SEARS HOLDINGS CORP
Form 10-Q
August 24, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 29, 2017

OR

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

Commission file number 000-51217, 001-36693
SEARS HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 20-1920798 |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |
| 3333 BEVERLY ROAD, HOFFMAN ESTATES, ILLINOIS | 60179 |
| (Address of principal executive offices) | (Zip Code) |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ¨ Accelerated filer x Non-accelerated filer (Do not check if a smaller reporting company) ¨ Smaller reporting company ¨ Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No x

As of August 18, 2017, the registrant had 107,445,403 common shares, $0.01 par value, outstanding.

SEARS HOLDINGS CORPORATION
INDEX TO QUARTERLY REPORT ON FORM 10-Q
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

SEARS HOLDINGS CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)
PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

| millions, except per share data | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| REVENUES | | | | |
| Merchandise sales | $3,498 | $4,648 | $6,927 | $9,050 |
| Services and other[1][2] | 867 | 1,015 | 1,739 | 2,007 |
| Total revenues | 4,365 | 5,663 | 8,666 | 11,057 |
| COSTS AND EXPENSES | | | | |
| Cost of sales, buying and occupancy - merchandise sales[3] | 2,902 | 3,809 | 5,785 | 7,431 |
| Cost of sales and occupancy - services and other[1] | 492 | 594 | 980 | 1,189 |
| Total cost of sales, buying and occupancy | 3,394 | 4,403 | 6,765 | 8,620 |
| Selling and administrative | 1,369 | 1,484 | 2,636 | 2,987 |
| Depreciation and amortization | 83 | 92 | 170 | 187 |
| Impairment charges | 5 | 7 | 20 | 15 |
| Gain on sales of assets | (380) | (54) | (1,121) | (115) |
| Total costs and expenses | 4,471 | 5,932 | 8,470 | 11,694 |
| Operating income (loss) | (106) | (269) | 196 | (637) |
| Interest expense | (123) | (99) | (251) | (184) |
| Interest and investment loss | (12) | (13) | (14) | (17) |
| Other loss | — | (1) | — | — |
| Loss before income taxes | (241) | (382) | (69) | (838) |
| Income tax (expense) benefit | (10) | (13) | 62 | (28) |
| NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $(251) | $(395) | $(7) | $(866) |
| NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | | | | |
| Basic loss per share | $(2.34) | $(3.70) | $(0.07) | $(8.11) |
| Diluted loss per share | $(2.34) | $(3.70) | $(0.07) | $(8.11) |
| Basic weighted average common shares outstanding | 107.3 | 106.9 | 107.2 | 106.8 |
| Diluted weighted average common shares outstanding | 107.3 | 106.9 | 107.2 | 106.8 |

(1) Includes merchandise sales to Sears Hometown and Outlet Stores, Inc. ("SHO") of $257 million and $283 million for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively, and $511 million and $576 million for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. Pursuant to the terms of the separation, merchandise is sold to SHO at cost.

(2) Includes revenue from Lands' End, Inc. ("Lands' End") for retail services and rent for Lands' End Shops at owned Sears locations, participation in the Shop Your Way® program and corporate shared services of $12 million and $12 million for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively, and $24 million and $23 million for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively.

(3) Includes rent expense (consisting of straight-line rent expense offset by amortization of a deferred gain on sale-leaseback) of $19 million and $21 million for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively, and $38 million and $42 million for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively, pursuant to the master lease with Seritage Growth Properties ("Seritage"). Also includes installment expenses of $12 million and $17 million for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively, and $24 million and $34 million for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively.

See accompanying notes.

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

| millions | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| Net loss | $(251) | $(395) | $(7) | $(866) |
| Other comprehensive income | | | | |
| Pension and postretirement adjustments, net of tax | 127 | 64 | 177 | 128 |
| Currency translation adjustments, net of tax | — | — | 1 | — |
| Total other comprehensive income | 127 | 64 | 178 | 128 |
| Comprehensive income (loss) attributable to Holdings' shareholders | $(124) | $(331) | $171 | $(738) |

See accompanying notes.

SEARS HOLDINGS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | $212 | $276 | $ 286 |
| Restricted cash | 230 | — | — |
| Accounts receivable[(1)] | 370 | 390 | 466 |
| Merchandise inventories | 3,433 | 4,684 | 3,959 |
| Prepaid expenses and other current assets[(2)] | 318 | 275 | 285 |
| Total current assets | 4,563 | 5,625 | 4,996 |
| Property and equipment (net of accumulated depreciation and amortization of $2,676, $3,032 and $2,841) | 1,969 | 2,465 | 2,240 |
| Goodwill | 269 | 269 | 269 |
| Trade names and other intangible assets | 1,249 | 1,906 | 1,521 |
| Other assets | 301 | 349 | 336 |
| TOTAL ASSETS | $8,351 | $10,614 | $ 9,362 |
| LIABILITIES | | | |
| Current liabilities | | | |
| Short-term borrowings[(3)] | $546 | $164 | $ — |
| Current portion of long-term debt and capitalized lease obligations[(4)] | 1,052 | 550 | 590 |
| Merchandise payables | 670 | 1,345 | 1,048 |
| Other current liabilities[(5)] | 1,686 | 1,802 | 1,956 |
| Unearned revenues | 704 | 775 | 748 |
| Other taxes | 302 | 317 | 339 |
| Total current liabilities | 4,960 | 4,953 | 4,681 |
| Long-term debt and capitalized lease obligations[(6)] | 2,405 | 2,837 | 3,573 |
| Pension and postretirement benefits | 1,731 | 2,072 | 1,750 |
| Deferred gain on sale-leaseback | 455 | 686 | 563 |
| Sale-leaseback financing obligation | 230 | 164 | 235 |
| Other long-term liabilities | 1,578 | 1,703 | 1,641 |
| Long-term deferred tax liabilities | 643 | 892 | 743 |
| Total Liabilities | 12,002 | 13,307 | 13,186 |
| Commitments and contingencies | | | |
| DEFICIT | | | |
| Total Deficit | (3,651 ) | (2,693 ) | (3,824 ) |
| TOTAL LIABILITIES AND DEFICIT | $8,351 | $10,614 | $ 9,362 |

(1) Includes $25 million, $35 million and $81 million of net amounts receivable from SHO, and $4 million, $9 million and $14 million of amounts receivable from Seritage at July 29, 2017, July 30, 2016 and January 28, 2017, respectively. Also includes $1 million of net amounts receivable from Lands' End at July 29, 2017.

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

(3) Includes balances held by related parties of $245 million and $100 million at July 29, 2017 and July 30, 2016, respectively, related to our Line of Credit Loans (as defined in Note 2) and commercial paper. See Notes 2 and 11 for further information.

(4) Includes balances held by related parties of $131 million, $216 million and $216 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively, related to our 2016 Secured Loan Facility.

(5) Includes $1 million of net amounts payable to Lands' End at January 28, 2017, and $24 million and $11 million of amounts payable to Seritage at July 29, 2017 and January 28, 2017, respectively.

(6) Includes balances held by related parties of $1.6 billion, $874 million and $1.7 billion at July 29, 2017, July 30, 2016 and January 28, 2017, 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 11 for further information.

See accompanying notes.

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

| millions | 26 Weeks Ended July 29, 2017 | July 30, 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | $(7) | $(866) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Deferred tax valuation allowance | (200) | (37) |
| Depreciation and amortization | 170 | 187 |
| Impairment charges | 20 | 15 |
| Gain on sales of assets | (1,121) | (115) |
| Pension and postretirement plan contributions | (134) | (148) |
| Pension plan settlements | 200 | — |
| Mark-to-market adjustments of financial instruments | 17 | 13 |
| Amortization of deferred gain on sale-leaseback | (40) | (44) |
| Amortization of debt issuance costs and accretion of debt discount | 62 | 37 |
| Other | (36) | — |
| Change in operating assets and liabilities (net of acquisitions and dispositions): | | |
| Deferred income taxes | 99 | 36 |
| Merchandise inventories | 509 | 488 |
| Merchandise payables | (378) | (229) |
| Income and other taxes | (24) | 49 |
| Other operating assets | 52 | (14) |
| Other operating liabilities | (327) | (12) |
| Net cash used in operating activities | (1,138) | (640) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from sales of property and investments | 569 | 214 |
| Proceeds from Craftsman Sale | 572 | — |
| Proceeds from sales of receivables[1] | 293 | — |
| Purchases of property and equipment | (41) | (75) |
| Net cash provided by investing activities | 1,393 | 139 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from debt issuances[2] | 330 | 1,228 |
| Repayments of debt[3] | (717) | (35) |
| Increase (decrease) in short-term borrowings, primarily 90 days or less | 216 | (633) |
| Proceeds from sale-leaseback financing | 89 | — |
| Debt issuance costs[4] | (17) | (21) |
| Net cash (used in) provided by financing activities | (99) | 539 |
| NET INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH | 156 | 38 |
| TOTAL CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF YEAR | 286 | 238 |
| TOTAL CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF PERIOD | $442 | $276 |
| Supplemental Cash Flow Data: | | |
| Income taxes paid, net of refunds | $28 | $15 |

| | | |
|---|---|---|
| Cash interest paid[5] | 196 | 119 |
| Unpaid liability to acquire equipment and software | 6 | 15 |

[1] Proceeds in 2017 include $63 million from JPP, LLC and JPP II, LLC, entities affiliated with ESL (as defined in Note 1), for the sale of receivables.
[2] Proceeds in 2017 include $245 million from related parties in connection with the Line of Credit Loans. Proceeds in 2016 include $496 million from related parties in connection with the 2016 Term Loan and 2016 Secured Loan Facility. See Notes 2 and 11 for further information.
[3] Repayments in 2017 include $183 million to related parties in connection with the 2017 Secured Loan Facility, 2016 Secured Loan Facility and 2016 Term Loan. See Notes 2 and 11 for further information.
[4] Includes a one-time extension fee equal to $4 million to JPP, LLC and JPP II, LLC, entities affiliated with ESL (as defined in Note 1) during the 26 weeks ended July 29, 2017. See Note 2 for further information.
[5] Cash interest paid includes $82 million and $36 million interest paid to related parties related to our borrowings during the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. See Notes 2 and 11 for further information.

See accompanying notes.

SEARS HOLDINGS CORPORATION
Condensed Consolidated Statements of Deficit
(Unaudited)

| | Deficit Attributable to Holdings' Shareholders | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| dollars and shares in millions | Number of Shares | Common Stock | Treasury Stock | Capital in Excess of Par Value | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests | Total |
| Balance at January 30, 2016 | 107 | $ 1 | $ (5,928) | $ 9,173 | $ (3,291) | $ (1,918) | $ 7 | $ (1,956) |
| Comprehensive loss | | | | | | | | |
| Net loss | — | — | — | — | (866) | — | — | (866) |
| Pension and postretirement adjustments, net of tax | — | — | — | — | — | 128 | — | 128 |
| Total Comprehensive Loss | | | | | | | | (738) |
| Stock awards | — | — | 15 | (16) | — | — | — | (1) |
| Associate stock purchase | — | — | 4 | | — | — | — | 4 |
| Distribution to noncontrolling interest | — | — | — | — | — | — | (2) | (2) |
| Balance at July 30, 2016 | 107 | $ 1 | $ (5,909) | $ 9,157 | $ (4,157) | $ (1,790) | $ 5 | $ (2,693) |
| Balance at January 28, 2017 | 107 | $ 1 | $ (5,891) | $ 9,130 | $ (5,512) | $ (1,552) | $ — | $ (3,824) |
| Comprehensive income | | | | | | | | |
| Net loss | — | — | — | — | (7) | — | — | (7) |
| Pension and postretirement adjustments, net of tax | — | — | — | — | — | 177 | — | 177 |
| Currency translation adjustments, net of tax | — | — | — | — | — | 1 | — | 1 |
| Total Comprehensive Income | | | | | | | | 171 |
| Stock awards | — | — | 27 | (28) | — | — | — | (1) |
| Associate stock purchase | — | — | 3 | | — | — | — | 3 |
| Balance at July 29, 2017 | 107 | $ 1 | $ (5,861) | $ 9,102 | $ (5,519) | $ (1,374) | $ — | $ (3,651) |

See accompanying notes.

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

## NOTE 1—BASIS OF PRESENTATION

Sears Holdings Corporation ("Holdings") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings (together with its subsidiaries, "we," "us," "our," or the "Company") was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger"), on March 24, 2005. We are an integrated retailer with 1,250 full-line and specialty retail stores in the United States, operating through Kmart and Sears. We operate under two reportable segments: Kmart and Sears Domestic.

These interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full fiscal year. The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. These interim financial statements and related notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

### Pension Benefit Guaranty Corporation Agreement

On March 18, 2016, we entered into a five-year pension plan protection and forbearance agreement (the "PPPFA") 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 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 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 PPPFA 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 is permitted to 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 (the "Craftsman Receivable") and Holdings will receive payments of between 2.5% and 3.5% on new Stanley Black & Decker sales of Craftsman products made during the 15 year period following the closing. In connection with the Craftsman Sale, we recognized a gain in our Kmart segment of $492 million within gain on sales of assets in the Condensed Consolidated Statements of Operations for the 26 weeks ended July 29, 2017, and initially established a receivable of $234 million for the net present value of the Craftsman Receivable. During the 13 weeks ended July 29, 2017, we sold the Craftsman Receivable to a third-party purchaser.

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

In connection with the closing of the Craftsman Sale, Holdings reached an agreement with the PBGC pursuant to which the PBGC 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 Craftsman Receivable, with such payments 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.

Cash and Cash Equivalents and Restricted Cash

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. The Company classifies cash balances that are legally restricted pursuant to contractual arrangements as restricted cash.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Condensed Consolidated Balance Sheets that sum to the total of the same such amounts shown in the Condensed Consolidated Statements of Cash Flows as of July 29, 2017, July 30, 2016 and January 28, 2017.

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Cash and equivalents | $ 121 | $ 160 | $ 196 |
| Cash posted as collateral | 4 | 3 | 3 |
| Credit card deposits in transit | 87 | 113 | 87 |
| Total cash and cash equivalents | 212 | 276 | 286 |
| Restricted cash | 230 | — | — |
| Total cash balances | $ 442 | $ 276 | $ 286 |

Depreciation Expense

Depreciation expense included within depreciation and amortization reported in the Condensed Consolidated Statements of Operations was $82 million and $90 million for the 13 week periods ended July 29, 2017 and July 30, 2016, respectively, and $168 million and $184 million for the 26 week periods ended July 29, 2017 and July 30, 2016, respectively.

Liquidity

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

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"), initially 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.

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

Other actions announced during the fourth quarter of 2016 included a new Letter of Credit and Reimbursement Agreement (the "LC Facility Agreement"), originally providing for up to a $500 million (of which $271 million was committed at July 29, 2017) 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.

During fiscal year 2017, the Company continued to take actions to improve our liquidity. 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 with $407 million available to borrow at July 29, 2017 after giving consideration to existing outstanding borrowings. Our domestic credit facility permits us up to $500 million of FILO ("first in last out") loan capacity under the credit agreement and up to $2.0 billion of second lien loan capacity (of which $934 million was utilized at July 29, 2017) 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 2 of Notes to Condensed Consolidated Financial Statements). Other options available to us include refinancing existing debt, securitizing assets and additional real estate loans, which we have successfully executed in the past. Further, in fiscal 2017, the Company issued commercial paper to meet short-term liquidity needs, with the maximum amount outstanding during this time of $160 million, with no commercial paper outstanding at July 29, 2017.

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. As described above, the PBGC consented to the sale of the Craftsman-related assets that had been "ring-fenced" under the PPPFA.

Additionally, the marketing process for real estate under the Special Committee announced in February 2017 is actively proceeding. To date, the Company has received cash proceeds of approximately $276 million since the initiation of the marketing process under the Special Committee, which were used to reduce the amounts outstanding under the 2016 Secured Loan Facility from $500 million to $263 million, and under the 2017 Secured Loan Facility from $500 million to $461 million. An additional $382 million of net cash proceeds were received from the sales of properties in the normal course of business. Cash proceeds from real estate sales after the repayment of a portion of the secured loan facilities were used to reduce outstanding borrowings under the Company's domestic credit facility, as well as for general corporate purposes. Subsequent to second quarter end, the Company executed additional asset sales which generated cash proceeds of nearly $160 million, with approximately $25 million utilized to pay down amounts outstanding under the 2017 Real Estate Loan and the remainder used to pay down revolver borrowings. The Company expects additional real estate sales to occur throughout the remainder of fiscal year 2017.

During the second quarter, the Company also continued to achieve significant progress in our $1.25 billion restructuring program announced earlier this year, with over $1.0 billion in annualized cost savings actioned to date. Actions taken to date to realize the annualized cost savings have included simplification of the organizational structure of Sears Holdings, streamlining of operations, reducing unprofitable categories and the closure of under-performing stores. In fiscal year 2017, we have closed approximately 180 stores previously announced for closure, and an additional 150 stores previously announced for closure are expected to be closed by the end of the third quarter of 2017. As a result of these actions, the Company has begun to see improvement in the operations in the second quarter as the restructuring program actions, including the closing of unprofitable stores, have begun to take effect.

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

The Company continued to take actions during the second quarter of 2017 to improve liquidity. In May 2017, Sears Holdings reached agreement to extend the maturity of $400 million of our $500 million 2016 Secured Loan Facility maturing in July 2017 to January 2018. As noted above, the Company subsequently reduced the amounts outstanding under the 2016 Secured Loan Facility from $500 million to $263 million. The Company has options to further extend the remaining loan balance until July 2018.

Additionally, the Company also amended its existing Second Lien Credit Agreement dated September 1, 2016 in July 2017, to provide for the creation of a $500 million Line of Credit Loan Facility (the "Line of Credit Facility"). Seven investors have made loans to the Company under the Line of Credit Facility, including affiliates of ESL Investments, Inc. ("ESL"), certain of our directors and companies affiliated with them, and certain unaffiliated third party investors. As of July 29, 2017, $330 million is outstanding under the Line of Credit Facility. Finally, in August 2017, the Company executed amendments to its LC Facility. The amendments, among other things, extended the maturity of the $271 million LC Facility from its original maturity date of December 28, 2017 through December 28, 2018, eliminated the unused portion of the facility and released the real estate collateral that secured the original LC Facility. The amended LC Facility also permits the lenders, JPP, LLC and JPP II, LLC, affiliates of ESL, to syndicate all or a portion of their commitments under the LC Facility. As of the date of this report, $140 million of the LC Facility has been syndicated to unaffiliated third party lenders.

At July 29, 2017, the amount available to borrow under our revolving credit facility was approximately $191 million, compared to $165 million at January 28, 2017.

In July, the Company announced an agreement with Amazon to launch Kenmore products on Amazon.com, which we expect will significantly expand the reach of the Kenmore brand. We expect this partnership to drive growth opportunities across three of our divisions - Kenmore, Sears Home Services and Innovel Solutions, Inc. ("Innovel"). Innovel and Sears Home Services will provide white-glove service for delivery, installation and extended product protection for the full range of home appliances from Kenmore sold on Amazon.com. The Amazon Kenmore Store will feature the full line of Kenmore products for purchase across the United States, with select home appliances already available in California.

We acknowledge that we continue to face a challenging competitive environment. The comprehensive restructuring of our operations is delivering cost efficiencies and helping drive improvements in our operating performance. While we continue to focus on our overall profitability, including managing expenses, we reported a loss in the second quarter of 2017, and were required to fund cash used in operating activities with cash from investing and financing activities. We expect that the actions outlined above will further enhance our liquidity and financial flexibility. In addition, as previously discussed, we expect to generate additional liquidity through the monetization of our real estate, additional financing actions, and potential asset securitizations. 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, sales 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 monetizing our real estate portfolio and exploring potential asset securitizations, in our transition from an asset intensive, historically "store-only" based retailer to a more asset light, integrated membership-focused company.

We believe that the actions discussed above are probable of occurring and mitigate the liquidity risk raised by our historical operating results and satisfy our estimated liquidity needs during the next 12 months from the issuance of the financial statements. 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 actions described above or through some combination of other actions, while not expected, then our liquidity needs may exceed availability under our Amended Domestic Credit Agreement (as defined in Note 2) 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 our outstanding second lien debt) falls

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below the principal amount of such second lien debt plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for such debt on the last day of any two consecutive quarters, it could trigger an obligation to repurchase or repay second lien debt in an amount equal to such deficiency.

Sears Canada

At each of July 29, 2017, July 30, 2016 and January 28, 2017, the Company was the beneficial holder of approximately 12 million, or 12%, of the common shares of Sears Canada. In July 2017, Sears Canada filed for court protection and trading of its common shares was suspended. Accordingly, we recognized other-than-temporary impairment of $12 million within interest and investment loss in our Condensed Consolidated Statements of Operations during the 13 weeks ended July 29, 2017. Our equity method investment in Sears Canada was $32 million and $17 million at July 30, 2016 and January 28, 2017, respectively, and is included within other assets in the Condensed Consolidated Balance Sheets. The fair value of our equity method investment in Sears Canada was determined based on quoted market prices for its common stock. Our equity method investment in Sears Canada is valued using Level 1 measurements as defined in Note 5 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

NOTE 2—BORROWINGS

Total borrowings were as follows:

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Short-term borrowings: | | | |
| Unsecured commercial paper | $— | $ 101 | $ — |
| Secured borrowings | 216 | 63 | — |
| Line of credit loans | 330 | — | — |
| Long-term debt, including current portion: | | | |
| Notes and debentures outstanding | 3,360 | 3,211 | 4,018 |
| Capitalized lease obligations | 97 | 176 | 145 |
| Total borrowings | $ 4,003 | $ 3,551 | $ 4,163 |

The fair value of long-term debt, excluding capitalized lease obligations, was $3.3 billion at July 29, 2017, $3.2 billion at July 30, 2016 and $4.0 billion at January 28, 2017. The fair value of our debt was estimated based on quoted market prices for the same or similar issues or on current rates offered to us for debt of the same remaining maturities. Our long-term debt instruments are valued using Level 2 measurements as defined in Note 5 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

Unsecured Commercial Paper

We borrow through the commercial paper markets. At July 30, 2016, we had outstanding commercial paper borrowings of $101 million, while at July 29, 2017 and January 28, 2017, we had no commercial paper borrowings outstanding.

Letter of Credit Facility

On December 28, 2016, the Company, through Sears Roebuck Acceptance Corp. ("SRAC") and Kmart Corporation (together with SRAC, the "Borrowers"), entities wholly-owned and controlled, directly or indirectly by the Company, entered into the LC Facility Agreement providing for a $500 million secured standby letter of credit facility (of which $271 million was committed at July 29, 2017) from JPP, LLC and JPP II, LLC, entities affiliated with ESL (collectively, the "Lenders"), with Citibank, N.A., serving as administrative agent and issuing bank.

In August, the Company executed amendments to the LC Facility. The amendments, among other things, extended the maturity to December 28, 2018, eliminated the unused portion of the facility and released the real estate collateral that secured the original LC Facility. The amended LC Facility also permits the Lenders to syndicate all or

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a portion of their commitments under the facility to other lenders, of which $140 million has been syndicated to unaffiliated third party lenders as of the date of this report.

The amended LC Facility is guaranteed by the same subsidiaries of the Company that guarantee the obligations under the Amended Domestic Credit Agreement, as defined below. The amended LC Facility is secured by substantially the same collateral as the Amended Domestic Credit Agreement. The amended LC Facility contains a borrowing base calculation, pursuant to which the borrowers are required to cash collateralize the LC Facility if the aggregate obligations under the Amended Domestic Credit Agreement, amended LC Facility and certain other cash management and similar obligations exceed the Modified Borrowing Base, as defined in the amended LC Facility as of the end of any calendar month.

To secure their obligation to participate in letters of credit issued under the LC Facility, the lenders under the LC Facility are required to maintain cash collateral on deposit with the Issuing Bank in an amount equal to 102% of the commitments under the LC Facility. The Borrowers paid the Lenders an upfront fee equal to 1.00% of the aggregate amount of the Lender Deposit. In addition, the Borrowers are required to pay a commitment fee on the average daily amount of the Lender Deposit (as such amount may be increased or decreased from time to time) equal to the Eurodollar Rate (as defined under the Amended Domestic Credit Facility) plus 11.0%, as well as certain other fees. In the event of reductions of the commitments under the LC Facility or a termination of the LC Facility prior to the six month anniversary of the effective date of the Amendment, under certain circumstances the Borrowers will be required to pay an early reduction/termination fee equal to the commitment fee that would have accrued with respect to the reduced or terminated commitments from the date of reduction or termination until the six month anniversary.

The LC Facility Agreement includes certain representations and warranties, affirmative and negative covenants and other undertakings, which are subject to important qualifications and limitations set forth in the LC Facility Agreement. The LC Facility Agreement also contains certain events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, and bankruptcy or insolvency proceedings. If an event of default occurs, the Lenders may terminate all or any portion of the commitments under the LC Facility, require the Borrowers to cash collateralize the LC Facility and/or exercise any rights they might have under any of the related facility documents (including against the collateral), subject to certain limitations. At July 29, 2017 and January 28, 2017, respectively, we had $271 million and $200 million of letters of credit outstanding under the LC Facility.

2017 Secured Loan Facility

On January 3, 2017, the Company, through Sears, Kmart Stores of Illinois LLC, Kmart of Washington LLC and Kmart Corporation (collectively, "2017 Secured Loan Borrowers"), entities wholly-owned and controlled, directly or indirectly by the Company, obtained a $500 million real estate loan facility from the Lenders, entities affiliated with ESL. On January 3, 2017, $321 million was funded under the 2017 Secured Loan Facility, and an additional $179 million was drawn by the Company prior to January 28, 2017. The 2017 Secured Loan Facility matures on July 20, 2020. The Company used the proceeds of the 2017 Secured Loan Facility for general corporate purposes.

The 2017 Secured Loan Facility has an annual base interest rate of 8%, with accrued interest payable monthly during the term of the 2017 Secured Loan Facility. The Borrowers paid an upfront commitment fee equal to 1.0% of the full principal amount of the 2017 Secured Loan Facility and paid a funding fee equal to 1.0% of the amounts drawn under the 2017 Secured Loan Facility at the time such amounts were drawn.

The 2017 Secured Loan Facility is guaranteed by the Company and certain of its subsidiaries, and was secured by a first priority lien on 69 real properties owned by the 2017 Secured Loan Borrowers and guarantors at inception. In certain circumstances, the Lenders and the 2017 Secured Loan Borrowers may elect to substitute one or more properties as collateral. To the extent permitted under other debt of the Company or its affiliates, the 2017 Secured Loan Facility may be prepaid at any time in whole or in part, without penalty or premium. The 2017 Secured Loan Borrowers are required to apply the net proceeds of the sale of any real property collateral for the 2017 Secured Loan Facility to repay the loan and used proceeds of $39 million to pay interest and a portion of the loan during the 26 weeks ended July 29, 2017.

The 2017 Secured Loan Facility includes certain representations and warranties, indemnities and covenants, including with respect to the condition and maintenance of the real property collateral. The 2017 Secured Loan Facility has certain events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, and bankruptcy or insolvency proceedings. If there is an event of default, the Lenders may declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have under any of the 2017 Secured Loan Facility documents (including against the collateral), and require the 2017 Secured Loan Borrowers to pay a default interest rate equal to the greater of (i) 2.5% in excess of the base interest rate and (ii) the prime rate plus 1%. The carrying value of the 2017 Secured Loan Facility, net of the remaining debt issuance costs, was $446 million and $485 million at July 29, 2017 and January 28, 2017, respectively.

2016 Secured Loan Facility

On April 8, 2016, the Company, through Sears, Sears Development Co., Innovel, Big Beaver of Florida Development, LLC and Kmart Corporation (collectively, "2016 Secured Loan Borrowers"), entities wholly-owned and controlled, directly or indirectly by the Company, obtained a $500 million real estate loan facility from JPP, LLC, JPP II, LLC, and Cascade Investment, LLC (collectively, the "2016 Secured Loan Lenders"). JPP, LLC and JPP II, LLC are entities affiliated with ESL. The first $250 million of the 2016 Secured Loan Facility was funded on April 8, 2016 and the remaining $250 million was funded on April 22, 2016. The funds were used to reduce outstanding borrowings under the Company's asset-based revolving credit facility and for general corporate purposes. The 2016 Secured Loan Facility had an original maturity date of July 7, 2017. The Company reached an agreement to extend the maturity of $400 million of the 2016 Secured Loan Facility to January 2018, with options to further extend the maturity of the loan for up to an additional six months, to July 6, 2018, subject to the satisfaction of certain conditions and the payment of certain fees. The 2016 Secured Loan Facility is included within current portion of long-term debt in the Condensed Consolidated Balance Sheets for all periods presented. The carrying value of the 2016 Secured Loan Facility, net of the remaining debt issuance costs, was $258 million, $489 million and $494 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively.

The 2016 Secured Loan Facility has an annual base interest rate of 8%, with accrued interest payable monthly during the term of the 2016 Secured Loan Facility. The 2016 Secured Loan Borrowers paid an upfront commitment fee equal to 1.0% of the full principal amount of the 2016 Secured Loan Facility and paid a funding fee equal to 1.0% of the amounts drawn under the 2016 Secured Loan Facility at the time such amounts were drawn. In connection with the maturity extension, the Company paid a one-time extension fee equal to $8 million dollars to the extending Lenders. The 2016 Secured Loan Facility is guaranteed by the Company and was originally secured by a first priority lien on 21 real properties owned by the 2016 Secured Loan Borrowers. The 2016 Secured Loan Facility includes customary representations and warranties, indemnities and covenants, including with respect to the condition and maintenance of the real property collateral.

The 2016 Secured Loan Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, and bankruptcy or insolvency proceedings. If there is an event of default, the 2016 Secured Loan Lenders may declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have under any of the 2016 Secured Loan Facility documents (including against the collateral), and require the 2016 Secured Loan Borrowers to pay a default interest rate equal to the greater of (i) 2.5% in excess of the base interest rate and (ii) the prime rate plus 1%. The Loan Facility may be prepaid at any time in whole or in part, without penalty or premium and $238 million of proceeds from real estate transactions was used to pay interest and a portion of the loan during the 26 weeks ended July 29, 2017.

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Domestic Credit Agreement

The Borrowers and Holdings are party to an amended and restated credit agreement (the "Amended Domestic Credit Agreement") with a syndicate of lenders. Pursuant to the Amended Domestic Credit Agreement, the Borrowers have borrowed two senior secured term loan facilities having original principal amounts of $1.0 billion and $750 million (the "Term Loan" and "2016 Term Loan," respectively). The Amended Domestic Credit Agreement currently provides for a $1.5 billion asset-based revolving credit facility (the "Revolving Facility") with a $1.0 billion letter of credit sub-facility, which matures on July 20, 2020. The Term Loan matures on June 30, 2018 and the 2016 Term Loan matures on July 20, 2020. The Amended Domestic Credit Agreement includes an accordion feature that allows the Borrowers to use, subject to borrowing base requirements, existing collateral for the facility to obtain up to $1.0 billion of additional borrowing capacity, of which $750 million was utilized for the 2016 Term Loan (described below). The Amended Domestic Credit Agreement also includes a FILO tranche feature that allows up to an additional $500 million of borrowing capacity and allows Holdings and its subsidiaries to undertake short-term borrowings outside the facility up to $1.0 billion.

Revolving advances under the Amended Domestic Credit Agreement bear interest at a rate equal to, at the election of the Borrowers, either the London Interbank Offered Rate ("LIBOR") or a base rate, in either case plus an applicable margin dependent on Holdings' consolidated leverage ratio (as measured under the Amended Domestic Credit Agreement). The margin with respect to borrowings ranges from 3.50% to 4.00% for LIBOR loans and from 2.50% to 3.00% for base rate loans. The Amended Domestic Credit Agreement also provides for the payment of fees with respect to issued and undrawn letters of credit at a rate equal to the margin applicable to LIBOR loans and a commitment fee with respect to unused amounts of the Revolving Facility at a rate equal to 0.625% per annum.

The Revolving Facility is in place as a funding source for general corporate purposes and is secured by a first lien on substantially all of our domestic inventory and credit card and pharmacy receivables, and is subject to a borrowing base formula to determine availability. The Revolving Facility is guaranteed by all domestic subsidiaries of Holdings that own inventory or credit card or pharmacy receivables. The Revolving Facility also permits aggregate second lien indebtedness of up to $2.0 billion, of which $934 million in second lien notes were outstanding at July 29, 2017, resulting in $1.1 billion of permitted second lien indebtedness, subject to limitations contained in our other outstanding indebtedness. If, through asset sales or other means, the value of the above 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 could have access to a lesser amount determined by the borrowing base. Such 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, but rather we could be limited to borrowing a lesser amount determined by the borrowing base as calculated pursuant to the terms of such indenture.

The Term Loan bears interest at a rate equal to, at the election of the Borrowers, either LIBOR (subject to a 1.00% LIBOR floor) or a base rate, plus an applicable margin for LIBOR loans of 4.50% and for base rate loans of 3.50%. Currently, the Borrowers are required to repay the Term Loan in quarterly installments of $2.5 million, with the remainder of the Term Loan maturing June 30, 2018. Additionally, the Borrowers are required to make certain mandatory repayments of the Term Loan from excess cash flow (as defined in the Amended Domestic Credit Agreement). The Term Loan may be prepaid in whole or part without penalty. The Term Loan is secured by the same collateral as the Revolving Facility on a pari passu basis with the Revolving Facility, and is guaranteed by the same subsidiaries of the Company that guarantee the Revolving Facility. At July 29, 2017, July 30, 2016 and January 28, 2017, respectively, we had borrowings of $727 million, $975 million and $970 million under the Term Loan, and carrying value, net of the remaining discount and debt issuance costs, of $723 million, $965 million and $963 million. As disclosed in Note 1, a portion of the proceeds received from the Craftsman Sale were used to reduce outstanding borrowings under the Term Loan.

Amounts borrowed pursuant to the 2016 Term Loan bear interest at a rate equal to LIBOR plus 750 basis points, subject to a 1.00% LIBOR floor. The Company received approximately $722 million in net proceeds from the 2016

Term Loan, which proceeds were used to reduce outstanding borrowings under its asset-based revolving credit facility. The 2016 Term Loan has a maturity date of July 20, 2020, which is the same maturity date as the Company's revolving credit facility commitments, and does not amortize. The 2016 Term Loan is subject to a prepayment premium of 2% of the aggregate principal amount of the 2016 Term Loan prepaid on or prior to April 8, 2017 and 1% of the aggregate principal amount of the 2016 Term Loan prepaid after April 8, 2017 and on or prior to April 8, 2018. The obligations under the Amended Domestic Credit Agreement, including the 2016 Term Loan, are secured

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by a first lien on substantially all of the domestic inventory and credit card and pharmacy receivables of the Company and its subsidiaries and aggregate advances under the Amended Domestic Credit Agreement are subject to a borrowing base formula. The carrying value of the 2016 Term Loan, net of the remaining discount and debt issuance costs, was $555 million, $723 million and $726 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively. As disclosed in Note 1, a portion of the proceeds received from the Craftsman Sale were used to reduce outstanding borrowings under the 2016 Term Loan.

The Amended Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, subject to specified exceptions that are available if, in each case, no event of default under the credit facility exists immediately before or after giving effect to the restricted payment. These include exceptions that require that projected availability under the credit facility, as defined, to be 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. As of July 29, 2017, our fixed charge ratio was less than 1.0 to 1.0, and we are subject to these other requirements based on our availability. 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.

At July 29, 2017 and July 30, 2016, we had $216 million and $63 million, respectively, of Revolving Facility borrowings and $389 million, $656 million and $464 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively, of letters of credit outstanding under the Revolving Facility. At July 29, 2017, July 30, 2016 and January 28, 2017, the amount available to borrow under the Revolving Facility was $191 million, $191 million and $165 million, respectively, which reflects the effect of the springing fixed charge coverage ratio covenant and the borrowing base limitation. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

Second Lien Credit Agreement

On September 1, 2016, the Company, SRAC, and Kmart Corporation (together with SRAC, the "ABL Borrowers") entered into a Second Lien Credit Agreement with the Lenders thereunder, entities affiliated with ESL, pursuant to which the ABL Borrowers borrowed $300 million under a term loan (the "Second Lien Term Loan"). The Company received net proceeds of $291 million, which were used for general corporate purposes.

The maturity date for the Second Lien Term Loan is July 20, 2020 and the Second Lien Term Loan will not amortize. The Second Lien Term Loan bears interest at a rate equal to, at the election of the ABL Borrowers, either LIBOR (subject to a 1.00% floor) or a specified prime rate ("Base Rate"), in either case plus an applicable margin. The margin with respect to the Second Lien Term Loan is 7.50% for LIBOR loans and 6.50% for Base Rate loans.

The Second Lien Credit Agreement was amended on July 7, 2017, providing an uncommitted line of credit facility under which subsidiaries of the Company may from time to time borrow line of credit loans ("Line of Credit Loans") with maturities less than 180 days, subject to applicable borrowing base limitations, in an aggregate principal amount not to exceed $500 million at any time outstanding. The Company received net proceeds of $330 million from the issuance of Line of Credit loans from a syndicate of lenders, some of which are entities affiliated with ESL, Bruce R. Berkowitz, and Thomas J. Tisch. See Note 11 for further information. The proceeds were used for the repayment of indebtedness and general corporate purposes.

The Company's obligations under the Second Lien Credit Agreement are secured on a pari passu basis with the Company’s obligations under that certain Indenture, dated as of October 12, 2010, pursuant to which the Company issued its Senior Secured Notes (defined below). The collateral includes inventory, receivables and other related assets of the Company and its subsidiaries which are obligated on the Second Lien Term Loan and the Senior

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Secured Notes. The Second Lien Credit Agreement is guaranteed by all domestic subsidiaries of the Company that guarantee the Company's obligations under its existing Revolving Facility.
The Second Lien Credit Agreement includes representations and warranties, covenants and other undertakings, and events of default that are substantially similar to those contained in the Amended Domestic Credit Agreement. The carrying value of the Second Lien Term Loan, net of the remaining debt issuance costs, was $293 million and $292 million at July 29, 2017 and January 28, 2017, respectively. The carrying value of the Line of Credit Loans was $330 million at July 29, 2017.
Senior Secured Notes
In October 2010, we sold $1.0 billion aggregate principal amount of senior secured notes (the "Senior Secured Notes"), which bear interest at 6 5/8% per annum and mature on October 15, 2018. Concurrent with the closing of the sale of the Senior Secured Notes, the Company sold $250 million aggregate principal amount of Senior Secured Notes to the Company's domestic pension plan in a private placement, none of which remain in the domestic pension plan as a result of the Tender Offer discussed below. The Senior Secured Notes are guaranteed by certain subsidiaries of the Company and are secured by a security interest in certain assets consisting primarily of domestic inventory and credit card receivables (the "Collateral"). The lien that secures the Senior Secured Notes is junior in priority to the lien on such assets that secures obligations under the Amended Domestic Credit Agreement, as well as certain other first priority lien obligations. The Company used the net proceeds of this offering to repay borrowings outstanding under a previous domestic credit agreement on the settlement date and to fund the working capital requirements of our retail businesses, capital expenditures and for general corporate purposes. The indenture under which the Senior Secured Notes were issued contains restrictive covenants that, among other things, (1) limit the ability of the Company and certain of its domestic subsidiaries to create liens and enter into sale and leaseback transactions and (2) limit the ability of the Company to consolidate with or merge into, or sell other than for cash or lease all or substantially all of its assets to, another person. The indenture also provides for certain events of default, which, if any were to occur, would permit or require the principal and accrued and unpaid interest on all the then outstanding Senior Secured Notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding Senior Secured Notes at a purchase price equal to 101% of the principal amount if the borrowing base (as calculated pursuant to the indenture) falls below the principal value of the Senior Secured Notes plus any other indebtedness for borrowed money that is secured by liens on the Collateral for two consecutive quarters or upon the occurrence of certain change of control triggering events. The Company may call the Senior Secured Notes at a premium based on the "Treasury Rate" as defined in the indenture, plus 50 basis points. On September 6, 2011, we completed our offer to exchange the Senior Secured Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.
On August 3, 2015, the Company commenced a tender offer (the "Tender Offer") to purchase for cash up to $1.0 billion principal amount of its Senior Secured Notes, which expired on August 28, 2015. Approximately $936 million principal amount of the Senior Secured Notes were validly tendered and not validly withdrawn in the Tender Offer. Holders who validly tendered and did not validly withdraw Senior Secured Notes at or prior to the early tender date of August 14, 2015 received total consideration of $990 per $1,000 principal amount of Senior Secured Notes that were accepted for purchase, which included an early tender payment of $30 per $1,000 principal amount of Senior Secured Notes accepted for purchase, plus accrued and unpaid interest up to, but excluding, the settlement date. Holders who validly tendered and did not validly withdraw Senior Secured Notes after the early tender date but at or prior to the expiration date of August 28, 2015 received total consideration of $960 per $1,000 principal amount of Senior Secured Notes accepted for purchase, plus accrued and unpaid interest up to, but excluding, the settlement date.
We accounted for the Tender Offer in accordance with accounting standards applicable to extinguishment of liabilities and debt modifications and extinguishments. Accordingly, we de-recognized the net carrying amount of Senior Secured Notes of $929 million (comprised of the principal amount of $936 million, offset by unamortized debt issuance costs and discount of $7 million), and the reacquisition cost was $929 million.

The carrying value of Senior Secured Notes, net of the remaining discount and debt issuance costs, was $303 million, $302 million and $303 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively.

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Senior Unsecured Notes
On October 20, 2014, the Company announced its Board of Directors had approved a rights offering allowing its stockholders to purchase up to $625 million in aggregate principal amount of 8% senior unsecured notes due 2019 and warrants to purchase shares of its common stock. The subscription rights were distributed to all stockholders of the Company as of October 30, 2014, the record date for this rights offering, and every stockholder had the right to participate on the same terms in accordance with its pro rata ownership of the Company's common stock, except that holders of the Company's restricted stock that was unvested as of the record date received cash awards in lieu of subscription rights. This rights offering closed on November 18, 2014 and was oversubscribed.
Accordingly, on November 21, 2014, the Company issued $625 million aggregate original principal amount of 8% senior unsecured notes due 2019 (the "Senior Unsecured Notes") and received proceeds of $625 million which were used for general corporate purposes. The Senior Unsecured Notes are the unsecured and unsubordinated obligations of the Company and rank equal in right of payment with the existing and future unsecured and unsubordinated indebtedness of the Company. The Senior Unsecured Notes bear interest at a rate of 8% per annum and the Company will pay interest semi-annually on June 15 and December 15 of each year. The Senior Unsecured Notes are not guaranteed.
We accounted for the Senior Unsecured Notes in accordance with accounting standards applicable to distinguishing liabilities from equity and debt with conversion and other options. Accordingly, we allocated the proceeds received for the Senior Unsecured Notes based on the relative fair values of the Senior Unsecured Notes and warrants, which resulted in a discount to the notes of approximately $278 million. The fair value of the Senior Unsecured Notes and warrants was estimated based on quoted market prices for the same issues using Level 1 measurements as defined in Note 5 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017. The discount is being amortized over the life of the Senior Unsecured Notes using the effective interest method with an effective interest rate of 11.55%. Approximately $26 million and $21 million of the discount was amortized during the 26 week periods ended July 29, 2017 and July 30, 2016, respectively. The remaining discount was approximately $169 million, $218 million and $195 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively. The carrying value of the Senior Unsecured Notes, net of the remaining discount and debt issuance costs, was approximately $454 million, $404 million and $428 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively.
Wholly-owned Insurance Subsidiary and Intercompany Securities
We have numerous types of insurable risks, including workers' compensation, product and general liability, automobile, warranty, asbestos and environmental claims and the extended service contracts we sell to our customers. Certain of the associated risks are managed through Holdings' wholly owned insurance subsidiary, Sears Reinsurance Company Ltd. ("Sears Re"), a Bermuda Class 3 insurer.
In accordance with applicable insurance regulations, Sears Re holds marketable securities to support the insurance coverage it provides. Sears has utilized two securitization structures to issue specific securities in which Sears Re has invested its capital to fund its insurance obligations. In November 2003, Sears formed a Real Estate Mortgage Investment Conduit, or REMIC. The real estate associated with 133 properties was contributed to indirect wholly owned subsidiaries of Sears, and then leased back to Sears. The contributed properties were mortgaged and the REMIC issued to wholly owned subsidiaries of Sears (including Sears Re) $1.3 billion (par value) of securities (the "REMIC Securities") that are secured by the mortgages and collateral assignments of the store leases. Payments to the holders on the REMIC Securities are funded by the lease payments. In May 2006, a subsidiary of Holdings contributed the rights to use the Kenmore®, Craftsman® and DieHard® trademarks in the U.S. and its possessions and territories to KCD IP, LLC, an indirect wholly-owned subsidiary of Holdings. KCD IP, LLC has licensed the use of the trademarks to subsidiaries of Holdings, including Sears and Kmart. Asset-backed securities with a par value of $1.8 billion (the "KCD Securities") were issued by KCD IP, LLC and subsequently purchased by Sears Re, the collateral for which includes the trademark rights and royalty income. Payments to the holders on the KCD Securities are funded by the royalty payments. In connection with the Craftsman Sale, KCD Securities with par value of $900

million were redeemed in March 2017. The issuers of the REMIC Securities and KCD Securities and the owners of these real estate and trademark assets are bankruptcy remote, special purpose entities that are indirect wholly owned subsidiaries of Holdings. Cash flows received from rental streams and licensing fee streams paid by Sears, Kmart, other affiliates and third parties, are used for the payment of fees and interest on these securities. In the fourth quarter of fiscal 2013, Holdings contributed all of the outstanding capital stock of Sears Re to SRe Holding Corporation, a direct wholly owned subsidiary of Holdings. Sears Re thereafter reduced its excess statutory capital through the distribution of all REMIC Securities held by it to SRe Holding Corporation. Since the inception of the REMIC and KCD IP, LLC, the REMIC Securities and the KCD Securities have been entirely held by our wholly owned consolidated subsidiaries. At July 29, 2017, the net book value of the securitized trademark rights was approximately $0.7 billion. At both July 30, 2016 and January 28, 2017, the net book value of the securitized trademark rights was approximately $1.0 billion. The net book value of the securitized real estate assets was approximately $0.6 billion at each of July 29, 2017, July 30, 2016 and January 28, 2017.

Trade Creditor Matters

We have ongoing discussions concerning our liquidity and financial position with the vendor community and third parties that offer various credit protection services to our vendors. The topics discussed have included such areas as pricing, payment terms and ongoing business arrangements. As of the date of this report, we have not experienced any significant disruption in our access to merchandise or our operations.

NOTE 3—STORE CLOSING CHARGES, SEVERANCE COSTS, IMPAIRMENTS AND REAL ESTATE TRANSACTIONS

Store Closings and Severance

We closed 14 stores in our Kmart segment and 7 stores in our Sears Domestic segment that we previously announced would close during the 13 week period ended July 29, 2017, and 125 stores in our Kmart segment and 51 stores in our Sears Domestic segment during the 26 week period ended July 29, 2017. We made the decision to close 92 stores in our Kmart segment and 45 stores in our Sears Domestic segment during the 13 week period ended July 29, 2017, and 114 stores in our Kmart segment and 55 stores in our Sears Domestic segment during the 26 week period ended July 29, 2017.

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

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which we no longer intend to receive any economic benefit are accrued for when we cease to use the leased space and have been reduced for any estimated sublease income.

We expect to record additional charges of approximately $42 million during 2017 related to stores that we had previously made the decision to close, but have not yet closed.

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Store closing costs and severance recorded for the 13- and 26- week periods ended July 29, 2017 and July 30, 2016 were as follows:

| millions | Markdowns[1] | Severance Costs[2] | Lease Termination Costs[2] | Other Charges[2] | Impairment and Accelerated Depreciation[3] | Total Store Closing Costs |
|---|---|---|---|---|---|---|
| Kmart | $ 68 | $ 8 | $ (18 ) | $ 10 | $ 4 | $ 72 |
| Sears Domestic | 21 | 23 | 10 | 6 | 4 | 64 |
| Total for the 13 week period ended July 29, 2017 | $ 89 | $ 31 | $ (8 ) | $ 16 | $ 8 | $ 136 |
| | | | | | | |
| Kmart | $ 3 | $ 1 | $ (25 ) | $ — | $ — | $ (21 ) |
| Sears Domestic | 1 | 1 | 1 | — | 1 | 4 |
| Total for the 13 week period ended July 30, 2016 | $ 4 | $ 2 | $ (24 ) | $ — | $ 1 | $ (17 ) |
| | | | | | | |
| Kmart | $ 78 | $ 13 | $ (2 ) | $ 13 | $ 5 | $ 107 |
| Sears Domestic | 26 | 34 | 35 | 7 | 9 | 111 |
| Total for the 26 week period ended July 29, 2017 | $ 104 | $ 47 | $ 33 | $ 20 | $ 14 | $ 218 |
| | | | | | | |
| Kmart | $ 54 | $ 6 | $ (19 ) | $ 11 | $ 4 | $ 56 |
| Sears Domestic | 10 | 2 | 2 | 3 | 1 | 18 |
| Total for the 26 week period ended July 30, 2016 | $ 64 | $ 8 | $ (17 ) | $ 14 | $ 5 | $ 74 |

(1) Recorded within cost of sales, buying and occupancy in the Condensed Consolidated Statements of Operations.

(2) Recorded within selling and administrative in the Condensed Consolidated Statements of Operations. Lease termination costs are net of estimated sublease income, and include the reversal of closed store reserves for which the lease agreement has been terminated and the reversal of deferred rent balances related to closed stores.

(3) Costs for the 13- and 26- week periods ended July 29, 2017 and July 30, 2016 are recorded within depreciation and amortization in the Condensed Consolidated Statements of Operations.

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Store closing costs and severance accruals of $228 million, $126 million and $216 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively, were as shown in the table below. Store closing accruals included $128 million, $57 million and $122 million within other current liabilities and $100 million, $69 million and $94 million within other long-term liabilities in the Condensed Consolidated Balance Sheets at July 29, 2017, July 30, 2016, and January 28, 2017, respectively.

| millions | Severance Costs | Lease Termination Costs | Other Charges | Total |
|---|---|---|---|---|
| Balance at July 30, 2016 | $ 38 | $ 82 | $ 6 | $126 |
| Store closing costs | 33 | 98 | 27 | 158 |
| Payments/utilizations | (17 ) | (36 ) | (15 ) | (68 ) |
| Balance at January 28, 2017 | 54 | 144 | 18 | 216 |
| Store closing costs | 47 | 53 | 20 | 120 |
| Store closing capital lease obligations | — | 25 | — | 25 |
| Payments/utilizations | (53 ) | (60 ) | (20 ) | (133 ) |
| Balance at July 29, 2017 | $ 48 | $ 162 | $ 18 | $228 |

Long-Lived Assets

In accordance with accounting standards governing the impairment or disposal of long-lived assets, we performed an impairment test of certain of our long-lived assets due to events and changes in circumstances during the 13- and 26-week periods ended July 29, 2017 that indicated an impairment might have occurred. As a result of impairment testing, the Company recorded impairment charges of $5 million, of which $2 million and $3 million were recorded within the Sears Domestic and Kmart segments, respectively, during the 13 week period ended July 29, 2017, and $20 million, of which $12 million and $8 million were recorded within the Sears Domestic and Kmart segments, respectively, during the 26 week period ended July 29, 2017.

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

Real Estate Transactions

On April 1, 2015, April 13, 2015 and April 30, 2015, Holdings and General Growth Properties, Inc. ("GGP"), Simon Property Group, Inc. ("Simon") and The Macerich Company ("Macerich"), respectively, announced that they entered into three distinct real estate joint ventures (collectively, the "JVs"). Holdings contributed 31 properties to the JVs where Holdings currently operates stores (the "JV properties"), in exchange for a 50% interest in the JVs and $429 million in cash ($426 million, net of closing costs) (the "JV transactions"). The JV transactions valued the JV properties at $858 million in the aggregate.

On July 7, 2015, Holdings completed its rights offering and sale-leaseback transaction (the "Seritage transaction") with Seritage Growth Properties ("Seritage"), an independent publicly traded real estate investment trust ("REIT"). As part of the Seritage transaction, Holdings sold 235 properties to Seritage (the "REIT properties") along with Holdings' 50% interest in the JVs. Holdings received aggregate gross proceeds from the Seritage transaction of $2.7 billion ($2.6 billion, net of closing costs). The Seritage transaction valued the REIT properties at $2.3 billion in the aggregate.

In connection with the Seritage transaction and JV transactions, Holdings entered into agreements with Seritage and the JVs under which Holdings leases 255 of the properties (the "Master Leases"), with the remaining properties being leased by Seritage to third parties. Holdings has closed 15 stores pursuant to recapture notices from Seritage or the JVs and 36 stores pursuant to lease terminations. Also, in July 2017, Seritage sold a 50% joint venture interest in five of the properties and Holdings will pay rent to the new landlord. Holdings recorded rent expense of $22 million and $26 million within cost of sales, buying and occupancy in the Condensed Consolidated Statements of

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Operations for the 13 week periods ended July 29, 2017 and July 30, 2016, respectively, and $44 million and $50 million for the 26 week periods ended July 29, 2017 and July 30, 2016, respectively. Rent expense consisted of straight-line rent expense offset by amortization of deferred gain on sale-leaseback, as shown in the tables below.

| | 13 Weeks Ended July 29, 2017 | | | 13 Weeks Ended July 30, 2016 | | |
|---|---|---|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings | Kmart | Sears Domestic | Sears Holdings |
| Straight-line rent expense | $5 | $ 36 | $ 41 | $8 | $ 40 | $ 48 |
| Amortization of deferred gain on sale-leaseback | (2 ) | (17 ) | (19 ) | (5 ) | (17 ) | (22 ) |
| Rent expense | $3 | $ 19 | $ 22 | $3 | $ 23 | $ 26 |

| | 26 Weeks Ended July 29, 2017 | | | 26 Weeks Ended July 30, 2016 | | |
|---|---|---|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings | Kmart | Sears Domestic | Sears Holdings |
| Straight-line rent expense | $11 | $ 73 | $ 84 | $17 | $ 77 | $ 94 |
| Amortization of deferred gain on sale-leaseback | (6 ) | (34 ) | (40 ) | (9 ) | (35 ) | (44 ) |
| Rent expense | $5 | $ 39 | $ 44 | $8 | $ 42 | $ 50 |

We accounted for the Seritage transaction and JV transactions in accordance with accounting standards applicable to real estate sales and sale-leaseback transactions. We determined that the Seritage and JV transactions qualify for sales recognition and sale-leaseback accounting, with the exception of four properties for which we had continuing involvement as a result of an obligation to redevelop the stores for a third-party tenant and pay rent on behalf of the third-party tenant until it commences rent payments to the JVs.

With the exception of the four properties that had continuing involvement, in accordance with accounting standards related to sale-leaseback transactions, Holdings recognized any loss on sale immediately, any gain on sale in excess of the present value of minimum lease payments immediately, and any remaining gain was deferred and will be recognized in proportion to the related rent expense over the lease term. Accordingly, during the second quarter of 2015, Holdings recognized an immediate net gain of $508 million within gain on sales of assets in the Consolidated Statement of Operations for 2015.

The remaining gain of $894 million 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 Condensed Consolidated Statements of Operations, over the lease term. At July 29, 2017, July 30, 2016 and January 28, 2017, respectively, $156 million, $90 million and $132 million of the deferred gain on sale-leaseback is classified as current within other current liabilities. At July 29, 2017, July 30, 2016 and January 28, 2017, respectively, $455 million, $686 million and $563 million is classified as long-term deferred gain on sale-leaseback in the Condensed Consolidated Balance Sheets.

During the 26 week periods ended July 29, 2017 and July 30, 2016, respectively, Holdings recorded gains of $49 million and $26 million related to the 100% recapture of seven and three stores that closed pursuant to recapture notices from Seritage, of which $27 million and $13 million related to the gain that had previously been deferred as we no longer have continuing involvement in those properties, and $22 million and $13 million related to lease termination proceeds. In addition, the Master Leases provide Seritage and the JVs a recapture right with respect to approximately 50% of the space within the stores at the REIT properties and JV properties (subject to certain exceptions), in addition to all of the automotive care centers, and all outparcels or outlots, as well as certain portions of parking areas and common areas, except as set forth in the Master Leases, for no additional consideration. As space is recaptured pursuant to the recapture right, Holdings' obligation to pay rent is reduced proportionately. Accordingly, Holdings recognizes gains equal to the unamortized portion of the gain that had previously been deferred which exceeds the present value of minimum lease payments, as reduced due to recapture activity. During the 26 week periods ended July 29, 2017 and July 30, 2016, respectively, Holdings recorded gains as a result of recapture activity of $5 million and $9 million that had previously been deferred. The Master Leases also provide Holdings certain rights to terminate the Master Leases with respect to REIT properties or JV properties that cease to be profitable for operation by Holdings. In order to terminate the Master Lease with respect to a certain property,

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Holdings must make a payment to Seritage or the JV of an amount equal to one year of rent (together with taxes and other expenses) with respect to such property. Holdings recorded gains related to stores that closed pursuant to lease terminations of $24 million that had previously been deferred during the 26 week period ended July 29, 2017. The corresponding expenses for termination payments to Seritage were recorded in fiscal year 2016 when we notified Seritage of our intention to terminate the leases and the stores were announced for closure. Holdings also recorded expenses of $24 million for termination payments to Seritage, which is reported as amounts payable to Seritage at July 29, 2017. Holdings also recorded immediate gains of $40 million during the 26 week period ended July 29, 2017, for the amount of gains on sale in excess of the present value of minimum lease payments for two of the properties that were previously accounted for as financing transactions. As the redevelopment at the stores had been completed and the third-party tenant had commenced rent payments to the JVs, the Company determined that the continuing involvement no longer existed and that the properties qualified for sales recognition and sale-leaseback accounting. Holdings initially accounted for the four properties that had continuing involvement as a financing transaction in accordance with accounting standards related to sale-leaseback transactions. Accordingly, Holdings recorded a sale-leaseback financing obligation of $164 million, which is classified as a long-term sale-leaseback financing obligation on the Condensed Consolidated Balance Sheets at July 30, 2016 and January 28, 2017. The sale-leaseback financing obligation decreased to $70 million at July 29, 2017 as two of the properties qualified for sales recognition and sale-leaseback accounting as further described above. We continued to report the real property assets of $22 million, $61 million and $62 million at July 29, 2017, July 30, 2016 and January 28, 2017, respectively, in our Condensed Consolidated Balance Sheets, which are included in our Sears Domestic segment.
On July 17, 2017, Holdings completed a sale-leaseback transaction pursuant to which Holdings sold three distribution centers that served as collateral for the 2016 Secured Loan Facility for cash proceeds of $89 million ($84 million net of prepaid rent). The net proceeds were used to pay interest and a portion of the 2016 Secured Loan Facility. We accounted for the transaction as a financing transaction in accordance with accounting standards applicable to sale-leaseback transactions as a result of the requirement to prepay rent for one year. Accordingly, Holdings recorded a sale-leaseback financing obligation of $89 million, which is classified as a sale-leaseback financing obligation in the Condensed Consolidated Balance Sheets at July 29, 2017. We continued to report real property assets of $7 million at July 29, 2017 in our Condensed Consolidated Balance Sheets, which are included in our Sears Domestic segment. The obligation for future minimum lease payments at July 29, 2017 is $12 million over the lease term, and is $2 million, $4 million, $4 million and $2 million in 2017, 2018, 2019 and 2020, including $4 million that was prepaid upon closing the transaction.
On January 27, 2017, Holdings and CBL and Associates Properties, Inc. ("CBL") completed a sale-leaseback transaction pursuant to which Holdings sold five Sears Full-line stores and two Sears Auto Centers located at CBL malls for net proceeds of $71 million (the "CBL transaction"). In connection with the CBL transaction, Holdings entered into 10-year leaseback agreements. The agreements provide both CBL and Holdings the right to terminate each lease, and provide Holdings the option to relocate its operations at each mall to a location of up to 15,000 square feet. The agreement also contains an earn-out provision pursuant to which Holdings would receive a maximum amount of $14.5 million additional consideration if CBL redevelops any of the properties within a specified time period and achieves more than a specified return on investment. We accounted for the CBL transaction as a financing transaction in accordance with accounting standards applicable to sale-leaseback transactions as a result of continuing involvement through the earn-out provision. Accordingly, Holdings recorded a sale-leaseback financing obligation of $71 million, which is classified as a sale-leaseback financing obligation in the Condensed Consolidated Balance Sheets at both July 29, 2017 and January 28, 2017. We continued to report real property assets of $33 million and $34 million at July 29, 2017 and January 28, 2017, respectively, in our Condensed Consolidated Balance Sheets, which are included in our Sears Domestic segment.
In addition to the Seritage transaction, JV transactions and other sale-leaseback financing transactions described above, we recorded gains on the sales of assets for other significant items described as follows. During the 13 week

period ended July 29, 2017, we recorded gains of $176 million on the sale of three Sears Full-line stores that served as collateral for our real estate loan facilities. We received net proceeds of $202 million for the sale of these stores, of which $126 million was used to pay interest and a portion of the 2016 Secured Loan Facility, $19 million was used to pay interest and a portion of the 2017 Secured Loan Facility, and $57 million was used to repay a portion of our revolving credit facility. During the 13 week period ended July 29, 2017, we also recorded gains of $74 million

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on the sale of four Sears Full-line stores and amendment and lease termination of two Sears Full-line stores for which we received $94 million of cash proceeds, $21 million of which was received in 2016. In connection with the sales of three of the Sears Full-line stores, we entered into leaseback agreements with terms ranging from six months to one year.

During the 26 week period ended July 29, 2017, we also recorded gains of $96 million on the sale of three Sears Full-line stores for which we received $104 million of cash proceeds. In connection with the sales of the Sears Full-line stores, we entered into leaseback agreements for up to one year.

During the 26 week period ended July 29, 2017, we recorded gains on the sales of assets of $40 million recognized on the sale of two Kmart stores that served as collateral for our real estate loan facilities. We received net proceeds of $48 million for the sale of these stores, of which $28 million was used to pay interest and a portion of the 2016 Secured Loan Facility and $20 million was used to pay interest and a portion of the 2017 Secured Loan Facility.

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

We determined that we have surrendered substantially all of our rights and obligations, and, therefore, immediate gain recognition is appropriate on all of these transactions.

NOTE 4—EQUITY

Loss per Share

The following table sets forth the components used to calculate basic and diluted loss per share attributable to Holdings' shareholders.

| millions, except loss per share | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| Basic weighted average shares | 107.3 | 106.9 | 107.2 | 106.8 |
| Diluted weighted average shares | 107.3 | 106.9 | 107.2 | 106.8 |
| | | | | |
| Net loss attributable to Holdings' shareholders | $(251) | $(395) | $(7) | $(866) |
| | | | | |
| Loss per share attributable to Holdings' shareholders: | | | | |
| Basic | $(2.34) | $(3.70) | $(0.07) | $(8.11) |
| Diluted | $(2.34) | $(3.70) | $(0.07) | $(8.11) |

Accumulated Other Comprehensive Loss

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

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Pension and postretirement adjustments (net of tax of $(225), $(296), and $(225), respectively) | $(1,372) | $(1,787) | $ (1,549) |
| Currency translation adjustments (net of tax of $0 for all periods presented) | (2) | (3) | (3) |
| Accumulated other comprehensive loss | $(1,374) | $(1,790) | $ (1,552) |

Pension and postretirement adjustments relate to the net actuarial loss on our pension and postretirement plans recognized as a component of accumulated other comprehensive loss.

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Income Tax Expense Allocated to Each Component of Other Comprehensive Income

Income tax expense allocated to each component of other comprehensive income was as follows:

| millions | 13 Weeks Ended July 29, 2017 | | | 13 Weeks Ended July 30, 2016 | | |
|---|---|---|---|---|---|---|
| | Before Tax Amount | Tax Expense | Net of Tax Amount | Before Tax Amount | Tax Expense | Net of Tax Amount |
| Other comprehensive income | | | | | | |
| Pension and postretirement adjustments[1] | $127 | $ — | $ 127 | $64 | $ — | $ 64 |
| Total other comprehensive income | $127 | $ — | $ 127 | $64 | $ — | $ 64 |

| millions | 26 Weeks Ended July 29, 2017 | | | 26 Weeks Ended July 30, 2016 | | |
|---|---|---|---|---|---|---|
| | Before Tax Amount | Tax Expense | Net of Tax Amount | Before Tax Amount | Tax Expense | Net of Tax Amount |
| Other comprehensive income | | | | | | |
| Pension and postretirement adjustments[1] | $177 | $ — | $ 177 | $128 | $ — | $ 128 |
| Currency translation adjustments | 1 | — | 1 | — | — | — |
| Total other comprehensive income | $178 | $ — | $ 178 | $128 | $ — | $ 128 |

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

NOTE 5—BENEFIT PLANS

Pension and Postretirement Benefit Plans

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

| millions | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| | July 29, 2017 | July 30, 2016 | July 29, 2017 | July 30, 2016 |
| Components of net periodic expense: | | | | |
| Interest cost | $45 | $ 58 | $98 | $ 116 |
| Expected return on plan assets | (46 ) | (51 ) | (103 ) | (101 ) |
| Amortization of experience losses[1] | 247 | 64 | 297 | 128 |
| Net periodic expense | $246 | $ 71 | $292 | $ 143 |

(1) Amortization of experience losses for the 13- and 26- weeks ended July 29, 2017 includes $200 million as a result of the pension annuity purchase described below.

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Contributions
During the 13- and 26- week periods ended July 29, 2017, we made total contributions of $65 million and $134 million, respectively, to our pension and postretirement plans. During the 13- and 26- week periods ended July 30, 2016, we made total contributions of $72 million and $148 million, respectively, to our pension and postretirement plans. We anticipate making aggregate contributions to our defined benefit and postretirement plans of approximately $190 million over the remainder of 2017. As discussed in Note 1, the Company agreed to grant the PBGC a lien on, and subsequently contribute to the Company's pension plans, the value of the Craftsman Receivable, 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.
Pension Plan Amendment
Effective December 1, 2016, the SHC Domestic plan was amended to change its plan year from a calendar year end to a November 30th year end, to spin off a new SHC Pension Plan 2 ("Plan 2") and to rename the Sears Holdings Pension Plan as Sears Holdings Pension Plan 1 ("Plan 1"). In conjunction with these amendments, the Company requested that the Internal Revenue Service ("IRS") approve the foregoing change in plan year and to approve a change in actuarial funding method in connection with the spin-off and change in plan year. The Company has received IRS approval of the change in plan year and the request for approval to the change in actuarial funding method remains pending with the IRS.
Pension Annuity Purchase for Retirees
In May 2017, the Company executed an irrevocable agreement to purchase a group annuity contract from Metropolitan Life Insurance Company ("MLIC"), under which MLIC will pay future pension benefit payments to approximately 51,000 retirees from Plan 2. The agreement calls for a transfer of approximately $515 million of Plan 2's benefit obligations to MLIC. This action had an immaterial impact on the funded status of our total pension obligations, but reduced the size of the Company's combined pension plan, reduced future cost volatility, and reduced future plan administrative expenses. The annuity purchase resulted in a non-cash charge of $200 million for losses previously accumulated in other comprehensive income (loss), which were recognized through the statement of operations upon settlement during the 13 week period ending July 29, 2017.
In August 2017, the Company reached another agreement with MLIC to annuitize an additional $512 million of its pension liability, under which MLIC will pay future pension benefit payments to an additional approximately 20,000 retirees from Plan 2. This action is expected to have an immaterial impact on the funded status of our total pension obligations, but will serve to further reduce the size of the Company's combined pension plan, reduce future cost volatility, and reduce future plan administrative expenses. This annuity purchase will result in an estimated non-cash charge of between $175 million and $225 million for losses previously accumulated in other comprehensive income (loss), which are recognized through the statement of operations immediately upon settlement and will be recorded during the 13 week period ending October 28, 2017.
NOTE 6—INCOME TAXES
We had gross unrecognized tax benefits of $153 million at July 29, 2017, $144 million at July 30, 2016 and $142 million at January 28, 2017. Of the amount at July 29, 2017, $99 million, would, if recognized, impact our effective tax rate, with the remaining amount being comprised of unrecognized tax benefits related to gross temporary differences or any other indirect benefits. During the 13- and 26- week periods ended July 29, 2017, gross

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unrecognized tax benefits increased by $3 million and $11 million, respectively, due to state activity. During the 13- and 26- week periods ended July 30, 2016, gross unrecognized tax benefits increased by $3 million and $7 million, respectively, due to state activity. We expect that our unrecognized tax benefits could decrease by as much as $6 million over the next 12 months for tax audit settlements and the expiration of the statute of limitations for certain jurisdictions.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. At July 29, 2017, July 30, 2016 and January 28, 2017, the total amount of interest and penalties included in our tax accounts in our Condensed Consolidated Balance Sheet was $67 million ($44 million net of federal benefit), $60 million ($39 million net of federal benefit) and $61 million ($40 million net of federal benefit), respectively. The total amount of net interest expense (net of federal benefit) recognized as part of income tax expense in our Condensed Consolidated Statements of Operations was $2 million and $2 million, respectively, for the 13 week periods ended July 29, 2017 and July 30, 2016, and $4 million and $3 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016.

We file income tax returns in both the United States and various foreign jurisdictions. The U.S. Internal Revenue Service ("IRS") has completed its examination of all federal tax returns of Holdings through the 2009 return, and all matters arising from such examinations have been resolved. In addition, Holdings and Sears are under examination by various state, local and foreign income tax jurisdictions for the years 2003 through 2016, and Kmart is under examination by such jurisdictions for the years 2006 through 2014.

At the end of 2016, we had a federal and state net operating loss ("NOL") deferred tax asset of $2.3 billion, which will expire predominately between 2019 and 2036. We have credit carryforwards of $875 million, which will expire between 2018 and 2036.

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

In connection with the Craftsman Sale in the first quarter of 2017, the Company realized a tax benefit of $101 million on the deferred taxes related to the indefinite-life intangible for the trade name sold to Stanley Black & Decker. In addition, the Company incurred a taxable gain of approximately $963 million. There was no federal income tax payable resulting from the taxable gain due to the utilization of NOL tax attributes of approximately $361 million with a valuation allowance release of the same amount. However, there was state income tax of $4 million payable after the utilization of state tax attributes.

At January 28, 2017, we had a valuation allowance of $5.5 billion to record only the portion of the deferred tax asset that more likely than not will be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted in the future if estimates of future taxable income during the carryforward period are increased, or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth. We will continue to evaluate our valuation allowance as the year progresses for any change in circumstances that causes a change in judgment about the realizability of the deferred tax asset.

The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax accounting income. As such, for the 13- and 26- week periods ended July 29, 2017, our effective income tax rates were an expense of 4.1% and a benefit of 89.9%, respectively. Our tax rate continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic jurisdictions where it is not more likely than not that such benefits would be realized. During the first quarter of fiscal 2017, the Company realized a significant tax benefit on the reversal of deferred taxes related to the Craftsman trade name. In addition, the 13- and 26- week periods ended July 29, 2017 were negatively impacted by foreign branch taxes and state income taxes.

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NOTE 7—SUMMARY OF SEGMENT DATA
These reportable segment classifications are based on our business formats, as described in Note 1. The Kmart format represents both an operating and reportable segment. The Sears Domestic reportable segment consists of the aggregation of several business formats. These formats are evaluated by our Chief Operating Decision Maker ("CODM") to make decisions about resource allocation and to assess performance.
Each of these segments derives its revenues from the sale of merchandise and related services to customers, primarily in the United States. The merchandise and service categories are as follows:

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

| | 13 Weeks Ended July 29, 2017 | | |
|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings |
| Merchandise sales | | | |
| Hardlines | $438 | $ 1,552 | $ 1,990 |
| Apparel and Soft Home | 526 | 483 | 1,009 |
| Food and Drug | 497 | 2 | 499 |
| Total merchandise sales | 1,461 | 2,037 | 3,498 |
| Services and other | | | |
| Services | 2 | 481 | 483 |
| Other | 12 | 372 | 384 |
| Total services and other | 14 | 853 | 867 |
| Total revenues | 1,475 | 2,890 | 4,365 |
| Costs and expenses | | | |
| Cost of sales, buying and occupancy - merchandise sales | 1,193 | 1,709 | 2,902 |
| Cost of sales and occupancy - services and other | 2 | 490 | 492 |
| Total cost of sales, buying and occupancy | 1,195 | 2,199 | 3,394 |
| Selling and administrative | 323 | 1,046 | 1,369 |
| Depreciation and amortization | 14 | 69 | 83 |
| Impairment charges | 3 | 2 | 5 |
| Gain on sales of assets | (79) | (301) | (380) |
| Total costs and expenses | 1,456 | 3,015 | 4,471 |
| Operating income (loss) | $19 | $ (125) | $ (106) |
| Total assets | $2,011 | $ 6,340 | $ 8,351 |
| Capital expenditures | $3 | $ 16 | $ 19 |

SEARS HOLDINGS CORPORATION
Notes to Condensed Consolidated Financial Statements—(Continued)
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| | 13 Weeks Ended July 30, 2016 | | |
|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings |
| Merchandise sales | | | |
| Hardlines | $666 | $ 1,869 | $2,535 |
| Apparel and Soft Home | 759 | 571 | 1,330 |
| Food and Drug | 781 | 2 | 783 |
| Total merchandise sales | 2,206 | 2,442 | 4,648 |
| Services and other | | | |
| Services | 2 | 561 | 563 |
| Other | 13 | 439 | 452 |
| Total services and other | 15 | 1,000 | 1,015 |
| Total revenues | 2,221 | 3,442 | 5,663 |
| Costs and expenses | | | |
| Cost of sales, buying and occupancy - merchandise sales | 1,756 | 2,053 | 3,809 |
| Cost of sales and occupancy - services and other | 4 | 590 | 594 |
| Total cost of sales, buying and occupancy | 1,760 | 2,643 | 4,403 |
| Selling and administrative | 498 | 986 | 1,484 |
| Depreciation and amortization | 15 | 77 | 92 |
| Impairment charges | 1 | 6 | 7 |
| Gain on sales of assets | (44) | (10) | (54) |
| Total costs and expenses | 2,230 | 3,702 | 5,932 |
| Operating loss | $(9) | $ (260) | $(269) |
| Total assets | $2,719 | $ 7,895 | $10,614 |
| Capital expenditures | $12 | $ 23 | $35 |

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

| | 26 Weeks Ended July 29, 2017 | | |
|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings |
| Merchandise sales | | | |
| Hardlines | $820 | $ 3,007 | $ 3,827 |
| Apparel and Soft Home | 1,064 | 978 | 2,042 |
| Food and Drug | 1,055 | 3 | 1,058 |
| Total merchandise sales | 2,939 | 3,988 | 6,927 |
| Services and other | | | |
| Services | 3 | 953 | 956 |
| Other | 26 | 757 | 783 |
| Total services and other | 29 | 1,710 | 1,739 |
| Total revenues | 2,968 | 5,698 | 8,666 |
| Costs and expenses | | | |
| Cost of sales, buying and occupancy - merchandise sales | 2,420 | 3,365 | 5,785 |
| Cost of sales and occupancy - services and other | 5 | 975 | 980 |
| Total cost of sales, buying and occupancy | 2,425 | 4,340 | 6,765 |
| Selling and administrative | 715 | 1,921 | 2,636 |
| Depreciation and amortization | 27 | 143 | 170 |
| Impairment charges | 8 | 12 | 20 |
| Gain on sales of assets | (676) | (445) | (1,121) |
| Total costs and expenses | 2,499 | 5,971 | 8,470 |
| Operating income (loss) | $469 | $ (273) | $ 196 |
| Total assets | $2,011 | $ 6,340 | $ 8,351 |
| Capital expenditures | $9 | $ 32 | $ 41 |

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

| | 26 Weeks Ended July 30, 2016 | | |
|---|---|---|---|
| millions | Kmart | Sears Domestic | Sears Holdings |
| Merchandise sales | | | |
| Hardlines | $1,226 | $ 3,577 | $4,803 |
| Apparel and Soft Home | 1,488 | 1,142 | 2,630 |
| Food and Drug | 1,614 | 3 | 1,617 |
| Total merchandise sales | 4,328 | 4,722 | 9,050 |
| Services and other | | | |
| Services | 5 | 1,077 | 1,082 |
| Other | 27 | 898 | 925 |
| Total services and other | 32 | 1,975 | 2,007 |
| Total revenues | 4,360 | 6,697 | 11,057 |
| Costs and expenses | | | |
| Cost of sales, buying and occupancy - merchandise sales | 3,486 | 3,945 | 7,431 |
| Cost of sales and occupancy - services and other | 9 | 1,180 | 1,189 |
| Total cost of sales, buying and occupancy | 3,495 | 5,125 | 8,620 |
| Selling and administrative | 1,042 | 1,945 | 2,987 |
| Depreciation and amortization | 34 | 153 | 187 |
| Impairment charges | 4 | 11 | 15 |
| Gain on sales of assets | (90 ) | (25 ) | (115 ) |
| Total costs and expenses | 4,485 | 7,209 | 11,694 |
| Operating loss | $(125 ) | $ (512 ) | $(637 ) |
| Total assets | $2,719 | $ 7,895 | $10,614 |
| Capital expenditures | $23 | $ 52 | $75 |

NOTE 8—SUPPLEMENTAL FINANCIAL INFORMATION

Other long-term liabilities at July 29, 2017, July 30, 2016 and January 28, 2017 consisted of the following:

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Unearned revenues | $ 593 | $ 686 | $ 639 |
| Self-insurance reserves | 533 | 571 | 535 |
| Other | 452 | 446 | 467 |
| Total | $ 1,578 | $ 1,703 | $ 1,641 |

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The Company sells service contracts that provide for preventative maintenance and repair/replacement coverage on consumer products over periods of time ranging from 12 to 144 months. Revenues from the sale of service contracts, and the related direct acquisition costs, are deferred and amortized on a straight-line basis over the lives of the associated contracts, while the associated service costs are expensed as incurred. The table below shows activity related to unearned revenues for service contracts, which are recorded within other current liabilities and other long-term liabilities in the Condensed Consolidated Balance Sheets.

| millions | Unearned Revenues |
|---|---|
| Balance at July 30, 2016 | $ 1,368 |
| Sales of service contracts | 405 |
| Revenue recognized on existing service contracts | (474 ) |
| Balance at January 28, 2017 | 1,299 |
| Sales of service contracts | 366 |
| Revenue recognized on existing service contracts | (446 ) |
| Balance at July 29, 2017 | $ 1,219 |

NOTE 9—LEGAL PROCEEDINGS

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

We are subject to various other legal and governmental proceedings and investigations, including some involving the practices and procedures in our more highly regulated businesses. Some matters contain class action allegations, environmental and asbestos exposure allegations and other consumer-based, regulatory or qui tam claims, each of which may seek compensatory, punitive or treble damage claims (potentially in large amounts), as well as other types of relief. Additionally, some of these claims or actions, such as the qui tam claims, have the potential for significant statutory penalties. At this time, the Company is not able to either predict the outcome of these lawsuits or reasonably estimate a potential range of loss with respect to these lawsuits.

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

Because litigation outcomes are inherently unpredictable, our evaluation of legal proceedings often involves a series of complex assessments by management about future events and can rely heavily on estimates and assumptions. If the assessments indicate that loss contingencies that could be material to any one of our financial statements are not probable, but are reasonably possible, or are probable, but cannot be estimated, then we disclose the nature of the loss contingencies, together with an estimate of the range of possible loss or a statement that such loss is not reasonably estimable. While the consequences of certain unresolved proceedings are not presently determinable, and an estimate of the probable and reasonably possible loss or range of loss in excess of amounts accrued for such proceedings cannot be reasonably made, an adverse outcome from such proceedings could have a material effect on

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our earnings in any given reporting period. However, in the opinion of our management, after consulting with legal counsel, and taking into account insurance and reserves, the ultimate liability related to current outstanding matters is not expected to have a material effect on our financial position, liquidity or capital resources.

NOTE 10—RECENT ACCOUNTING PRONOUNCEMENTS

Compensation - Retirement Benefits

In March 2017, the Financial Accounting Standards Board ("FASB") issued an accounting standards update which requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments in the update must be applied retrospectively. We are currently evaluating the effect the update will have on our consolidated financial statements.

Goodwill

In January 2017, the FASB issued an accounting standards update which simplifies the test for goodwill impairment. To address concerns over the cost and complexity of the two-step goodwill impairment test, the amendments in this update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. This update is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the effect the update will have on our consolidated financial statements.

Business Combinations

In January 2017, the FASB issued an accounting standards update which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of businesses. The amendments in this update provide a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments in this update require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. This update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments in the update must be applied prospectively. We are currently evaluating the effect the update will have on our consolidated financial statements.

Statement of Cash Flows

In November 2016, the FASB issued accounting standards updates which address diversity in practice in the classification and presentation of changes in restricted cash in the statement of cash flows. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash. Therefore, restricted cash should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. These updates are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments in the updates must be applied using a retrospective transition method to each period presented. The Company adopted the update in the first quarter of 2017.

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Consolidation - Interests Held Through Related Parties That are Under Common Control
In October 2016, the FASB issued an accounting standards update to amend the accounting standards on how a reporting entity that is the single decision maker of a variable interest entity ("VIE") should treat indirect interests in the entity held through related parties that are under common control with the reporting entity when determining whether it is the primary beneficiary of that VIE. The primary beneficiary of a VIE is the reporting entity that has a controlling financial interest in a VIE and, therefore, consolidates the VIE. A reporting entity has an indirect interest in a VIE if it has a direct interest in a related party that, in turn, has a direct interest in the VIE. Under the amendments, a single decision maker is not required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety. Instead, a single decision maker is required to include those interests on a proportionate basis consistent with indirect interests held through other related parties. The Company adopted the update in the first quarter of 2017. The adoption of the new standard did not have an impact on the Company's consolidated financial position, results of operations or cash flows.
Income Taxes - Intra-Entity Transfers of Assets Other Than Inventory
In October 2016, the FASB issued an accounting standards update to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Current accounting standards prohibit the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. In addition, interpretations of this guidance have developed in practice for transfers of certain intangible and tangible assets. This prohibition on recognition is an exception to the principle of comprehensive recognition of current and deferred income taxes in accounting standards. To more faithfully represent the economics of intra-entity asset transfers, the amendments in this update require that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this update do not change accounting standards for the pre-tax effects of an intra-entity asset transfer under accounting standards applicable to consolidation, or for an intra-entity transfer of inventory. The update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted as of the beginning of an annual reporting period. The amendments in this update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently evaluating the effect the update will have on our consolidated financial statements.
Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments
In August 2016, the FASB issued accounting standards updates which address diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows, including: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. These updates are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments in the update must be applied using a retrospective transition method to each period presented. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. We are currently evaluating the effect the update will have on our consolidated financial statements.
Leases
In February 2016, the FASB issued an accounting standards update which replaces the current lease accounting standard. The update will require, among other items, lessees to recognize a right-of-use asset and a lease liability for most leases. Extensive quantitative and qualitative disclosures, including significant judgments made by management,

will be required to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing contracts. The update is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The new standard must be

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adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. We are currently evaluating the effect the update will have on our consolidated financial statements, and expect the update will have a material impact on our consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued an accounting standards update which replaces the current revenue recognition standards. Subsequently, the FASB has also issued accounting standards updates which clarify the guidance. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard was initially released as effective for fiscal years beginning after December 15, 2016; however, the FASB has decided to defer the effective date of this accounting standard update for one year. Early adoption of the update is permitted, but not before the original date for fiscal years beginning after December 15, 2016. The update may be applied retrospectively for each period presented or as a cumulative-effect adjustment at the date of adoption. The Company continues to evaluate the adoption of this standard. Based on our preliminary assessment, we determined the adoption will impact the accounting for our Shop Your Way program and revenues from gift cards. The expense for Shop Your Way points is currently recognized as customers earn them and recorded in cost of sales. The new guidance will require the Company to allocate the transaction price to products and points on a relative standalone selling price basis, deferring the portion of revenue allocated to the points and recognizing a contract liability for unredeemed points. The new guidance will also change the timing of recognition of the unredeemed portion of our gift cards, which is currently recognized using the remote method. The new guidance will require application of the proportional method. We continue to evaluate the impact of this standard on revenues from other sources, including: sales of services; extended service contracts; net commissions earned from leased departments in retail stores; and co-branded credit card programs.

NOTE 11—RELATED PARTY DISCLOSURE

Mr. Lampert is Chairman of our Board of Directors and its Finance Committee and is the Chairman and Chief Executive Officer of ESL. Additionally, on February 1, 2013, Mr. Lampert became our Chief Executive Officer, in addition to his role as Chairman of the Board. ESL owned approximately 49% of our outstanding common stock at July 29, 2017 (excluding shares of common stock that ESL may acquire within 60 days upon the exercise of warrants to purchase shares of our common stock).

Bruce R. Berkowitz has been a member of our Board of Directors since February 2016. Mr. Berkowitz serves as the Chief Investment Officer of Fairholme Capital Management, LLC, an investment adviser registered with the SEC, and is the President and a Director of Fairholme Funds, Inc., a SEC-registered investment company providing investment management services to three mutual funds (together with Fairholme Capital Management, LLC and other affiliates, "Fairholme"). Fairholme owned approximately 27% of our outstanding common stock at July 29, 2017 (excluding shares of common stock that Fairholme may acquire within 60 days upon the exercise of warrants to purchase shares of our common stock).

Thomas J. Tisch has been an independent member of our Board of Directors since 2005. Mr. Tisch owned approximately 4% of our outstanding common stock at July 29, 2017.

Unsecured Commercial Paper

During the 26 week periods ended July 29, 2017 and July 30, 2016, ESL and its affiliates held unsecured commercial paper issued by SRAC, an indirect wholly owned subsidiary of Holdings. For the commercial paper outstanding to ESL, the weighted average of each of maturity, annual interest rate and principal amount outstanding was 8.1 days, 8% and $58 million and 34.4 days, 7.97% and $55 million, respectively, during the 26 week periods ended July 29, 2017 and July 30, 2016. The largest aggregate amount of principal outstanding to ESL at any time since the beginning of 2017 was $160 million, and $2 million of interest was paid by SRAC to ESL during the 26 week period ended

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The commercial paper purchases were made in the ordinary course of business on substantially the same terms, including interest rates, as terms prevailing for comparable transactions with other persons, and did not present features unfavorable to the Company.

LC Facility

On December 28, 2016, the Company, through the Borrowers, entered into the LC Facility Agreement, which was subsequently amended in August 2017, and which provides for a $271 million amended LC Facility. At July 29, 2017 and January 28, 2017, we had $271 million and $200 million, respectively, of letters of credit outstanding under the LC Facility, which amounts were initially committed by entities affiliated with ESL, and the Lenders under the LC Facility maintain cash collateral on deposit with the Issuing Bank of $276 million. $140 million of the amount originally committed by entities affiliated with ESL under the LC Facility has been syndicated to unaffiliated third party lenders as of the date of this report. See Note 2 for additional information regarding the LC Facility, as amended.

2017 Secured Loan Facility

On January 3, 2017, the Company, through the 2017 Secured Loan Borrowers, obtained a $500 million real estate loan facility from the Lenders, entities affiliated with ESL. At July 29, 2017 and January 28, 2017, JPP LLC and JPP II, LLC, entities affiliated with ESL, held $461 million and $500 million of principal amount of the 2017 Secured Loan Facility, respectively. Approximately $39 million of proceeds received from real estate transactions were used to reduce outstanding borrowings under the 2017 Secured Loan Facility, all of which were repaid to entities affiliated with ESL. See Note 2 for additional information regarding the 2017 Secured Loan Facility.

2016 Secured Loan Facility

In April 2016, the Company, through the 2016 Secured Loan Borrowers, obtained a $500 million real estate loan facility from the 2016 Secured Loan Lenders, some of which are entities affiliated with ESL. In May 2017, Sears Holdings reached agreement to extend the maturity of $400 million of the $500 million 2016 Secured Loan Facility maturing in July 2017 to January 2018. At July 29, 2017, July 30, 2016 and January 28, 2017, entities affiliated with ESL held $131 million, $216 million and $216 million, respectively, of principal amount of the 2016 Secured Loan Facility. Proceeds received from real estate transaction were used to reduce outstanding borrowings under the 2016 Secured Loan Facility, of which $84 million was repaid to entities affiliated with ESL. See Note 2 for additional information regarding the 2016 Secured Loan Facility, as amended.

2016 Term Loan

In April 2016, the Company, through the ABL Borrowers, obtained a $750 million senior secured term loan under the Amended Domestic Credit Agreement with a syndicate of lenders, including $146 million (net of original issue discount) from JPP, LLC and JPP II, LLC, entities affiliated with ESL, and $100 million from the Company's domestic pension plans. At July 29, 2017, JPP LLC and JPP II, LLC, and the Company's domestic pension plans, respectively, held $114 million and $76 million of principal of the 2016 Term Loan. At both July 30, 2016 and January 28, 2017, JPP LLC and JPP II, LLC, and the Company's domestic pension plans, respectively, held $150 million and $100 million of principal of the 2016 Term Loan. As disclosed in Note 1, a portion of the proceeds received from the Craftsman Sale were used to reduce outstanding borrowings under the 2016 Term Loan, of which $36 million and $24 million was repaid to JPP LLC and JPP II, LLC, and the Company's domestic pension plans, respectively. See Note 2 for additional information regarding the 2016 Term Loan.

Second Lien Credit Agreement

In September 2016, the Company, through the ABL Borrowers, obtained a $300 million Second Lien Term Loan from the Lenders, entities affiliated with ESL. At both July 29, 2017 and January 28, 2017, JPP LLC and JPP II, LLC held $300 million of principal of the Second Lien Term Loan.

Additionally, as further discussed in Note 2, in July 2017, the Company amended its Second Lien Credit Agreement to create an additional $500 million Line of Credit Loan Facility. The Company received $330 million in net

proceeds from Line of Credit Loans during the 13 weeks ended July 29, 2017, including $200 million, $25 million and $20 million from ESL and its affiliates, Mr. Berkowitz and his affiliates, and Mr. Tisch and his affiliates, respectively, which also represents the principal amount of Line of Credit Loans held by these parties at July 29, 2017. See Note 2 for additional information regarding the Second Lien Credit Agreement, as amended.

Senior Secured Notes

At each of July 29, 2017, July 30, 2016 and January 28, 2017, Mr. Lampert and ESL held an aggregate of approximately $11 million of principal of the Company's Senior Secured Notes.

At each of July 29, 2017, July 30, 2016 and January 28, 2017, Fairholme held an aggregate of approximately $46 million of principal of the Company's Senior Secured Notes.

Subsidiary Notes

At each of July 29, 2017, July 30, 2016 and January 28, 2017, Mr. Lampert and ESL held an aggregate of $3 million of principal amount of unsecured notes issued by SRAC (the "Subsidiary Notes").

At each of July 29, 2017, July 30, 2016 and January 28, 2017, Fairholme held an aggregate of $14 million of principal amount of Subsidiary Notes.

Senior Unsecured Notes and Warrants

At both July 29, 2017 and January 28, 2017, Mr. Lampert and ESL held an aggregate of approximately $188 million of principal amount of the Company's Senior Unsecured Notes, and 10,033,472 warrants to purchase shares of Holdings common stock. At July 30, 2016, Mr. Lampert and ESL held an aggregate of approximately $193 million of principal amount of the Company's Senior Unsecured Notes, and 10,033,472 warrants to purchase shares of Holdings common stock.

At July 29, 2017, July 30, 2016 and January 28, 2017, respectively, Fairholme held an aggregate of approximately $362 million, $357 million and $357 million of principal amount of the Company's Senior Unsecured Notes, and 6,648,050, 6,732,415 and 6,713,725 warrants to purchase shares of Holdings common stock.

Sears Canada

ESL owns approximately 45% of the outstanding common shares of Sears Canada (based on publicly available information as of July 27, 2017). Fairholme owns approximately 19% of the outstanding common shares of Sears Canada (based on publicly available information as of August 4, 2017).

Lands' End

ESL owns approximately 65% of the outstanding common stock of Lands' End (based on publicly available information as of July 26, 2017). Holdings and certain of its subsidiaries entered into a transition services agreement in connection with the spin-off pursuant to which Lands' End and Holdings agreed to provide, on an interim, transitional basis, various services, including but not limited to, tax services, logistics services, auditing and compliance services, inventory management services, information technology services and continued participation in certain contracts shared with Holdings and its subsidiaries, as well as agreements related to Lands' End Shops at Sears and participation in the Shop Your Way® program. The majority of the services under the transition services agreement with Lands' End have expired or been terminated. In July 2016, the Company and Lands' End executed an agreement pursuant to which the Company will provide foreign buying office support and sourcing services to Lands' End. The agreement expires on August 31, 2017.

Amounts due to or from Lands' End are non-interest bearing, and generally settled on a net basis. Holdings invoices Lands' End on at least a monthly basis. At July 29, 2017, Holdings reported a net amount receivable to Lands' End of $1 million in accounts receivable in the Condensed Consolidated Balance Sheet. At January 28, 2017, Holdings reported a net amount payable to Lands' End of $1 million in other current liabilities in the Condensed Consolidated Balance Sheet. Amounts related to revenue from retail services and rent for Lands' End Shops at Sears, participation in the Shop Your Way® program and corporate shared services were $15 million and $15 million, respectively, for

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

the 13 week periods ended July 29, 2017 and July 30, 2016, and $30 million and $30 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016. The amounts Lands' End earned related to call center services and commissions were $3 million for the 13 week period ended July 30, 2016, and $2 million and $5 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016.

SHO

ESL owns approximately 57% of the outstanding common stock of SHO (based on publicly available information as of December 1, 2016). Holdings and certain of its subsidiaries engage in transactions with SHO pursuant to various agreements with SHO which, among other things, (1) govern the principal transactions relating to the rights offering and certain aspects of our relationship with SHO following the separation, (2) establish terms under which Holdings and certain of its subsidiaries will provide SHO with services, and (3) establish terms pursuant to which Holdings and certain of its subsidiaries will obtain merchandise for SHO.

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

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

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

Amounts due to or from SHO are non-interest bearing, settled on a net basis, and have payment terms of 10 days after the invoice date. The Company invoices SHO on a weekly basis. At July 29, 2017, July 30, 2016 and January 28, 2017, Holdings reported a net amount receivable from SHO of $25 million, $35 million and $81 million, respectively, within accounts receivable in the Condensed Consolidated Balance Sheets. Amounts related to the sale of inventory and related services, royalties, and corporate shared services were $286 million and $321 million, respectively, for the 13 week periods ended July 29, 2017 and July 30, 2016, and $567 million and $656 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016. The net amounts SHO earned related to commissions were $19 million and $22 million, respectively, for the 13 week periods ended July 29, 2017 and July 30, 2016, and $36 million and $44 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016. Additionally, the Company has guaranteed lease obligations for certain SHO store leases that were assigned as a result of the separation. See Note 4 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017 for further information related to these guarantees.

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

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

Seritage

ESL owns approximately 7.9% of the total voting power of Seritage, and approximately 39% of the limited partnership units of Seritage Growth Properties, L.P. (the "Operating Partnership"), the entity that now owns the properties sold by the Company in the Seritage transaction and through which Seritage conducts its operations (based on publicly available information as of February 23, 2017). Mr. Lampert is also currently the Chairman of the Board of Trustees of Seritage. Fairholme owns approximately 12% of the outstanding Class A common shares of Seritage and 100% of the outstanding Class C non-voting common shares of Seritage (based on publicly available information as of December 31, 2016).

In connection with the Seritage transaction as described in Note 3, Holdings entered into a master lease agreement with Seritage. The initial amount of aggregate annual base rent under the master lease is $134 million for the REIT properties, with increases of 2% per year beginning in the second lease year. At July 30, 2016, Holdings reported prepaid rent of $9 million within prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets. Holdings recorded rent expense of $19 million and $21 million, respectively, in cost of sales, buying and occupancy for the 13 week periods ended July 29, 2017 and July 30, 2016. Rent expense consists of straight-line rent expense of $32 million and $36 million, respectively, offset by amortization of a deferred gain recognized pursuant to the sale and leaseback of properties from Seritage of $13 million and $15 million, respectively, for the 13 week periods ended July 29, 2017 and July 30, 2016.

Holdings recorded rent expense of $38 million and $42 million, respectively, in cost of sales, buying and occupancy for the 26 week periods ended July 29, 2017 and July 30, 2016. Rent expense consists of straight-line rent expense of $64 million and $72 million, respectively, offset by amortization of a deferred gain recognized pursuant to the sale and leaseback of properties from Seritage of $26 million and $30 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016.

In addition to base rent under the Master Lease, Holdings pays monthly installment expenses for property taxes and insurance at all REIT properties where Holdings is a tenant and installment expenses for common area maintenance, utilities and other operating expenses at REIT properties that are multi-tenant locations where Holdings and other third parties are tenants. The initial amount of aggregate installment expenses under the Master Lease was $70 million, based on estimated installment expenses, and currently is $44 million as a result of reconciling actual installment expenses and recapture activity. Holdings paid $12 million and $17 million, respectively, for the 13 week periods ended July 29, 2017 and July 30, 2016, and $24 million and $34 million, respectively, for the 26 week periods ended July 29, 2017 and July 30, 2016, recorded in cost of sales, buying and occupancy. At July 29, 2017, July 30, 2016 and January 28, 2017, respectively, Holdings reported an amount receivable from Seritage of $4 million, $9 million and $14 million within accounts receivable in the Condensed Consolidated Balance Sheets. At July 29, 2017 and January 28, 2017, respectively, Holdings reported amounts payable to Seritage of $24 million and $11 million within other current liabilities in the Condensed Consolidated Balance Sheets.

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

NOTE 12—GUARANTOR/NON-GUARANTOR SUBSIDIARY FINANCIAL INFORMATION

At July 29, 2017, the principal amount outstanding of the Company's 6 5/8% Senior Secured Notes due 2018 was $303 million. The Senior Secured Notes were issued in 2010 by Sears Holdings Corporation ("Parent"). The Senior Secured Notes are guaranteed by certain of our 100% owned domestic subsidiaries that own the collateral for the notes, as well as by SRAC (the "guarantor subsidiaries"). The following condensed consolidated financial information presents the Condensed Consolidating Balance Sheets at July 29, 2017, July 30, 2016 and January 28, 2017, the Condensed Consolidating Statements of Operations and the Condensed Consolidating Statements of Comprehensive Income (Loss) for the 13- and 26- week periods ended July 29, 2017 and July 30, 2016, and the Condensed Consolidating Statements of Cash Flows for the 26 week periods ended July 29, 2017 and July 30, 2016 of (i) Parent; (ii) the guarantor subsidiaries; (iii) the non-guarantor subsidiaries; (iv) eliminations and (v) the Company on a consolidated basis.

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

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

Condensed Consolidating Balance Sheet
July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Current assets | | | | | |
| Cash and cash equivalents | $— | $ 180 | $ 32 | $ — | $ 212 |
| Restricted cash | 230 | — | — | — | 230 |
| Intercompany receivables | — | — | 27,871 | (27,871) | — |
| Accounts receivable | — | 350 | 20 | — | 370 |
| Merchandise inventories | — | 3,433 | — | — | 3,433 |
| Prepaid expenses and other current assets | 31 | 661 | 432 | (806) | 318 |
| Total current assets | 261 | 4,624 | 28,355 | (28,677) | 4,563 |
| Total property and equipment, net | — | 1,262 | 707 | — | 1,969 |
| Goodwill and intangible assets | — | 355 | 1,261 | (98) | 1,518 |
| Other assets | 405 | 1,304 | 1,532 | (2,940) | 301 |
| Investment in subsidiaries | 9,307 | 27,692 | — | (36,999) | — |
| TOTAL ASSETS | $9,973 | $ 35,237 | $ 31,855 | $ (68,714) | $ 8,351 |
| Current liabilities | | | | | |
| Short-term borrowings | $— | $ 689 | $ — | $ (143) | $ 546 |
| Current portion of long-term debt and capitalized lease obligations | — | 1,052 | — | — | 1,052 |
| Merchandise payables | — | 672 | (2) | — | 670 |
| Intercompany payables | 11,416 | 16,455 | — | (27,871) | — |
| Other current liabilities | 37 | 2,108 | 1,158 | (611) | 2,692 |
| Total current liabilities | 11,453 | 20,976 | 1,156 | (28,625) | 4,960 |
| Long-term debt and capitalized lease obligations | 2,130 | 3,036 | — | (2,761) | 2,405 |
| Pension and postretirement benefits | — | 1,727 | 4 | — | 1,731 |
| Deferred gain on sale-leaseback | — | 455 | — | — | 455 |
| Sale-leaseback financing obligation | — | 141 | 89 | — | 230 |
| Long-term deferred tax liabilities | 48 | — | 738 | (143) | 643 |
| Other long-term liabilities | — | 1,211 | 560 | (193) | 1,578 |
| Total Liabilities | 13,631 | 27,546 | 2,547 | (31,722) | 12,002 |
| EQUITY (DEFICIT) | | | | | |
| Shareholder's equity (deficit) | (3,658) | 7,691 | 29,308 | (36,992) | (3,651) |
| Total Equity (Deficit) | (3,658) | 7,691 | 29,308 | (36,992) | (3,651) |
| TOTAL LIABILITIES AND EQUITY (DEFICIT) | $9,973 | $ 35,237 | $ 31,855 | $ (68,714) | $ 8,351 |

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

Condensed Consolidating Balance Sheet
July 30, 2016

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

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

Condensed Consolidating Balance Sheet
January 28, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Current assets | | | | | |
| Cash and cash equivalents | $— | $ 260 | $ 26 | $ — | $ 286 |
| Intercompany receivables | — | — | 27,415 | (27,415 ) | — |
| Accounts receivable | — | 441 | 25 | — | 466 |
| Merchandise inventories | — | 3,959 | — | — | 3,959 |
| Prepaid expenses and other current assets | 23 | 692 | 856 | (1,286 ) | 285 |
| Total current assets | 23 | 5,352 | 28,322 | (28,701 ) | 4,996 |
| Total property and equipment, net | — | 1,504 | 736 | — | 2,240 |
| Goodwill and intangible assets | — | 360 | 1,528 | (98 ) | 1,790 |
| Other assets | 4 | 285 | 931 | (884 ) | 336 |
| Investment in subsidiaries | 9,110 | 26,703 | — | (35,813 ) | — |
| TOTAL ASSETS | $9,137 | $ 34,204 | $ 31,517 | $ (65,496 ) | $ 9,362 |
| Current liabilities | | | | | |
| Short-term borrowings | $— | $ 108 | $ — | $ (108 ) | $ — |
| Current portion of long-term debt and capitalized lease obligations | — | 1,189 | — | (599 ) | 590 |
| Merchandise payables | — | 1,048 | — | — | 1,048 |
| Intercompany payables | 11,830 | 15,585 | — | (27,415 ) | — |
| Other current liabilities | 17 | 2,479 | 1,219 | (672 ) | 3,043 |
| Total current liabilities | 11,847 | 20,409 | 1,219 | (28,794 ) | 4,681 |
| Long-term debt and capitalized lease obligations | 1,215 | 3,160 | — | (802 ) | 3,573 |
| Pension and postretirement benefits | — | 1,746 | 4 | — | 1,750 |
| Deferred gain on sale-leaseback | — | 563 | — | — | 563 |
| Sale-leaseback financing obligation | — | 235 | — | — | 235 |
| Long-term deferred tax liabilities | 48 | — | 724 | (29 ) | 743 |
| Other long-term liabilities | — | 808 | 1,038 | (205 ) | 1,641 |
| Total Liabilities | 13,110 | 26,921 | 2,985 | (29,830 ) | 13,186 |
| EQUITY (DEFICIT) | | | | | |
| Shareholder's equity (deficit) | (3,973 ) | 7,283 | 28,532 | (35,666 ) | (3,824 ) |
| Noncontrolling interest | — | — | — | — | — |
| Total Equity (Deficit) | (3,973 ) | 7,283 | 28,532 | (35,666 ) | (3,824 ) |
| TOTAL LIABILITIES AND EQUITY (DEFICIT) | $9,137 | $ 34,204 | $ 31,517 | $ (65,496 ) | $ 9,362 |

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

Condensed Consolidating Statement of Operations
For the 13 Weeks Ended July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Merchandise sales | $— | $ 3,490 | $ — | $ 8 | $ 3,498 |
| Services and other | — | 891 | 547 | (571) | 867 |
| Total revenues | — | 4,381 | 547 | (563) | 4,365 |
| Cost of sales, buying and occupancy - merchandise sales | — | 2,884 | — | 18 | 2,902 |
| Cost of sales and occupancy - services and other | — | 586 | 203 | (297) | 492 |
| Total cost of sales, buying and occupancy | — | 3,470 | 203 | (279) | 3,394 |
| Selling and administrative | (33) | 1,476 | 210 | (284) | 1,369 |
| Depreciation and amortization | — | 67 | 16 | — | 83 |
| Impairment charges | — | 5 | — | — | 5 |
| Gain on sales of assets | 6 | (386) | — | — | (380) |
| Total costs and expenses | (27) | 4,632 | 429 | (563) | 4,471 |
| Operating income (loss) | 27 | (251) | 118 | — | (106) |
| Interest expense | (154) | (237) | (4) | 272 | (123) |
| Interest and investment income (loss) | 28 | 64 | 168 | (272) | (12) |
| Income (loss) before income taxes | (99) | (424) | 282 | — | (241) |
| Income tax (expense) benefit | — | 21 | (31) | — | (10) |
| Equity (deficit) in earnings in subsidiaries | (152) | 177 | — | (25) | — |
| NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $(251) | $ (226) | $ 251 | $ (25) | $ (251) |

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

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

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Merchandise sales | $— | $ 4,643 | $ — | $ 5 | $ 4,648 |
| Services and other | — | 1,065 | 756 | (806) | 1,015 |
| Total revenues | — | 5,708 | 756 | (801) | 5,663 |
| Cost of sales, buying and occupancy - merchandise sales | — | 3,796 | — | 13 | 3,809 |
| Cost of sales and occupancy - services and other | — | 731 | 264 | (401) | 594 |
| Total cost of sales, buying and occupancy | — | 4,527 | 264 | (388) | 4,403 |
| Selling and administrative | 1 | 1,596 | 300 | (413) | 1,484 |
| Depreciation and amortization | — | 74 | 18 | — | 92 |
| Impairment charges | — | 7 | — | — | 7 |
| Gain on sales of assets | — | (152) | — | 98 | (54) |
| Total costs and expenses | 1 | 6,052 | 582 | (703) | 5,932 |
| Operating income (loss) | (1) | (344) | 174 | (98) | (269) |
| Interest expense | (115) | (159) | 14 | 161 | (99) |
| Interest and investment income (loss) | 11 | 55 | 82 | (161) | (13) |
| Other loss | — | — | (1) | — | (1) |
| Income (loss) before income taxes | (105) | (448) | 269 | (98) | (382) |
| Income tax (expense) benefit | — | 34 | (47) | — | (13) |
| Equity (deficit) in earnings in subsidiaries | (192) | 140 | — | 52 | — |
| NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $(297) | $ (274) | $ 222 | $ (46) | $ (395) |

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

Condensed Consolidating Statement of Operations
For the 26 Weeks Ended July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Merchandise sales | $ — | $ 6,914 | $ — | $ 13 | $ 6,927 |
| Services and other | — | 1,765 | 1,157 | (1,183) | 1,739 |
| Total revenues | — | 8,679 | 1,157 | (1,170) | 8,666 |
| Cost of sales, buying and occupancy - merchandise sales | — | 5,740 | — | 45 | 5,785 |
| Cost of sales and occupancy - services and other | — | 1,188 | 441 | (649) | 980 |
| Total cost of sales, buying and occupancy | — | 6,928 | 441 | (604) | 6,765 |
| Selling and administrative | (32) | 2,807 | 427 | (566) | 2,636 |
| Depreciation and amortization | — | 138 | 32 | — | 170 |
| Impairment charges | — | 20 | — | — | 20 |
| Gain on sales of assets | (486) | (635) | — | — | (1,121) |
| Total costs and expenses | (518) | 9,258 | 900 | (1,170) | 8,470 |
| Operating income (loss) | 518 | (579) | 257 | — | 196 |
| Interest expense | (271) | (458) | (8) | 486 | (251) |
| Interest and investment income (loss) | 38 | 103 | 331 | (486) | (14) |
| Income (loss) before income taxes | 285 | (934) | 580 | — | (69) |
| Income tax (expense) benefit | — | 150 | (88) | — | 62 |
| Equity (deficit) in earnings in subsidiaries | (292) | 347 | — | (55) | — |
| NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $ (7) | $ (437) | $ 492 | $ (55) | $ (7) |

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

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

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Merchandise sales | $— | $ 9,042 | $ — | $ 8 | $ 9,050 |
| Services and other | — | 2,086 | 1,378 | (1,457) | 2,007 |
| Total revenues | — | 11,128 | 1,378 | (1,449) | 11,057 |
| Cost of sales, buying and occupancy - merchandise sales | — | 7,399 | — | 32 | 7,431 |
| Cost of sales and occupancy - services and other | — | 1,463 | 512 | (786) | 1,189 |
| Total cost of sales, buying and occupancy | — | 8,862 | 512 | (754) | 8,620 |
| Selling and administrative | 2 | 3,195 | 485 | (695) | 2,987 |
| Depreciation and amortization | — | 151 | 36 | — | 187 |
| Impairment charges | — | 15 | — | — | 15 |
| Gain on sales of assets | — | (211) | (2) | 98 | (115) |
| Total costs and expenses | 2 | 12,012 | 1,031 | (1,351) | 11,694 |
| Operating income (loss) | (2) | (884) | 347 | (98) | (637) |
| Interest expense | (189) | (304) | (6) | 315 | (184) |
| Interest and investment income (loss) | 11 | 76 | 211 | (315) | (17) |
| Income (loss) before income taxes | (180) | (1,112) | 552 | (98) | (838) |
| Income tax (expense) benefit | — | 70 | (98) | — | (28) |
| Equity (deficit) in earnings in subsidiaries | (588) | 286 | — | 302 | — |
| NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $(768) | $ (756) | $ 454 | $ 204 | $ (866) |

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the 13 Weeks Ended July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net income (loss) | $(251) | $ (226) | $ 251 | $ (25) | $ (251) |
| Other comprehensive income | | | | | |
| Pension and postretirement adjustments, net of tax | — | 127 | — | — | 127 |
| Total other comprehensive income | — | 127 | — | — | 127 |
| Comprehensive income (loss) attributable to Holdings' shareholders | $(251) | $ (99) | $ 251 | $ (25) | $ (124) |

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

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

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

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the 26 Weeks Ended July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net income (loss) | $ (7) | $ (437) | $ 492 | $ (55) | $ (7) |
| Other comprehensive income | | | | | |
| Pension and postretirement adjustments, net of tax | — | 177 | — | — | 177 |
| Currency translation adjustments, net of tax | — | — | 1 | — | 1 |
| Unrealized net gain, net of tax | — | — | 26 | (26) | — |
| Total other comprehensive income | — | 177 | 27 | (26) | 178 |
| Comprehensive income (loss) attributable to Holdings' shareholders | $ (7) | $ (260) | $ 519 | $ (81) | $ 171 |

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

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

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

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

Condensed Consolidating Statement of Cash Flows
For the 26 Weeks Ended July 29, 2017

| millions | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net cash provided by (used in) operating activities | $(11) | $ (1,436) | $ 309 | $ — | $ (1,138) |
| Proceeds from sales of property and investments | — | 569 | — | — | 569 |
| Proceeds from Craftsman sale | 572 | — | — | — | 572 |
| Proceeds from sales of receivables | 293 | — | — | — | 293 |
| Purchases of property and equipment | — | (36) | (5) | — | (41) |
| Net investing with Affiliates | (582) | — | (298) | 880 | — |
| Net cash provided by (used in) investing activities | 283 | 533 | (303) | 880 | 1,393 |
| Proceeds from debt issuances | — | 330 | — | — | 330 |
| Repayments of long-term debt | (39) | (678) | — | — | (717) |
| Increase in short-term borrowings, primarily 90 days or less | — | 216 | — | — | 216 |
| Proceeds from sale-leaseback financing | — | 89 | — | — | 89 |
| Debt issuance costs | (3) | (14) | — | — | (17) |
| Net borrowing with Affiliates | — | 880 | — | (880) | — |
| Net cash provided by (used in) financing activities | (42) | 823 | — | (880) | (99) |
| NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH | 230 | (80) | 6 | — | 156 |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH BEGINNING OF YEAR | — | 260 | 26 | — | 286 |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH END OF PERIOD | $230 | $ 180 | $ 32 | $ — | $ 442 |

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

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

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

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SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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

The following discussion should be read in conjunction with Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

OVERVIEW OF HOLDINGS

Holdings, the parent company of Kmart and Sears, was formed in connection with the March 24, 2005 merger of these two companies. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 1,250 full-line and specialty retail stores in the United States, operating as Kmart and Sears. Further, we operate a number of websites under the Sears.com and Kmart.com banners, which offer millions of products and provide the capability for our members and customers to engage in cross-channel transactions such as free store pickup; buy in store/ship to home; and buy online, return in store. We are also the home of Shop Your Way®, a free member-based social shopping platform that offers rewards, personalized services and a unique experience. Shop Your Way® connects all of the ways members shop - in store, at home, online and by phone.

We conduct our operations in two business segments: Kmart and Sears Domestic. The nature of operations conducted within each of these segments is discussed within the "Business Segments" section of Item 1 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2017. Our business segments have been determined in accordance with accounting standards regarding the determination, and reporting, of business segments.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

CONSOLIDATED RESULTS OF OPERATIONS

| millions, except per share data | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| REVENUES | | | | |
| Merchandise sales | $3,498 | $4,648 | $6,927 | $9,050 |
| Services and other | 867 | 1,015 | 1,739 | 2,007 |
| Total revenues | 4,365 | 5,663 | 8,666 | 11,057 |
| COSTS AND EXPENSES | | | | |
| Cost of sales, buying and occupancy - merchandise sales | 2,902 | 3,809 | 5,785 | 7,431 |
| Gross margin dollars - merchandise sales | 596 | 839 | 1,142 | 1,619 |
| Gross margin rate - merchandise sales | 17.0 % | 18.1 % | 16.5 % | 17.9 % |
| Cost of sales and occupancy - services and other | 492 | 594 | 980 | 1,189 |
| Gross margin dollars - services and other | 375 | 421 | 759 | 818 |
| Gross margin rate - services and other | 43.3 % | 41.5 % | 43.6 % | 40.8 % |
| Total cost of sales, buying and occupancy | 3,394 | 4,403 | 6,765 | 8,620 |
| Total gross margin dollars | 971 | 1,260 | 1,901 | 2,437 |
| Total gross margin rate | 22.2 % | 22.2 % | 21.9 % | 22.0 % |
| Selling and administrative | 1,369 | 1,484 | 2,636 | 2,987 |
| Selling and administrative expense as a percentage of total revenues | 31.4 % | 26.2 % | 30.4 % | 27.0 % |
| Depreciation and amortization | 83 | 92 | 170 | 187 |
| Impairment charges | 5 | 7 | 20 | 15 |
| Gain on sales of assets | (380 ) | (54 ) | (1,121 ) | (115 ) |
| Total costs and expenses | 4,471 | 5,932 | 8,470 | 11,694 |
| Operating income (loss) | (106 ) | (269 ) | 196 | (637 ) |
| Interest expense | (123 ) | (99 ) | (251 ) | (184 ) |
| Interest and investment loss | (12 ) | (13 ) | (14 ) | (17 ) |
| Other loss | — | (1 ) | — | — |
| Loss before income taxes | (241 ) | (382 ) | (69 ) | (838 ) |
| Income tax (expense) benefit | (10 ) | (13 ) | 62 | (28 ) |
| NET LOSS ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | $(251 ) | $(395 ) | $(7 ) | $(866 ) |
| NET LOSS PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS | | | | |
| Basic loss per share | $(2.34 ) | $(3.70 ) | $(0.07 ) | $(8.11 ) |
| Diluted loss per share | $(2.34 ) | $(3.70 ) | $(0.07 ) | $(8.11 ) |
| Basic weighted average common shares outstanding | 107.3 | 106.9 | 107.2 | 106.8 |
| Diluted weighted average common shares outstanding | 107.3 | 106.9 | 107.2 | 106.8 |

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SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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 of 70 basis points for both the 13- and 26- week periods ended July 29, 2017, did not impact comparable store sales for the 13 week period ended July 30, 2016, and resulted in a benefit of 10 basis points for the 26 week period July 30, 2016. In addition, comparable store sales have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period, which resulted in a benefit of approximately 60 basis points and 40 basis points, respectively, for the 13- and 26- week periods ended July 29, 2017. The change in unshipped sales reserves resulted in a negative impact of approximately 10 basis points for the 13 week period ended July 30, 2016 and did not have any impact on the 26 week period ended July 30, 2016.

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

We recorded a net loss attributable to Holdings' shareholders for the second quarter of $251 million, or $2.34 loss per diluted share, and $395 million, or $3.70 loss per diluted share, for 2017 and 2016, respectively. For the first six months, we recorded a net loss attributable to Holdings' shareholders of $7 million, or $0.07 loss per diluted share, and $866 million, or $8.11 loss per diluted share, in 2017 and 2016, respectively.

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

Adjusted EBITDA was determined as follows:

| millions | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| | July 29, 2017 | July 30, 2016 | July 29, 2017 | July 30, 2016 |
| Net loss attributable to Holdings per statement of operations | $(251) | $(395) | $(7) | $(866) |
| Income tax expense (benefit) | 10 | 13 | (62) | 28 |
| Interest expense | 123 | 99 | 251 | 184 |
| Interest and investment loss | 12 | 13 | 14 | 17 |
| Other loss | — | 1 | — | — |
| Operating income (loss) | (106) | (269) | 196 | (637) |
| Depreciation and amortization | 83 | 92 | 170 | 187 |
| Gain on sales of assets | (380) | (54) | (1,121) | (115) |
| Before excluded items | (403) | (231) | (755) | (565) |
| | | | | |
| Closed store reserve and severance | 128 | (18) | 204 | 69 |
| Pension expense | 246 | 72 | 291 | 144 |
| Other[1] | (24) | 1 | (9) | 9 |
| Amortization of deferred Seritage gain | (19) | (22) | (40) | (44) |
| Impairment charges | 5 | 7 | 20 | 15 |
| Adjusted EBITDA | $(67) | $(191) | $(289) | $(372) |

[1] The 13- and 26- week periods ended July 29, 2017 consisted of items associated with legal matters and transaction costs associated with strategic initiatives, while the 13- and 26- week periods ended July 30, 2016 consisted of expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

Adjusted EBITDA for our segments was as follows:

| | 13 Weeks Ended | | | | | |
|---|---|---|---|---|---|---|
| | July 29, 2017 | | | July 30, 2016 | | |
| millions | Kmart | Sears Domestic | Sears Holdings | Kmart | Sears Domestic | Sears Holdings |
| Operating income (loss) per statement of operations | $19 | $(125) | $(106) | $(9) | $(260) | $(269) |
| Depreciation and amortization | 14 | 69 | 83 | 15 | 77 | 92 |
| Gain on sales of assets | (79) | (301) | (380) | (44) | (10) | (54) |
| Before excluded items | (46) | (357) | (403) | (38) | (193) | (231) |
| | | | | | | |
| Closed store reserve and severance | 68 | 60 | 128 | (21) | 3 | (18) |
| Pension expense | — | 246 | 246 | — | 72 | 72 |
| Other[(1)] | (24) | — | (24) | — | 1 | 1 |
| Amortization of deferred Seritage gain | (2) | (17) | (19) | (5) | (17) | (22) |
| Impairment charges | 3 | 2 | 5 | 1 | 6 | 7 |
| Adjusted EBITDA | $(1) | $(66) | $(67) | $(63) | $(128) | $(191) |
| % to revenues | (0.1)% | (2.3)% | (1.5)% | (2.8)% | (3.7)% | (3.4)% |

| | 26 Weeks Ended | | | | | |
|---|---|---|---|---|---|---|
| | July 29, 2017 | | | July 30, 2016 | | |
| millions | Kmart | Sears Domestic | Sears Holdings | Kmart | Sears Domestic | Sears Holdings |
| Operating income (loss) per statement of operations | $469 | $(273) | $196 | $(125) | $(512) | $(637) |
| Depreciation and amortization | 27 | 143 | 170 | 34 | 153 | 187 |
| Gain on sales of assets | (676) | (445) | (1,121) | (90) | (25) | (115) |
| Before excluded items | (180) | (575) | (755) | (181) | (384) | (565) |
| | | | | | | |
| Closed store reserve and severance | 102 | 102 | 204 | 52 | 17 | 69 |
| Pension expense | — | 291 | 291 | — | 144 | 144 |
| Other[(1)] | (24) | 15 | (9) | 8 | 1 | 9 |
| Amortization of deferred Seritage gain | (6) | (34) | (40) | (9) | (35) | (44) |
| Impairment charges | 8 | 12 | 20 | 4 | 11 | 15 |
| Adjusted EBITDA | $(100) | $(189) | $(289) | $(126) | $(246) | $(372) |
| % to revenues | (3.4)% | (3.3)% | (3.3)% | (2.9)% | (3.7)% | (3.4)% |

[(1)] The 13- and 26- week periods ended July 29, 2017 consisted of items associated with legal matters and transaction costs associated with strategic initiatives, while the 13- and 26- week periods ended July 30, 2016 consisted of expenses associated with legal matters, transaction costs associated with strategic initiatives and other expenses.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

The following tables set forth results of operations on a GAAP and "As Adjusted" basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Condensed Consolidated Statements of Operations during the 13- and 26- week periods ended July 29, 2017 and July 30, 2016.

13 Weeks Ended July 29, 2017

| millions, except per share data | GAAP | Adjustments: Pension Expense | Closed Store Reserve, Store Impairments and Severance | Gain on Sales of Assets | Mark-to-Market Adjustments | Amortization of Deferred Seritage Gain | Other[1] | Tax Matters | As Adjusted |
|---|---|---|---|---|---|---|---|---|---|
| Gross margin impact | $971 | $— | $ 89 | $— | $ — | $ (19) | $— | $ — | $ 1,041 |
| Selling and administrative impact | 1,369 | (246) | (39) | — | — | — | 24 | — | 1,108 |
| Depreciation and amortization impact | 83 | — | (8) | — | — | — | — | — | 75 |
| Impairment charges impact | 5 | — | (5) | — | — | — | — | — | — |
| Gain on sales of assets impact | (380) | — | — | 315 | — | — | — | — | (65) |
| Operating loss impact | (106) | 246 | 141 | (315) | — | (19) | (24) | — | (77) |
| Interest and investment loss impact | (12) | — | — | — | 12 | — | — | — | — |
| Income tax expense impact | (10) | (92) | (53) | 118 | (5) | 7 | 9 | 101 | 75 |
| After tax impact | (251) | 154 | 88 | (197) | 7 | (12) | (15) | 101 | (125) |
| Diluted loss per share impact | $(2.34) | $1.44 | $ 0.82 | $(1.84) | $ 0.07 | $ (0.11) | $(0.14) | $ 0.94 | $(1.16) |

(1) Consisted of items associated with legal matters.

13 Weeks Ended July 30, 2016

| millions, except per share data | GAAP | Adjustments: Pension Expense | Closed Store Reserve, Store Impairments and Severance | Gain on Sales of Assets | Mark-to-Market Adjustments | Amortization of Deferred Seritage Gain | Other[1] | Tax Matters | As Adjusted |
|---|---|---|---|---|---|---|---|---|---|
| Gross margin impact | $1,260 | $— | $ 4 | $— | $ — | $ (22) | $— | $ — | $ 1,242 |
| Selling and administrative impact | 1,484 | (72) | 22 | — | — | — | (1) | — | 1,433 |
| Depreciation and amortization impact | 92 | — | (1) | — | — | — | — | — | 91 |
| Impairment charges impact | 7 | — | (7) | — | — | — | — | — | — |
| Gain on sales of assets impact | (54) | — | — | 21 | — | — | — | — | (33) |
| Operating loss impact | (269) | 72 | (10) | (21) | — | (22) | 1 | — | (249) |
| Interest and investment loss impact | (13) | — | — | — | 14 | — | — | — | 1 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Income tax expense impact | (13) | (27) | 4 | 8 | (5) | 8 | — | 156 | 131 |
| After tax impact | (395) | 45 | (6) | (13) | 9 | (14) | 1 | 156 | (217) |
| Diluted loss per share impact | $(3.70) | $0.42 | $ (0.05) | $(0.12) | $ 0.08 | $ (0.13) | $0.01 | $ 1.46 | $(2.03) |

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

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

| | 26 Weeks Ended July 29, 2017 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Adjustments | | | | | | | | |
| millions, except per share data | GAAP | Pension Expense | Closed Store Reserve, Store Impairments and Severance | Gain on Sale of Trade name | Gain on Sales of Assets | Mark-to-Market Adjustments | Amortization of Deferred Seritage Gain | Other[1] | Tax Matters | As Adjusted |
| Gross margin impact | $1,901 | $— | $ 104 | $— | $— | $ — | $ (40 ) | $— | $— | $1,965 |
| Selling and administrative impact | 2,636 | (291 ) | (100 ) | — | — | — | — | 9 | — | 2,254 |
| Depreciation and amortization impact | 170 | — | (14 ) | — | — | — | — | — | — | 156 |
| Impairment charges | 20 | — | (20 ) | — | — | — | — | — | — | — |
| Gain on sales of assets impact | (1,121 ) | — | — | 492 | 504 | — | — | — | — | (125 ) |
| Operating income impact | 196 | 291 | 238 | (492 ) | (504 ) | — | (40 ) | (9 ) | — | (320 ) |
| Interest and investment loss impact | (14 ) | — | — | — | — | 17 | — | — | — | 3 |
| Income tax benefit impact | 62 | (109 ) | (89 ) | 185 | 189 | (6 ) | 15 | 3 | (37 ) | 213 |
| After tax impact | (7 ) | 182 | 149 | (307 ) | (315 ) | 11 | (25 ) | (6 ) | (37 ) | (355 ) |
| Diluted loss per share impact | $(0.07 ) | $1.70 | $ 1.39 | $(2.86) | $(2.94) | $ 0.10 | $ (0.23 ) | $(0.06) | $(0.34) | $(3.31 ) |

[1] Consisted of expenses associated with legal matters and transaction costs associated with strategic initiatives.

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

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Diluted loss per share impact | $(8.11) | $0.85 | $ 0.52 | $(0.27) | $ 0.11 | $ (0.26) | $0.06 | $ 3.20 | $(3.90) |

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

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

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

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

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

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

- Pension expense – Contributions to our pension plans remain a significant use of our cash on an annual basis. Cash contributions to our pension and postretirement plans are separately disclosed on the cash flow statement. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, we have a legacy pension obligation for past service performed by Kmart and Sears associates. The annual pension expense included in our statement of operations related to these legacy domestic pension plans was relatively minimal in years prior to 2009. However, due to the severe decline in the capital markets that occurred in the latter part of 2008, and the resulting abnormally low interest rates, which continue to persist, our domestic pension expense was $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.

In conjunction with executing an irrevocable agreement to purchase a group annuity contract in May 2017, the Company recorded a non-cash charge of $200 million during the second quarter of 2017 for losses previously accumulated in other comprehensive income (loss), which were recognized through the statement of operations upon settlement.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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

| millions | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| Components of net periodic expense: | | | | |
| Interest cost | $44 | $ 57 | $95 | $ 114 |
| Expected return on plan assets | (46 ) | (51 ) | (103 ) | (101 ) |
| Recognized net loss and other | 248 | 66 | 299 | 131 |
| Net periodic expense | $246 | $ 72 | $291 | $ 144 |

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

Actuarial gains and losses occur when actual experience differs from the estimates used to allocate the change in value of pension plans to expense throughout the year or when assumptions change, as they may each year. Significant factors that can contribute to the recognition of actuarial gains and losses include changes in discount rates used to remeasure pension obligations on an annual basis or upon a qualifying remeasurement, differences between actual and expected returns on plan assets and other changes in actuarial assumptions. Management believes these actuarial gains and losses are primarily financing activities that are more reflective of changes in current conditions in global financial markets (and in particular interest rates) that are not directly related to the underlying business and that do not have an immediate, corresponding impact on the benefits provided to eligible retirees. For further information on the actuarial assumptions and plan assets referenced above, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Application of Critical Accounting Policies and Estimates - Defined Benefit Pension Plans, and Note 7 of Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

- Closed store reserve and severance – We are transforming our Company to a less asset-intensive business model. Throughout this transformation, we continue to make choices related to our stores, which could result in sales, closures, lease terminations or a variety of other decisions.
- Impairment charges – Accounting standards require the Company to evaluate the carrying value of fixed assets, goodwill and intangible assets for impairment. As a result of the Company's analysis, we have recorded impairment charges related to certain fixed asset and indefinite-lived intangible asset balances.
- Gains on sales of assets – We have recorded significant gains on sales of assets, as well as gains on sales of joint venture interests, which were primarily attributable to several real estate transactions, including gains recognized due to recaptures by Seritage and the JVs. Management considers these gains on sale of assets to result from investing decisions rather than ongoing operations.
- Mark-to-market adjustments – We elected the fair value option for the equity method investment in Sears Canada, and the change in fair value is recorded in interest and investment income in the Condensed Consolidated Statement of Operations. Management considers activity related to our retained investment in Sears Canada to result from investing decisions rather than ongoing operations. Furthermore, we do not consider the short term fluctuations in Sears

Canada's stock price useful in assessing our operating performance.

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- 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 Condensed Consolidated Statement of Operations, over the lease term. Management considers the amortization of the deferred Seritage gain to result from investing decisions rather than ongoing operations.
- Other – transaction costs associated with strategic initiatives, items associated with legal matters and other expenses.
- Domestic tax matters – In 2011, we recorded a non-cash charge to establish a valuation allowance against substantially all of our domestic deferred tax assets. Accounting rules generally require that a valuation reserve be established when income has not been generated over a three-year cumulative period to support the deferred tax asset. While an accounting loss was recorded, we believe no economic loss has occurred as these net operating losses and tax benefits remain available to reduce future taxes as income is generated in subsequent periods. As this valuation allowance has a significant impact on the effective tax rate, we have adjusted our results to reflect a standard effective tax rate for the Company beginning in fiscal 2011 when the valuation allowance was first established.

13-week period ended July 29, 2017 compared to the 13-week period ended July 30, 2016

Revenues and Comparable Store Sales

Total revenues decreased $1.3 billion to $4.4 billion for the second quarter of 2017 compared to the prior year second quarter, primarily driven by the decrease in merchandise sales of $1.2 billion. The decline in merchandise sales was primarily driven by having fewer Kmart and Sears Full-line stores in operation, which accounted for approximately $771 million of the decline, as well as an 11.5% decline in comparable store sales during the quarter, which accounted for approximately $422 million of the decline. Services and other revenues declined $148 million for the second quarter of 2017, primarily driven by a decline in service-related revenues of approximately $80 million, as well as a decline in revenues from Sears Hometown and Outlet Stores, Inc. ("SHO") of approximately $35 million.

Kmart comparable store sales declined 9.4% during the second quarter primarily driven by declines in the pharmacy, grocery & household, drug store and consumer electronics categories. Sears Domestic comparable store sales decreased 13.2% during the second quarter, primarily driven by decreases in the home appliances, apparel, lawn & garden and consumer electronics categories.

Gross Margin

Total gross margin decreased $289 million to $971 million for the second quarter of 2017, as compared to the prior year second quarter, primarily due to the above noted decline in sales, as well as a decline in gross margin rate for merchandise sales. Gross margin for the second quarter of 2017 included charges related to store closure of $89 million, compared to $4 million for the second quarter of 2016. Gross margin for the quarter also included credits of $19 million and $22 million in 2017 and 2016, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction.

Kmart's gross margin rate for the second quarter declined 180 basis points compared to the prior year second quarter, while Sears Domestic's gross margin rate improved 70 basis points for the quarter. Gross margin for Kmart and Sears Domestic were negatively impacted by expenses associated with store closures. Excluding the impact of significant items noted in our Adjusted Earnings per Share tables, Kmart's gross margin rate would have improved 280 basis points, while Sears Domestic's gross margin rate would have improved 130 basis points. The improvement in Kmart's gross margin rate was primarily due to margin rate improvement in the apparel category. The improvement in Sears Domestic's gross margin rate was primarily driven by improvement in the apparel category, partially offset by a decline in the home appliances category. The margin rate improvement in both segments benefited from an overall decline in overall markdowns.

In addition, as a result of the Seritage and JV transactions, the second quarter of 2017 included additional rent expense of approximately $44 million while the second quarter of 2016 included additional rent expense of

approximately $48 million. Due to the structure of the leases, we expect that our cash rent obligations to Seritage and the joint venture partners will decline, over time, as space in these stores is recaptured. From the inception of the Seritage transaction to date, we have received recapture notices on 36 properties and also exercised our right to terminate the lease on 56 properties, which is estimated to reduce our rent payments by approximately $52 million on an annual basis.

Selling and Administrative Expenses

Selling and administrative expenses decreased $115 million in the second quarter of 2017 compared to the prior year, as expense reductions realized as a result of the strategic actions to improve our operational efficiencies and reduce costs were partially offset by a non-cash charge of $200 million associated with the pension annuity purchase completed in May 2017. (See Note 5 of Notes to Condensed Consolidated Financial Statements for additional information regarding the non-cash charge.)

The second quarters of 2017 and 2016 included significant items related to our pension plan, store closings and severance, legal matters and transaction costs associated with strategic initiatives which aggregated to expense of $261 million and $51 million, respectively. Excluding these items, selling and administrative expenses declined $325 million from the prior year quarter primarily due to a decrease in payroll expense. In addition, advertising expense also declined as we shift away from traditional advertising to use of Shop Your Way® points expense, which is included within gross margin.

Our selling and administrative expenses as a percentage of total revenues ("selling and administrative expense rate") was 31.4% for the second quarter of 2017, compared to 26.2% in the prior year, and increased due to the decline in revenues, partially offset by the overall decrease in expenses noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased by $9 million in the second quarter of 2017 to $83 million, primarily due to having fewer assets to depreciate.

Impairment Charges

We recorded impairment charges of $5 million and $7 million during the second quarter of 2017 and 2016, respectively, related to the impairment of long-lived assets. Impairment charges recorded are described further in Note 3 of Notes to Condensed Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets for the quarter of $380 million in 2017 and $54 million in 2016. The gains recorded in the second quarter of 2017 included $262 million recognized on the sale of nine Sears Full-line stores and one Kmart store and $53 million of gains as a result of recapture activity and one store that qualified for sales recognition and sale-leaseback accounting in the second quarter. The gains recorded during the second quarter of 2016 included a gain of $12 million recognized on the sale of one distribution center, as well as gains of $9 million related to recapture activity of JV properties which had previously been deferred. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

The Company reported an operating loss of $106 million in the second quarter of 2017 compared to $269 million in the second quarter of 2016. Operating loss for the second quarter of 2017 and 2016 included significant items noted above which aggregated to operating expense of $29 million and $20 million, respectively. Excluding these items, we would have reported an operating loss of $77 million and $249 million for the second quarter of 2017 and 2016, respectively. The improvement in adjusted operating loss in 2017 was primarily driven by the overall decline in selling and administrative expenses, partially offset by the decline in gross margin dollars.

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Interest and Investment Loss

We recorded interest and investment loss of $12 million during the second quarter of 2017 compared to $13 million during the second quarter of 2016. The second quarter of 2017 and 2016 included a loss of $12 million and $14 million, respectively, related to our equity investment in Sears Canada.

Income Taxes

Our effective tax rate for the second quarter of 2017 was an expense rate of 4.1% compared to an expense rate of 3.4% in the prior year second quarter. The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2017 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. During the first quarter of 2017, the Company realized a significant tax benefit on the reversal of deferred taxes related to the sale of the Craftsman trade name. During the second quarter of 2017, the Company realized a tax benefit on the reversal of deferred taxes related to indefinite-life assets associated with property sold during the quarter. In addition, the second quarters of 2017 and 2016 were negatively impacted by foreign branch taxes and state income taxes.

26-week period ended July 29, 2017 compared to the 26-week period ended July 30, 2016

Revenues and Comparable Store Sales

Total revenues decreased $2.4 billion to $8.7 billion for the first half of 2017, as compared to revenues of $11.1 billion for the first half of 2016. The decrease in revenue was primarily driven by the effect of having fewer Kmart and Sears Full-line stores in operation, which accounted for $1.3 billion of the decline, as well as a decrease in comparable store sales of 11.7% during the first half of 2017, which accounted for $839 million of the revenue decline. Services and other revenues declined $268 million during the first half of 2017 as compared to the first half of 2016, primarily driven by a decline in service-related revenues of approximately $126 million, as well as a decline in revenues from SHO of approximately $88 million during the first half of 2017 compared to the first half of 2016.

Kmart comparable store sales decreased 10.3%, with declines experienced in the grocery & household, pharmacy, apparel, home and consumer electronics categories. Sears Domestic comparable store sales decreased 12.8% primarily driven by decreases in the home appliances, apparel, lawn & garden and consumer electronics categories.

Gross Margin

Total gross margin decreased $536 million to $1.9 billion for the first half of 2017, as compared to the prior year, primarily due to the above noted decline in sales, as well as a decline in gross margin rate for merchandise sales. Gross margin for the first half of 2017 included charges related to store closure of $104 million, compared to $64 million for the first half of 2016. Gross margin for the first half also included credits of $40 million and $44 million in 2017 and 2016, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction.

As compared to the prior year period, Kmart's gross margin rate for the first half of 2017 declined 150 basis points, while Sears Domestic's gross margin rate improved 30 basis points. Gross margin for Kmart and Sears Domestic were negatively impacted by expenses associated with store closures. Excluding the impact of significant items noted in our Adjusted Earnings per Share tables, Kmart's gross margin rate would have declined 20 basis points, while Sears Domestic's gross margin rate would have improved 60 basis points. The decline in Kmart's gross margin rate was primarily driven by declines experienced in the grocery & household and pharmacy categories, while the improvement in Sears Domestic's gross margin rate was primarily driven by improvement in the apparel category, partially offset by a decline in the home appliances category.

In addition, as a result of the Seritage and JV transactions, the first half of 2017 and 2016 included additional rent expense of approximately $89 million and $102 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 36 properties and also exercised our right to terminate the lease on 56 properties, which is estimated to reduce our rent payments by approximately $52 million on an annual basis.

Selling and Administrative Expenses

Selling and administrative expenses decreased $351 million in the first half of 2017 compared to the first half of 2016, as expense reductions realized as a result of the strategic actions to improve our operational efficiencies and reduce costs were partially offset by a non-cash charge of $200 million associated with the pension annuity purchase completed in May 2017. (See Note 5 of Notes to Condensed Consolidated Financial Statements for additional information regarding the non-cash charge.)

The first half of 2017 and 2016 included significant items related to our pension plan, store closings and severance, legal matters and transaction costs associated with strategic initiatives which aggregated to expense of $382 million and $158 million, respectively. Excluding these items, selling and administrative expenses in 2017 declined $575 million from the first half of the prior year primarily due to a decrease in payroll expense. In addition, advertising expense also declined as we shift away from traditional advertising to use of Shop Your Way® points expense, which is included within gross margin.

Our selling and administrative expense rate was 30.4% for the first half of 2017, compared to 27.0% in the prior year, and increased as the decrease in expenses noted above was more than offset by the decline in revenues.

Depreciation and Amortization

Depreciation and amortization expense decreased by $17 million in the first half of 2017 to $170 million, primarily due to having fewer assets to depreciate.

Impairment Charges

We recorded impairment charges of $20 million and $15 million during the first half of 2017 and 2016, respectively, related to the impairment of long-lived assets. Impairment charges recorded are described further in Note 3 of Notes to Condensed Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets of $1.1 billion and $115 million for the first half of 2017 and 2016, respectively. The gains recorded in the first half of 2017 included a gain of $492 million recognized on the Craftsman Sale, in addition to $386 million recognized on the sale of 12 Sears Full-line stores and two Kmart stores and $118 million of gains as a result of recapture and lease termination activity and two stores that qualified for sales recognition and sale-leaseback accounting in the first half. The gains recorded in the first half of 2016 included gains of $35 million as a result of recapture activity, as well as a gain of $12 million recognized on the sale of one distribution center. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

The Company reported an operating income of $196 million in the first half of 2017 as compared to an operating loss of $637 million in the first half of 2016. Operating income (loss) for the first half of 2017 and 2016 included significant items noted above which aggregated to operating income of $516 million and operating expense of $151 million, respectively. Excluding these items, we would have reported an operating loss of $320 million and $486 million for the first half of 2017 and 2016, respectively. The decrease in adjusted operating loss in 2017 was primarily due to the decline in selling and administrative expenses, partially offset by the decline in gross margin dollars.

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Interest and Investment Loss

We recorded an interest and investment loss of $14 million during the first half of 2017 compared to $17 million during the first half of 2016. The first half of 2017 and 2016 included a loss of $17 million and $20 million, respectively, related to our equity investment in Sears Canada.

Income Taxes

Our effective tax rate for the first half of 2017 was a benefit rate of 89.9% compared to an expense rate of 3.3% in for the first half of 2016. The application of the requirements for accounting for income taxes in interim periods, after consideration of our valuation allowance, causes a significant variation in the typical relationship between income tax expense and pretax income. Our tax rate in 2017 continues to reflect the effect of not recognizing the benefit of current period losses in certain domestic and foreign jurisdictions where it is not more likely than not that such benefits would be realized. During the first half of 2017, the Company realized a significant tax benefit on the reversal of deferred taxes related to the sale of the Craftsman trade name. In addition, the first half of 2017 and 2016 were negatively impacted by foreign branch taxes and state income taxes.

SEGMENT OPERATIONS

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

Kmart

Kmart results and key statistics were as follows:

| millions, except number of stores | 13 Weeks Ended July 29, 2017 | 13 Weeks Ended July 30, 2016 | 26 Weeks Ended July 29, 2017 | 26 Weeks Ended July 30, 2016 |
|---|---|---|---|---|
| Total revenues | $1,475 | $2,221 | $2,968 | $4,360 |
| | | | | |
| Cost of sales, buying and occupancy | 1,195 | 1,760 | 2,425 | 3,495 |
| Gross margin dollars | 280 | 461 | 543 | 865 |
| Gross margin rate | 19.0 % | 20.8 % | 18.3 % | 19.8 % |
| | | | | |
| Selling and administrative | 323 | 498 | 715 | 1,042 |
| Selling and administrative expense as a percentage of total revenues | 21.9 % | 22.4 % | 24.1 % | 23.9 % |
| Depreciation and amortization | 14 | 15 | 27 | 34 |
| Impairment charges | 3 | 1 | 8 | 4 |
| Gain on sales of assets | (79) | (44) | (676) | (90) |
| Total costs and expenses | 1,456 | 2,230 | 2,499 | 4,485 |
| Operating income (loss) | $19 | $(9) | $469 | $(125) |
| Adjusted EBITDA | $(1) | $(63) | $(100) | $(126) |
| Number of stores | | | 610 | 883 |

13-week period ended July 29, 2017 compared to the 13-week period ended July 30, 2016

Revenues and Comparable Store Sales

For the quarter, Kmart's revenues decreased by $746 million to $1.5 billion in 2017, primarily due to the effect of having fewer stores in operation, which accounted for approximately $592 million of the decline, as well as the decrease in comparable store sales of 9.4%, which accounted for approximately $152 million of the decline.

Comparable store sales declined 9.4%, primarily driven by declines in the pharmacy, grocery & household, drug store and consumer electronics categories.

Gross Margin

For the quarter, Kmart generated total gross margin dollars of $280 million in 2017 compared to $461 million in 2016. Gross margin for the second quarter included charges of $68 million and $3 million in 2017 and 2016, respectively, related to store closures. Gross margin for the second quarter also included credits of $2 million and $5 million in 2017 and 2016, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction.

Kmart's gross margin rate for the quarter declined 180 basis points to 19.0% in 2017 from 20.8% in 2016. Excluding the impact of significant items recorded in gross margin during the quarter, Kmart's gross margin rate would have improved 280 basis points. The improvement in Kmart's gross margin rate was primarily due to margin rate improvement in the apparel category due to an overall decline in markdowns.

In addition, as a result of the Seritage and JV transactions, the second quarter of 2017 and 2016 included additional rent expense of approximately $5 million and $8 million, respectively.

Selling and Administrative Expenses

For the quarter, Kmart's selling and administrative expenses decreased $175 million in 2017 as compared to the second quarter in 2016. Selling and administrative expenses for the second quarter of 2017 and 2016 were impacted by significant items related to store closures, as well as legal matters, which aggregated to income of $24 million in 2017 and expense of $24 million in 2016. Excluding these items, selling and administrative expenses decreased $175 million primarily due to decreases in payroll and advertising expenses.

Kmart's selling and administrative expense rate for the quarter was 21.9% in 2017 and 22.4% in 2016 and decreased due to the overall decrease in expenses noted above, partially offset by the decline in revenues.

Gain on Sales of Assets

Kmart recorded a total gain on sales of assets for the quarter of $79 million and $44 million in 2017 and 2016, respectively. The gains recorded in the second quarter of 2017 included $12 million recognized on the sale of one Kmart store and $3 million of gains as a result of recapture activity. The gains recorded during the second quarter of 2016 included a gain of $12 million recognized on the sale of one distribution center. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

For the quarter, Kmart recorded an operating income of $19 million in 2017 and operating loss of $9 million in 2016. Operating income for the second quarter of 2017 included significant items noted above which aggregated to operating expense of $34 million. Operating loss for the second quarter of 2016 included significant items noted above which aggregated to operating expense of $37 million. Excluding these items, Kmart would have reported an operating income of $53 million for the second quarter of 2017 compared to an operating loss of $46 million for the second quarter 2016. The improvement in Kmart's adjusted operating income (loss) was primarily driven by the decrease in selling and administrative expenses, partially offset by the decline in gross margin dollars.

26-week period ended July 29, 2017 compared to the 26-week period ended July 30, 2016

Revenues and Comparable Store Sales

For the first half of 2017, Kmart's revenues decreased by $1.4 billion to $3.0 billion in 2017, primarily due to the effect of having fewer stores in operation, which accounted for approximately $1.1 billion of the decline, as well as the decrease in comparable store sales, which accounted for approximately $330 million of the decline.

Comparable store sales decreased 10.3%, with declines experienced in the grocery & household, pharmacy, apparel, home and consumer electronics.

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Gross Margin

For the first half of 2017, Kmart generated $543 million in gross margin compared to $865 million in the first half of 2016. The decrease in Kmart's gross margin dollars is due to a decrease in revenues, as well as a decrease in gross margin rate. Gross margin for the first half of the year included charges of $78 million and $54 million in 2017 and 2016, respectively, related to store closures. Gross margin for the first half of the year also included credits of $6 million and $9 million in 2017 and 2016, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction.

Kmart's gross margin rate for the first half of the year declined 150 basis points to 18.3% in 2017 from 19.8% in 2016. Excluding the impact of significant items recorded in gross margin during the first half of the year, Kmart's gross margin rate would have declined 20 basis points, with the decrease primarily driven by declines in the grocery & household and pharmacy categories.

In addition, as a result of the Seritage and JV transactions, the first half of 2017 and 2016 included additional rent expense of approximately $11 million and $19 million, respectively.

Selling and Administrative Expenses

For the first half of 2017, Kmart's selling and administrative expenses decreased $327 million as compared to the first half of 2016. Selling and administrative expenses for the first half of 2017 and 2016 were impacted by significant items related to store closings and severance, as well as legal matters, which netted to $0 million in 2017 and aggregated to expense of $6 million in 2016. Excluding these items, selling and administrative expenses decreased $321 million primarily due to decreases in payroll and advertising expenses.

Kmart's selling and administrative expense rate for the first half was 24.1% and 23.9% in 2017 and 2016, respectively, and increased primarily due to the decline in revenues, partially offset by the overall decrease in expenses noted above.

Gain on Sales of Assets

Kmart recorded a total gain on sales of assets for the first half of $676 million and $90 million in 2017 and 2016, respectively. The gains recorded in the first half of 2017 included a gain of $492 million recognized on the Craftsman Sale, in addition to $40 million recognized on the sale of two Kmart stores and $30 million of gains as a result of recapture and lease termination activity. The gains recorded during the first half of 2016 included gains of $22 million related to recapture activity, as well as a gain of $12 million recognized on the sale of one distribution center. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Income (Loss)

For the first half of the year, Kmart recorded an operating income of $469 million in 2017, compared to an operating loss of $125 million in 2016. Operating income for the first half included significant items noted above which aggregated to operating income of $477 million in 2017 and operating expense of $25 million in 2016. Excluding these items, Kmart would have reported an operating loss of $8 million and $100 million for the first half of 2017 and 2016, respectively. The decrease in Kmart's adjusted operating loss was primarily driven by the decrease in selling and administrative expenses, partially offset by the decline in gross margin dollars.

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13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

Sears Domestic

Sears Domestic results and key statistics were as follows:

| | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| millions, except number of stores | July 29, 2017 | July 30, 2016 | July 29, 2017 | July 30, 2016 |
| Total revenues | $2,890 | $3,442 | $5,698 | $6,697 |
| Cost of sales, buying and occupancy | 2,199 | 2,643 | 4,340 | 5,125 |
| Gross margin dollars | 691 | 799 | 1,358 | 1,572 |
| Gross margin rate | 23.9 % | 23.2 % | 23.8 % | 23.5 % |
| Selling and administrative | 1,046 | 986 | 1,921 | 1,945 |
| Selling and administrative expense as a percentage of total revenues | 36.2 % | 28.6 % | 33.7 % | 29.0 % |
| Depreciation and amortization | 69 | 77 | 143 | 153 |
| Impairment charges | 2 | 6 | 12 | 11 |
| Gain on sales of assets | (301 ) | (10 ) | (445 ) | (25 ) |
| Total costs and expenses | 3,015 | 3,702 | 5,971 | 7,209 |
| Operating loss | $(125 ) | $(260 ) | $(273 ) | $(512 ) |
| Adjusted EBITDA | $(66 ) | $(128 ) | $(189 ) | $(246 ) |
| Number of: | | | | |
| Full-line stores | | | 619 | 683 |
| Specialty stores | | | 21 | 26 |
| Total Sears Domestic Stores | | | 640 | 709 |

13-week period ended July 29, 2017 compared to the 13-week period ended July 30, 2016

Revenues and Comparable Store Sales

For the quarter, Sears Domestic's revenues decreased by $552 million to $2.9 billion. The decline in revenue was primarily driven by a decrease in comparable store sales of 13.2%, which accounted for $270 million of the decline, and the effect of having fewer Full-line stores in operation, which accounted for approximately $179 million of the decline.

Comparable store sales for the quarter declined primarily due to decreases in the home appliances, apparel, lawn & garden and consumer electronics categories.

Gross Margin

For the quarter, Sears Domestic generated gross margin dollars of $691 million in 2017, compared to $799 million in 2016. Gross margin for the second quarter included charges of $21 million and $1 million in 2017 and 2016, respectively, related to store closures. Gross margin for the second quarter also included credits of $17 million in both 2017 and 2016 related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction.

Sears Domestic's gross margin rate for the quarter improved 70 basis points to 23.9% in 2017 from 23.2% in 2016. Excluding the impact of significant items recorded in gross margin during the quarter, Sears Domestic's gross margin rate would have improved 130 basis points primarily driven by improvement in the apparel category due to an overall decline in markdowns, partially offset by a decline in the home appliances category.

In addition, as a result of the Seritage and JV transactions, the second quarter of 2017 and 2016 included additional rent expense of approximately $39 million and $40 million, respectively.

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Selling and Administrative Expenses

For the quarter, Sears Domestic's selling and administrative expenses increased $60 million in 2017 as compared to the prior year. Selling and administrative expenses for the second quarter of 2017 and 2016 were impacted by significant items related to pension, store closures and severance and transactions costs associated with strategic initiatives, which aggregated to expense of $285 million and $75 million, respectively. The second quarter of 2017 included a non-cash charge of $200 million associated with the pension annuity purchase completed in May 2017. Excluding these items, selling and administrative expenses decreased $150 million primarily due to decreases in payroll expense and advertising expenses.

Sears Domestic's selling and administrative expense rate for the quarter was 36.2% in 2017 and 28.6% in 2016 and increased primarily due to the decline in revenues, as well as the overall increase in expenses noted above.

Gain on Sales of Assets

Sears Domestic recorded a total gain on sales of assets for the quarter of $301 million and $10 million in 2017 and 2016, respectively. The gains recorded in the second quarter of 2017 included $250 million recognized on the sale of nine Sears Full-line stores and $50 million of gains as a result of recapture activity and one store that qualified for sales recognition and sale-leaseback accounting in the second quarter. The gains recorded during the second quarter of 2016 included gains of $9 million related to recapture activity. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

For the quarter, Sears Domestic reported an operating loss of $125 million and $260 million in 2017 and 2016, respectively. Sears Domestic's operating loss for the second quarter of 2017 and 2016 included significant items which aggregated to operating income of $5 million and operating expense of $57 million, respectively. Excluding these items, we would have reported an operating loss of $130 million and $203 million for the second quarter of 2017 and 2016, respectively. The decrease in adjusted operating loss in 2017 was primarily driven by the above noted decrease in selling and administrative expenses, partially offset by a decrease in gross margin.

26-week period ended July 29, 2017 compared to the 26-week period ended July 30, 2016

Revenues and Comparable Store Sales

For the first half of 2017, Sears Domestic's revenues decreased by $999 million to $5.7 billion. The decline in revenue was primarily driven by a decrease in comparable store sales of 12.8%, which accounted for approximately $509 million of the decline, and the effect of having fewer Full-line stores in operation, which accounted for approximately $267 million of the decline.

Comparable store sales for the first half of 2017 declined primarily due to decreases in the home appliances, apparel, lawn & garden and consumer electronics categories.

Gross Margin

For the first half of the year, Sears Domestic generated gross margin dollars of $1.4 billion and $1.6 billion in 2017 and 2016, respectively. Gross margin for the first half of 2017 and 2016 included credits of $34 million and $35 million, respectively, related to the amortization of the deferred gain on sale of assets associated with the Seritage transaction. Gross margin for the first half of the year also included charges of $26 million and $10 million in 2017 and 2016, respectively, related to store closures.

Sears Domestic's gross margin rate for the first half of the year improved 30 basis points to 23.8% in 2017 from 23.5% in 2016. Excluding the impact of significant items recorded in gross margin during the first half of 2017 and 2016, Sears Domestic's gross margin rate would have improved 60 basis points primarily driven by improvement in the apparel category, partially offset by a decline in the home appliances category.

In addition, as a result of the Seritage and JV transactions, the first half of 2017 and 2016 included additional rent expense of approximately $78 million and $83 million, respectively.

Selling and Administrative Expenses

For the first half of the year, Sears Domestic's selling and administrative expenses decreased $24 million in 2017 as compared to the prior year. Selling and administrative expenses for the first half of 2017 and 2016 were impacted by significant items related to pension, store closures and severance and transactions costs associated with strategic initiatives, which aggregated to expense of $382 million and $152 million, respectively. The first half of 2017 included a non-cash charge of $200 million associated with the pension annuity purchase completed in May 2017. Excluding these items, selling and administrative expenses decreased $254 million in the first half of 2017 primarily due to decreases in payroll and advertising expenses.

Sears Domestic's selling and administrative expense rate for the first half of the year was 33.7% in 2017 and 29.0% in 2016 and increased as a result of the decline in revenues, partially offset by the overall decrease in expenses noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased by $10 million in the first half of 2017 to $143 million, primarily due to having fewer assets to depreciate.

Gain on Sales of Assets

Sears Domestic recorded a total gain on sales of assets of $445 million and $25 million for the first half of 2017 and 2016, respectively. The gains recorded in the first half of 2017 included gains of $346 million recognized on the sale of 12 Sears Full-line stores and $88 million of gains as a result of recapture and lease termination activity and two stores that qualified for sales recognition and sale-leaseback accounting in the first half. The gains recorded during the first half of 2016 included gains of $13 million related to recapture activity. See Note 3 of Notes to Condensed Consolidated Financial Statements for further discussion of the gain on sales of assets.

Operating Loss

For the first half of the year, Sears Domestic reported an operating loss of $273 million and $512 million in 2017 and 2016, respectively. Sears Domestic's operating loss for the first half of 2017 and 2016 included significant items which aggregated to operating income of $39 million and operating expense of $126 million, respectively. Excluding these items, we would have reported an operating loss of $312 million and $386 million for the first half of 2017 and 2016, respectively. The decrease in adjusted operating loss in 2017 was primarily driven by the above noted decrease in selling and administrative, partially offset by a decrease in gross margin.

ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION

Cash Balances

Our cash and cash equivalents include all highly liquid investments with original maturities of three months or less at the date of purchase. Our cash balances as of July 29, 2017, July 30, 2016 and January 28, 2017 are detailed in the following table.

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Cash and equivalents | $ 121 | $ 160 | $ 196 |
| Cash posted as collateral | 4 | 3 | 3 |
| Credit card deposits in transit | 87 | 113 | 87 |
| Total cash and cash equivalents | 212 | 276 | 286 |
| Restricted cash | 230 | — | — |
| Total cash balances | $ 442 | $ 276 | $ 286 |

We had total cash balances of $442 million at July 29, 2017, including restricted cash of $230 million, compared to $276 million at July 30, 2016 and $286 million at January 28, 2017.

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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 $61 million, $41 million and $29 million as of July 29, 2017, July 30, 2016 and January 28, 2017, respectively.

Operating Activities

During the first half of 2017, we used net cash in operating activities of $1.1 billion compared to $0.6 billion in the first half of 2016. 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 more cash in operations for the first half of 2017 compared to the prior year primarily due to declines in merchandise payables and other liabilities.

Merchandise inventories were $3.4 billion and $4.7 billion at July 29, 2017 and July 30, 2016, respectively, while merchandise payables were $0.7 billion and $1.3 billion at July 29, 2017 and July 30, 2016, respectively. Our inventory balances at July 29, 2017 decreased approximately $1.3 billion from the prior year second quarter 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, tools and consumer electronics categories. Kmart inventory also decreased in virtually all categories, with the most notable decreases in the apparel, drugstore, home and grocery & household categories.

Investing Activities

During the first half of 2017, we generated net cash flows from investing activities of $1.4 billion, which consisted of cash proceeds from the Craftsman Sale of $572 million, from the sale of properties and investments of $569 million and from the sale of receivables of $293 million, partially offset by cash used for capital expenditures of $41 million. During the first half of 2016, we generated net cash flows from investing activities of $139 million, which consisted of cash proceeds from the sale of properties and investments of $214 million, partially offset by cash used for capital expenditures of $75 million.

Financing Activities

For the first half of 2017, we used net cash flows in financing activities of $99 million, which primarily consisted of repayments of debt of $717 million, primarily repayments of amounts outstanding under the Company's term loan, the 2016 Secured Loan Facility and the 2017 Secured Loan Facility, partially offset by proceeds of $330 million from the Line of Credit Loans, as well as an increase in short-term borrowings of $216 million. During the first half of 2016, we generated cash flows from financing activities of $539 million, which consisted of net proceeds from the 2016 Term Loan of $722 million, as well as net cash proceeds from the 2016 Secured Loan Facility of $485 million, which were partially offset by a decrease in short-term borrowings of $633 million and debt repayments of $35 million.

Liquidity

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

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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"), initially 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.

Other actions announced during the fourth quarter of 2016 included a new Letter of Credit and Reimbursement Agreement (the "LC Facility Agreement"), originally providing for up to a $500 million (of which $271 million was committed at July 29, 2017) 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.

During fiscal year 2017, the Company continued to take actions to improve our liquidity. 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 with $407 million available to borrow at July 29, 2017 after giving consideration to existing outstanding borrowings. 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 $934 million was utilized at July 29, 2017) 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 2 of Notes to Condensed Consolidated Financial Statements). Other options available to us include refinancing existing debt, securitizing assets and additional real estate loans, which we have successfully executed in the past. Further, in fiscal 2017, the Company issued commercial paper to meet short-term liquidity needs, with the maximum amount outstanding during this time of $160 million, with no commercial paper outstanding at July 29, 2017.

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. As described above, the PBGC consented to the sale of the Craftsman-related assets that had been "ring-fenced" under the PPPFA.

Additionally, the marketing process for real estate under the Special Committee announced in February 2017 is actively proceeding. To date, the Company has received cash proceeds of approximately $276 million since the initiation of the marketing process under the Special Committee, which were used to reduce the amounts outstanding under the 2016 Secured Loan Facility from $500 million to $263 million, and under the 2017 Secured Loan Facility from $500 million to $461 million. An additional $382 million of net cash proceeds were received from the sales of properties in the normal course of business. Cash proceeds from real estate sales after the repayment of a portion of the secured loan facilities were used to reduce outstanding borrowings under the Company's domestic credit facility, as well as for general corporate purposes. Subsequent to second quarter end, the Company executed additional asset sales which generated cash proceeds of nearly $160 million, with approximately $25 million utilized to pay down amounts outstanding under the 2017 Real Estate Loan and the remainder used to pay down revolver borrowings. The Company expects additional real estate sales to occur throughout the remainder of fiscal year 2017.

During the second quarter, the Company also continued to achieve significant progress in our $1.25 billion restructuring program announced earlier this year, with over $1.0 billion in annualized cost savings actioned to date.

Actions taken to date to realize the annualized cost savings have included simplification of the organizational structure of Sears Holdings, streamlining of operations, reducing unprofitable categories and the closure of under-performing stores. In fiscal year 2017, we have closed approximately 180 stores previously announced for closure, and an additional 150 stores previously announced for closure are expected to be closed by the end of the third quarter of 2017. As a result of these actions, the Company has begun to see improvement in the operations in the second quarter as the restructuring program actions, including the closing of unprofitable stores, have begun to take effect.

The Company continued to take actions during the second quarter of 2017 to improve liquidity. In May 2017, Sears Holdings reached agreement to extend the maturity of $400 million of our $500 million 2016 Secured Loan Facility maturing in July 2017 to January 2018. As noted above, the Company subsequently reduced the amounts outstanding under the 2016 Secured Loan Facility from $500 million to $263 million. The Company has options to further extend the remaining loan balance until July 2018.

Additionally, the Company also amended its existing Second Lien Credit Agreement dated September 1, 2016 in July 2017, to provide for the creation of a $500 million Line of Credit Loan Facility (the "Line of Credit Facility"). Seven investors have made loans to the Company under the Line of Credit Facility, including affiliates of ESL Investments, Inc. ("ESL"), certain of our directors and companies affiliated with them, and certain unaffiliated third party investors. As of July 29, 2017, $330 million is outstanding under the Line of Credit Facility. Finally, in August 2017, the Company executed amendments to its LC Facility. The amendments, among other things, extended the maturity of the $271 million LC Facility from its original maturity date of December 28, 2017 through December 28, 2018, eliminated the unused portion of the facility and released the real estate collateral that secured the original LC Facility. The amended LC Facility also permits the lenders, JPP, LLC and JPP II, LLC, affiliates of ESL, to syndicate all or a portion of their commitments under the LC Facility. As of the date of this report, $140 million of the LC Facility has been syndicated to unaffiliated third party lenders.

At July 29, 2017, the amount available to borrow under our revolving credit facility was approximately $191 million, compared to $165 million at January 28, 2017.

In July, the Company announced an agreement with Amazon to launch Kenmore products on Amazon.com, which we expect will significantly expand the reach of the Kenmore brand. We expect this partnership to drive growth opportunities across three of our divisions - Kenmore, Sears Home Services and Innovel. Innovel and Sears Home Services will provide white-glove service for delivery, installation and extended product protection for the full range of home appliances from Kenmore sold on Amazon.com. The Amazon Kenmore Store will feature the full line of Kenmore products for purchase across the United States, with select home appliances already available in California.

We acknowledge that we continue to face a challenging competitive environment. The comprehensive restructuring of our operations is delivering cost efficiencies and helping drive improvements in our operating performance. While we continue to focus on our overall profitability, including managing expenses, we reported a loss in the second quarter of 2017, and were required to fund cash used in operating activities with cash from investing and financing activities. We expect that the actions outlined above will further enhance our liquidity and financial flexibility. In addition, as previously discussed, we expect to generate additional liquidity through the monetization of our real estate, additional financing actions, and potential asset securitizations. 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, sales 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 monetizing our real estate portfolio and exploring potential asset securitizations, in our transition from an asset intensive, historically "store-only" based retailer to a more asset light, integrated membership-focused company.

We believe that the actions discussed above are probable of occurring and mitigate the liquidity risk raised by our historical operating results and satisfy our estimated liquidity needs during the next 12 months from the issuance of the financial statements. 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 actions described above or through some combination of other actions, while not expected, then our liquidity needs may exceed availability 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 our outstanding second lien debt) falls below the principal amount of such second lien debt plus the principal amount of any other indebtedness for borrowed money that is secured by liens on the collateral for such debt on the last day of any two consecutive quarters, it could trigger an obligation to repurchase or repay second lien debt in an amount equal to such deficiency.

Our outstanding borrowings at July 29, 2017, July 30, 2016 and January 28, 2017 were as follows:

| millions | July 29, 2017 | July 30, 2016 | January 28, 2017 |
|---|---|---|---|
| Short-term borrowings: | | | |
| Unsecured commercial paper | $ — | $ 101 | $ — |
| Secured borrowings | 216 | 63 | — |
| Line of credit loans | 330 | — | — |
| Long-term debt, including current portion: | | | |
| Notes and debentures outstanding | 3,360 | 3,211 | 4,018 |
| Capitalized lease obligations | 97 | 176 | 145 |
| Total borrowings | $ 4,003 | $ 3,551 | $ 4,163 |

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

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

| | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| millions | July 29, 2017 | July 30, 2016 | July 29, 2017 | July 30, 2016 |
| Secured borrowings: | | | | |
| Maximum daily amount outstanding during the period | $629 | $312 | $629 | $1,150 |
| Average amount outstanding during the period | 524 | 111 | 366 | 463 |
| Amount outstanding at period-end | 216 | 63 | 216 | 63 |
| Weighted average interest rate | 6.0 % | 5.2 % | 6.0 % | 4.4 % |
| Unsecured commercial paper: | | | | |
| Maximum daily amount outstanding during the period | $160 | $137 | $160 | $184 |
| Average amount outstanding during the period | 56 | 61 | 39 | 64 |
| Amount outstanding at period-end | — | 101 | — | 101 |
| Weighted average interest rate | 8.3 % | 7.9 % | 8.2 % | 7.8 % |
| Line of credit loans: | | | | |
| Maximum daily amount outstanding during the period | $330 | $— | $330 | $— |
| Average amount outstanding during the period | 54 | — | 27 | — |
| Amount outstanding at period-end | 330 | — | 330 | — |
| Weighted average interest rate | 9.0 % | — % | 9.0 % | — % |

Information about our Domestic Credit Agreement, Term Loan, Letter of Credit Facility, 2017 Secured Loan Facility, 2016 Secured Loan Facility, Secured Short-term Loan, 2016 Term Loan, Second Lien Credit Agreement Senior Secured Notes, Senior Unsecured Notes, Unsecured Commercial Paper and Wholly-owned Insurance Subsidiary and Intercompany Securities is included in Note 2 of Notes to Condensed Consolidated Financial Statements.

## Intangible Asset Impairment Assessment

We continue to monitor our performance and do not believe an event has occurred that would result in an indefinite-lived intangible asset impairment at quarter end. However, further indefinite-lived intangible impairment charges may be recognized in future periods to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry, deterioration in our performance or our future projections, if actual results are not consistent with our estimates and assumptions used in the 2016 year-end impairment analysis, or changes in our plans for one or more indefinite-lived intangible assets. The intangible asset impairment analysis is particularly sensitive to changes in the projected revenue growth rate and the assumed weighted-average cost of capital. Changes to these key assumptions could result in revisions of management's estimates of the fair value of the indefinite-lived intangible assets and could result in impairment charges in the future, which could be material to our results of operations.

## Recent Accounting Pronouncements

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

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

The following factors, among others, could cause actual results to differ from those set forth in the forward-looking statements: our ability to successfully implement our integrated retail strategy to transform our business; our ability to successfully manage our inventory levels; initiatives to improve our liquidity through inventory management and other actions; vendors' lack of willingness to provide acceptable payment terms or otherwise restricting financing to purchase inventory or services; possible limits on our access to our domestic credit facility, which is subject to a borrowing base limitation and a springing fixed charge coverage ratio covenant, capital markets and other financing sources; our ability to successfully achieve our plans to generate liquidity through potential transactions or otherwise; our ability to achieve cost savings initiatives; potential liabilities in connection with the separation of Lands' End and disposition of a portion of our ownership interest in Sears Canada; payment-related risks that could increase our operating costs, expose us to fraud or theft, subject us to potential liability and potentially disrupt our business operations, the impact of seasonal buying patterns, including seasonal fluctuations in weather conditions, which are difficult to forecast with certainty; fluctuations in our sales due to changes in customers' spending patterns and prevailing economic conditions; our dependence on sources outside the United States for significant amounts of our merchandise; our reliance on third parties to provide us with services in connection with the administration of certain aspects of our business and the transfer of significant internal historical knowledge to such parties; impairment charges for goodwill and intangible assets or fixed-asset impairment for long-lived assets; our ability to attract, motivate and retain key executives and other associates; the substantial influence exerted over the Company by affiliates of our 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; and the timing, amount and other risks related to required pension plan funding.

Certain of these and other factors are discussed in more detail in our Annual Report on Form 10-K for the fiscal year ended January 28, 2017 and in our other filings with the Securities and Exchange Commission, which may be accessed through the Commission's website at www.sec.gov.

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

SEARS HOLDINGS CORPORATION
13 and 26 Weeks Ended July 29, 2017 and July 30, 2016

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding. All debt securities are considered non-trading. At July 29, 2017, 45% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at July 29, 2017, which totaled approximately $1.8 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by $18 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

Item 4. Controls and Procedures

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

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

SEARS HOLDINGS CORPORATION

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

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

The following table provides information about shares of common stock we acquired during the second quarter of 2017. During the 13-week period ended July 29, 2017, we did not repurchase any shares of our common stock under our common share repurchase program. At July 29, 2017, we had approximately $504 million of remaining authorization under the program.

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program[1] | Average Price Paid per Share for Publicly Announced Program | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|---|---|---|---|---|---|
| April 30, 2017 to May 27, 2017 | — | $ — | — | $ — | |
| May 28, 2017 to July 1, 2017 | 5,176 | 7.55 | — | — | |
| July 2, 2017 to July 29, 2017 | — | — | — | — | |
| Total | 5,176 | $ 7.55 | — | $ — | $ 503,907,832 |

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

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

Item 6. Exhibits

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

(b) Exhibits

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

SEARS HOLDINGS CORPORATION

SIGNATURES

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

| | |
|---|---|
| | SEARS HOLDINGS CORPORATION |
| Date: August 24, 2017 | By: /s/ ROBERT A. RIECKER |
| | Name: Robert A. Riecker |
| | Title: Chief Financial Officer* |

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

SEARS HOLDINGS CORPORATION
EXHIBIT INDEX

| | |
|---|---|
| *2.1 | Second Amendment to Purchase and Sale Agreement, dated July 28, 2017, by and between Sears Holdings Corporation and Stanley Black & Decker. |
| 3.1 | Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K, dated March 24, 2005, filed on March 24, 2005 (File No. 000-51217)). |
| 3.2 | Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K, dated January 22, 2014, filed on January 24, 2014 (File No. 000-51217)). |
| 10.1 | Amended and Restated Loan Agreement, dated as of May 22, 2017, between Sears, Roebuck and Co., Innovel Solutions, Inc., Big Beaver of Florida Development, LLC and Kmart Corporation, as Borrowers, and JPP, LLC, JPP II, LLC and Cascade Investment, L.L.C., as Initial Lenders (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated May 22, 2017, filed on May 24, 2017 (File No. 001-36693)). |
| *10.2 | Amendment No. 1 to Consent, Waiver and Amendment, dated as of June 29, 2017, among Sears Holdings Corporation, the subsidiaries of Sears Holdings Corporation party thereto and Pension Benefit Guaranty Corporation. |
| *10.3 | Amendment, dated July 3, 2017, to Amended and Restated Loan Agreement, dated as of May 22, 2017, between Sears, Roebuck and Co., Innovel Solutions, Inc., Big Beaver of Florida Development, LLC and Kmart Corporation, as Borrowers, and JPP, LLC, JPP II, LLC and Cascade Investment, L.L.C., as Initial Lenders. |
| 10.4 | First Amendment to Second Lien Credit Agreement, dated as of July 7, 2017, among Sears Holdings Corporation, Sears Roebuck Acceptance Corp. and Kmart Corporation, the lenders party thereto, and JPP, LLC, as administrative agent and collateral administrator (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated July 7, 2017, filed on July 7, 2017 (File No. 001-36693)). |
| 10.5 | Second Amendment, dated August 1, 2017, to Letter of Credit and Reimbursement Agreement, dated as of December 28, 2016, among Sears Holdings Corporation, Sears Roebuck Acceptance Corp., Kmart Corporation, the financial institutions party thereto from time to time as L/C Lenders, and Citibank, N.A., as Administrative Agent and Issuing Bank. (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated August 1, 2017, filed on August 3, 2017 (File No. 001-36693)). |
| 10.6 | Third Amendment, dated August 9, 2017, to Letter of Credit and Reimbursement Agreement, dated as of December 28, 2016, among Sears Holdings Corporation, Sears Roebuck Acceptance Corp., Kmart Corporation, the financial institutions party thereto from time to time as L/C Lenders, and Citibank, N.A., as Administrative Agent and Issuing Bank. (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, dated August 9, 2017, filed on August 10, 2017 (File No. 001-36693)). |

| | |
|---|---|
| †*10.7 | Letter from Registrant to Sean Skelley, dated as of June 8, 2017. |
| †*10.8 | Special Incentive Award Agreement, dated June 8, 2017, by and between Sears Holdings Corporation and Sean Skelley. |
| 31.1 | Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SEARS HOLDINGS CORPORATION
EXHIBIT INDEX

| | |
|---|---|
| 101 | The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended July 29, 2017, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Statements of Operations (Unaudited) for the 13 and 26 weeks ended July 29, 2017 and July 30, 2016; (ii) the Condensed Consolidated Statements of Comprehensive Loss (Unaudited) for the 13 and 26 weeks ended July 29, 2017 and July 30, 2016; (iii) the Condensed Consolidated Balance Sheets (Unaudited) as of July 29, 2017, July 30, 2016 and January 28, 2017; (iv) the Condensed Consolidated Statements of Cash Flows (Unaudited) for the 26 weeks ended July 29, 2017 and July 30, 2016; (v) the Condensed Consolidated Statements of Deficit (Unaudited) for the 26 weeks ended July 29, 2017 and July 30, 2016; and (vi) the Notes to the Condensed Consolidated Financial Statements (Unaudited). |

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* Filed herewith.
† A management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 6 of Form 10-Q.