flows that may be insufficient to recover the investment in the property over the remaining useful life, or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the asset or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques. See Note 13 for further information regarding long-lived asset impairment charges recorded.

We account for costs associated with location closings in accordance with accounting standards pertaining to accounting for costs associated with exit or disposal activities. As such, we record a liability for costs associated with location closings, which includes employee severance, inventory markdowns and other liquidation fees when management makes the decision to exit a location. We record a liability for future lease costs (net of estimated sublease income) when we cease to use the location.

Goodwill, Trade Names and Related Impairments

Trade names acquired as part of the Merger account for the majority of our intangible assets recognized in the Consolidated Balance Sheet. The majority of these trade name assets, such as Sears, Kenmore and Craftsman, are expected to generate cash flows indefinitely, do not have estimable or finite useful lives and, therefore, are accounted for as indefinite-lived assets not subject to amortization. Certain intangible assets, including favorable lease rights, contractual arrangements and customer lists, have estimable, finite useful lives, which are used as the basis for their amortization. The estimated useful lives of such assets are determined using a number of factors, including the demand for the asset, competition and the level of expenditure required to maintain the cash flows associated with the asset.

Our goodwill results from the Merger. We perform annual goodwill and indefinite-lived intangible asset impairment tests at the last day of our November accounting period each year and assess the need to update the tests between annual tests if events or circumstances occur that would more likely than not reduce the fair value of the reporting unit or an indefinite-lived intangible asset below its carrying amount. A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and the testing for

recoverability of a significant asset group within the reporting unit. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements.