SEARS HOLDINGS CORP
Form 10-K
March 20, 2013

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

FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended February 2, 2013
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 000-51217

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

Delaware	20-1920798
(State of Incorporation)	(I.R.S. Employer Identification No.)
3333 Beverly Road, Hoffman Estates, Illinois	60179
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

On March 2, 2013, the registrant had 106,386,171 common shares outstanding. The aggregate market value (based on the closing price of the Registrant's common shares for stocks quoted on the NASDAQ Global Select Market) of the Registrant's common shares owned by non-affiliates (which are assumed, solely for the purpose of this calculation, to be stockholders other than (i) directors and executive officers of the Registrant and (ii) any person known by the Registrant to beneficially own five percent or more of the Registrant's common shares), as of the last business day of the Registrant's most recently completed second fiscal quarter, was approximately $1.1 billion.

Documents Incorporated By Reference

Part III of this Form 10-K incorporates by reference certain information from the Registrant’s definitive proxy statement relating to our Annual Meeting of Stockholders to be held on May 1, 2013 (the “2013 Proxy Statement”), which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Form 10-K relates.

PART I

Item 1. Business

General

Sears Holdings Corporation ("Holdings") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings (together with its subsidiaries, "we," "us," "our," or the "Company") was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger") on March 24, 2005. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 2,019 full-line and 54 specialty retail stores in the United States operating through Kmart and Sears and 475 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ("Sears Canada"), a 51%-owned subsidiary. Further, we operate a number of websites under the sears.com and kmart.com banners which offer more than 60 million products and provide the capability for our customers to engage in cross-channel transactions such as buy online/pick-up in store; buy in store/ship to home; and buy online, return in store. We are also the home of SHOP YOUR WAY™, a social shopping experience where Members have the ability to earn points, receive additional benefits and interact/shop with each other through shopyourway.com. The Company is the leading home appliance retailer as well as a leader in tools, lawn and garden, fitness equipment and automotive repair and maintenance. Key proprietary brands include Kenmore®, Craftsman® and DieHard®. We also maintain a broad apparel offering including such well-known labels as Lands' End®, the Kardashian Kollection, Jaclyn Smith, Joe Boxer, Sandra Lee and Levi's, as well as Sofia by Sofia Vergara and the Country Living Home Collection. We are the nation's largest provider of home services, with more than 14 million service calls made annually.

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

Business Segments

During 2012, we operated three reportable segments: Kmart, Sears Domestic and Sears Canada. Financial information, including revenues, operating income (loss), total assets and capital expenditures for each of these business segments is contained in Note 17 of Notes to Consolidated Financial Statements. Information regarding the components of revenue for Holdings is included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as Note 17.

Kmart

At February 2, 2013, the Company operated a total of 1,221 Kmart stores across 49 states, Guam, Puerto Rico, and the U.S. Virgin Islands. This store count consists of 1,196 discount stores, averaging 94,000 square feet, and 25 Super Centers, averaging 168,000 square feet. Most Kmart stores are one-floor, free-standing units that carry a wide array of products across many merchandise categories, including consumer electronics, seasonal merchandise, outdoor living, toys, lawn and garden equipment, food and consumables and apparel, including products sold under such well-known labels as Jaclyn Smith and Joe Boxer, and certain proprietary Sears brand products (such as Kenmore, Craftsman, and DieHard) and services. We also offer an assortment of major appliances, including Kenmore-branded products, in virtually all of our locations. There are 896 Kmart stores that also operate in-store pharmacies. The Super Centers generally operate 24 hours a day and combine a full-service grocery along with the merchandise selection of a discount store. There are also 21 Sears Auto Centers operating in Kmart stores. Sears Auto Centers offer a variety of professional automotive repair and maintenance services, as well as a full assortment of automotive accessories. Kmart continues to offer its layaway program, which allows customers to cost-effectively finance their purchases both in-store and online. In addition, we have expanded the ways our customers can receive their purchases, allowing our customers to buy online and pick up in store. This service, powered by MyGofer, is now available in over 956 Kmart stores via either mygofer.com or kmart.com. Kmart also sells its products through

its kmart.com website and provides customers the option of buying through a mobile app or online and picking up their merchandise in one of our Kmart stores.

Sears Domestic

At February 2, 2013, Sears Domestic operations consisted of the following:

- Full-line Stores—798 stores, of which 788 are Full-line stores located across all 50 states and Puerto Rico. These stores are primarily mall-based locations averaging 136,000 square feet. Full-line stores offer a wide array of products and service offerings across many merchandise categories, including appliances, consumer electronics, tools, sporting goods, outdoor living, lawn and garden equipment, certain automotive services and products, such as tires and batteries, home fashion products, as well as apparel, footwear, jewelry and accessories for the whole family. Our product offerings include our proprietary Kenmore, Craftsman, DieHard, Lands' End, Covington, Apostrophe, and Canyon River Blues brand merchandise. In addition, at February 2, 2013, we operated 10 Sears Essentials/Grand stores located in 10 states. In 2012, we converted eight Sears Essentials/Grand stores to Kmart stores. These stores are primarily free-standing units averaging 157,000 square feet, offering health and beauty products, pantry goods, household products and toys in addition to the offerings of the typical mall-based store. We also have 714 Sears Auto Centers operating in association with Full-line stores and eight Sears Auto Centers operating out of Sears Essentials/Grand stores. In addition, there are 36 free standing Sears Auto Centers that operate independently of Full-line stores. Sears also extends the availability of its product selection through the use of its sears.com website, which offers an assortment of home, apparel and accessory merchandise and provides customers the option of buying through a mobile app or online and picking up their merchandise in one of our Full-line stores.
- Specialty Stores—54 specialty stores (primarily consisting of the 36 free standing Sears Auto Centers noted above and 14 Lands' End retail stores noted below) located in free-standing, off-mall locations or high-traffic neighborhood shopping centers.
    - Lands' End—Lands' End, Inc. (“Lands' End”) is a leading direct merchant of traditionally styled casual clothing, accessories and footwear for men, women and children, as well as home products and soft luggage. These products are offered through multiple selling channels including landsend.com, one of the leading apparel websites, as well as catalog mailings, and international businesses. Lands' End has 14 retail stores, averaging 8,600 square feet, which offer Lands' End merchandise primarily from catalog and Internet channel overstocks. In addition, Lands' End has 280 “store within a store” departments primarily inside Sears Domestic Full-line locations.
- Commercial Sales—We sell Sears merchandise, parts, and services to commercial customers through our business-to-business Sears Commercial Sales and Appliance Builder/Distributor businesses.
- Sears Commercial Sales provides appliances and services to commercial customers in the single-family residential construction/remodel, property management, multi-family new construction, and government/military sectors.
- Our Appliance Builder/Distributor business offers premium appliance and plumbing fixtures to architects, designers, and new construction or remodeling customers, and is currently operating in nine markets with 17 facilities.
- Home Services—Product Repair Services, the nation's largest product repair service provider, is a key element in our active relationship with more than 43 million households. With almost 8,000 service technicians making over 14 million service and installation calls annually, this business delivers a broad range of retail-related residential and commercial services across all 50 states, Puerto Rico, Guam and the Virgin Islands under either the Sears Parts & Repair Services or A&E Factory Service brand names. Commercial and residential customers can obtain parts and repair services for all major brands of products within the appliances, lawn and garden equipment, consumer electronics, floor care products, and heating and cooling systems categories. We also provide repair parts with supporting instructions for “do-it-yourself” customers through our searspartsdirect.com website. This business also offers protection agreements, product installation services and Kenmore and Carrier brand residential heating

and cooling systems. Home Services also includes home improvement services (primarily siding, windows, cabinet refacing, kitchen remodeling, roofing, carpet and upholstery cleaning, air duct cleaning, and garage door installation and repair) provided through Sears Home Improvement Services and Sears Home & Business Franchises.

Sears Canada

Sears Canada, a consolidated, 51%-owned subsidiary of Sears, conducts retail operations in Canada similar to those conducted by Sears Domestic, with a greater emphasis on apparel and other softlines than in the U.S. stores.

At February 2, 2013, Sears Canada operated a total of 118 full-line stores, 357 specialty stores (including 48 furniture and appliance stores, 261 dealer stores operated under independent local ownership, four appliance and mattress stores, 33 Corbeil stores, and 11 outlet stores), nine home services showrooms, 1,512 catalog pick-up locations and 101 travel offices. Sears Canada also sells its products through its sears.ca website.

Separation of Sears Hometown and Outlet Businesses

On October 11, 2012, we completed the separation of our Sears Hometown and Outlet businesses through a rights offering transaction. Holdings received gross proceeds of $446.5 million with respect to the transaction, consisting of $346.5 million for the sale of Sears Hometown and Outlet Stores, Inc. ("SHO") common shares and $100 million through a dividend from SHO prior to the separation. Prior to the separation, SHO entered into an asset-based senior secured revolving credit facility with a group of financial institutions to provide (subject to availability under a borrowing base) for aggregate maximum borrowings of $250 million. Borrowings of $100 million from this revolving credit facility were used to fund the dividend paid to Holdings. We accounted for this separation in accordance with accounting standards applicable to common control transactions as ESL Investments, Inc. (together with its affiliated funds, "ESL") is a majority shareholder of Holdings and became a majority shareholder of SHO as a result of exercising subscription rights pursuant to the rights offering. Accordingly, we classified the difference between the proceeds received and the carrying value of net assets contributed to SHO as a reduction of capital in excess of par value in the Consolidated Statement of Equity for the period ended February 2, 2013.

In connection with the separation, Holdings and certain of its subsidiaries entered into various agreements with SHO under the terms described in Note 15. Because of the various agreements with SHO, the Company has determined that it has significant continuing cash flows with SHO. Accordingly, the operating results for SHO through the date of the separation are presented within the consolidated continuing operations of Holdings and the Sears Domestic segment in the accompanying Consolidated Financial Statements. See Note 15 of Notes to Consolidated Financial Statements for further information related to the agreements with SHO.

Partial Spin-Off of Interest in Sears Canada

On November 13, 2012, we completed a partial spin-off (the “spin-off”) of our interest in Sears Canada. Prior to the spin-off, Holdings beneficially owned approximately 96% of the issued and outstanding common shares of Sears Canada. In connection with the spin-off, we distributed approximately 45 million common shares of Sears Canada held by Holdings on a pro rata basis to holders of Holdings' common stock. Following the spin-off, Holdings was the beneficial holder of approximately 51% of the issued and outstanding common shares of Sears Canada, and as such, Holdings has maintained control of Sears Canada and will continue to consolidate the results of Sears Canada. We accounted for the spin-off as an equity transaction in accordance with accounting standards applicable to noncontrolling interests. Accordingly, we reclassified a portion of our ownership interest in Sears Canada and accumulated other comprehensive loss to noncontrolling interest in the Consolidated Statement of Equity at February 2, 2013.

At February 2, 2013, January 28, 2012 and January 29, 2011, Holdings was the beneficial holder of approximately 52 million, or 51%, 97 million, or 95%, and 97 million, or 92%, respectively, of the common shares of Sears Canada.

Acquisition of Noncontrolling Interest

During the first quarter of 2010, we acquired approximately 19 million additional common shares of Sears Canada. We paid a total of $560 million for the additional shares and accounted for the acquisition of additional interest in Sears Canada as an equity transaction in accordance with accounting standards applicable to noncontrolling interests. Accordingly, we reclassified an accumulated other comprehensive loss from noncontrolling interest to controlling interest in the Consolidated Statement of Equity for the period ended January 29, 2011.

Spin-Off of Orchard Supply Hardware Stores Corporation

On December 30, 2011, we completed the spin-off to our shareholders of all the capital stock of Orchard Supply Hardware Stores Corporation (“Orchard”) that was owned by Holdings immediately prior to the spin-off, consisting of common stock that represented approximately 80% of the voting power of Orchard's outstanding capital stock and preferred stock that represented 100% of Orchard's outstanding nonvoting capital stock. In connection with the spin-off, Holdings and certain of its subsidiaries entered into various agreements with Orchard, including a distribution agreement, a transition services agreement, an appliance sale and consignment agreement and brand license agreements. In addition, certain tax matters between Holdings and Orchard are governed by a tax sharing agreement entered into in 2005.

Real Estate Transactions

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

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

Trademarks and Trade Names

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

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

Seasonality

The retail business is seasonal in nature, and we generate a high proportion of our revenues, operating income and operating cash flows during the fourth quarter of our year, which includes the holiday season. As a result, our overall profitability is heavily impacted by our fourth quarter operating results. Additionally, in preparation for the fourth quarter holiday season, we significantly increase our merchandise inventory levels, which are financed from operating cash flows, credit terms received from vendors and borrowings under our domestic credit agreement (described in the “Uses and Sources of Liquidity” section below). Fourth quarter reported revenues accounted for 30% of total reported revenues in each of the years 2012, 2011 and 2010. See Note 19 to our Consolidated Financial Statements for further information on revenues earned by quarter in 2012 and 2011.

Competition

Our business is subject to highly competitive conditions. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, consumer electronics dealers, auto service providers, specialty retailers, wholesale clubs, as well as many other retailers operating on a national, regional or local level in the U.S. and Canada. Online and catalog businesses, which handle similar lines of merchandise, also compete with us. Walmart, Target, Kohl's, J.C. Penney, Macy's, The Home Depot, Lowe's, Best Buy and Amazon are some of the national retailers and businesses with which we compete. The Home Depot and Lowe's are major competitors in relation to our home appliance business, which accounted for approximately 15% of our 2012 and 16% of our 2011 and 2010 reported revenues. Sears Canada competes in Canada with Hudson's Bay Company, other Canadian-based store and online retailers, as well as certain U.S.-based competitors, including some of those mentioned above, that are expanding into Canada. Success in these competitive marketplaces is based on factors such as price, product assortment and quality, service and convenience, including availability of retail-related services such as access to credit, product delivery, repair and installation. Additionally, we are influenced by a number of factors including, but not limited to, the cost of goods, consumer debt availability and buying patterns, economic conditions, customer preferences, inflation, currency exchange fluctuations, weather patterns, and catastrophic events. Item 1A in this report on Form 10-K contains further information regarding risks to our business.

Employees

At February 2, 2013, subsidiaries of Holdings had approximately 246,000 employees in the United States and U.S. territories, and approximately 28,000 employees in Canada through Sears Canada. These employee counts include part-time employees.

Our Website; Availability of SEC Reports and Other Information

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

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

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

Item 1A. Risk Factors

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

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

In order for our business to be successful, we must identify, obtain supplies of, and offer to our customers, attractive, innovative and high-quality merchandise on a continuous basis. Our products and services must satisfy the desires of our customers, whose preferences may change in the future. If we misjudge either the demand for products and services we sell or our customers' purchasing habits and tastes, we may be faced with excess inventories of some products and missed opportunities for products and services we chose not to offer. In addition, our sales may decline or we may be required to sell the merchandise we have obtained at lower prices. This would have a negative effect on our business and results of operations.

Our integrated retail strategy is based on a number of initiatives, including our SHOP YOUR WAY program, that depend on our ability to respond quickly to ongoing technology developments and implement new ways to understand and rely on the data to interact with our members and customers in order to achieve expected benefits.

If we do not successfully manage our inventory levels, our operating results will be adversely affected.
We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory as we seek to minimize out-of-stock levels across all product categories and to maintain in-stock levels. In addition, we have plans to reduce peak domestic inventory in fiscal year 2013 by $500 million from $8.6 billion at the end of the third quarter of fiscal year 2012. We obtain a significant portion of our inventory from vendors located outside the United States. Some of these vendors often require lengthy advance notice of our requirements in order to be able to supply products in the quantities we request. This usually requires us to order merchandise, and enter into purchase order contracts for the purchase and manufacture of such merchandise, well in advance of the time these products will be offered for sale. As a result, we may experience difficulty in responding to a changing retail environment, which makes us vulnerable to changes in price. If we do not accurately anticipate the future demand for a particular product or the time it will take to obtain new inventory, our inventory levels will not be appropriate and our results of operations may be negatively impacted.
If we are unable to compete effectively in the highly competitive retail industry, our business and results of operations could be materially adversely affected.
The retail industry is highly competitive with few barriers to entry. We compete with a wide variety of retailers, including other department stores, discounters, home improvement stores, appliances and consumer electronics retailers, auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level in the U.S. and Canada. Some of our competitors are actively engaged in new store expansion. Online and catalog businesses, which handle similar lines of merchandise, and some of which are not required to collect sales taxes on purchases made by their customers, also compete with us. In this competitive marketplace, success is based on factors such as price, product assortment and quality, service and convenience.
Our success depends on our ability to differentiate ourselves from our competitors with respect to shopping convenience, a quality assortment of available merchandise and superior customer service. We must also successfully respond to our customers' changing tastes. The performance of our competitors, as well as changes in their pricing policies, marketing activities, new store openings and other business strategies, could have a material adverse effect on our business, financial condition and results of operations.
Our business has been and will continue to be affected by worldwide economic conditions; a failure of the economy to sustain its recovery, a renewed decline in consumer-spending levels and other conditions, including inflation and changing prices of energy, could lead to reduced revenues and gross margins, and negatively impact our liquidity.
Many economic and other factors are outside of our control, including consumer and commercial credit availability, consumer confidence and spending levels, including the impact of payroll tax increases on U.S. consumers, inflation, employment levels, housing sales and remodels, consumer debt levels, fuel costs and other challenges currently affecting the global economy, the full impact of which on our business, results of operations and financial condition cannot be predicted with certainty. These economic conditions adversely affect the disposable income levels of, and the credit available to, our customers, which could lead to reduced demand for our merchandise. Changing fuel and energy costs may have a significant impact on our operations. We require significant quantities of fuel for the vehicles used by technicians in our home services business and we are exposed to the risk associated with variations in the market price for petroleum products. We could experience a disruption in energy supplies, including our supply of gasoline, as a result of factors that are beyond our control, which could have an adverse effect on our business. Certain of our vendors also could experience increases in the cost of various raw materials, such as cotton, oil-related materials, steel and rubber, which could result in increases in the prices that we pay for merchandise, particularly apparel, appliances and tires. The domestic and international political situation also affects consumer confidence. The threat, outbreak or escalation of terrorism, military conflicts or other hostilities could lead to a decrease in consumer spending. Any of these events and factors could cause us to increase inventory markdowns and promotional expenses, thereby reducing our gross margins and operating results.

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

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

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

In addition to credit terms from vendors, our liquidity needs are funded by our operating cash flows and, to the extent necessary, borrowings under our credit agreements and commercial paper program and access to capital markets. The availability of financing depends on numerous factors, including economic and market conditions, our operating performance, our credit ratings, and lenders' assessments of our prospects and the prospects of the retail industry in general. Changes in these factors may affect our cost of financing, liquidity and our ability to access financing sources, including the accordion feature of our domestic revolving credit facility and possible second lien indebtedness that is permitted under the domestic revolving credit facility. Rating agencies revise their ratings for the companies that they follow from time to time and our ratings may be revised or withdrawn in their entirety at any time.

While the Company's domestic revolving credit facility currently provides for up to $3.275 billion of lender commitments, our ability to borrow funds under this facility is limited by a borrowing base determined relative to the value, from time to time, of eligible inventory, accounts receivable and certain other assets. If, through asset sales or other means, the value of these eligible assets is not sufficient to support borrowings of up to the full amount of the commitments under this facility, we will not have full access to the facility, but rather could have access to a lesser amount determined by the borrowing base.

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

We cannot predict whether our plans to generate liquidity, reduce inventory and reduce fixed costs will be successful.

We have plans to generate at least $500 million of additional liquidity over the next 12 months, reduce peak domestic inventory in fiscal year 2013 by $500 million from $8.6 billion at the end of the third quarter of fiscal year 2012 and reduce our fixed cost base by $200 million during fiscal year 2013. The achievement of these objectives is subject to risks and uncertainties with respect to market conditions and other factors that may cause our actual results, performance or achievements to be materially different from our plans, and there can be no assurance that transactions to monetize assets or other actions to generate liquidity will become available on acceptable terms. Our ability to reduce fixed costs, which include occupancy costs and certain payroll costs, may be limited by our contractual obligations and other factors.

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

Our business is seasonal, with a high proportion of revenues, operating income and operating cash flows being generated during the fourth quarter of our year, which includes the holiday season. As a result, our fourth quarter operating results significantly impact our annual operating results. Our fourth quarter operating results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions.

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

Our business is sensitive to customers' spending patterns, which in turn are subject to prevailing economic conditions. Our sales and results of operations have fluctuated in the past, and we expect them to continue to fluctuate in the future. A variety of other factors affect our sales and financial performance, including:

- actions by our competitors, including opening of new stores in our existing markets or changes to the way these competitors go to market online,
- seasonal fluctuations due to weather conditions,
- changes in our merchandise strategy and mix,
- changes in population and other demographics, and
- timing of our promotional events.

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

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

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

- potential economic and political instability in countries where our suppliers are located,
- increases in shipping costs,
- manufacturing and transportation delays and interruptions,
- supplier compliance with applicable laws, including labor and environmental laws, and with our global compliance program for suppliers and factories,
- adverse fluctuations in currency exchange rates, and
- changes in U.S. and foreign laws affecting the importation and taxation of goods, including duties, tariffs and quotas, or changes in the enforcement of those laws.

We rely extensively on computer systems to implement our integrated retail strategy, process transactions, summarize results and otherwise manage our business. Disruptions in these systems could harm our ability to run our business.

Given the significance of our online and mobile capabilities and the number of individual transactions we have each year, it is critical that we maintain uninterrupted operation of our computer and communications hardware and software systems, some of which are based on end-of-life or legacy technology, operate with minimal or no vendor support and are otherwise difficult to maintain. Our systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees. Operating legacy systems subject us to inherent costs and risks associated with maintaining, upgrading and replacing these systems and retaining sufficiently skilled personnel to maintain and operate the systems, demands on management time, and other risks and costs.

Cyber-security risks such as malicious software and attempts to gain unauthorized access to data are rapidly evolving and could lead to disruptions in our systems, unauthorized release of confidential or otherwise protected information or corruption of data. If individuals are successful in infiltrating, breaking into, disrupting, damaging or otherwise stealing from the computer systems of the Company or its third-party providers, or if our systems are otherwise damaged or cease to function properly, we may have to make a significant investment to fix or replace them, we may suffer interruptions in our operations in the interim, we may face costly litigation, and our reputation with our members and customers may be harmed. Any material interruption in our computer operations may have a material adverse effect on our business or results of operations. In addition, we are pursuing initiatives to transform our information technology processes and systems. These initiatives are highly complex and include replacing legacy systems, upgrading existing systems, and acquiring new systems and hardware with updated functionality. The risk of disruption is increased in periods when such complex and significant systems changes are undertaken.

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

Any significant security compromise or breach of member and customer, associate or company data, either held or maintained by the Company or our third-party providers, could significantly damage our reputation and brands and result in additional costs, lost sales, fines and/or lawsuits. The regulatory environment related to information security and privacy is increasingly rigorous, with new and constantly changing requirements applicable to our business, and compliance with those requirements could result in additional costs. There is no guarantee that the procedures that we have implemented to protect against unauthorized access to secured data are adequate to safeguard against all data security breaches. A data security breach could negatively impact our business and our results of operations.

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

We have entered into agreements with third-party service providers (both domestic and overseas) to provide processing and administrative functions over a broad range of areas, and we may continue to do so in the future. These areas include finance and accounting, information technology, including IT development, call center, human resources and procurement functions. Services provided by third parties as a part of outsourcing initiatives could be interrupted as a result of many factors, such as acts of God or contract disputes, and any failure by third parties to provide us with these services on a timely basis or within our service level expectations and performance standards could result in a disruption of our business. In addition, to the extent we are unable to maintain our outsourcing arrangements; we would incur substantial costs, including costs associated with hiring new employees, in order to return these services in-house. These outsourcing arrangements also carry the risk that the Company will fail to adequately retain the significant internal historical knowledge of our business and systems that is transferred to the service providers as the employment of the Company's personnel who possess such knowledge ends.

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

At February 2, 2013, we had goodwill and intangible asset balances of $3.3 billion, which are subject to periodic testing for impairment. Our long-lived assets, primarily stores, also are subject to periodic testing for impairment. A significant amount of judgment is involved in the periodic testing. Failure to achieve sufficient levels of cash flow within each of our reporting units, or sales of our branded products or cash flow generated from operations at individual store locations could result in impairment charges for goodwill and intangible assets or fixed asset impairment for long-lived assets, which could have a material adverse effect on our reported results of operations. Impairment charges, if any, resulting from the periodic testing are non-cash. A significant and sustained decline in our stock price could result in goodwill impairment charges. During times of financial market volatility, significant judgment is used to determine the underlying cause of the decline and whether stock price declines are short-term in nature or indicative of an event or change in circumstances. See Notes 12 and 13 of Notes to Consolidated Financial Statements for further information.

The loss of key personnel may disrupt our business and adversely affect our financial results.

We depend on the contributions of key personnel, including Edward S. Lampert, our Chairman and Chief Executive Officer, and other key employees, for our future success. Although certain executives have employment agreements with us, changes in our senior management and any future departures of key employees may disrupt our business and materially adversely affect our results of operations.

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

Affiliates of Edward S. Lampert, our Chairman and Chief Executive Officer, beneficially own approximately 55% of the outstanding shares of our common stock. These affiliates are controlled, directly or indirectly, by Mr. Lampert. Accordingly, these affiliates, and thus Mr. Lampert, have substantial influence over many, if not all, actions to be taken or approved by our stockholders, including the election of directors and any transactions involving a change of control.

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

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

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

We may be subject to product liability claims if people or properties are harmed by the products we sell or the services we offer.

Some of the products we sell may expose us to product liability claims relating to personal injury, death, or property damage caused by such products, and may require us to take actions such as product recalls. We also provide various services, which could also give rise to such claims. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.

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

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

Our pension and postretirement benefit plan obligations are currently underfunded, and we may have to make significant cash payments to some or all of these plans, which would reduce the cash available for our businesses.

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

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The following table summarizes the locations of our Kmart and Sears Domestic stores at February 2, 2013:

	Kmart		Sears Domestic		
State/Territory	Discount Stores	Super Centers	Full-line Mall Stores	Sears Essentials/ Grand Stores	Specialty Stores
Alabama	24	—	10	—	—
Alaska	—	—	3	—	—
Arizona	16	—	14	—	—
Arkansas	5	—	7	—	1
California	102	—	79	1	5
Colorado	13	—	11	1	1
Connecticut	8	—	8	—	—
Delaware	6	—	4	—	—
District of Columbia	—	—	—	—	—
Florida	69	—	51	—	1
Georgia	28	—	19	—	—
Hawaii	7	—	6	—	—
Idaho	8	—	5	—	—
Illinois	46	4	35	1	9
Indiana	31	3	18	—	1
Iowa	21	—	9	—	2
Kansas	11	—	8	—	1
Kentucky	27	—	9	—	—
Louisiana	11	—	13	—	1
Maine	6	—	5	—	—
Maryland	21	—	19	—	—
Massachusetts	19	—	21	—	—
Michigan	69	6	24	—	—
Minnesota	21	—	12	—	4
Mississippi	7	—	5	—	—
Missouri	27	—	10	1	—
Montana	9	—	3	—	—
Nebraska	8	—	4	—	—
Nevada	10	—	4	1	1
New Hampshire	6	—	6	—	—
New Jersey	35	—	20	—	5
New Mexico	15	—	7	—	—
New York	52	1	45	—	6
North Carolina	43	—	21	—	—
North Dakota	7	—	4	—	—
Ohio	52	7	38	1	1
Oklahoma	9	—	10	—	—
Oregon	13	—	8	—	1
Pennsylvania	95	2	42	1	2
Rhode Island	1	—	2	—	—
South Carolina	25	—	12	—	—
South Dakota	9	—	2	—	—
Tennessee	32	—	18	—	—

Texas	20	—	58	1	1
Utah	15	—	4	1	1
Vermont	3	—	2	—	—
Virginia	39	1	20	1	1
Washington	15	—	20	—	2
West Virginia	15	1	7	—	—
Wisconsin	28	—	15	—	6
Wyoming	9	—	2	—	—
Puerto Rico	23	—	9	—	1
U.S. Virgin Islands	4	—	—	—	—
Guam	1	—	—	—	—
Totals	1,196	25	788	10	54

	Kmart		Sears Domestic			Sears Canada		
	Discount Stores	Super Centers	Full-line Mall Stores	Sears Essentials/ Grand Stores	Specialty Stores	Full-line Stores	Specialty Stores	Total
Owned	184	19	497	8	26	14	2	750
Leased	1,012	6	291	2	28	104	77	1,520
Independently-owned and operated stores	—	—	—	—	—	—	278	278
Stores at February 2, 2013	1,196	25	788	10	54	118	357	2,548

In addition, at February 2, 2013, we had 38 domestic supply chain distribution centers, of which 12 were owned and 26 were leased for terms ranging from three to five years. Of the total, 10 primarily support Kmart stores, 24 primarily support Sears stores and four support both Sears and Kmart stores. We also had 465 domestic store warehouses, customer call centers and service facilities (including 17 facilities related to our appliance builder/distributor business), most of which are leased for terms ranging generally from three to five years or are part of other facilities included in the above table. Many of our facilities are also used to support our online channels.

Our principal executive offices are located on a 200-acre site owned by us at the Prairie Stone office park in Hoffman Estates, Illinois. The complex consists of six interconnected office buildings totaling approximately two million gross square feet of office space. In addition, we have a campus in Dodgeville, Wisconsin supporting the corporate headquarters, distribution center and customer sales/service operations for Lands' End. We also own an 86,000 square foot office building in Troy, Michigan. We operate numerous buying offices throughout the world that procure product internationally, as well as an information technology center in Pune, India.

At February 2, 2013, Sears Canada operated a total of 118 full-line stores, 357 specialty stores (including 48 furniture and appliance stores, 261 hometown dealer stores operated under independent local ownership, four appliance and mattress stores, 33 Corbeil stores, and 11 outlet stores), nine home services showrooms, 1,512 catalog pick-up locations and 101 travel offices.

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

Item 3. Legal Proceedings

Item 103 of SEC Regulation S-K requires that we disclose legal proceedings to which the Company and a governmental authority is a party and that arise under laws dealing with the discharge of materials into the environment or the protection of the environment, if the proceeding reasonably involves potential monetary sanctions of $100,000 or more. Disclosure also is required as to any such proceedings known by us to be contemplated by governmental authorities. In that connection, we note that Sears was a party to administrative actions brought by the California Air Resources Board (“CARB”) that alleged that Sears offered for sale certain mini bikes and stand-up scooters that were not certified by CARB. The parties have entered into a settlement agreement that provides for the payment by Sears of a $285,200 penalty. The vendor of this merchandise has agreed to reimburse Sears for the full amount of the penalty pursuant to its indemnification obligations to Sears.

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

Item 4. Mine Safety Disclosures

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

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

Name	Position	Date First Became an Executive Officer	Age
Edward S. Lampert	Chairman of the Board and Chief Executive Officer	2013	50
Ronald D. Boire	Executive Vice President, Chief Merchandising Officer and President, Sears Full Line Stores and Kmart Formats	2012	51
Imran Jooma	Executive Vice President and President, Online, Marketing, Pricing & Financial Services	2012	40
Robert A. Schriesheim	Executive Vice President and Chief Financial Officer	2011	52
Dane A. Drobny	Senior Vice President, General Counsel and Corporate Secretary	2010	45
William K. Phelan	Senior Vice President, Finance	2005	50
Robert A. Riecker	Vice President, Controller and Chief Accounting Officer	2012	48

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

Mr. Boire joined the Company as Executive Vice President, Chief Merchandising Officer and President, Sears Full Line Stores and Kmart Formats in January 2012. He served from October 2009 until January 2012 as President and Chief Executive Officer of Brookstone, a consumer products company. He served as President, U.S. Toys, North America, for Toys “R” Us, a specialty retailer of toys and juvenile products, from July 2006 until September 2009. He previously served as Executive Vice President, Global Merchandise Manager of Best Buy Co., Inc., a retailer of consumer electronics and related products from May 2003 to June 2006. Prior to joining Best Buy Co., Inc., Mr. Boire served for 17 years in a variety of increasingly senior roles at Sony Electronics Inc., a marketer of electronic products and services.

Mr. Jooma joined the Company in June 2007 as Vice President, e-Commerce, and has served in his current position since November 2011. He was elected Executive Vice President in November 2012. From May 2010 until November 2011, he served as the Company's Senior Vice President and President, e-Commerce. From August 2009 until May 2010, he served as Senior Vice President, e-Commerce, of the Company. Prior to joining the Company, he served as Vice President of eCommerce at Circuit City Stores, Inc. and prior thereto as the Divisional Vice President of eCommerce at OfficeMax Incorporated.

Mr. Schriesheim joined the Company as Executive Vice President in August 2011 and became Executive Vice President and Chief Financial Officer that same month. Prior to joining the Company, he served as the Chief Financial Officer of Hewitt Associates, Inc., a global human resources consulting and outsourcing company, from January 2010 to October 2010. From October 2006 to January 2010, he served as Executive Vice President and Chief Financial Officer of Lawson Software, Inc., an ERP software provider. From August 2002 to October 2006, he was affiliated with ARCH Development Partners, LLC, a seed stage venture capital fund. Before joining ARCH, Mr. Schriesheim held executive positions at Global TeleSystems, SBC Equity Partners, Ameritech, AC Nielsen and Brooke Group Ltd. Mr. Schriesheim has served as a director of Skyworks Solutions, Inc. since May 2006 and is chairman of its audit committee. He also served as a director of Dobson Communications Corp. from 2004 to 2007, a director of Lawson Software from 2006 to 2011, a director and Co-Chairman of MSC.Software Corporation from 2007 to 2009 and a director of Georgia Gulf Corporation from 2009 to 2010.

Mr. Drobny joined us as Senior Vice President, General Counsel and Corporate Secretary in May 2010. Prior to joining the Company, he practiced law with the law firm of Winston & Strawn LLP, most recently as Capital Partner, from September 1993 until May 2010.

Mr. Phelan was elected Senior Vice President, Finance of the Company in January 2012. From September 2007 until January 2012, he served as Senior Vice President and Controller of the Company. From May 2011 until August 2011, Mr. Phelan served as our acting Chief Financial Officer, while from May 2009 until May 2011 and from August 2011 until January 2012, he also served as our Chief Accounting Officer. From December 2007 until December 2008, Mr. Phelan also served as the Company's Treasurer. From the consummation of the Merger until September 2007, Mr. Phelan served as Vice President and Controller. Prior to the consummation of the Merger, he served as Assistant Controller of Sears.

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

PART II

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

Holdings' common stock is quoted on The NASDAQ Stock Market under the ticker symbol SHLD. There were 14,217 shareholders of record at March 2, 2013. The quarterly high and low sales prices for Holdings' common stock are set forth below.

	Fiscal Year 2012 Sears Holdings			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Common stock price				
High	$85.90	$65.70	$67.20	$68.77
Low	$41.14	$46.28	$47.01	$38.40

	Fiscal Year 2011 Sears Holdings			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Common stock price				
High	$94.79	$86.72	$83.25	$80.37
Low	$73.59	$66.15	$51.14	$28.89

Holdings has not paid and does not expect to pay cash dividends in the foreseeable future.

Equity Compensation Plan Information

The following table reflects information about securities authorized for issuance under our equity compensation plans at February 2, 2013.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans*
Equity compensation plans approved by security holders	—	—	261,774
Equity compensation plans not approved by security holders	—	—	—
Total	—	—	261,774

* Represents shares of common stock that may be issued pursuant to our 2006 Stock Plan. Excludes shares covered by an outstanding plan award that, subsequent to February 2, 2013, ultimately are not delivered on an unrestricted basis (for example, because the award is forfeited, canceled, settled in cash or used to satisfy tax withholding obligations). Awards under the 2006 Stock Plan may be restricted stock awards, a grant of shares of our common stock in connection with an award made under a long-term incentive plan, or certain other awards.

Stock Performance Graph

Comparison of Five-Year Cumulative Stockholder Return

The following graph compares the cumulative total return to stockholders on Holdings' common stock from February 1, 2008 through February 1, 2013, the last trading day before the end of our 2012 year, with the return on the S&P 500 Stock Index, the S&P 500 Retailing Index and the S&P 500 Department Stores Index for the same period. The graph assumes an initial investment of $100 on February 1, 2008 in each of our common stock, the S&P 500 Stock Index, the S&P Retailing Index and the S&P 500 Department Stores Index.

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

	Feb. 1, 2008	Jan. 30, 2009	Jan. 29, 2010	Jan. 28, 2011	Jan. 27, 2012	Feb. 1, 2013
Sears Holdings	$100.00	$37.78	$86.12	$70.24	$41.55	$49.89
S&P 500 Stock Index	$100.00	$60.64	$80.72	$97.89	$103.10	$121.25
S&P 500 Retailing Index	$100.00	$62.28	$96.85	$123.37	$140.16	$178.46
S&P 500 Department Stores Index	$100.00	$47.25	$78.97	$90.57	$102.24	$105.40

Purchase of Equity Securities

The following table provides information about shares of common stock we acquired during the fourth quarter of 2012. During the quarter ended February 2, 2013, we did not repurchase any shares of our common stock under our common share repurchase program. At February 2, 2013, we had approximately $504 million of remaining authorization under the program.

	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program[2]	Average Price Paid per Share for Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
October 28, 2012 to November 24, 2012	706	$64.54	—	$—	
November 25, 2012 to December 29, 2012	1,824	42.01	—	—	
December 30, 2012 to February 2, 2013	18,919	43.99	—	—	
Total	21,449	$44.50	—	$—	$ 504,000,000

(1) Consists entirely of 21,449 shares acquired from associates to meet withholding tax requirements from the vesting of restricted stock.

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

The domestic credit agreement (described in the “Uses and Sources of Liquidity” section below) limits our ability to make restricted payments, including dividends and share repurchases, under certain circumstances, including if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

Item 6. Selected Financial Data

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

dollars in millions, except per share and store data	Fiscal 2012	2011	2010	2009	2008
Summary of Operations					
Revenues[1]	$39,854	$41,567	$42,664	$43,360	$46,007
Domestic comparable store sales %	(2.5)%	(2.2)%	(1.3)%	(4.7)%	(7.7)%
Net income (loss) from continuing operations attributable to Holdings' shareholders[2]	(930)	(3,113)	122	218	295
Per Common Share					
Basic:					
Net income (loss) from continuing operations attributable to Holdings' shareholders	$(8.78)	$(29.15)	$1.09	$1.85	$2.32
Diluted:					
Net income (loss) from continuing operations attributable to Holdings' shareholders	$(8.78)	$(29.15)	$1.09	$1.85	$2.32
Holdings' book value per common share	$25.89	$40.26	$78.19	$79.21	$76.91
Financial Data					
Total assets	$19,340	$21,381	$24,360	$24,901	$25,444
Long-term debt	1,579	1,693	1,872	949	1,220
Long-term capital lease obligations	364	395	472	510	552
Capital expenditures	378	432	426	350	486
Adjusted EBITDA	626	277	1,385	1,744	1,524
Number of stores	2,548	4,010	3,949	3,862	3,862

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

(2) The periods presented were impacted by certain significant items, which affected the comparability of amounts reflected in the above selected financial data. For 2012, 2011 and 2010, these significant items are discussed within Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations.” 2009 results include the impact of domestic pension expense of $170 million, a $131 million charge related to store closings and severance, a gain on the sale of Sears Canada Headquarters of $44 million, a gain of $32 million recorded in connection with the settlement of Visa/MasterCard antitrust litigation, mark-to-market losses of $33 million on Sears Canada hedge transactions and a tax benefit of $41 million related to the resolution of certain income tax matters. 2008 results include the impact of a $98 million charge related to asset impairments, a $77 million charge related to store closings and severance, mark-to-market gains of $81 million on Sears Canada hedge transactions, the reversal of a $62 million reserve because of the overturning of an adverse jury verdict relating to the redemption of certain Sears, Roebuck and Co. bonds in 2004, a tax benefit of $8 million related to the resolution of certain income tax matters and gains of $13 million on negotiated repurchases of debt securities prior to maturity.

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

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

- Overview of Holdings
- Results of Operations:
  - Fiscal Year
  - Holdings' Consolidated Results
  - Business Segment Results
- Analysis of Consolidated Financial Condition
- Contractual Obligations and Off-Balance Sheet Arrangements
- Application of Critical Accounting Policies and Estimates
- Cautionary Statement Regarding Forward-Looking Information

The discussion that follows should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8.

OVERVIEW OF HOLDINGS

Holdings, the parent company of Kmart and Sears, was formed in connection with the March 24, 2005 Merger of these two companies. We are an integrated retailer with significant physical and intangible assets, as well as virtual capabilities enabled through technology. We currently operate a national network of stores with 2,019 full-line and 54 specialty retail stores in the United States, operating through Kmart and Sears, and 475 full-line and specialty retail stores in Canada operating through Sears Canada Inc. (“Sears Canada”), a 51%-owned subsidiary. Further, we operate a number of websites under the Sears.com and Kmart.com banners which offer more than 60 million products and provide the capability for our customers to engage in cross-channel transactions such as buy online/pick-up in store; buy in store/ship to home; and buy online, return in store. We are also the home of SHOP YOUR WAY™, a social shopping experience where members have the ability to earn points, receive additional benefits and interact/shop with each other through shopyourway.com. The Company is the leading home appliance retailer as well as a leader in tools, lawn and garden, fitness equipment and automotive repair and maintenance. Key proprietary brands include Kenmore®, Craftsman® and DieHard®. We also maintain a broad apparel offering including such well-known labels as Lands' End®, the Kardashian Kollection, Jaclyn Smith, Joe Boxer, Sandra Lee and Levi's, as well as Sofia by Sofia Vergara and the Country Living Home Collection. We are the nation's largest provider of home services, with more than 14 million service calls made annually.

We currently conduct our operations in three business segments: Kmart, Sears Domestic and Sears Canada. The nature of operations conducted within each of these segments is discussed within the “Business Segments” section of Item 1 in this report on Form 10-K. Our business segments have been determined in accordance with accounting standards regarding the determination, and reporting, of business segments.

Our focus continues to be on our core customers, our Members, and finding ways to provide them value and convenience through Integrated Retail and our SHOP YOUR WAY Membership platform. We have invested significantly in our online ecommerce platforms, our Membership rewards program and the technology needed to support these initiatives. Our actions in 2012 were guided by the following strategic priorities:

Innovation Around Our Customers and Members

We continue to focus on building and growing a deeply engaging membership program, called SHOP YOUR WAY. SHOP YOUR WAY is more than just a typical loyalty program. It is a comprehensive platform that transforms customer transactions into relationships and allows us to know our Members better and to serve them better as well. It includes the rewards program, our shopyourway.com social shopping platform, our SHOP YOUR WAY Max free shipping platform and a variety of other applications and components. Collectively, these elements change the way we do business both inside and outside the Company.

We are also focused on providing integrated retail solutions for our Members and customers. We rolled out tablets and mobile devices to Sears Domestic stores across the country. The tablets are equipped to help our store associates provide a better overall shopping experience. Our associates can use tablets to look at product specifications, compare products side-by-side and search for inventory if it is not readily available at the store. More information about products, inventory, pricing and reviews is now available at their fingertips, which means Members can have more confidence in their product selection.

We have designed other experiences that provide seamless and convenient integrated experiences for our Members. Building on our Buy Online Pick Up In Store and Ready in 5 promise, we developed a Return/Exchange in 5 capability that allows Members to fill out the product return information online. Members simply drop off or exchange the item they want to return at our Merchandise Pick Up area within five minutes or less.

Core Retail Excellence

We are also focused on providing great merchandise value to our customers and Members. In 2012, we launched several innovative brand offerings such as Outdoor Life, Alphaline electronics accessories, and RoadHandler tires. In January 2013, we announced that we would be developing two new apparel lines in a collaborative effort between SHOP YOUR WAY and our Kmart format. We have a long heritage of building celebrity brands, both at Sears and Kmart. We chose to partner with Nicki Minaj and Adam Levine for this collaboration because of their creativity, their global appeal and their strong interest in developing their clothing brands in a unique and innovative manner.

We are focused on providing flexibility and convenience for our Members through such things as buy online/pick-up in store, buy in store/ship to home, digital receipts and returns and exchanges in five minutes or less. We enhanced our layaway program and added the capability for our Members to make layaway payments online and have the items from their layaway shipped directly to their homes when their contract has been completed. We also provide our customers with easy access to a broad and diverse range of products and categories through marketplace on sears.com.

Financial and Operational Discipline

In 2012, we also demonstrated our financial flexibility by positively impacting our liquidity by $1.8 billion, while unlocking the value in our asset portfolio, as part of our on-going asset re-configuration where we are re-deploying our capital in support of our member-centric, integrated retail strategy. Actions taken included:

- the separation of our Sears Hometown and Outlet businesses through a rights offering transaction, which generated gross proceeds of approximately $447 million;
- the partial spin-off of 45% of Sears Canada;
- the execution of various real estate transactions which generated cash proceeds of approximately $440 million;
- Reducing inventory by nearly $1.0 billion below last year's level and adjusting our promotional cadence to be more targeted;
- Reducing our fixed cost structure by over $500 million; and
- Capitalizing on an opportunity to reduce risk related to our legacy pension obligation by making a voluntary offer to former employees to pay a lump sum.

We are an asset-rich enterprise with substantial liquidity, unencumbered real estate and well-established stand-alone businesses, including Lands' End and Sears Canada. We expect to generate at least $500 million of additional liquidity through monetization of assets over the next 12 months. In addition to our asset monetizations, we currently expect to reduce 2013 peak domestic inventory by $500 million from the 2012 level of $8.6 billion at the end of the third quarter as a result of stores already or expected to be closed, initiatives underway to reduce slow-moving inventory and modest productivity improvement. This action is expected to generate $300 million of cash after consideration of related payables. We also expect to further reduce our fixed cost base by another $200 million in 2013.

RESULTS OF OPERATIONS

Fiscal Year

Our fiscal year end is the Saturday closest to January 31 each year. Fiscal year 2012 consisted of 53 weeks while fiscal years 2011 and 2010 consisted of 52 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years. The following fiscal periods are presented in this report.

Fiscal year	Ended	Weeks
2012	February 2, 2013	53
2011	January 28, 2012	52
2010	January 29, 2011	52

Holdings' Consolidated Results

Holdings' consolidated results of operations for 2012, 2011 and 2010 are summarized as follows:

millions, except per share data	2012	2011	2010
REVENUES			
Merchandise sales and services	$39,854	$41,567	$42,664
COSTS AND EXPENSES			
Cost of sales, buying and occupancy	29,340	30,966	31,000
Gross margin dollars	10,514	10,601	11,664
Gross margin rate	26.4 %	25.5 %	27.3 %
Selling and administrative	10,660	10,664	10,425
Selling and administrative expense as a percentage of revenues	26.7 %	25.7 %	24.4 %
Depreciation and amortization	830	853	869
Impairment charges	330	649	—
Gain on sales of assets	(468)	(64)	(67)
Total costs and expenses	40,692	43,068	42,227
Operating income (loss)	(838)	(1,501)	437
Interest expense	(267)	(289)	(293)
Interest and investment income	94	41	36
Other income (loss)	1	(2)	(14)
Income (loss) from continuing operations before income taxes	(1,010)	(1,751)	166
Income tax expense	(44)	(1,369)	(27)
Income (loss) from continuing operations	(1,054)	(3,120)	139
Income (loss) from discontinued operations, net of tax	—	(27)	11
Net income (loss)	(1,054)	(3,147)	150
(Income) loss attributable to noncontrolling interests	124	7	(17)
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(930)	$(3,140)	$133
Amounts attributable to Holdings' shareholders:			
Income (loss) from continuing operations, net of tax	$(930)	$(3,113)	$122
Income (loss) from discontinued operations, net of tax	—	(27)	11
Net income (loss)	$(930)	$(3,140)	$133
NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS			
Diluted income (loss) per share from continuing operations	$(8.78)	$(29.15)	$1.09
Diluted income (loss) per share from discontinued operations	—	(0.25)	0.10
	$(8.78)	$(29.40)	$1.19
Diluted weighted average common shares outstanding	105.9	106.8	111.7

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. In addition, comparable store sales amounts include sales from sears.com and kmart.com shipped directly to customers and have been adjusted for the change in the unshipped sales reserves recorded at the end of each reporting period. Comparable store sales results for 2012 were calculated based on the 52-week period ended January 26, 2013 as compared to the comparable 52-week period in the prior year.

2012 Compared to 2011

Net Loss from Continuing Operations Attributable to Holdings' Shareholders

We recorded a net loss from continuing operations attributable to Holdings' shareholders of $930 million ($8.78 loss per diluted share from continuing operations) and $3.1 billion ($29.15 loss per diluted share from continuing operations) for 2012 and 2011, respectively. Our results for 2012 and 2011 were affected by a number of significant items, including non-cash charges related to pension settlements and the impairment of goodwill balances and a $1.8 billion non-cash charge to establish a valuation allowance against our domestic deferred tax assets in 2011. Our net loss from continuing operations as adjusted for these significant items was $215 million ($2.03 loss per diluted share from continuing operations) for 2012 and $482 million ($4.52 loss per diluted share from continuing operations) for 2011. The improvement in net loss for the year reflected an improvement in gross margin rate of 90 basis points and a decrease in selling and administrative expenses, which were partially offset by a decline in gross margin dollars, given lower sales.

In addition to our net income (loss) from continuing operations determined in accordance with GAAP, for purposes of evaluating operating performance, we use an Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA") measurement as well as Adjusted Earnings per Share (“Adjusted EPS”). Adjusted EBITDA is computed as net income (loss) attributable to Sears Holdings Corporation appearing on the Statements of Operations excluding income (loss) attributable to noncontrolling interest, income tax expense, interest expense, interest and investment income, other income (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 operating performance 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.

25

Adjusted EBITDA was determined as follows:

millions	2012	2011	2010
Net income (loss) attributable to SHC per statement of operations	$(930)	$(3,140)	$133
Income (loss) attributable to noncontrolling interest	(124)	(7)	17
(Income) loss from discontinued operations, net of tax	—	27	(11)
Income tax expense	44	1,369	27
Interest expense	267	289	293
Interest and investment income	(94)	(41)	(36)
Other income (loss)	(1)	2	14
Operating income (loss)	(838)	(1,501)	437
Depreciation and amortization	830	853	869
Gain on sales of assets	(468)	(64)	(67)
Before excluded items	(476)	(712)	1,239
Impairment charges	330	649	—
Pension settlements	455	—	—
Closed store reserve and severance	140	254	26
Domestic pension expense	165	74	120
Transaction costs	12	—	—
Hurricane losses	—	12	—
Adjusted EBITDA as defined	$626	$277	$1,385
% to revenues	1.6%	0.7%	3.2%

Adjusted EBITDA for our segments was as follows:

	2012				2011				2010			
millions	Kmart	Sears Domestic	Sears Canada	Sears Holdings	Kmart	Sears Domestic	Sears Canada	Sears Holdings	Kmart	Sears Domestic	Sears Canada	Sears Holdings
Operating income (loss) per statement of operations	$5	$(656)	$(187)	$(838)	$(34)	$(1,447)	$(20)	$(1,501)	$353	$(149)	$233	$437
Depreciation and amortization	147	578	105	830	149	601	103	853	149	620	100	869
Gain on sales of assets	(37)	(261)	(170)	(468)	(34)	(30)	—	(64)	(7)	(46)	(14)	(67)
Before excluded items	115	(339)	(252)	(476)	81	(876)	83	(712)	495	425	319	1,239
Closed store reserve and severance	76	44	20	140	76	160	18	254	13	13	—	26
Impairment charges	10	25	295	330	15	634	—	649	—	—	—	—
Pension settlements	—	452	3	455	—	—	—	—	—	—	—	—
Domestic pension expense	—	165	—	165	—	74	—	74	—	120	—	120
	—	9	3	12	—	—	—	—	—	—	—	—

Transaction costs												
Hurricane losses	—	—	—	—	—	12	—	12	$—	$—	$—	$—
Adjusted EBITDA as defined	$201	$356	$69	$626	$172	$4	$101	$277	$508	$558	$319	$1,385
% to revenues	1.4 %	1.7 %	1.6 %	1.6 %	1.1 %	—%	2.2 %	0.7 %	3.3 %	2.5 %	6.7 %	3.2 %

We also believe that use of Adjusted EPS improves the comparability of year-to-year results and is representative of our underlying performance. We have chosen to provide this supplemental information to illustrate the results of operations giving effect to the non-GAAP adjustments shown in the reconciliations below, and to provide an additional measure of performance.

The following tables set forth results of operations on a GAAP and "As Adjusted" basis, as well as the impact each significant item used in calculating Adjusted EBITDA had on specific income and expense amounts reported in our Consolidated Statements of Operations during the years 2012, 2011 and 2010.

	Year Ended February 2, 2013									
millions, except per share data	GAAP	Closed Store Reserve, Store Impairments and Severance	Gain on Sales of Assets	Transaction Costs	Goodwill Impairment	Pension Settlements	Domestic Pension Expense	Gain on Sale of Canadian Joint Venture	Tax Matters	As Adjusted
Cost of sales, buying and occupancy impact	$29,340	$ (35)	$—	$—	$—	$—	$—	$—	$—	$29,305
Selling and administrative impact	10,660	(105)	—	(12)	—	(455)	(165)	—	—	9,923
Depreciation and amortization impact	830	(22)	—	—	—	—	—	—	—	808
Impairment charges impact	330	(35)	—	—	(295)	—	—	—	—	—
Gain on sales of assets impact	(468)	—	419	—	—	—	—	—	—	(49)
Operating loss impact	(838)	197	(419)	12	295	455	165	—	—	(133)
Interest and investment income impact	94	—	—	—	—	—	—	(25)	—	69
Income tax expense impact	(44)	(74)	157	(5)	—	—	(62)	9	143	124
Loss attributable to noncontrolling interest impact	124	(7)	8	—	(145)	(1)	—	12	—	(9)
After tax and noncontrolling interest impact	(930)	116	(254)	7	150	454	103	(4)	143	(215)
Diluted loss per share impact	$(8.78)	$ 1.09	$(2.40)	$ 0.07	$ 1.42	$ 4.29	$ 0.97	$ (0.04)	$ 1.35	$(2.03)

	Year Ended January 28, 2012									
millions, except per share data	GAAP	Domestic Pension Expense	Closed Store Reserve, Store Impairments and Severance	Mark-to-Market Losses	Gain on Sales of Assets	Hurricane Losses	Goodwill Impairment	Tax Matters	Discontinued Operations	As Adjusted
Cost of sales, buying and	$30,966	$—	$ (130)	$ —	$—	$—	$—	$—	$ —	$30,836

occupancy impact										
Selling and administrative impact	10,664	(74)	(124)	—	—	(12)	—	—	—	10,454
Depreciation and amortization impact	853	—	(8)	—	—	—	—	—	—	845
Impairment charges impact	649	—	(98)	—	—	—	(551)	—	—	—
Gain on sales of assets impact	(64)	—	—	—	33	—	—	—	—	(31)
Operating loss impact	(1,501)	74	360	—	(33)	12	551	—	—	(537)
Other loss impact	(2)	—	—	6	—	—	—	—	—	4
Income tax expense impact	(1,369)	(28)	(134)	(2)	13	(5)	—	1,819	—	294
Loss from discontinued operations, net of tax impact	(27)	—	—	—	—	—	—	—	27	—
Loss attributable to noncontrolling interest impact	7	—	(1)	(1)	—	—	—	—	—	5
After tax and noncontrolling interest impact	(3,140)	46	225	3	(20)	7	551	1,819	27	(482)
Diluted loss per share impact	$(29.40)	$0.43	$ 2.10	$ 0.03	$(0.19)	$0.07	$5.16	$17.03	$0.25	$(4.52)

Year Ended January 29, 2011

millions, except per share data	GAAP	Domestic Pension Expense	Closed Store Reserve and Severance	Mark-to-Market Losses	Gain on Sales of Real Estate	Canadian Dividend Tax Impact	Tax Matters	Discontinued Operations	As Adjusted
Cost of sales, buying and occupancy impact	$31,000	$—	$ (12)	$ —	$ —	$ —	$—	$—	$30,988
Selling and administrative impact	10,425	(120)	(14)	—	—	—	—	—	10,291
Depreciation and amortization impact	869	—	(10)	—	—	—	—	—	859
Gain on sales of assets impact	(67)	—	—	—	35	—	—	—	(32)
Operating income impact	437	120	36	—	(35)	—	—	—	558
Other loss impact	(14)	—	—	6	—	—	—	—	(8)
Income tax expense impact	(27)	(24)	(6)	(1)	7	9	(13)	—	(55)
Income from discontinued operations, net of tax, impact	11	—	—	—	—	—	—	(11)	—
Income attributable to noncontrolling interest impact	(17)	—	—	(1)	—	—	—	—	(18)
After tax and noncontrolling interest impact	133	96	30	4	(28)	9	(13)	(11)	220
Diluted income per share impact	$1.19	$0.86	$ 0.27	$ 0.04	$ (0.25)	$ 0.08	$(0.12)	$ (0.10)	$1.97

During 2012, we recorded a $455 million non-cash charge related to pension settlements as a result of the requirement to expense the unrealized actuarial losses. The charge had no effect on equity because the unrealized actuarial losses were already recognized in accumulated other comprehensive income/(loss). Accordingly, the effect on retained earnings was offset by a corresponding reduction in accumulated other comprehensive loss.

During 2011, we recorded a $1.8 billion non-cash charge to establish a valuation allowance against 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.

Contributions to our pension plans remain a significant use of our cash on an annual basis. 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 financial statements 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, our domestic pension expense was $165 million in 2012, $74 million in 2011 and $120 million in 2010.

During 2010, Sears Canada paid $754 million in dividends of which Holdings received $639 million. As Sears Canada is a consolidated subsidiary of Holdings, no income was recognized on the receipt of the dividend. However, Holdings did record $9 million of income tax expense related to the dividend.

Revenues and Comparable Store Sales

Revenues decreased $1.7 billion, or 4.1%, to $39.9 billion, as compared to revenues of $41.6 billion in 2011. The decline in revenue was primarily the result of having fewer Kmart and Sears Full-line stores in operation, a decrease in domestic comparable store sales of 2.5% and the separation of the Sears Hometown and Outlet businesses, partially offset by the inclusion of an additional week of revenues in 2012. The Company recorded approximately $500 million of revenues during the 53rd week of 2012. The separation of the Sears Hometown and Outlet businesses resulted in a net decrease in revenues of approximately $100 million. Additionally, Sears Canada had a 5.6% decline in comparable stores sales and revenues for the year included a decrease of $37 million due to changes in foreign currency exchange rates.

Domestic comparable store sales declined 2.5% with declines of 1.4% at Sears Domestic and 3.7% at Kmart. Excluding the consumer electronics category, total domestic comparable store sales decreased 1.4% with Sears Domestic decreasing only 0.1% and Kmart decreasing 2.8%.

The decline in comparable store sales of 1.4% at Sears Domestic was driven by decreases in consumer electronics, lawn and garden and home appliances as well as at Sears Auto Centers. These decreases were partially offset by increases in apparel and home. The Kmart decline in comparable store sales of 3.7% reflects decreases in a majority of its categories, most notably the consumer electronics, pharmacy, grocery and household and drug store categories.

Gross Margin

Gross margin declined $87 million to $10.5 billion in 2012 from $10.6 billion in 2011 and included charges of $35 million and $130 million related to store closures for 2012 and 2011, respectively. Excluding these items, gross margin declined $182 million as the above noted decline in revenues was only partially offset by an improvement in gross margin rate. In addition, Sears Canada's gross margin included a decrease of $11 million related to the impact of foreign currency exchange rates.

Sears Domestic's gross margin rate improved 120 basis points in 2012 primarily due to improved margins in the apparel, home appliance and footwear categories, which were partially offset by declines in the consumer electronics category and the Lands' End customer direct business. Kmart’s gross margin rate improved 70 basis points in 2012 due to the improvement in the apparel, pharmacy and toys categories which were partially offset by a decline in the consumer electronics category. Sears Canada’s gross margin rate decreased 10 basis points in 2012 due to declines in the fitness and recreation, children's wear, jewelry, accessories and luggage and footwear categories.

Selling and Administrative Expenses

Selling and administrative expenses for 2012 were flat with the prior year and included expenses related to pension plans, store closings and severance of $725 million in 2012 and $198 million in 2011. The current year also included $12 million of transaction costs associated with strategic initiatives while 2011 included expense of $12 million related to hurricane losses in 2011. Excluding these items, selling and administrative expenses declined $531 million due to reductions in advertising, supplies and payroll expenses. Selling and administrative expenses at Sears Canada for 2012 included a decrease of $10 million related to the impact of foreign currency exchange rates.

Selling and administrative expenses as a percentage of revenues ("selling and administrative expense rate") were 26.7% and 25.7% for 2012 and 2011, respectively, and increased primarily as a result of the above noted charges.

Depreciation and Amortization

Depreciation and amortization expense decreased by $23 million during 2012 to $830 million and included charges of $22 million and $8 million in 2012 and 2011, respectively, taken in connection with store closings. The decrease is primarily due to having fewer assets available for depreciation.

Impairment Charges

During 2012, we recorded impairment charges of $295 million and $35 million related to the impairment of goodwill and long-lived assets, respectively. We also recorded impairment charges during 2011 of $551 million and $98 million related to the impairment of goodwill and long-lived assets, respectively. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets of $468 million in 2012 and $64 million in 2011, which were primarily attributable to several real estate transactions. The gain on sale of assets in 2012 included a gain of $223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for $270 million in cash proceeds, and a gain of $163 million recognized on the surrender and early termination of the leases on three properties operated by Sears Canada, under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received $170 million Canadian in cash proceeds. In connection with these transactions, we surrendered substantially all of our rights and obligations under our preexisting lease agreements and agreed to surrender each of the premises in periods ranging from six to 23 months from the date of closing. Gain on sales of assets recorded in 2012 also included a gain of $33 million related to the sale of a store operated under The Great Indoors format, one Sears Full-line store and one Kmart store. During 2011, the gain on sales of assets included a gain of $21 million recognized on the sale of two stores operated under The Great Indoors format and $12 million recognized on the sale of a store operated under the Kmart format.

Operating Loss

We recorded an operating loss of $838 million and $1.5 billion in 2012 and 2011, respectively. Operating loss for 2012 included non-cash charges related to pension settlements and the impairment of Sears Canada goodwill balances, expenses related to domestic pension plans, store closings and store impairments and severance and transaction costs, as well as the gains on sales of assets which aggregated to $705 million. Operating loss for 2011 included a non-cash charge of $551 million related to goodwill balances of certain reporting units, expenses related to domestic pension plans, store closings, severance and hurricane losses and a net gain on the sales of assets which aggregated to $964 million. Excluding these items, operating loss improved $404 million primarily due to the improvement in gross margin rate and a decrease in selling and administrative expenses, which were partially offset by a decline in gross margin dollars, given lower sales.

Interest Expense

We incurred $267 million and $289 million in interest expense during 2012 and 2011, respectively. The decrease is due to lower average outstanding borrowings.

Income Taxes

Our income tax effective rate was 4.4% in 2012 and 78.2% in 2011. The 2012 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 will be realized. The prior year tax rate is the result of significant tax matters in 2011 which included a non-cash charge of $1.8 billion to establish a valuation allowance against certain deferred income tax assets.

2011 Compared to 2010

Net Income (Loss) from Continuing Operations Attributable to Holdings' Shareholders

We recorded a net loss from continuing operations attributable to Holdings' shareholders of $3.1 billion ($29.15 loss per diluted share from continuing operations) for 2011, as compared to net income from continuing operations of $122 million ($1.09 per diluted share from continuing operations) in 2010. Our results for 2011 and 2010 were affected by a number of significant items, including a $1.8 billion non-cash charge to establish a valuation allowance against our domestic deferred tax assets in 2011. Our net loss from continuing operations as adjusted for these significant items was $482 million ($4.52 loss per diluted share from continuing operations) for 2011 and our net income from continuing operations adjusted for these similar significant items was $220 million ($1.97 per diluted share from continuing operations) for 2010. The decrease in net income for the year reflected a decrease in operating income of $1.9 billion, including the impact of non-cash impairment charges and charges related to store closures. Excluding these items, operating income declined $1.1 billion, primarily related to a decline in our gross margin dollars, given lower sales, and a decline in gross margin rate of 180 basis points, and an increase in selling and administrative expenses.

Revenues and Comparable Store Sales

Revenues decreased $1.1 billion, or 2.6%, to $41.6 billion in 2011, as compared to revenues of $42.7 billion in 2010. The decline in revenues was primarily a result of a 2.2% decrease in domestic comparable stores sales and the effect of having fewer Kmart and Sears Full-line stores in operation. Additionally, Sears Canada had a 7.7% decline in comparable store sales, which was partially offset by an increase of $171 million due to changes in the Canadian foreign exchange rate.

For the year, domestic comparable store sales declined 2.2%, with declines of 3.0% at Sears Domestic and 1.4% at Kmart. Decreases in sales at Sears Domestic were driven by appliances and consumer electronics, and were partially offset by increases in the home category. The Kmart declines in comparable store sales included decreases in the consumer electronics, pharmacy, home, apparel and jewelry categories, partially offset by an increase in the grocery and household category.

Gross Margin

We generated gross margin of $10.6 billion in 2011 and $11.7 billion in 2010. The total decline in gross margin dollars of $1.1 billion was primarily driven by decreases in the gross margin rate across all of our segments, and included charges of $130 million and $12 million in 2011 and 2010, respectively, related to store closures and an increase of $51 million related to the impact of foreign currency exchange rates on gross margin at Sears Canada. Kmart's gross margin rate declined 190 basis points in 2011 mainly due to higher commodity costs and markdowns in apparel and home, markdowns in consumer electronics, as well as declines in most other categories. Sears Domestic's gross margin rate declined 180 basis points in 2011 primarily due to reduced margins in the home appliance, consumer electronics, and Lands' End categories and declines in home services. Sears Canada's gross margin rate declined 170 basis points in 2011 as a result of clearing inventory, due to an enhanced focus on improving inventory productivity.

Selling and Administrative Expenses

Our selling and administrative expenses increased $239 million in 2011 to $10.7 billion. Domestic selling and administrative expenses increased $132 million from last year predominately due to increases in insurance and store closing expenses. Selling and administrative expenses at Sears Canada for 2011 increased $107 million from last year, and included an increase of $42 million related to the impact of foreign currency exchange rates. On a Canadian dollar basis, selling and administrative expenses increased by $65 million primarily due to increased investment in strategic projects and severance expense.

Selling and administrative expenses for 2011 included domestic pension plan expense of $74 million, store closing costs and severance of $124 million and $12 million of hurricane losses. Selling and administrative expenses for 2010 included domestic pension plan expense of $120 million and store closing costs and severance of $14 million.

Selling and administrative expenses as a percentage of revenues (“selling and administrative expense rate”) were 25.7% for 2011 and 24.4% for 2010, and increased as a result of the above noted increase in selling and administrative expenses, as well as the decline in revenues.

Depreciation and Amortization

Depreciation and amortization expense decreased by $16 million during 2011 to $853 million and included charges of $8 million and $10 million in 2011 and 2010, respectively, taken in connection with store closings. The decrease is primarily attributable to having fewer assets available for depreciation.

Impairment Charges

We recorded impairment charges of $551 million and $98 million during 2011 related to impairment of goodwill and long-lived assets, respectively. We did not record any such impairments in 2010. Impairment charges recorded during 2011 are further described in Notes 12 and 13 in Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded a gain on the sales of assets of $64 million during 2011 and $67 million in 2010. Gain on sales of assets for 2011 included a gain of $21 million recognized on the sale of two stores operated under The Great Indoors format and $12 million recognized on the sale of a store operated under the Kmart format. Gain on sales of assets for 2010 was impacted by the recognition of previously deferred gains on sales of assets. We sold a Sears Auto Center in October 2006, at which time we leased back the property for a period of time. Given the terms of the contract, for accounting purposes, the excess of proceeds received over the carrying value of the associated property was deferred. We closed our operations at this location during the first quarter of 2010 and, as a result, recognized a gain of $35 million on this sale at that time.

Operating Income (Loss)

We recorded an operating loss of $1.5 billion in 2011, as compared to operating income of $437 million in 2010. Operating loss for 2011 included a $551 million non-cash impairment charge related to goodwill balances of certain reporting units, expenses related to domestic pension plans, store closings, severance and hurricane losses, and a net gain on sales of assets, which aggregated to $964 million. Operating income for 2010 included expenses related to domestic pension plans, store closings and severance and a gain on sale of assets, which aggregated to $121 million. The decline in operating income of $1.9 billion was primarily the result of a decline in our gross margin dollars, given lower overall sales, and a decline in our gross margin rate of 180 basis points and an increase in the above noted charges.

Other Loss

Other loss is primarily comprised of mark-to-market and settlement gains and losses on Sears Canada hedge transactions. Total net mark-to-market and settlement losses of $1 million and $15 million were recorded on these transactions in 2011 and 2010, respectively. See Notes 4 and 5 to the Consolidated Financial Statements for further information regarding these transactions.

Income Taxes

Our income tax expense effective tax rate for the year was 78.2% in 2011 and 16.3% in 2010. The increase in our tax rate was primarily due to several significant tax matters, which included a non-cash charge of $1.8 billion to establish a valuation allowance against certain deferred income tax assets and the nondeductible nature of our goodwill impairment.

Business Segment Results

Kmart

Kmart results and key statistics were as follows:

millions, except number of stores	2012		2011		2010	
Merchandise sales and services	$14,567		$15,285		$15,593	
Comparable store sales %	(3.7	)%	(1.4	)%	0.8	%
Cost of sales, buying and occupancy	11,158		11,818		11,757	
Gross margin dollars	3,409		3,467		3,836	
Gross margin rate	23.4	%	22.7	%	24.6	%
Selling and administrative	3,284		3,371		3,341	
Selling and administrative expense as a percentage of revenues	22.5	%	22.1	%	21.4	%
Depreciation and amortization	147		149		149	
Impairment charges	10		15		—	
Gain on sales of assets	(37	)	(34	)	(7	)
Total costs and expenses	14,562		15,319		15,240	
Operating income (loss)	$5		$(34	)	$353	
Adjusted EBITDA	$201		$172		$508	
Total Kmart stores	1,221		1,305		1,307	

2012 Compared to 2011

Revenues and Comparable Store Sales

Kmart’s revenues decreased by $718 million to $14.6 billion as comparable store sales decreased 3.7% in 2012. The decrease in revenue was also due to the impact of Kmart having fewer stores in operation during 2012. These declines were partially offset by the inclusion of approximately $190 million of revenues recorded in the 53rd week of 2012. The decrease in comparable store sales of 3.7% reflects decreases in a majority of its categories, most notably in the consumer electronics, pharmacy, grocery and household, and drug store categories. Excluding the consumer electronics category, Kmart comparable store sales decreased 2.8%. The decrease in consumer electronics sales continue to be negatively impacted by price compression as well as market shifts such as moves to smartphone technology and away from digital cameras, GPS devices, MP3 players and camcorders in addition to transitions to online gaming and applications while the decrease in pharmacy sales was driven by the conversion of brand name drugs to equivalent generic drugs. The decrease in the grocery and household category was primarily attributable to competitive pressures in this category.

Gross Margin

Kmart generated $3.4 billion in gross margin in 2012 and $3.5 billion in 2011. The decrease in Kmart’s gross margin is due to the above noted decrease in sales which was partially offset an improvement in gross margin rate and included $21 million and $46 million for markdowns recorded in connection with store closings during 2012 and 2011, respectively.

Kmart’s gross margin rate increased 70 basis points to 23.4% in 2012 from 22.7% in 2011 mainly due to improvements in the apparel, pharmacy and toys categories which were partially offset by a decline in the consumer electronics category.

Selling and Administrative Expenses

Kmart’s selling and administrative expenses decreased $87 million in 2012. The decrease primarily reflects decreases in payroll and advertising expenses. Selling and administrative expenses for 2012 and 2011 were impacted by expenses of $55 million and $30 million, respectively, related to store closings and severance.

Kmart’s selling and administrative expense rate was 22.5% in 2012 and 22.1% in 2011 and increased primarily as a result of lower expense leverage due to the sales decline noted above.

Depreciation and Amortization

Depreciation and amortization expense decreased $2 million in 2012 to $147 million and included $9 million of charges taken in connection with store closings. The decrease is primarily due to having fewer assets to depreciate.

Impairment charges

We recorded impairment charges of $10 million and $15 million in 2012 and 2011, respectively, related to impairment of long-lived assets. Impairment charges recorded during 2012 and 2011 are further described in Note 13 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Kmart recorded a total net gain on sales of assets of $37 million and $34 million in 2012 and 2011, respectively. The gains on sales of assets in 2012 included a gain of $11 million recognized on the sale of one store while 2011 included a gain of $12 million recognized on the sale of one store.

Operating Income (Loss)

Kmart recorded operating income of $5 million in 2012 as compared to an operating loss of $34 million in 2011. This improvement was primarily driven by the improvement in gross margin rate and a decrease in selling and administrative expenses which more than offset the above noted decrease in revenues. Operating income in 2012 included expenses related to store closing and severance costs of $85 million and store impairments of $10 million as well as a gain of $11 million related to the sale of one store. Kmart's operating loss for 2011 included expenses related to store impairments of $15 million, store closing and severance costs of $76 million as well as a gain of $12 million related to the sale of one store.

2011 Compared to 2010

Revenues and Comparable Store Sales

Kmart's total sales decreased by $308 million, as comparable store sales decreased 1.4% in 2011. The declines in revenue were primarily due to lower comparable store sales and the effect of having fewer Kmart stores in operation. The Kmart declines in comparable store sales included decreases in the consumer electronics, pharmacy, home, apparel and jewelry categories, partially offset by an increase in the grocery and household category.

Gross Margin

Kmart generated $3.5 billion in gross margin in 2011 and $3.8 billion in 2010. The decrease in gross margin dollars of $369 million was mainly driven by a decline in the gross margin rate and included charges of $46 million and $6 million for markdowns recorded in connection with store closings announced during 2011 and 2010, respectively.

Kmart's gross margin rate was 22.7% in 2011 and 24.6% in 2010. The decline of 190 basis points was mainly due to higher commodity costs and markdowns in apparel and home, as well as markdowns in consumer electronics.

Selling and Administrative Expenses

Kmart's selling and administrative expenses increased $30 million in 2011. The increase was mainly due to an increase in store closing expenses. Selling and administrative expenses were impacted by store closing costs and severance of $30 million and $7 million, in 2011 and 2010, respectively.

Kmart's selling and administrative expense rate was 22.1% in 2011 and 21.4% in 2010, and increased primarily as a result of Kmart's decline in revenues.

Impairment Charges

We recorded impairment charges of $15 million during 2011 related to impairment of long-lived assets. We did not record any such impairments in 2010. Impairment charges recorded during 2011 are further described in Note 13 in Notes to Consolidated Financial Statements.

Gain on Sales of Assets

Kmart recorded a total net gain on sales of assets of $34 million in 2011 and $7 million in 2010. The gains on sales of assets in 2011 included a gain of $12 million recognized on the sale of one store.

Operating Income (Loss)

Kmart recorded an operating loss of $34 million in 2011, as compared to operating income of $353 million in 2010. The decrease in Kmart's operating results was primarily the result of a decline in gross margin dollars, driven by the declines in the gross margin rate and revenues, and an increase in selling and administrative expenses. Kmart's operating loss for 2011 included expenses related to impairments of $15 million, store closing and severance costs of $76 million as well as a gain of $12 million related to the sale of one store. Operating income in 2010 included store closing and severance costs of $13 million.

Sears Domestic

Sears Domestic results and key statistics were as follows:

millions, except number of stores	2012	2011	2010
Merchandise sales and services	$20,977	$21,649	$22,275
Comparable store sales %	(1.4)%	(3.0)%	(3.1)%
Cost of sales, buying and occupancy	15,107	15,849	15,910
Gross margin dollars	5,870	5,800	6,365
Gross margin rate	28.0%	26.8%	28.6%
Selling and administrative	6,184	6,042	5,940
Selling and administrative expense as a percentage of revenues	29.5%	27.9%	26.7%
Depreciation and amortization	578	601	620
Impairment charges	25	634	—
Gain on sales of assets	(261)	(30)	(46)
Total costs and expenses	21,633	23,096	22,424
Operating loss	$(656)	$(1,447)	$(149)
Adjusted EBITDA	$356	$4	$558
Number of:			
Full-line stores[(1)]	798	867	894
Specialty stores[(2)]	54	1,338	1,265
Total Domestic Sears Stores	852	2,205	2,159

(1) 2012 included 788 Full-line stores and 10 Sears Essentials/Grand stores; 2011 included 834 Full-line stores and 33 Sears Essentials/Grand stores; 2010 included 842 Full-line stores and 52 Sears Essentials/Grand stores

(2) 2011 and 2010 included 1,273 and 1,205 stores, respectively, of Sears Hometown and Outlet Stores, Inc.

2012 Compared to 2011

Revenues and Comparable Store Sales

Sears Domestic's revenues decreased by $672 million as comparable store sales decreased 1.4%. The decline in revenue is mainly due to the impact of having fewer Sears Full-line stores in operation, the decline in comparable store sales and the separation of the Sears Hometown and Outlet businesses, partially offset by the inclusion of approximately $275 million of revenues recorded in the 53rd week of 2012. The separation of the Sears Hometown and Outlet businesses resulted in a net decrease in revenues of approximately $100 million.

The decrease of 1.4% in comparable store sales was driven by decreases in the consumer electronics, lawn and garden and home appliances categories, as well as at Sears Auto Centers. These decreases were partially offset by increases in apparel and home. Consumer electronics continues to be negatively impacted by price compression, as well as market shifts such as moves to smartphone technology and away from digital cameras, GPS devices, MP3 Players and camcorders in addition to transitions to online gaming and applications. Excluding the consumer electronics category, Sears Domestic comparable stores sales decreased only 0.1%.

Gross Margin

Sears Domestic generated gross margin dollars of $5.9 billion in 2012 and $5.8 billion in 2011 as the decline in revenues in 2012 noted above was offset by an improvement in gross margin rate. Gross margin for 2012 and 2011 included charges of $14 million and $84 million, respectively, for markdowns recorded in connection with store closings.

Sears Domestic’s gross margin rate was 28.0% in 2012 and 26.8% in 2011. The increase of 120 basis points was mainly due to improvements in the apparel, home appliance and footwear categories, which were partially offset by declines in the consumer electronics category and our Lands' End customer direct business.

Selling and Administrative Expenses

Sears Domestic’s selling and administrative expenses increased $142 million in 2012 as compared to 2011. Selling and administrative expenses for 2012 were impacted by expenses of $617 million related to pension plans and $30 million related to store closings and severance, while 2011 was impacted by expenses of $74 million related to pension plans and $76 million related to store closings and severance. Selling and administrative expenses for 2012 also included $9 million of transaction costs associated with strategic initiatives while 2011 included expense of $12 million related to hurricane losses. Excluding these items, selling and administrative expenses decreased $352 million due to declines in advertising and payroll expenses.

Sears Domestic’s selling and administrative expense rate was 29.5% in 2012 and 27.9% in 2011 and increased as a result of the above noted expenses.

Depreciation and Amortization

Depreciation and amortization expense decreased $23 million to $578 million during 2012 and included charges of $13 million and $8 million in 2012 and 2011, respectively, taken in connection with store closings. The decrease is primarily attributable to having fewer assets available for depreciation.

Impairment Charges

During 2012, we recorded impairment charges of $25 million related to the impairment of long-lived assets. We also recorded impairment charges during 2011 of $551 million and $98 million related to the impairment of goodwill and long-lived assets, respectively. Impairment charges recorded in both years are described further in Notes 12 and 13 in Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded total gains on sales of assets of $261 million in 2012 and $30 million in 2011 which were primarily attributable to several real estate transactions. The gain on sale of assets in 2012 included a gain of $223 million recognized on the sale of eleven (six owned and five leased) Sears Full-line store locations to General Growth Properties for $270 million in cash proceeds. In connection with this transaction, we surrendered substantially all of our rights and obligations under our preexisting lease agreements and agreed to surrender each of the premises in periods ranging from six to 23 months from the date of closing. Gain on sales of assets recorded in 2012 also included a gain of $22 million related to the sale of a store operated under The Great Indoors format and one Sears Full-line store. The gain on sales of assets in 2011 included a gain of $21 million recognized on the sale of two stores operated under the Great Indoors format.

Operating Loss

Sears Domestic reported an operating loss of $656 million in 2012 compared to $1.4 billion in 2011. Sears Domestic’s operating loss improved as the increase in selling and administrative expenses noted above was more than offset by lower impairment charges, an increase in the gains on sales of assets and an increase in gross margin dollars. Sears Domestic’s operating loss included expenses related to domestic pension plans and store closings and severance of $674 million and $242 million in 2012 and 2011, respectively, impairments of $25 million and $634 million in 2012 and 2011 respectively, $9 million of transaction costs associated with strategic initiatives in 2012 and hurricane losses of $12 million in 2011, as well as a gains of $245 million and $21 million in 2012 and 2011, respectively, related to the sale of real estate assets.

2011 Compared to 2010

Revenues and Comparable Store Sales

Sears Domestic's total sales decreased by $626 million to $21.6 billion in 2011, as comparable store sales decreased 3.0%. The decline in revenue was mainly due to the decrease in comparable store sales, as well as the impact of having fewer Sears Full-line stores in operation. The decrease in comparable store sales was primarily driven by declines in the appliances and consumer electronics categories, and were partially offset by an increase in the home category.

Gross Margin

Sears Domestic generated gross margin dollars of $5.8 billion in 2011 and $6.4 billion in 2010. The decrease of $565 million was mainly a result of a decline in Sears Domestic's gross margin rate during 2011 and included charges of $84 million and $6 million for markdowns recorded in connection with store closings announced during 2011 and 2010, respectively.

Sears Domestic's gross margin rate was 26.8% in 2011 and 28.6% in 2010. The decline of 180 basis points was primarily due to reduced margins in the home appliance, consumer electronics, and Lands' End categories and declines in home services.

Selling and Administrative Expenses

Sears Domestic's selling and administrative expenses increased $102 million to $6.0 billion in 2011. The increase was mainly due to increases in insurance and store closing expenses. Selling and administrative expenses included domestic pension plan expense of $74 million in 2011 and $120 million in 2010, store closing costs and severance of $76 in 2011 and $7 million in 2010, and hurricane losses of $12 million in 2011.

Our selling and administrative expense rate was 27.9% for 2011 and 26.7% for 2010, and increased due to the above noted increase in expense and decline in sales.

Depreciation and Amortization

Depreciation and amortization expense decreased by $19 million to $601 million during 2011, and included charges of $8 million and $10 million in 2011 and 2010, respectively, taken in connection with store closings. The decrease is primarily attributable to having fewer assets available for depreciation.

Gain on Sales of Assets

Sears Domestic recorded a total net gain on sales of assets of $30 million in 2011 and $46 million in 2010. The gains on sales of assets in 2011 included a gain of $21 million recognized on the sale of two stores operated under The Great Indoors format. The gain on sales of assets in 2010 was due to the recognition of a previously deferred gain from the October 2006 sale of one of our Sears Auto Centers. At the time of the sale, we leased back the property for a period of time. Given the terms of the contract, for accounting purposes, the excess of proceeds received over the carrying value of the associated property was deferred. We closed our operations at this location during the first quarter of 2010 and, as a result, recognized a gain of $35 million on this sale at that time.

Impairment Charges

We recorded impairment charges of $551 million and $83 million during 2011 related to impairment of goodwill and long-lived assets, respectively. We did not record any such impairments in 2010. Impairment charges recorded during 2011 are further described in Notes 12 and 13 in Notes to Consolidated Financial Statements.

Operating Loss

Sears Domestic reported an operating loss of $1.4 billion in 2011 and $149 million in 2010. The increase in Sears Domestic's operating loss was primarily the result of lower gross margin dollars, driven by declines in the gross margin rate and revenues, and the impairment charges noted above. Sears Domestic's operating loss included expenses related to impairments of $634 million in 2011, domestic pension plans and store closing costs and severance of $242 million in 2011 and $143 million in 2010, hurricane losses of $12 million in 2011, as well as gains of $21 million and $35 million in 2011 and 2010, respectively, related to the sale of real estate.

Sears Canada

Sears Canada, a consolidated, 51%-owned subsidiary of Sears, conducts similar retail operations as Sears Domestic. Sears Canada results and key statistics were as follows:

millions, except number of stores	2012	2011	2010
Merchandise sales and services	$4,310	$4,633	$4,796
Comparable store sales %	(5.6)%	(7.7)%	(4.0)%
Cost of sales, buying and occupancy	3,075	3,299	3,333
Gross margin dollars	1,235	1,334	1,463
Gross margin rate	28.7%	28.8%	30.5%
Selling and administrative	1,192	1,251	1,144
Selling and administrative expense as a percentage of revenues	27.7%	27.0%	23.9%
Depreciation and amortization	105	103	100
Impairment charges	295	—	—
Gain on sales of assets	(170)	—	(14)
Total costs and expenses	4,497	4,653	4,563
Operating income (loss)	$(187)	$(20)	$233
Adjusted EBITDA	$69	$101	$319
Number of:			
Full-line stores	118	122	122
Specialty stores	357	378	361
Total Sears Canada Stores	475	500	483

2012 Compared to 2011

Revenues and Comparable Store Sales

Sears Canada’s revenues decreased $323 million for 2012 as compared to the same period last year and included a $37 million decrease due to the impact of exchange rates during the year. On a Canadian dollar basis, revenues decreased by $286 million predominately due to a 5.6% decrease in comparable store sales primarily due to sales decreases in the tools, lawn and garden, electronics, bed and bath, women's apparel and menswear categories, partially offset by an increase in major appliances. These declines were partially offset by the inclusion of approximately $35 million of revenues recorded in the 53rd week of 2012.

Gross Margin

Gross margin dollars decreased $99 million in 2012 to $1.2 billion and included an $11 million decrease due to the impact of exchange rates. Gross margin decreased $88 million on a Canadian dollar basis. Sears Canada’s gross margin rate decreased 10 basis points to 28.7%, in 2012 from 28.8% in 2011, due to decreases in the fitness and recreation, children's wear, jewelry, accessories and luggage, and footwear categories.

Selling and Administrative Expenses

For 2012, Sears Canada’s selling and administrative expenses decreased $59 million, and included a decrease of $10 million due to the impact of exchange rates. On a Canadian dollar basis, selling and administrative expenses decreased by $49 million primarily due to decreases in advertising. Selling and administrative expenses for 2012 included expenses of $20 million related to store closings and severance, $3 million related to pension settlements and $3 million of transaction costs associated with strategic initiatives. Selling and administrative expenses for 2011 included severance expenses of $18 million.

Sears Canada’s selling and administrative expense rate was 27.7% in 2012 and 27.0% in 2011 and increased primarily due to the above noted decline in revenues.

Impairment Charges

We recorded impairment charges of $295 million in 2012 related to goodwill. We did not record any such impairments in 2011. Impairment charges recorded are further described in Note12 of Notes to Consolidated Financial Statements.

Gain on Sales of Assets

We recorded a total gain on sales of assets of $170 million in 2012 which included a gain of $163 million recognized on the surrender and early termination of the leases on three properties under an agreement with The Cadillac Fairview Corporation Limited for which Sears Canada received $170 million Canadian in cash proceeds. In connection with this transaction, we surrendered substantially all of our rights and obligations under our preexisting lease agreements and agreed to surrender each of the premises in six months from the date of closing.

Operating Loss

Sears Canada recorded an operating loss of $187 million and $20 million in 2012 and 2011, respectively. Operating loss in 2012 included expenses of $20 million related to store closings and severance, $3 million related to pension settlements and $3 million of transaction costs associated with strategic initiatives, as well as an impairment charge of $295 million and a gain on sales of assets of $163 million in 2012. Operating loss in 2011 included expenses related to store closings and severance of $18 million. The increase in operating loss was primarily due to the decline in sales, partially offset by the gain on sales of assets noted above as well as the decrease in selling and administrative expenses.

2011 Compared to 2010

Revenues and Comparable Store Sales

Sears Canada's revenues decreased by $163 million in 2011 to $4.6 billion and included a $171 million increase due to the impact of exchange rates. On a Canadian dollar basis, revenues decreased by $334 million, due to a 7.7% decline in comparable store sales primarily attributable to sales declines in the hardlines and home categories, with industry-wide price compression and aggressive competition affecting sales in major appliances, electronics and home décor products. Revenue in the apparel and accessories categories also experienced declines primarily in women's wear and men's wear.

Gross Margin

Total gross margin dollars decreased $129 million to $1.3 billion for 2011 and included a $51 million increase due to the impact of exchange rates. Gross margin decreased $180 million on a Canadian dollar basis primarily as a result of a decline in gross margin rate. Sears Canada's margin rate decreased 170 basis points to 28.8% in 2011, from 30.5% in 2010, as a result of clearing inventory, due to an enhanced focus on improving inventory productivity.

Selling and Administrative Expenses

Sears Canada's selling and administrative expenses increased $107 million to $1.3 billion in 2011, and included an increase of $42 million due to the impact of exchange rates and severance expenses of $18 million recorded during 2011. On a Canadian dollar basis, selling and administrative expenses increased by $65 million primarily due to increased investment in strategic projects and the above noted severance expense.

Sears Canada's selling and administrative expense rate was 27.0% in 2011 and 23.9% in 2010, and increased primarily due to the above noted increase in expenses and decrease in sales.

Operating Income (Loss)

Sears Canada recorded an operating loss of $20 million in 2011 and operating income of $233 million in 2010. The $253 million decrease in operating results primarily reflects the above noted declines, on a Canadian dollar basis, in sales and gross margin, and the increase in selling and administrative expenses.

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 February 2, 2013 and January 28, 2012 are detailed in the following table.

millions	February 2, 2013	January 28, 2012
Domestic		
Cash and equivalents	$227	$182
Cash posted as collateral	20	20
Credit card deposits in transit	133	155
Total domestic cash and cash equivalents	380	357
Sears Canada	229	390
Total cash and cash equivalents	609	747
Restricted cash	9	7
Total cash balances	$618	$754

We had total cash balances of $618 million at February 2, 2013 and $754 million at January 28, 2012. The decrease in cash during 2012 was primarily due to uses of cash for contributions to our pension and postretirement benefit plans of $593 million, capital expenditures of $378 million and repayments of long-term debt of $335 million, partially offset by cash generated from the sale of properties of $532 million and from the separation of Sears Hometown and Outlet Stores, Inc. of $447 million, as well as reductions in working capital needs.

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.

Restricted cash consists of cash related to Sears Canada’s balances, which have been pledged as collateral for letters of credit obligations issued under its offshore merchandise purchasing program and with counterparties related to outstanding derivative contracts, as well as funds held in trust in accordance with regulatory requirements governing advance ticket sales related to Sears Canada’s travel business.

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 $114 million and $68 million as of February 2, 2013 and January 28, 2012, respectively.

Investment of Available Capital

Since the Merger, we have continued to invest in our businesses to transform the customer experience as the retail industry evolves and provide the opportunity for attractive returns. Further, through February 2, 2013, we have repurchased approximately $6.0 billion of our common shares since the Merger and may continue to repurchase shares subject to market conditions and board authorization. In addition, we may pursue investments in the form of acquisitions, joint ventures, and partnerships where we believe appropriate returns can be obtained.

Our Board of Directors has delegated authority to direct investment of our surplus cash to our Chairman and Chief Executive Officer, Edward S. Lampert, subject to various limitations that have been or may be from time to time adopted by the Board of Directors and/or Finance Committee of the Board of Directors.

Operating Activities and Cash Flows

The Company used $303 million of cash in its continuing operations during 2012 and $307 million during 2011 as the decrease in our net loss in 2012 compared to the prior year was offset by increases in contributions to our pension and postretirement benefit plans. 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.

The Company used $307 million in cash flows in its continuing operations during 2011 and generated $77 million of cash in its continuing operations in 2010. We used more cash in 2011 compared to 2010 mainly as a result of our net loss in 2011 and an increase in contributions to our pension and postretirement benefit plans, partially offset by a decrease in other working capital needs.

Merchandise inventories were $7.6 billion at February 2, 2013 and $8.4 billion at January 28, 2012. Merchandise payables were $2.8 billion at February 2, 2013 and $2.9 billion at January 28, 2012. Our Domestic inventory balances decreased approximately $895 million from $7.7 billion at January 28, 2012 to $6.8 billion at February 2, 2013. Excluding the inventory related to the Sears Hometown and Outlet store businesses, domestic inventory decreased $501 million from the prior year due to both improved productivity and store closures. Sears Domestic inventory decreased in virtually all categories, with the most notable decreases in the consumer electronics, home appliances, home and tools and paint categories. Kmart inventory also decreased in virtually all categories with the most notable decreases in the consumer electronics, pharmacy and drug and grocery and household categories. Sears Canada's inventory levels increased approximately $46 million from $745 million at January 28, 2012 to $791 million at February 2, 2013, primarily due to the timing of merchandise receipts and a reduction in reserves due to improved inventory quality.

Investing Activities and Cash Flows

We generated net cash flows from investing activities from continuing operations of $191 million in 2012, compared to net cash flows used in investing activities from continuing operations of $352 million and $391 million in 2011 and 2010, respectively.

For 2012, net cash flows generated from investing activities included cash proceeds from the sales of properties of $532 million and $37 million from changes in investments and restricted cash, which were partially offset by cash used for capital expenditures of $378 million. Net cash flows used in investing activities from continuing operations in 2011and 2010 was primarily used for purchases of property and equipment.

We spent $378 million, $432 million, and $ 426 million during 2012, 2011 and 2010, respectively. Capital expenditures during 2012 included investments in online and mobile shopping capabilities, enhancements to the SHOP YOUR WAY Membership platform, information technology infrastructure, and store maintenance. Capital expenditures in 2011 included investments in online initiatives, information technology infrastructure, in-home consultative sales technology, and maintenance for stores and distribution centers. Capital expenditures during 2010 included investments in online initiatives, information technology and infrastructure for stores and distribution centers.

We anticipate 2013 capital expenditure levels to be similar to 2012 levels. It should be noted that in the normal course of business, we consider opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash and cause our capital expenditure levels to vary from period

to period. In addition, we review leases that will expire in the short term in order to determine the appropriate action to take with respect to them. During 2012, we purchased one previously leased operating property for $6 million while in 2011, we purchased five previously leased operating properties for $17 million. We did not make any such purchases 2010.

Financing Activities and Cash Flows

Net cash used in financing activities from continuing operations was $27 million in 2012 and $64 million in 2010, while, in 2011, the Company generated net cash from financing activities of $47 million. Financing activities for 2012 included gross cash proceeds of $446.5 million as a result of the separation of SHO, which consisted of $346.5 million in cash proceeds received for the sale of SHO common shares and $100 million received through a dividend from SHO prior to the separation. The proceeds received were used to fund repayments on our domestic revolving credit facility. The financing activities in 2011 reflect an increase in debt to fund operations, and common share repurchase activity while the financing activities in 2010 reflect purchases of Sears Canada shares, debt repayments and common share repurchase activity, which were funded in part from $1.25 billion of proceeds from our senior secured notes offering in October 2010.

Repayments of long-term debt were $335 million, $611 million and $358 million in 2012, 2011 and 2010, respectively. These repayments were offset by gross cash proceeds of $446.5 million as a result of the separation of SHO in 2012, an increase of $815 million in total short-term borrowings and proceeds of $104 million from Sears Canada's credit facility in 2011, and $1.4 billion in proceeds from debt issuance in 2010.

In 2010, we took various financing actions to extend our capital structure. These actions included Holdings issuing $1.25 billion of 6 5/8% senior secured notes due 2018 which are secured by domestic inventory and credit card accounts receivable and Sears Canada entering into a five-year $800 million Canadian credit facility which is secured by a first lien on Sears Canada's inventory and receivable balances.

During 2010, we acquired approximately 19 million additional Sears Canada common shares. We paid a total of $560 million for the additional shares. In addition, Sears Canada purchased and cancelled approximately 2.2 million common shares during 2010 under its Normal Course Issuer Bid, at a cost of $43 million. Sears Canada declared and paid cash dividends of $7.00 Canadian per common share, or approximately $754 million Canadian ($708 million U.S.). Accordingly, Sears Canada paid $69 million to minority shareholders in connection with these dividends. For further information, see Note 2 of Notes to Consolidated Financial Statements.

During 2012, we did not repurchase any of our common shares under our share repurchase program. We did repurchase $183 million and $394 million of our common stock pursuant to our common share repurchase program in 2011 and 2010, respectively. The common share repurchase program was initially announced in 2005 and had a total authorization since inception of the program of $6.5 billion. At February 2, 2013, we had approximately $504 million of remaining authorization under the program. The common share repurchase program has no stated expiration date and share repurchases may be implemented using a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated share repurchase transactions, the purchase of call options, the sale of put options or otherwise, or by any combination of such methods.

Uses and Source of Liquidity

Our primary need for liquidity is to fund working capital requirements of our businesses, capital expenditures and for general corporate purposes, including debt repayment, pension plan contributions and common share repurchases. We consider ourselves to be an asset-rich enterprise with substantial liquidity and financial flexibility benefiting from multiple funding resources such as our $3.275 billion domestic revolving credit facility through April 2016, an $800 million Canadian revolving credit facility through September 2015, which may be subject to potential reserves, and $1.24 billion of senior secured notes due in 2018. Further, there is approximately $338 million of remaining Sears debt from the Merger. These funding resources are described in more detail below. At February 2, 2013, we had liquid assets of $5.4 billion consisting of cash balances of $618 million and $4.8 billion of inventory, net of payables.

The domestic revolving credit facility and senior secured notes are firmly in place for the next several years and are supported by an asset base which includes $6.8 billion of inventory, owned and leased real estate assets, market leading proprietary brands such as Kenmore, Craftsman and DieHard, and well-established stand-alone businesses such as Lands’ End and Sears Canada. This asset base provides us flexibility as we continue to transform our business.

We took several actions in 2012 to enhance our financial flexibility, generate liquidity and financially de-risk our Company. By transforming our Company to a more nimble, less asset-intensive business model, we are reducing the level of risk in our operational structure and balance sheet while concurrently improving the returns on our invested capital. The focus of this model is to win in the new retail marketplace by leveraging our stores, brands, online channels, social media assets and membership programs as an integrated retailer.

In summary, our actions positively impacted our liquidity by $1.8 billion, even after consideration of the $203 million domestic pension contribution we chose to make in September 2012, while unlocking the value in our asset portfolio. These actions have included:

- the separation of our Sears Hometown and Outlet businesses through a rights offering transaction, which generated gross proceeds of approximately $447 million;
- the partial spin-off of 45% of Sears Canada;
- the execution of various real estate transactions which generated cash proceeds of approximately $440 million;
- Reducing inventory by nearly $1.0 billion below last year's level and adjusting our promotional cadence to be more targeted;
- Reducing our fixed cost structure by over $500 million; and
- Capitalizing on an opportunity to reduce risk related to our legacy pension obligation by making a voluntary offer to former employees to pay a lump sum.

We expect to generate at least $500 million in additional liquidity through monetization of assets over the next 12 months through selective actions that are consistent with our focus on creating long-term value. The exact form and amount will depend on specific circumstances and opportunities, including market conditions. In addition to our asset monetizations, we currently expect to reduce 2013 peak domestic inventory by $500 million from the 2012 level of $8.6 billion at the end of the third quarter as a result of stores already or expected to be closed, initiatives underway to reduce slow-moving inventory and modest productivity improvement. This action is expected to generate $300 million of cash after consideration of related payables. We also expect to further reduce our fixed cost base by another $200 million in 2013.

Our outstanding borrowings at February 2, 2013 and January 28, 2012 were as follows:

millions	February 2, 2013	January 28, 2012
Short-term borrowings:		
Unsecured commercial paper	$345	$337
Secured borrowings	749	838
Long-term debt, including current portion:		
Notes and debentures outstanding	1,593	1,863
Capitalized lease obligations	433	455
Total borrowings	$3,120	$3,493

Domestic Credit Agreement

During the first quarter of 2011, we entered into a $3.275 billion credit agreement (the “Domestic Credit Agreement”) which expires in April 2016. We view this credit facility as our most cost efficient funding mechanism and therefore use it as a primary source of funding.

Advances under the 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. The Domestic Credit Agreement’s interest rates for LIBOR-based borrowings vary based on leverage in the range of LIBOR plus 2.0% to 2.5%. Interest rates for base rate-based borrowings vary based on leverage in the range of the applicable base rate plus 1.0% to 1.5%. Commitment fees are in a range of 0.375% to 0.625% based on usage.

The Domestic Credit Agreement includes a $1.5 billion letter of credit sub-limit and an uncommitted accordion feature that provides us the flexibility, subject to certain terms and conditions, to use the existing collateral under the credit facility to obtain an aggregate amount of up to $1.0 billion in additional borrowing capacity. The Domestic Credit Agreement permits aggregate second lien indebtedness of up to $2.0 billion, of which $1.2 billion in second lien notes were outstanding at February 2, 2013, providing the Company the capacity to issue up to an additional $760 million in second lien indebtedness. The Domestic Credit Agreement is in place as a funding source for general corporate purposes and is an asset based revolving credit facility under which Sears Roebuck Acceptance Corp. ("SRAC") and Kmart Corporation are the borrowers. The Domestic Credit Agreement is secured by a first lien on most of our domestic inventory and credit card and pharmacy receivables, and is subject to a borrowing base formula to determine availability.

The Domestic Credit Agreement limits our ability to make restricted payments, including dividends and share repurchases, under certain circumstances, including if availability under the credit facility, as defined, is less than 15%. It also imposes various other requirements, which take effect if availability falls below designated thresholds, including a cash dominion requirement and a requirement that the fixed charge ratio at the last day of any quarter be not less than 1.0 to 1.0.

At February 2, 2013 and January 28, 2012, we had $749 million and $838 million respectively, of borrowings and $754 million and $626 million, respectively, of letters of credit outstanding under the Domestic Credit Agreement. As a result, our availability under the agreement was $1.8 billion at both February 2, 2013 and January 28, 2012. The majority of the letters of credit outstanding are used to provide collateral for our insurance programs.

Senior Secured Notes

In October 2010, we sold $1 billion aggregate principal amount of senior secured notes (the "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 Notes, the Company sold $250 million aggregate principal amount of Notes to the Company's domestic pension plan in a private placement. The 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 Notes is junior in priority to the lien on such assets that secures obligations under the 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 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 notes to be due and payable immediately. Generally, the Company is required to offer to repurchase all outstanding 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 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 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 Notes held by nonaffiliates for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended.

Sears Canada Credit Agreement

In September 2010, Sears Canada entered into a five-year, $800 million Canadian senior secured revolving credit facility (the "Sears Canada Facility"). The Sears Canada Facility is available for Sears Canada's general corporate purposes and is secured by a first lien on inventory and credit card receivables. Availability under the

Sears Canada Facility is determined pursuant to a borrowing base formula based on inventory and credit card receivables, subject to certain limitations. At February 2, 2013 we had no borrowings outstanding under the Sears Canada Facility. At January 28, 2012, we had approximately $101 million ($101 million Canadian) of borrowings outstanding under the Sears Canada Facility. Availability under this agreement was approximately $503 million ($502 million Canadian) and $415 million ($415 million Canadian), respectively, at February 2, 2013 and January 28, 2012. The current availability may be reduced by reserves currently estimated by the Company to be approximately $300 million, which may be applied by the lenders at their discretion pursuant to the Credit Facility agreement. As a result of judicial developments relating to the priorities of pension liability relative to certain secured obligations, Sears Canada has executed an amendment to the Sears Canada Credit Facility which would provide additional security to lenders, with respect to the Company's unfunded pension liability by pledging certain real estate assets as collateral thereby partially reducing the potential reserve amounts by up to $150 million the lenders could apply. The potential additional reserve amount may increase or decrease in the future based on estimated net pension liabilities.

Letters of Credit Facility

Effective March 15, 2013, we agreed to terminate our $500 million uncommitted letter of credit facility dated January 20, 2011 with Wells Fargo Bank, National Association ("Wells Fargo") in advance of the scheduled termination date of January 20, 2014, as no letters of credit have been issued and outstanding under the facility since May 2011. The facility was secured by a first priority lien on cash placed on deposit at Wells Fargo in an amount equal to 103% of the face value of all issued and outstanding letters of credit.

Debt Repurchase Authorization

In 2005, our Finance Committee of the Board of Directors authorized the repurchase, subject to market conditions and other factors, of up to $500 million of our outstanding indebtedness in open market or privately negotiated transactions. Our wholly owned finance subsidiary, Sears Roebuck Acceptance Corp. (“SRAC”), has repurchased $215 million of its outstanding notes. In 2011, Sears Holdings repurchased $10 million of senior secured notes, recognizing a gain of $2 million. The unused balance of this authorization is $275 million

Unsecured Commercial Paper

We borrow through the commercial paper markets. At February 2, 2013 and January 28, 2012 , we had outstanding commercial paper borrowings of $345 million and $337 million, respectively. ESL held $285 million and $250 million, respectively, of our commercial paper at February 2, 2013 and January 28, 2012, including $169 million and $130 million, respectively, held by Edward S. Lampert. See Note 15 for further discussion of these borrowings.

Debt Ratings

Our corporate family debt ratings at February 2, 2013 appear in the table below:

Moody’s Investors Service	Standard & Poor’s Ratings Services	Fitch Ratings
B3	CCC+	CCC

Domestic Pension Plan Funding

Contributions to our pension plans remain a significant use of our cash on an annual basis. While the Company's pension plan is frozen, and thus associates do not currently earn pension benefits, the company has a legacy pension obligation for past service performed by Kmart and Sears associates. During 2012, we contributed $516 million to our domestic pension plans. We estimate that the domestic pension contribution will be $352 million in 2013 and approximately $510 million in 2014, though the ultimate amount of pension contributions could be affected by changes in the applicable regulations as well as financial market and investment performance.

As previously reported, on July 6, 2012, federal legislation signed into law allows pension plan sponsors to use higher interest rate assumptions in valuing plan liabilities and determining funding obligations. As a result of this legislation, the Company's domestic pension plan was within $203 million of being 80% funded under applicable law. In order to reduce the risks of gross pension obligations, the Company elected to contribute an additional $203 million to its domestic pension plan on September 14, 2012, after which its domestic pension plan was 80% funded under applicable law.

Effective September 17, 2012, the Company amended its domestic pension plan, primarily related to lump sum benefit eligibility, and began notifying certain former employees of the Company of its offer to pay those employees' pension benefit in a lump sum. These amendments did not have a significant impact on our plan. Former employees eligible for the voluntary lump sum payment option are generally those who are vested traditional formula participants of the Plan who terminated employment prior to January 1, 2012 and who have not yet started receiving monthly payments of their pension benefits.

The Company offered the one-time voluntary lump sum window in an effort to reduce its long-term pension obligations and ongoing annual pension expense. This voluntary offer was made to approximately 86,000 eligible terminated vested participants, representing approximately $2.0 billion of the Company's total qualified pension plan liabilities. Eligible participants had until November 19, 2012 to make their election. The Company made payments of approximately $1.5 billion to employees who made the election in December 2012 and funded the payments from existing pension plan assets. In connection with this transaction, the Company incurred a non-cash charge to operations of approximately $452 million pre-tax in the fourth quarter of 2012 as a result of the requirement to expense the unrealized actuarial losses. The charge had no effect on equity because the unrealized actuarial losses are already recognized in accumulated other comprehensive income/(loss). Accordingly, the effect on retained earnings was offset by a corresponding reduction in accumulated other comprehensive loss.

Wholly owned Insurance Subsidiary and Intercompany Securities

We have numerous types of insurable risks, including workers' compensation, product and general liability, automobile, warranty, asbestos and environmental claims and the extended service contracts we sell to our customers. In addition, we provide credit insurance to third party creditors of the Company to mitigate their credit risk with the Company. The associated risks are managed through Holdings' wholly owned insurance subsidiary, Sears Reinsurance Company Ltd. ("Sears Re"), a Bermuda Class 3 insurer.

In accordance with applicable insurance regulations, Sears Re holds marketable securities to support the insurance coverage it provides. Sears utilizes two securitization structures to issue specific securities in which Sears Re invests 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 125 Full-line stores was contributed to indirect wholly owned subsidiaries of Sears, and then leased back to Sears. The contributed stores were mortgaged and the REMIC issued securities that are secured by the mortgages and collateral assignments of the store leases. Sears Re and two other indirect wholly owned subsidiaries of Holdings own $1.3 billion (par value) of these mortgage-backed securities. Payments to Sears Re on these 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 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 Sears Re on these asset-backed securities are funded by the royalty payments. The issuers of these mortgage-backed and asset-backed 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. Since the inception of the REMIC and KCD IP, LLC, these mortgage-backed and asset-backed securities have been entirely held by our wholly owned consolidated subsidiaries in support of our insurance activities. At February 2, 2013 and January 28, 2012, 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 $0.8 billion at February 2, 2013 and January 28, 2012.

46

Contractual Obligations and Off-Balance Sheet Arrangements

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

Contractual Obligations	Total	Payments Due by Period Within 1 Year	1-3 Years	4-5 Years	After 5 Years	Other
millions						
Operating leases	$4,535	$720	$1,148	$739	$1,928	$—
Short-term debt	1,094	1,094	—	—	—	—
Capital lease obligations	643	113	201	125	204	—
Royalty license fees[(1)]	91	59	30	2	—	—
Purchase obligations	102	19	41	40	2	—
Pension funding obligations	2,475	381	928	660	506	—
Long-term debt including current portion and interest	2,095	47	71	116	1,861	—
Liability and interest related to uncertain tax positions[(2)]	218	—	—	—	—	218
Total contractual obligations	$11,253	$2,433	$2,419	$1,682	$4,501	$218

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

(2) At February 2, 2013, our uncertain tax position liability and gross interest payable were $161 million and $57 million, respectively. We are unable to reasonably estimate the timing of liabilities and interest payments arising from uncertain tax positions in individual years due to the uncertainties in the timing of the effective settlement of tax positions.

Other Commercial Commitments

We issue various types of guarantees in the normal course of business. We had the following guarantees outstanding at February 2, 2013:

millions	Bank Issued	SRAC Issued	Other	Total
Standby letters of credit	$774	$47	$—	$821
Commercial letters of credit	8	133	—	141
Secondary lease obligations and performance guarantee	—	—	77	77

The secondary lease obligations relate to certain store leases of previously divested Sears businesses. We remain secondarily liable if the primary obligor defaults.

Application of Critical Accounting Policies and Estimates

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

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

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

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

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

Valuation of Inventory

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

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

Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise, fashion trends and weather conditions. In addition, inventory is also evaluated against corporate pre-determined historical markdown cadences. When a decision is made to permanently markdown merchandise, the resulting gross margin reduction is recognized in the period the markdown is recorded. The timing of the decision, particularly surrounding the balance sheet date, can have a significant effect on the results of operations.

Shrinkage is estimated as a percentage of sales for the period from the date of the last physical inventory to the end of the year. Physical inventories are taken annually for all stores and inventory records are adjusted accordingly. The shrinkage rate from the most recent physical inventory, in combination with historical experience, is used as the basis for the shrinkage accrual following the physical inventory.

Self Insurance Reserves

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

Defined Benefit Pension Plans

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

The Company's actuarial valuations utilize key assumptions including discount rates and expected returns on plan assets. We are required to consider current market conditions, including changes in interest rates and plan asset investment returns, in determining these assumptions. Actuarial assumptions may differ materially from actual results due to changing market and economic conditions, changes in investment strategies, higher or lower withdrawal rates, and longer or shorter life spans of participants.

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

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

millions	1 percentage-point Increase	1 percentage-point Decrease
Effect on interest cost component	$30	$(39)
Effect on pension benefit obligation	$(674)	$814

For 2013 and beyond, the domestic weighted-average health care cost trend rates used in measuring the postretirement benefit expense are a 8.5% trend rate in 2013 to an ultimate trend rate of 6.5% in 2017. A one-percentage-point change in the assumed health care cost trend rate would have the following effects on the postretirement liability:

millions	1 percentage-point Increase	1 percentage-point Decrease
Effect on total service and interest cost components	$1	$(1)
Effect on postretirement benefit obligation	$31	$(27)

Income Taxes

We account for income taxes according to accounting standards for such taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the book basis and tax basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If future utilization of deferred tax assets is uncertain, the Company may record a valuation allowance against certain deferred tax assets.

In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results adjusted for the results of discontinued operations and changes in accounting policies and incorporate assumptions including the amount of future state, federal and foreign pre-tax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. In evaluating the objective evidence that historical results provide, we consider cumulative operating income (loss) over the past several years. These assumptions require significant judgment about the forecasts of future taxable income. After consideration of evidence regarding the ability to realize our deferred tax assets, we established a valuation allowance against certain deferred income tax assets in 2012 and 2011. The Company continues to monitor its operating performance and evaluate the likelihood of the future realization of these deferred tax assets. At the end of 2012, we had a state separate entity deferred tax asset of $145 million. In the event the Company does not achieve its forecasted results for 2013, an additional valuation allowance may be required.

In accordance with accounting standards for uncertain tax positions, we record unrecognized tax benefits for positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Further, we record the largest amount of the unrecognized tax benefit that is greater than 50% likely of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine whether the recognition threshold has been met and, if so, the appropriate amount of unrecognized tax benefits to be recorded in the Consolidated Financial Statements. Management reevaluates tax positions each period in which new information about recognition or measurement becomes available.

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

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

Goodwill and Intangible Asset Impairment Assessments

At February 2, 2013 and January 28, 2012, we had goodwill balances of $379 million and $841 million, respectively, and intangible asset balances of $2.9 billion at both periods. The Company evaluates the carrying value of goodwill and intangible assets for possible impairment under accounting standards governing goodwill and other intangible assets. The majority of our goodwill and intangible assets relate to Kmart's acquisition of Sears in March 2005. We allocated goodwill, which is defined as the total purchase price less the fair value of all assets and liabilities acquired, to reporting units at the acquisition date. As required by accounting standards, we perform annual goodwill and intangible impairment tests in the fourth quarter and update the tests between annual tests if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and the testing for recoverability of a significant asset group within a reporting unit. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements.

Goodwill Impairment Assessments

Our goodwill resides in multiple reporting units. The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. We estimate fair value using the best information available, using both a market approach, as well as a discounted cash flow model, commonly referred to as the income approach. The market approach determines the value of a reporting unit by deriving market multiples for reporting units based on assumptions potential market participants would use in establishing a bid price for the unit. This approach therefore assumes strategic initiatives will result in improvements in operational performance in the event of purchase, and includes the application of a discount rate based on market participant assumptions with respect to capital structure and access to capital markets. The income approach uses a reporting unit's projection of estimated operating results and cash flows that is discounted using a weighted-average cost of capital that reflects current market conditions appropriate to each of our reporting units. The projection uses management's best estimates of economic and market conditions over the projected period, including growth rates in sales, costs, estimates of future expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, future estimates of capital expenditures and changes in future working capital requirements. Our final estimate of fair value of reporting units is developed by weighting the fair values determined through both the market participant and income approaches, where comparable market participant information is available.

If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. The amount of impairment is determined by comparing the implied fair value of reporting unit goodwill to the carrying value of the goodwill in the same manner as if the reporting unit was being acquired in a business combination. Specifically, we allocate the fair value to all of the assets and liabilities of the reporting unit, including any unrecognized intangible assets, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we record an impairment charge for the difference.

After performing the first step of the process, we determined goodwill recorded at reporting units within the Sears Canada and Sears Domestic segments in 2012 and 2011, respectively, was potentially impaired. The impairment determination was primarily driven by the combination of lower sales and continued margin pressure coupled with expense increases which led to a decline in our operating profit. After performing the second step of the process, we determined that the total amount of goodwill recorded at these reporting units was impaired and

recorded charges of $295 million and $551 million in 2012 and 2011, respectively. We did not record any goodwill impairment charges in 2010.

The use of different assumptions, estimates or judgments in either step of the goodwill impairment testing process, such as the estimated future cash flows of our reporting units, the discount rate used to discount such cash flows, or the estimated fair value of the reporting units' tangible and intangible assets and liabilities, could significantly increase or decrease the estimated fair value of a reporting unit or its net assets, and therefore, impact the related impairment charge. At the 2012 annual impairment test date, the conclusion that no indication of goodwill impairment existed for the remaining reporting units would not have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of our reporting units to their net present value in determining their estimated fair values and/or (2) a 100 basis point decrease in the estimated sales growth rate and/or terminal period growth rate.

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

Intangible Asset Impairment Assessments

We review indefinite-lived intangible assets, primarily trade names, for impairment by comparing the carrying amount of each asset to the sum of undiscounted cash flows expected to be generated by the asset. We consider the income approach when testing intangible assets with indefinite lives for impairment on an annual basis. We determined that the income approach, specifically the Relief from Royalty Method, was most appropriate for analyzing our indefinite-lived assets. This method is based on the assumption that, in lieu of ownership, a firm would be willing to pay a royalty in order to exploit the related benefits of this asset class. The Relief from Royalty Method involves two steps: (1) estimation of reasonable royalty rates for the assets and (2) the application of these royalty rates to a net sales stream and discounting the resulting cash flows to determine a value. We multiplied the selected royalty rate by the forecasted net sales stream to calculate the cost savings (relief from royalty payment) associated with the assets. The cash flows are then discounted to present value by the selected discount rate and compared to the carrying value of the assets. We did not record any intangible asset impairment charges in 2012, 2011 or 2010.

The use of different assumptions, estimates or judgments in our intangible asset impairment testing process, such as the estimated future cash flows of assets and the discount rate used to discount such cash flows, could significantly increase or decrease the estimated fair value of an asset, and therefore, impact the related impairment charge. At the 2012 annual impairment test date, the above-noted conclusion that no indication of significant intangible asset impairment existed at the test date would not have changed had the test been conducted assuming: (1) a 100 basis point increase in the discount rate used to discount the aggregate estimated cash flows of our assets to their net present value in determining their estimated fair values (without any change in the aggregate estimated cash flows of our intangibles), (2) a 100 basis point decrease in the terminal period growth rate without a change in the discount rate of each intangible, or (3) a 10 basis point decrease in the royalty rate applied to the forecasted net sales stream of our assets.

Based on our sensitivity analysis, we do not believe that the indefinite-lived intangible balance is at risk of impairment at the end of the year because the fair values are substantially in excess of the carrying values. However, 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, or changes in our plans for one or more indefinite-lived intangible asset.

New Accounting Pronouncements

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements made in this Annual Report on Form 10-K and in other public announcements by us contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties 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. Forward-looking statements include information concerning our future financial performance, business strategy, plans, goals and objectives. Statements preceded or followed by, or that otherwise include, the words “believes,” “expects,” “anticipates,” “intends,” “estimates,” “plans,” “forecast,” “is likely to” and similar ex 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. 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 offer merchandise and services that our customers want, including our proprietary brand products; our ability to successfully implement initiatives to improve our liquidity through inventory management and other actions; competitive conditions in the retail and related services industries; worldwide economic conditions and business uncertainty, including the availability of consumer and commercial credit, changes in consumer confidence and spending, the impact of rising fuel prices, and changes in vendor relationships; vendors’ lack of willingness to provide acceptable payment terms or otherwise restricting financing to purchase inventory or services; possible limits on our access to capital markets and other financing sources, including incremental financings under the accordion feature of our domestic credit agreement and additional second lien financings, with respect to which we do not have commitments from lenders; our ability to successfully achieve our plans to generate liquidity, reduce inventory and reduce fixed costs; the impact of seasonal buying patterns, including seasonal fluctuations due to weather conditions, which are difficult to forecast with certainty; our dependence on sources outside the United States for significant amounts of our merchandise; our extensive reliance on computer systems, including legacy systems, to implement our integrated retail strategy, process transactions, summarize results and manage our business, which may be subject to disruptions or security breaches; 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; our ability to protect or preserve the image of our brands; the outcome of pending and/or future legal proceedings, including product liability claims and proceedings with respect to which the parties have reached a preliminary settlement; and the timing and amount of required pension plan funding.

Certain of these and other factors are discussed in more detail in Part I, Item 1A of this Annual Report on Form 10-K. While we believe that our forecasts and assumptions are reasonable, we caution that actual results may differ materially. We intend the forward-looking statements to speak only as of the time made and do not undertake to update or revise them as more information becomes available.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

Interest Rate Risk

We manage interest rate risk through the use of fixed and variable-rate funding. All debt securities are considered non-trading. At February 2, 2013, 35% of our debt portfolio was variable rate. Based on the size of this variable rate debt portfolio at February 2, 2013, which totaled approximately $1.1 billion, an immediate 100 basis point change in interest rates would have affected annual pretax funding costs by $11 million. These estimates do not take into account the effect on income resulting from invested cash or the returns on assets being funded. These estimates also assume that the variable rate funding portfolio remains constant for an annual period and that the interest rate change occurs at the beginning of the period.

Item 8. Financial Statements and Supplementary Data

SEARS HOLDINGS CORPORATION
Consolidated Statements of Operations

millions, except per share data	2012	2011	2010
REVENUES			
Merchandise sales and services	$39,854	$41,567	$42,664
COSTS AND EXPENSES			
Cost of sales, buying and occupancy	29,340	30,966	31,000
Selling and administrative	10,660	10,664	10,425
Depreciation and amortization	830	853	869
Impairment charges	330	649	—
Gain on sales of assets	(468)	(64)	(67)
Total costs and expenses	40,692	43,068	42,227
Operating income (loss)	(838)	(1,501)	437
Interest expense	(267)	(289)	(293)
Interest and investment income	94	41	36
Other income (loss)	1	(2)	(14)
Income (loss) from continuing operations before income taxes	(1,010)	(1,751)	166
Income tax expense	(44)	(1,369)	(27)
Income (loss) from continuing operations	(1,054)	(3,120)	139
Income (loss) from discontinued operations, net of tax	—	(27)	11
Net income (loss)	(1,054)	(3,147)	150
(Income) loss attributable to noncontrolling interests	124	7	(17)
NET INCOME (LOSS) ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS	$(930)	$(3,140)	$133
Amounts attributable to Holdings' shareholders:			
Income (loss) from continuing operations, net of tax	$(930)	$(3,113)	$122
Income (loss) from discontinued operations, net of tax	—	(27)	11
Net income (loss)	$(930)	$(3,140)	$133
NET INCOME (LOSS) PER COMMON SHARE ATTRIBUTABLE TO HOLDINGS' SHAREHOLDERS			
Basic:			
Continuing operations	$(8.78)	$(29.15)	$1.09
Discontinued operations	—	(0.25)	0.10
	$(8.78)	$(29.40)	$1.19
Diluted:			
Continuing operations	$(8.78)	$(29.15)	$1.09
Discontinued operations	—	(0.25)	0.10
	$(8.78)	$(29.40)	$1.19
Basic weighted average common shares outstanding	105.9	106.8	111.5
Diluted weighted average common shares outstanding	105.9	106.8	111.7

See accompanying Notes to Consolidated Financial Statements.

56

SEARS HOLDINGS CORPORATION
Consolidated Statements of Comprehensive Income (Loss)

millions	2012	2011	2010
Net income (loss)	$(1,054)	$(3,147)	$150
Other comprehensive income (loss)			
Pension and postretirement adjustments, net of tax	74	(789)	(12)
Deferred gain (loss) on derivatives, net of tax	5	(6)	(9)
Currency translation adjustments, net of tax	5	(38)	93
Total other comprehensive income (loss)	84	(833)	72
Comprehensive income (loss)	(970)	(3,980)	222
Comprehensive (income) loss attributable to noncontrolling interests	124	12	(71)
Comprehensive income (loss) attributable to Holdings' shareholders	$(846)	$(3,968)	$151

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Consolidated Balance Sheets

millions	February 2, 2013	January 28, 2012
ASSETS		
Current assets		
Cash and cash equivalents	$609	$747
Restricted cash	9	7
Accounts receivable	635	695
Merchandise inventories	7,558	8,407
Prepaid expenses and other current assets	454	388
Total current assets	9,265	10,244
Property and equipment		
Land	1,875	1,924
Buildings and improvements	6,072	6,186
Furniture, fixtures and equipment	2,950	2,786
Capital leases	347	314
Gross property and equipment	11,244	11,210
Less accumulated depreciation and amortization	(5,191)	(4,633)
Total property and equipment, net	6,053	6,577
Goodwill	379	841
Trade names and other intangible assets	2,881	2,937
Other assets	762	782
TOTAL ASSETS	$19,340	$21,381
LIABILITIES		
Current liabilities		
Short-term borrowings [(1)]	$1,094	$1,175
Current portion of long-term debt and capitalized lease obligations	83	230
Merchandise payables	2,761	2,912
Other current liabilities	2,683	2,892
Unearned revenues	931	964
Other taxes	480	523
Short-term deferred tax liabilities	382	516
Total current liabilities	8,414	9,212
Long-term debt and capitalized lease obligations [(2)]	1,943	2,088
Pension and postretirement benefits	2,730	2,738
Other long-term liabilities	2,126	2,186
Long-term deferred tax liabilities	955	816
Total Liabilities	16,168	17,040
Commitments and contingencies		
EQUITY		
Sears Holdings Corporation equity		
Preferred stock, 20 shares authorized; no shares outstanding	—	—
Common stock $0.01 par value; 500 shares authorized; 106 and 106 shares outstanding, respectively	1	1
Treasury stock—at cost	(5,970)	(5,981)
Capital in excess of par value	9,298	10,005

Retained earnings	885	1,865
Accumulated other comprehensive loss	(1,459)	(1,609)
Total Sears Holdings Corporation equity	2,755	4,281
Noncontrolling interest	417	60
Total Equity	3,172	4,341
TOTAL LIABILITIES AND EQUITY	$19,340	$21,381

(1) Includes $285 million and $250 million at February 2, 2013 and January 28, 2012, respectively, of unsecured commercial paper held by ESL and its affiliates.

(2) Includes $95 million at both February 2, 2013 and January 28, 2012 of senior secured notes held by ESL and its affiliates; and $3 million and $14 million at February 2, 2013 and January 28, 2012, respectively, of subsidiary notes held by ESL and its affiliates.

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Consolidated Statements of Cash Flows

millions	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$(1,054)	$(3,147)	$150
(Income) loss from discontinued operations, net of tax	—	27	(11)
Income (loss) from continuing operations	(1,054)	(3,120)	139
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Deferred tax valuation allowance	237	1,798	—
Depreciation and amortization	830	853	869
Impairment charges	330	649	—
Gain on sales of assets	(468)	(64)	(67)
Gain on sales of investments	(28)	—	—
Pension and postretirement plan contributions	(593)	(390)	(316)
Pension and postretirement plan settlements	455	—	—
Settlement of Canadian dollar hedges	6	—	(3)
Change in operating assets and liabilities (net of acquisitions and dispositions):			
Deferred income taxes	(206)	(533)	(15)
Merchandise inventories	427	545	(353)
Merchandise payables	(117)	(134)	(285)
Income and other taxes	(63)	(50)	(34)
Mark-to-market adjustments and settlements on Sears Canada U.S. dollar collar contracts	1	2	7
Other operating assets	(100)	67	(7)
Other operating liabilities	40	70	142
Net cash provided by (used in) operating activities—continuing operations	(303)	(307)	77
Net cash provided by operating activities—discontinued operations	—	32	46
Net cash provided by (used in) operating activities	(303)	(275)	123
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of property and investments	532	72	35
Net decrease in investments and restricted cash	37	8	—
Purchases of property and equipment	(378)	(432)	(426)
Net cash provided by (used in) investing activities—continuing operations	191	(352)	(391)
Net cash provided by (used in) investing activities—discontinued operations	—	43	(15)
Net cash provided by (used in) investing activities	191	(309)	(406)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from debt issuances	5	104	1,353
Repayments of long-term debt	(335)	(611)	(358)
Increase (decrease) in short-term borrowings, primarily 90 days or less	(81)	815	35
Sears Hometown and Outlet Stores, Inc. pre-separation funding	100	—	—
Proceeds from the sale of Sears Hometown and Outlet Stores, Inc.	347	—	—
Debt issuance costs	(3)	(35)	(28)
Purchase of Sears Canada shares	(10)	(43)	(603)
Sears Canada dividends paid to minority shareholders	(50)	—	(69)
Purchase of treasury stock	—	(183)	(394)
Net cash provided by (used in) financing activities—continuing operations	(27)	47	(64)
Net cash used in financing activities—discontinued operations	—	(75)	(31)

Net cash used in financing activities	(27)	(28)	(95)
Effect of exchange rate changes on cash and cash equivalents	1	—	57
NET DECREASE IN CASH AND CASH EQUIVALENTS	(138)	(612)	(321)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	747	1,359	1,680
CASH AND CASH EQUIVALENTS, END OF YEAR	$609	$747	$1,359
SUPPLEMENTAL INFORMATION:			
Capital lease obligation incurred	$61	$3	$15
Supplemental Cash Flow Data:			
Income taxes paid, net of refunds	$40	$94	$47
Cash interest paid	199	223	164
Unpaid liability to acquire equipment and software	30	52	56
Non-cash dividend in connection with Spin-Off transactions	(542)	(74)	—

See accompanying Notes to Consolidated Financial Statements.

SEARS HOLDINGS CORPORATION
Consolidated Statements of Equity

	Equity Attributable to Holdings' Shareholders							
dollars and shares in millions	Number of Shares	Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
Balance at January 30, 2010	115	$ 1	$ (5,446)	$ 10,465	$ 4,797	$ (721)	$ 339	$ 9,435
Comprehensive income								
Net income	—	—	—	—	133	—	17	150
Pension and postretirement adjustments, net of tax	—	—	—	—	—	(41)	29	(12)
Deferred loss on derivatives, net of tax	—	—	—	—	—	(9)	—	(9)
Currency translation adjustments, net of tax	—	—	—	—	—	68	25	93
Total Comprehensive Income								222
Stock awards	—	—	10	(11)	—	—	—	(1)
Purchase of Sears Canada shares	—	—	—	(269)	—	(76)	(236)	(581)
Sears Canada dividend paid to minority shareholders	—	—	—	—	—	—	(69)	(69)
Shares repurchased	(6)	—	(394)	—	—	—	—	(394)
Associate stock purchase	—	—	4	—	—	—	—	4
Other	—	—	—	—	—	—	(2)	(2)
Balance at January 29, 2011	109	$ 1	$ (5,826)	$ 10,185	$ 4,930			