SEARS HOLDINGS CORP
Form 10-K
March 26, 2008

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, 2008

or

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

SEARS HOLDINGS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**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 LLC**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 1, 2008, the Registrant had 132,346,315 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 August 4, 2007, the last business day of the Registrant s most recently completed second fiscal quarter, was approximately $7.7 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 5, 2008 (the 2008 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, we, us, or the Company) is the parent company of Kmart Holding Corporation (Kmart) and Sears, Roebuck and Co. (Sears). Holdings was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the Merger). The Merger, completed on March 24, 2005, combined two of America s oldest existing retail entities, both with origins dating to the late 1800s. We are a broadline retailer with 2,317 full-line and 1,150 specialty retail stores in the United States operating through Kmart and Sears and 380 full-line and specialty retail stores in Canada operating through Sears Canada Inc. (Sears Canada), a 70%-owned subsidiary.

Business Segments

During fiscal 2007, we operated three reportable segments: Kmart, Sears Domestic and Sears Canada. Financial information, including revenues, operating income and total assets for each of these business segments is contained in Note 19 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.

Kmart

As of February 2, 2008, Holdings operated a total of 1,382 Kmart stores across 49 states, Guam, Puerto Rico, and the U.S. Virgin Islands. This store count included 1,327 discount stores, averaging 92,000 square feet, and 55 Super Centers, averaging 165,000 square feet. Most Kmart stores are one-floor, free-standing units that carry a wide assortment of general merchandise, including products sold under such well-known labels as Jaclyn Smith, Joe Boxer and Martha Stewart Everyday. During fiscal 2005, we began selling certain proprietary Sears brand products, such as Kenmore, Craftsman, and DieHard brand products, and services within certain Kmart stores. At the end of fiscal 2005, approximately 100 Kmart stores were selling an assortment of Sears brand products, mainly within home appliances and tools. During the fall of fiscal 2006, we added Craftsman tool assortments into Kmart locations nationwide. As of February 2, 2008, approximately 280 Kmart stores were also selling an assortment of major home appliances, including Kenmore-branded products. There are 1,063 Kmart stores which also operate in-store pharmacies. The Super Centers generally operate 24-hours a day and combine a full-service grocery along with the general merchandise selection of a discount store. There are also 20 Sears Auto Centers operating in Kmart stores, including 11 which opened in 2007. Sears Auto Centers offer a variety of professional automotive repair and maintenance services as well as a full assortment of automotive accessories. Kmart also sells its products through its kmart.com website.

Sears Domestic

As of February 2, 2008, Sears Domestic operations consisted of the following:

Full-line Stores 935 broadline stores of which 860 are full-line stores located across all 50 states and Puerto Rico, primarily mall-based locations averaging 134,000 square feet. Full-line stores offer a wide array of products across many merchandise categories, including home appliances, consumer electronics, tools, fitness and lawn and garden equipment, certain automotive services and products, such as tires and batteries, home fashion products, as well as apparel, footwear and accessories for the whole family. Our product offerings include our proprietary Kenmore, Craftsman, DieHard, Lands End, Covington, Apostrophe, Canyon River Blues and Athletech brand merchandise. Also, as of February 2, 2008, we operated 75 Sears Essentials/Grand stores located in 26 states, primarily free-standing units averaging 113,000 square feet and offering health and beauty products, pantry goods, household products and toys in addition to the offerings of the typical mall-based store. There are 48 Sears Essentials/Grand stores which operate in-store pharmacies. Also, 785 Sears Auto Centers are operated in association with full-line stores and 29 Sears Auto Centers operated out of Sears Essentials/Grand stores. In addition, there are 29 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 the Internet and picking up their merchandise in Sears full-line stores.

Specialty Stores 1,150 specialty stores located across all 50 states and Puerto Rico, located primarily in free-standing, off-mall locations or high-traffic neighborhood shopping centers, and primarily consist of the operations of:

857 Dealer Stores Primarily independently-owned stores, predominantly located in smaller communities and averaging 8,800 square feet offering appliances, consumer electronics, lawn and garden equipment, hardware and automotive batteries. Most of our dealer stores carry proprietary Sears brands, such as Kenmore, Craftsman, and DieHard, as well as a wide assortment of national brands.

111 Sears Hardware Stores and 85 Orchard Supply Hardware Stores Neighborhood hardware stores averaging 40,000 square feet that carry Craftsman brand tools and lawn and garden equipment, Kenmore home appliances, Diehard batteries and a wide assortment of national brands and other home improvement products. 111 locations also offer a limited selection of home appliances.

16 The Great Indoors Stores Home decorating and remodeling superstores, averaging 143,000 square feet, dedicated to the four main rooms of the house: kitchen, bedroom, bathroom and great room.

62 Outlet Stores Locations offering overstock and/or distressed appliances, consumer electronics and lawn and garden equipment at a discount.

15 Lands End Retail Stores These retail stores, averaging 8,300 square feet, offer Lands End merchandise primarily from catalog and Internet channel overstocks.

Direct to Customer The Direct to Customer business includes the direct merchant business of Lands End, Inc. (Lands End). 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.

Commercial Sales We sell Sears merchandise, parts, and services to commercial customers through our business-to-business Sears Commercial Sales, Sears Commercial Solutions/Sears Parts Direct Commercial, 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 super-premium appliance and plumbing fixtures to architects, designers, and new construction or remodeling customers, currently operating in four markets with 29 showrooms.

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 over 10,000 service technicians making over 13 million service calls annually, this business delivers a broad range of retail-related residential and commercial services across all 50 states, Puerto Rico, Guam and the Virgin Islands under the Sears Parts & Repair Services and A&E Factory Service brand names.

Commercial and residential customers can obtain parts and repair services for all major brands of products within the home 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 PartsDirect.com website. Smaller items for repair can be brought into Sears Parts & Repair Centers located throughout the United States or to many Sears full-line, dealer and outlet stores. 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, HVAC and carpet and upholstery cleaning) provided through Sears Home Improvement Services.

Sears Canada

Sears Canada, a consolidated, 70%-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. In addition, Sears Canada conducted credit operations prior to the November 15, 2005 sale of its Credit and Financial Services operations to JPMorgan Chase & Co. (JPMorgan Chase).

As of February 2, 2008, Sears Canada operated a total of 121 full-line stores, 259 specialty stores (48 furniture and appliance stores, 163 dealer stores operated under independent local ownership, 5 appliances and mattresses stores, 30 Corbeil stores and 13 outlet stores), 37 floor covering stores, 1,826 catalog pick-up locations and 106 travel offices. Sears Canada also conducts business over the Internet through its website, sears.ca.

The Merger and Development of the Business

The Merger provided Holdings a means for leveraging the historical strengths of Kmart and Sears with the goal of making our products, brands and service offerings available through more locations and customer distribution channels. Furthermore, Holdings is striving to become more responsive to the needs of customers, thereby building long-term, value-added customer relationships.

Sears has a long-standing reputation for offering customers a wide variety of merchandise and related services, with a particular emphasis on its strong proprietary brands such as Kenmore, Craftsman, DieHard and Lands End. Historically, Sears conducted its business primarily using a mall-based format. At the time of the Merger, Sears operated 874 domestic full-line stores mainly located in such on-mall locations. In response to off-mall competitor growth, Sears commenced a strategy prior to the Merger to increase the number of its off-mall stores in order to expand distribution points for its brands, merchandise and services. Kmart, on the other hand, historically used large format, off-mall locations in selling a selection of general merchandise goods. At the time of the Merger, Kmart operated approximately 1,400 off-mall stores and sought to further improve its operational performance by pursuing opportunities to offer customers a differentiated high-quality product selection to distinguish itself from competitors.

With Kmart s approximately 1,400 off-mall locations, Holdings store base offers a greater number of customers the opportunity to purchase Sears products and services outside of Sears traditional mall-based stores. This increase in distribution points brought about by the Merger provided a more rapid and lower-cost store base growth than Sears would have been able to accomplish on its own. At the same time, the addition of Sears-owned brands and services, including Sears credit programs, to Kmart stores enhances the selection and value proposition offered to Kmart customers and helps to differentiate Kmart from its general merchandise competitors. During the fall of fiscal 2006, we added Craftsman brand tool assortments into Kmart locations nationwide. In addition, as of February 2, 2008, approximately 280 Kmart stores were also selling an assortment of major home appliances, including Kenmore-branded products. We will continue to explore opportunities to profitably cross-merchandise products and services between our Kmart and Sears formats.

Our combined store base of approximately 2,300 Kmart and domestic full-line stores allows Holdings to compete on a scale larger than that of many of our national competitors. The scale of the combined enterprise in the U.S. has also generated significant opportunities for realizing cost synergies across a number of areas, including merchandise and non-merchandise purchasing, delivery and distribution and within other selling, general and administrative expense areas. While we will continue to operate both the Sears and Kmart store formats in the foreseeable future, many of the functions supporting these formats have been integrated.

For accounting purposes, the Merger was treated as a purchase business combination, with Kmart acquiring Sears. In identifying Kmart as the acquiring entity, the companies took into account the relative share ownership of the Company after the Merger, the composition of the governing body of the combined entity and the designation of certain senior management positions. Accordingly, the historical financial statements of Kmart serve as the historical financial statements of Holdings, the registrant.

Additional information concerning the Merger is contained in Note 2 of Notes to Consolidated Financial Statements.

Bankruptcy of Kmart Corporation

Kmart Corporation (the Predecessor Company) is a predecessor operating company of Kmart (the Successor Company). In January 2002, the Predecessor Company and 37 of its U.S. subsidiaries (collectively, the Debtors) filed voluntary petitions for reorganization under Chapter 11 of the federal bankruptcy laws (Chapter 11). The Debtors decided to seek bankruptcy reorganization based upon a rapid decline in their liquidity resulting from below-plan sales and earnings performance in the fourth quarter of fiscal 2001, the evaporation of the surety bond market, an erosion of supplier confidence, intense competition and unsuccessful sales and marketing initiatives, as well as the continued recession and capital market volatility in existence at that time. The Predecessor Company utilized Chapter 11 to strengthen its balance sheet and reduce debt, focus its store portfolio on the most productive locations and terminate leases for closed stores, develop a more efficient organization and lower overall operating costs.

On May 6, 2003, the Predecessor Company emerged from reorganization proceedings under Chapter 11 pursuant to the terms of an Amended Joint Plan of Reorganization (the Plan of Reorganization) and related amended Disclosure Statement. This Plan received formal endorsement of the statutory creditors committee and, as modified, was confirmed by the U.S. Bankruptcy Court in April 2003. The Predecessor Company is presently an indirect wholly-owned subsidiary of Holdings. See Note 13 of Notes to Consolidated Financial Statements for further explanation of the bankruptcy and claims resolution process.

Sale of Sears Canada s Credit and Financial Services Operations

On November 15, 2005, Sears Canada completed the sale of substantially all of the assets and liabilities of its Credit and Financial Services operations to JPMorgan Chase for approximately $2.0 billion in cash proceeds, net of securitized receivables and other related costs and taxes. In addition, Sears Canada and JPMorgan Chase concurrently entered into a long-term marketing and servicing alliance with an initial term of ten years. Sears Canada used a portion of the proceeds it generated from the sale to fund an extraordinary cash dividend and a tax-free return of stated capital to shareholders of record on December 16, 2005. Holdings, as beneficial owner of approximately 54% of the outstanding common stock of Sears Canada at the time of the distribution, received $877 million in after-tax proceeds from this distribution. Additional information concerning the sale is contained in Note 5 of Notes to Consolidated Financial Statements.

Acquisition of Minority Interest in Sears Canada

In December 2005, we announced our intention to acquire 100% ownership of Sears Canada in order to allow Sears Canada to be in a better competitive position relative to other Canadian retailers and the Canadian operations of major U.S. retailers. During fiscal 2006, we increased our majority interest in Sears Canada from 54% to 70% by acquiring 17.8 million common shares of Sears Canada pursuant to the takeover bid. We paid a total of $282 million for the additional 17.8 million common shares acquired and accounted for the acquisition of an additional interest in Sears Canada as a purchase business combination for accounting purposes. The takeover bid expired on November 27, 2006.

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 15 of Notes to Consolidated Financial Statements.

Trademarks, Trade Names and Licenses

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 THE GREAT INDOORS®, OSH®, CANYON RIVER BLUES®, APOSTROPHE®, COVINGTON®, and ATHLETECH® . We also have the right to sell an exclusive line of Martha Stewart Everyday® products in our Kmart locations through January 2010, as well as within Sears Canada stores through August 2008. Our right to use our trade names and marks continues so long as we use them.

Seasonality

The retail business is seasonal in nature, and we generate a high proportion of our revenues and operating cash flows during the fourth quarter of our fiscal year, which includes the holiday season. 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, to the extent necessary, borrowings under our $4.0 billion, five-year credit agreement (described in the Uses and Sources of Liquidity section below). Fourth quarter reported revenues accounted for 30%, 31% and 33% of total reported revenues in fiscal years 2007, 2006 and 2005, respectively.

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 and auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level along with Internet and catalog businesses, which handle similar lines of merchandise. Wal-Mart, Target, Kohl s, JC Penney, Home Depot, Lowe s and Best Buy are some of the national retailers with which we compete. Home Depot, Lowe s and Best Buy are major competitors in relation to our home appliance business, which accounted for approximately 15% of our fiscal 2007 reported revenues. Sears Canada competes in Canada with Hudson s Bay Company and U.S.-based competitors, including those mentioned above, that are expanding into Canada. Success in this competitive marketplace 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 levels 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 company.

Employees

As of February 2, 2008, we had approximately 302,000 employees in the United States and U.S. territories, and approximately 35,000 employees in Canada through Sears Canada including, in each case, 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

References to us, we and our refer to the Company. The following risk factors could adversely affect our business, results of operations and financial condition. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us may also negatively impact us.

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.

If we do not successfully manage our inventory levels, our operating results will be adversely affected.

We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory as we seek to minimize out-of-stock levels across all product categories and to maintain in-stock levels. We obtain a significant portion of our inventory from vendors located outside the United States. 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, consumer electronics dealers and auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level. Some of our competitors are actively engaged in new store expansion. Internet and catalog businesses, which handle similar lines of merchandise, 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.

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 and operating cash flows being generated during the fourth quarter of our fiscal 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 on-line,
- 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 fiscal 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 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 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,
- transportation delays and interruptions,
- 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.

Decline in general economic conditions, consumer-spending levels and other conditions could lead to reduced consumer demand for our merchandise thereby reducing our revenues and gross margins.

Many economic and other factors outside our control, including consumer confidence, consumer spending levels, employment levels, prevailing interest rates, housing sales and remodels, consumer debt levels and inflation, as well as fuel costs and the availability of consumer credit, affect consumer-spending habits. In addition, disposable income levels may influence consumer-purchasing patterns. A general slowdown in the United States economy or an uncertain economic outlook could adversely affect consumer spending habits and our operating results.

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.

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

Given 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. Our systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, including breaches of our transaction processing or other systems that result in the compromise of confidential customer data, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees. If our systems are breached, 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 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 complex initiatives to transform our information technology processes and systems, which will include, for many systems, establishing a common platform across our lines of business, such as common human resources, supply chain and financial systems. The risk of disruption is increased in periods where such complex and significant systems changes are undertaken. Also, if we fail to successfully combine our systems, we may fail to realize cost savings anticipated to be derived from these initiatives.

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

From time to time 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, call center, human resources and procurement

functions. There can be no assurance that transition of the functions to third party service providers will be successful. 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.

We might not realize the benefits we are seeking from our new organizational structure.

Our new organizational structure is being built on five types of businesses: operating businesses; support businesses (e.g., finance, marketing); on-line businesses; real estate businesses, and brand businesses. If this new organizational structure results in ineffective collaboration among our employees, then our operating results may be harmed. Additionally, while these changes are designed to provide greater empowerment and accountability to employees and to enable us to continue to be more effective and efficient in meeting the needs of our customers, operating in this environment could affect employee morale and retention.

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 (chairman) 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, whose interests may be different than your interests, exert substantial influence over our Company.

Affiliates of Edward S. Lampert, the Chairman of our Board of Directors, beneficially own 49.6% 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, 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 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. We are impacted by trends in litigation, including class-action allegations brought under various consumer protection and employment laws, including wage and hour laws. 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 in this Form 10-K.

Our failure to successfully invest available surplus cash could negatively affect our performance

Our performance with respect to the investment of surplus cash is substantially dependent on the performance of Edward S. Lampert, to whom our Board of Directors has delegated authority to direct such investments, subject to certain limitations.

There can be no assurance that we will be successful in our efforts to identify investment opportunities that meet our requirements. Any such investments may include significant and highly concentrated direct investments, related derivative positions, or both, with respect to the equity securities of public companies. In addition, any such investments will involve risks, and Holdings balance sheet and results of operations may fluctuate, depending on the extent of excess funds and the timing, magnitude and performance of our investments. Furthermore, such investments would be subject to volatility due to market conditions and other conditions over which we may not have control, which may affect both the recorded value of the investments as well as our periodic earnings. Accordingly, the poor performance of a significant investment could have a material adverse effect on the results of operations and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The following table summarizes the locations of our Kmart and Sears Domestic stores as of February 2, 2008:

	Kmart		Sears Domestic		
State/Territory	Discount Stores	Super Centers	Full-line Mall Stores	Sears Essentials/ Grands	Specialty Stores
Alabama	26		13	3	32
Alaska			3		3
Arizona	18	2	14	1	12
Arkansas	6		7		33
California	100	1	81	10	134
Colorado	16	4	13	2	20
Connecticut	7		8	1	8
Delaware	6		4		5
Florida	98		55	10	26
Georgia	37	1	22	1	43
Hawaii	7		6		1
Idaho	8		6		6
Illinois	59	4	38	7	50
Indiana	37	5	21	2	35
Iowa	24		11		14
Kansas	11		9	2	22
Kentucky	30		11	1	22
Louisiana	11		13		19
Maine	6		6		11
Maryland	22		19	2	9
Massachusetts	18		21	1	9
Michigan	78	7	27	3	32
Minnesota	32		12		35
Mississippi	7		9		21
Missouri	25		13	4	45
Montana	10		3		7
Nebraska	8		5		10
Nevada	9	2	4	1	6
New Hampshire	6		6	3	8
New Jersey	37		20	5	19
New Mexico	15		7		9
New York	57	1	46		34
North Carolina	43	4	27		33
North Dakota	7		4		4
Ohio	71	11	42	2	50
Oklahoma	9		11		20
Oregon	14		9		21
Pennsylvania	99	2	45	2	33
Rhode Island	1		2		2
South Carolina	27	1	14	2	16
South Dakota	9		2		6
Tennessee	33	3	24	1	25
Texas	19	1	60	1	89
Utah	16		5	3	5
Vermont	3		2		8
Virginia	40	4	23	1	22
Washington	20		23		17
West Virginia	16	1	8		8
Wisconsin	33		15	4	39
Wyoming	9		2		7
Puerto Rico	22	1	9		5

U.S. Virgin Islands	4				
Guam	1				
Totals	1,327	55	860	75	1,150

	Kmart	Sears Domestic	Sears Canada