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SEARS: A Struggle for survival**[[1]](#endnote-1)**

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On January 20, 2017, Moody’s Investors Service, an American credit rating agency, downgraded the Corporate Family Rating for Sears Holdings Corporation (Sears) from Caa1 to Caa2,[[2]](#endnote-2) stating that the company did not have enough money to stay in business and was relying on outside funding or sale of assets to sustain operations.[[3]](#endnote-3) Neil Saunders, chief executive of the research firm Conlumino Ltd., compared Sears to the Titanic and remarked, “While Sears was once a titan of US retail, it now looks set to sink.”[[4]](#endnote-4)

In light of Sears’ poor financial performance and consecutive losses on a yearly basis, Paul Clark, a new MBA graduate and junior analyst, was assigned the task of analyzing Sears’ financial status and assessing the possibility of Sears’ bankruptcy. Clark collected the company financials and additional information about the company’s strategic moves and prepared to write his report.

RETAIL INDUSTRY IN THE United States

With today’s shopper and her new shopping journeys, it’s becoming more important than ever to optimize a shopper’s visit to store or site. This can be through an understanding of what she’s shopping for and ensuring there’s available inventory on site, or at least a very convenient option—to the shopper—to deliver products to her.[[5]](#endnote-5)

According to the National Retail Foundation, the retail sector in the United States contributed approximately US$2.6 trillion[[6]](#endnote-6) to the annual gross domestic product in 2015 and was the largest private sector employer in the country. With an estimated 40 million Americans employed in the retail industry, one in four jobs in the United States was in the retail sector.[[7]](#endnote-7)

Many retail stores closed in 2016 due to a consumer shift toward e-shopping and online retail. E-shopping and off-price retailing had become major trends in the sector because they tended to be convenient and offer innumerable benefits, such as discounts, offers, and free doorstep deliveries to the consumers. Internet sales had risen 23 per cent in 2015.[[8]](#endnote-8) The discounts available on branded merchandise at off-price stores drove the market demand. E-commerce was projected to contribute 9.8 per cent of the total country’s retail sales by 2019, making the Internet the preferred medium of procurement.[[9]](#endnote-9) Call it “the Amazon effect,” said Steve King. “As malls, big retail chains, even mom-and-pop neighbourhood stores see consumers buying more and more online, they’re trying to figure out a new business model.”[[10]](#endnote-10)

The future of retail is all about using technology to strengthen customer relationships and improve the customer experience, while making the day-to-day operations easier for merchants.[[11]](#endnote-11)

Another major worry for the retailers in the United States was the rapid expansion of low-price international retailers like Primark, the Irish fast fashion retailer; Aldi, a German discount supermarket chain; and Lidl Stiftung & Co. KG, another German global discount supermarket chain.[[12]](#endnote-12) These competitors raised the bar and led to increased competition in an already cutthroat industry.

Sears Holdings Corporation

Founded by Richard Warren Sears as a small wristwatch business in 1886,[[13]](#endnote-13) Sears operated a chain of department stores, attaining its current form after merging with Kmart Corporation in 2005.[[14]](#endnote-14) The integrated retailer provided merchandise and related services in brick and mortar stores and on an established, high-tech e-commerce platform.[[15]](#endnote-15)

In January 2017, Sears operated 1,430 full-line and specialty retail stores across the United States and employed approximately 140,000 full- and part-time employees. It also operated several websites, including sears.com and kmart.com, and it owned Shop Your Way, a social shopping forum where members earned points and received many other benefits by shopping on the web portal shopyourway.com. Sears was the largest provider of appliances, home services, garden equipment, fitness equipment, and product repair services, dealing with approximately 14 million service and installation calls annually. Its proprietary brands included Kenmore, Craftsman, and Diehard. Labels such as Jaclyn Smith, Joe Boxer, and The Country Living Home Collection were also offered in Sears’ stores.[[16]](#endnote-16)

Sears was listed on the Nasdaq National Market under the symbol SHLD and, as of April 1, 2017, had a market capitalization of US$1.1 billion.[[17]](#endnote-17)

Sears over the Years

After its start in the late 1800s, Sears soon transformed into a catalogue-based retailer commanding immense popularity across the United States. Sears products became a sensation across cities with millions of households filled with items ordered from the Sears catalogue.[[18]](#endnote-18) In 1918, three towns in central Illinois were home to a revolution when kit homes from the catalogue were ordered by Standard Oil Company and built as complete neighbourhoods for Standard Oil’s employees. The largest collection, in Carlinville, became known as “Standard Addition.”[[19]](#endnote-19) By 1940, Sears had sold about 70,000 of these kit houses in over 447 styles.[[20]](#endnote-20)

Sears opened its first brick-and-mortar store in 1925, in Chicago. Rapidly expanding all over the country, the company had more than 300 stores in just five years.[[21]](#endnote-21) During the mid-20th century, Sears diversified by entering real estate, insurance, online services, and credit card businesses, transforming the retailer into a conglomerate. It started Allstate Insurance Company in 1931, added Dean Witter Reynolds (stock brokerage) and Coldwell Banker (real estate) in 1981, started Prodigy Communications Corporation (an online services platform) as a joint venture with IBM in 1984, and introduced Discover credit cards in 1985.[[22]](#endnote-22)

Soon after, in 1993, Sears closed the catalogue business because people began to prefer to buy their general merchandise products in stores. When competing retailers such as Walmart Inc. entered the sector, Sears was pressured to place heavy discounts on its products. The company was forced to lay off thousands of employees as it closed hundreds of stores and its catalogue business. Private label brands and the credit card, which contributed 60 per cent of the company’s profits, declined, with the company disposing of both businesses in 2003.[[23]](#endnote-23)

That same year, the company entered the hypermarkets category by opening the Sears Grand stores. These oversized stores averaged 200,000 square feet and were located at standalone locations. The aim was to provide a single source shopping location near people’s homes in the suburbs, offering a broad range of products to satisfy a range of consumer needs.[[24]](#endnote-24)

In late 2004, Edward Lampert, chair of Kmart and the largest shareholder in both Kmart and Sears, led the merger of the two retailers. Kmart bought Sears for $11 billion, and several hundred Kmart stores were rebranded as Sears.[[25]](#endnote-25) Ironically, it was also at this time that e-commerce began to gain traction and brick-and-mortar retailers began losing their appeal to consumers.[[26]](#endnote-26) It was no surprise, then, that the company struggled after the merger.

Sears became a loss-making store from 2010 onward, struggling to cope with the changing retail industry and adapt to changing consumer expectations. The company introduced several programs to attract consumer attention but failed in its efforts. One of the programs was AdYourWay, an online service that provided customers with deals and offers of interest and alerted them of price drops on chosen products in the store. Another was MyGofer, a platform that enabled customers to buy daily basics and a range of other items online and pick them up from a physical store later the same day.[[27]](#endnote-27)

In 2013, the company was launched through major changes in efforts to revive the business, described as a “paradigm shift from traditional retailing to a member-centric company.”[[28]](#endnote-28) The effort was to focus on the company’s core customers and members, providing them value through an integrated retail experience consisting of physical stores, service businesses, a credit card, and its Shop Your Way platform. Sears was investing significantly in online e-commerce platforms, membership programs, and the technology needed to support these initiatives to stay abreast of the shift toward online shopping and the use of mobile technology and social media.[[29]](#endnote-29)

Financial Performance

The struggle for Sears started during the 2009 recession without any recovery by 2017. The intense pressure in the retail industry coupled with the lack of a coherent turnaround strategy led to Sears’ consistent decline over the years. Between fiscal year (FY) 2012/13 and FY 2016/17, the company closed a large number of stores and laid off more than 40 per cent of its staff (see Exhibit 2).[[30]](#endnote-30)

The company’s revenue declined continuously from FY 2011/12 to FY 2016/17. Despite a simultaneous decline in the total costs and expenses of the company during the same period, the company’s operating margins continued to suffer as a result of a steeper decline in the company’s revenue as compared to the reduction in costs. This deterioration of the company’s profitability also led to the erosion of the company’s equity capital over the period (see Exhibits 3 and 4).[[31]](#endnote-31)

Deterioration of the profitability was also accompanied by erosion of the company’s asset base and cash reserves. During the same period, Sears’ borrowings (long-term as well as short-term) increased significantly. The company had been forced to borrow to fund its operations and meet its financial obligations, which was evident from the increasing cash flows from the company’s investing and financing activities (see Exhibits 4 and 5).[[32]](#endnote-32)

Apart from poor financial performance, Sears also experienced an unusual number of high-level departures. According to LinkedIn data, at least 67 executives at the vice-president level or higher left during 2015–17. Fifteen of them left after fewer than two years of service, and seven left after fewer than 12 months, according to employee profiles.[[33]](#endnote-33)

Edward Lampert, Chief Executive Officer

Lampert, a former Wall Street prodigy, took over Sears’ reins as chairman of the company’s board of directors after the merger with Kmart was completed in 2005. In February 2013, he took on the additional responsibility of Sears’ chief executive officer (CEO) after Louis D’Ambrosio stepped down due to family health matters.[[34]](#endnote-34)

An economics major from Yale University, Lampert started his career as an intern at Goldman Sachs in 1984 and went on to become renowned on Wall Street, riding on the success of his hedge fund, ESL Investments Inc.[[35]](#endnote-35) Lampert drew comparisons with Warren Buffet for his investment style.[[36]](#endnote-36)

Lampert was Sears’ top shareholder, owning about 48 per cent of the company’s stock, including shares held by ESL Investments. He was also the company’s principal creditor.[[37]](#endnote-37) Yet, Lampert was rarely seen in the office, only visiting once a year for the shareholders’ meeting and, according to interviews with Sears employees, running the company through video conferencing the rest of the year. “The only way you see Eddie is through a screen. We used to joke about who had to go upstairs to get fixed and see Oz,” said one former executive.[[38]](#endnote-38)

As CEO, Lampert led the company through major changes in efforts to revive the business. It was his idea to transform Sears from traditional retailing to a membership company, investing in the e-commerce platforms and technology needed to make the transition. Nonetheless, Lampert’s leadership drew criticism from various quarters of the market. Critics asserted that Lampert was stripping the company of its most valuable properties and brands behind the veil of making Sears an “asset-light” organization. According to a lawsuit filed by Sears shareholders in June 2015, Sears was selling its remaining valuable prime real estate to a trust controlled by Lampert, increasing the rental and debt burden on the company.[[39]](#endnote-39) “He’s moving money from one pocket to the other pocket, and he’s protected himself on both sides,” one former vice-president said.[[40]](#endnote-40)

In 2014, Lampert spun off the clothing brand Lands’ End into a separate company. (Sears had acquired the company and its brand in 2002.) ESL Investments took a large stake in the newly independent company, which had a market capitalization many times that of Sears. Also in 2014, Lampert spun off Sears Canada Inc.,[[41]](#endnote-41) one of Sears’ subsidiaries, with ESL Investments being the largest shareholder in that entity too.[[42]](#endnote-42) Sears Canada Inc. was one of the biggest e-commerce retailers in Canada with sales of over $500 million—more than Walmart or any other online retailer in the country.[[43]](#endnote-43)

In another business move that favoured his own interests, Lampert directed a real estate transaction in 2015 that transferred 235 Sears stores to Seritage Growth Properties, a company owned by Lampert and other investors. Seritage paid $2.7 billion for the stores, shut down several of them—mostly prime locations—and transformed the properties into more usable office and commercial space, all while continuing to collect rent from Sears for the stores that remained opened.[[44]](#endnote-44)

In 2017, Lampert sold Craftsman, Sears’ popular in-house tool brand, to Stanley Black & Decker Inc. The deal was to provide Sears with cash and ongoing payments to tackle the company’s increasing debt and decreasing sales.[[45]](#endnote-45) Forty per cent of that debt was held by Lampert’s hedge fund. The loans, worth about $1.1 billion, were secured by Sears and Kmart real estate.[[46]](#endnote-46) Ned Weinberger, a lawyer representing Sears’ shareholders noted, “Eddie Lampert used his position at Sears as its CEO and controlling shareholder to further his and his hedge fund’s interests rather than the best interests of the company [by spinning off its] crown-jewel assets to the REIT [real estate investment trust] at an unfair price.”[[47]](#endnote-47)

Some analysts questioned whether Lampert really had an interest in retail. After becoming chair of Sears, Lampert avoided giving control of the department store chain to a seasoned retail executive. Instead, he brought in executives from the supermarket, restaurant, and telecommunications industries before taking over as CEO himself in 2013—the fifth CEO in seven years. “Eddie buys a once-great retailer but seems to be allergic to retailers,” said Erik Gordon, a professor at the University of Michigan’s Ross School of Business. “Eddie is a brilliant guy, but that doesn’t make him a retailer.”[[48]](#endnote-48)

GOING BANKRUPT?

Amid bankruptcy fears in 2017, Sears’ management announced key strategic measures to transform the existing business into an asset-light, rental-based model with enhanced focus on customer service and memberships, ultimately yielding greater financial flexibility and improved long-term operating performance of the business. The company took the following steps to achieve this transformation:

* An additional 150 stores were closed and sold: 108 Kmart and 42 Sears stores.
* The Craftsman business was sold for $775 million, and the use of a royalty-free, perpetual licence for the Craftsman brand was secured for 15 years. Sears would also benefit from a 15-year royalty stream on all third-party Craftsman sales to new customers.
* A $500 million loan was secured, backed by $800 million in real estate properties and a $500 million credit facility extended by Citibank to generate approximately $1 billion of liquidity for other general purposes. The credit facility was backed by affiliates of ESL Investments.
* Other units of the company’s properties were sold with the goal of raising $1 billion for increased liquidity.[[49]](#endnote-49)

On February 10, 2017, when announcing the next phase of strategic transformations, Lampert provided an optimistic report:

In the first several weeks of 2017, we undertook a series of transactions to optimize our capital structure and unlock value across our wide range of assets. Furthermore, we intend to use net proceeds from our announced Craftsman and real estate transactions, as well as from improvements in the operating performance of the Company, to meaningfully reduce our outstanding obligations and their associated expenses.[[50]](#endnote-50)

However, these measures failed to impress the markets, which remained skeptical of the company’s performance. When announcing the downgrade of Sears’ rating to Caa2, Moody’s analysts noted, “While the company continues to take substantial steps to improve its liquidity profile, it remains uncertain if its operational strategies will be sufficient for its cash burn to approach break-even levels.” Moody’s report had considered the recent announcements on increasing liquidity through asset divestitures, additional loans, and the sale of the Craftsman brand.[[51]](#endnote-51)

Fitch Ratings Inc. downgraded the ratings of Sears Roebuck Acceptance Corporation (SRAC), a financial subsidiary of Sears, from CC/RR4 to C/RR6.[[52]](#endnote-52) Fitch Ratings maintained a rating of CC for long-term issuer defaults on Sears Holdings Corporation and its subsidiaries. Analysts at Fitch Ratings expected the overall top line of Sears to decline 12–13 per cent in FY 2016/17, as Sears continued to close stores. The result was an expected EBITDA[[53]](#endnote-53) of between −$950 million and −$1 billion in 2016 and 2017. The analysts also expected a significant cash burn of approximately $800 million in 2016 and $1 billion in 2017 toward interest expenses, capital expenditures, and pension plan contributions.[[54]](#endnote-54)

The views of these rating agencies were further supported by industry watchers and analysts from other agencies. *Forbes* writer Paula Rosenblum asserted, “It remains a mystery how that [turnaround of Sears] will be supported after selling off iconic brands, without a seasoned merchant at the helm and spinning off parts of the business that actually added value.” She added, “This has indeed been the world’s longest liquidation sale.”[[55]](#endnote-55) Van Conway, an expert in bankruptcy and debt restructuring, said, “They are going out of business. This snowball is 90 per cent of the way to the bottom of the hill. The game’s over.”[[56]](#endnote-56)

Considering Sears’ past financial performance and its deteriorating revenues, Clark knew that he needed to not just analyze the financial health of the company but also the risk of bankruptcy. Given the views of the analysts, industry watchers, rating agencies, and Sears’ management, could the company still avert bankruptcy? Calculating the bankruptcy risk score, particularly the Altman Z-score, was the best way forward, he thought. The Altman bankruptcy prediction model had been one of the most commonly used tools for bankruptcy prediction. Clark created a template for calculating the Altman Z-score (see Exhibit 6). He then gathered his other tools of financial analysis and set to work.

EXHIBIT 1: SEARS Holdings Corporation SHARE PRICES, JANUARY 2012 TO APRIL 2017 (in US$)

Note: SHLD = Sears Holdings Corporation.

Source: Created by the case authors based on “Sears Share Price,” Yahoo Finance, accessed April 2, 2017, https://finance.yahoo.com/quote/SHLD/history?p=SHLD.

EXHIBIT 2: SEARS Holdings Corporation FIVE-YEAR RECORD

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **FY 2012/13** | **FY 2013/14** | **FY 2014/15** | **FY 2015/16** | **FY 2016/17** |
| Revenue (in US$ millions) | 39,854 | 36,188 | 31,198 | 25,146 | 22,138 |
| Revenue Growth (%) | — | −9.20% | −13.79% | −19.40% | −11.96% |
| Profit/(Loss) (in US$ millions) | (1,054) | (1,116) | (1,810) | (1,128) | (2,221) |
| Number of Stores | 2,019 | 1,980 | 1,672 | 1,725 | 1,430 |
| Number of Employees | 246,000 | 226,000 | 178,000 | 196,000 | 140,000 |

Source: Compiled by the case authors based on Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2017,” 2, 5, 58, 2016, accessed April 8, 2017, https://searsholdings.com/docs/investor/SHC\_2016\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 30, 2016,” 2, 5, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2015\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 31, 2015,” 2, 6, 64, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2014\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 1, 2014,” 2, 6, 63, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2013\_Form\_10-K.pdf; and Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 2, 2013,” 2, 6, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2012\_Form\_10-K.pdf.

EXHIBIT 3: SEARS Holdings Corporation CONSOLIDATED STATEMENT OF OPERATIONS (in US$ millions)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Fiscal Year Ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| **Revenues** |  |  |  |  |  |  |
| Merchandise Sales and Services | 41,567 | 39,854 | 36,188 | 31,198 | 25,146 | 22,138 |
| **Costs and Expenses** |  |  |  |  |  |  |
| Cost of Sales, Buying, and Occupancy | (30,966) | (29,340) | (27,433) | (24,049) | (19,336) | (17,452) |
| **Gross Margin** | **10,601** | **10,514** | **8,755** | **7,149** | **5,810** | **4,686** |
| Selling and Administrative Expenses | (10,664) | (10,660) | (9,384) | (8,220) | (6,857) | (6,109) |
| Depreciation and Amortization | (853) | (830) | (732) | (581) | (422) | (375) |
| Impairment Charges | (649) | (330) | (233) | (63) | (274) | (427) |
| Gain on Sales of Assets | 64 | 468 | 667 | 207 | 743 | 247 |
| **Total Costs and Expenses** | **(43,068)** | **(40,692)** | **(37,115)** | **(32,706)** | **(26,146)** | **(24,116)** |
| **Operating Loss** | **(1,501)** | **(838)** | **(927)** | **(1,508)** | **(1,000)** | **(1,978)** |
| Interest Expense | (289) | (267) | (254) | (313) | (323) | (404) |
| Interest and Investment Income | 41 | 94 | 207 | 132 | (62) | (26) |
| Other Income (Loss) | (2) | 1 | 2 | 4 | — | 13 |
| **Loss from Continuing Operations before Income Taxes** | **(1,751)** | **(1,010)** | **(972)** | **(1,685)** | **(1,385)** | **(2,395)** |
| Income Tax Expense | (1,369) | (44) | (144) | (125) | 257 | 174 |
| **Loss from Continuing Operations** | **(3,120)** | **(1,054)** | **(1,116)** | **(1,810)** | **(1,128)** | **(2,221)** |
| Loss from Discontinued Operations,  Net of Tax | (27) | — | — | — | — | — |
| **Net Loss** | **(3,147)** | **(1,054)** | **(1,116)** | **(1,810)** | **(1,128)** | **(2,221)** |
| (Income) Loss Attributable to  Non-controlling Interests | 7 | 124 | (249) | 128 | (1) | — |
| **Net Loss Attributable to Shareholders** | **(3,140)** | **(930)** | **(1,365)** | **(1,682)** | **(1,129)** | **(2,221)** |

Source: Compiled by the case authors based on Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2017,” 2, 5, 58, 2016, accessed April 8, 2017, https://searsholdings.com/docs/investor/SHC\_2016\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 30, 2016,” 2, 5, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2015\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 31, 2015,” 2, 6, 64, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2014\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 1, 2014,” 2, 6, 63, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2013\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 2, 2013,” 2, 6, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2012\_Form\_10-K.pdf; and Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2012,” 54, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2011\_Form\_10-K.pdf.

EXHIBIT 4: SEARS Holdings Corporation CONSOLIDATED BALANCE SHEET   
(in US$ millions)

| **Fiscal Year Ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** |  |  |  |  |  |  |
| **Current Assets** |  |  |  |  |  |  |
| Cash and Cash Equivalents | 747 | 609 | 1,028 | 250 | 238 | 286 |
| Restricted Cash | 7 | 9 | 10 | — | — | — |
| Accounts Receivables | 695 | 635 | 553 | 429 | 419 | 466 |
| Merchandise Inventories | 8,407 | 7,558 | 7,034 | 4,943 | 5,172 | 3,959 |
| Prepaid Expenses and Other Current Assets | 388 | 454 | 334 | 241 | 216 | 285 |
| **Total Current Assets** | **10,244** | **9,265** | **8,959** | **5,863** | **6,045** | **4,996** |
| **Property and Equipment** |  |  |  |  |  |  |
| Land | 1,924 | 1,875 | 1,850 | 1,701 | 827 | 770 |
| Buildings and Improvement | 6,186 | 6,072 | 5,405 | 4,701 | 3,140 | 2,954 |
| Furniture, Fixture, and Equipment | 2,786 | 2,950 | 2,587 | 1,629 | 1,352 | 1,133 |
| Capital Leases | 314 | 347 | 267 | 282 | 272 | 224 |
| **Gross Property and Equipment** | **11,210** | **11,244** | **10,109** | **8,313** | **5,591** | **5,081** |
| Less: Accumulated Depreciation and Amortization | (4,633) | (5,191) | (4,715) | (3,864) | (2,960) | (2,841) |
| **Total Property and Equipment, Net** | **6,577** | **6,053** | **5,394** | **4,449** | **2,631** | **2,240** |
| Goodwill | 841 | 379 | 379 | 269 | 269 | 269 |
| Trade Names and Other Intangible Assets | 2,937 | 2,881 | 2,850 | 2,097 | 1,909 | 1,521 |
| Other Assets | 782 | 762 | 679 | 507 | 483 | 336 |
| **Total Assets** | **21,381** | **19,340** | **18,261** | **13,185** | **11,337** | **9,362** |
| **Liabilities and Equity** |  |  |  |  |  |  |
| **Liabilities** |  |  |  |  |  |  |
| **Current Liabilities** |  |  |  |  |  |  |
| Short-Term Borrowings | 1,175 | 1,094 | 1,332 | 614 | 797 | — |
| Current Portion of Long-Term Debt and Capitalized Lease Obligations | 230 | 83 | 83 | 75 | 71 | 590 |
| Merchandise Payable | 2,912 | 2,761 | 2,496 | 1,621 | 1,574 | 1,048 |
| Other Current Liabilities | 2,892 | 2,683 | 2,527 | 2,087 | 1,925 | 1,956 |
| Unearned Revenues | 964 | 931 | 900 | 818 | 787 | 748 |
| Other Taxes | 523 | 480 | 460 | 380 | 284 | 339 |
| Short-Term Deferred Tax Liabilities | 516 | 382 | 387 | — | — | — |
| **Total Current Liabilities** | **9,212** | **8,414** | **8,185** | **5,595** | **5,438** | **4,681** |
| Long-Term Debt and Capitalized Lease Obligations | 2,088 | 1,943 | 2,834 | 3,087 | 2,108 | 3,573 |
| Pension and Post-Retirement Benefits | 2,738 | 2,730 | 1,942 | 2,404 | 2,206 | 1,750 |
| Deferred Gain on Sales Leaseback | — | — | — | — | 753 | 563 |
| Sales Leaseback Financing Obligations | — | — | — | — | 164 | 235 |
| Other Long-Term Liabilities | 2,186 | 2,126 | 2,008 | 1,849 | 1,731 | 1,641 |
| Long-Term Deferred Tax Liabilities | 816 | 955 | 1,109 | 1,195 | 893 | 743 |
| **Total Liabilities** | **17,040** | **16,168** | **16,078** | **14,130** | **13,293** | **13,186** |

Exhibit 4 (continued)

| **Fiscal Year Ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| --- | --- | --- | --- | --- | --- | --- |
| **Equity** |  |  |  |  |  |  |
| **Sears Equity** |  |  |  |  |  |  |
| Preferred Stock | — | — | — | — | — | — |
| Common Stock | 1 | 1 | 1 | 1 | 1 | 1 |
| Treasury Stock, at Cost | (5,981) | (5,970) | (5,963) | (5,949) | (5,928) | (5,891) |
| Capital in Excess of Par Value | 10,005 | 9,298 | 9,298 | 9,189 | 9,173 | 9,130 |
| Retained Earnings Deficit | 1,865 | 885 | (480) | (2,162) | (3,291) | (5,512) |
| Accumulated Other Comprehensive Loss | (1,609) | (1,459) | (1,117) | (2,030) | (1,918) | (1,552) |
| **Total Sears Equity (Deficit)** | **4,281** | **2,755** | **1,739** | **(951)** | **(1,963)** | **(3,824)** |
| Non-controlling Interest | 60 | 417 | 444 | 6 | 7 | — |
| **Total Equity** | **4,341** | **3,172** | **2,183** | **(945)** | **(1,956)** | **(3,824)** |
| **Total Liabilities and Equity** | **21,381** | **19,340** | **18,261** | **13,185** | **11,337** | **9,362** |

Source: Compiled by the case authors based on Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2017,” 2, 5, 58, 2016, accessed April 8, 2017, https://searsholdings.com/docs/investor/SHC\_2016\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 30, 2016,” 2, 5, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2015\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 31, 2015,” 2, 6, 64, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2014\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 1, 2014,” 2, 6, 63, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2013\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 2, 2013,” 2, 6, 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2012\_Form\_10-K.pdf; and Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2012,” 54, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2011\_Form\_10-K.pdf.

EXHIBIT 5: SEARS Holdings Corporation CASH FLOW STATEMENT (in US$ millions)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Fiscal Year Ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| **Cash Flow from Operating Activities** |  |  |  |  |  |  |
| **Net Income (Loss)** | **(3,147)** | **(1,054)** | **(1,116)** | **(1,810)** | **(1,128)** | **(2,221)** |
| Income from Discontinued Operations, Net of Tax | 27 | — | — | — | — | — |
| Income (Loss) from Continuing Operations | (3,120) | (1,054) | (1,116) | (1,810) | (1,128) | (2,221) |
| **Adjustments to Reconcile Net Income to Net Cash Used in Operating Activities** |  |  |  |  |  |  |
| Deferred Tax Valuation Allowance | 1,798 | 237 | 720 | 835 | 217 | 836 |
| Tax Benefit Resulting from Other Comprehensive Income Allocation | — | — | (97) | — | — | (71) |
| Depreciation and Amortization | 853 | 830 | 732 | 581 | 422 | 375 |
| Impairment Charges | 649 | 330 | 233 | 63 | 274 | 427 |
| Gain on Sales of Assets | (64) | (468) | (667) | (207) | (743) | (247) |
| Gain on Sales of Investment | — | (28) | (169) | (105) | — | — |
| Pension and Post-Retirement Plan Contributions | (390) | (593) | (426) | (450) | (311) | (334) |
| Pension and Post-Retirement Plan Settlement | — | 455 | — | — | — | — |
| Mark-to-Market Adjustments of Financial Instruments | — | — | — | (3) | 66 | 15 |
| Amortization of Deferred Gain on Sales Leaseback | — | — | — | — | (52) | (88) |
| Amortization of Debt Issuance Costs and Accretion of Debt Discount | — | — | — | — | — | 81 |
| Settlement of Canadian Dollar Hedges | — | 6 | 9 | 8 | — | — |
| **Change in Operating Assets and Liabilities (Net of Acquisitions and Dispositions)** |  |  |  |  |  |  |
| Deferred Income Taxes | (533) | (206) | (441) | (719) | (519) | (987) |
| Merchandise Inventories | 545 | 427 | 446 | 1,091 | (229) | 1,213 |
| Merchandise Payables | (134) | (117) | (230) | (528) | (47) | (526) |
| Income and Other Taxes | (50) | (63) | 63 | (110) | (95) | 80 |
| Mark-to-Market Adjustment and Settlements on Sears Canada US Dollar Collar Contracts | 2 | 1 | — | — | — | — |
| Mark-to-Market Adjustment and Settlements on Sears Canada US Derivatives Instrument | — | — | (6) | — | — | — |
| Other Operating Assets | 67 | (100) | 43 | (37) | 68 | (52) |
| Other Operating Liabilities | 70 | 40 | (203) | 4 | (90) | 118 |

Exhibit 5 (Continued)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Fiscal Year ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| **Net Cash Provided by (used in) Operating Activities—Continuing Operations** | **(307)** | **(303)** | **(1,109)** | **(1,387)** | **(2,167)** | **(1,381)** |
| Net Cash provided by Operating Activities—Discontinued Operations | 32 | — | — | — | — | — |
| **Net Cash Provided by (used in) Operating Activities** | **(275)** | **(303)** | **(1,109)** | **(1,387)** | **(2,167)** | **(1,381)** |
| **Cash Flows from Investing Activities** |  |  |  |  |  |  |
| Proceeds from Sales of Property and Investments | 72 | 532 | 995 | 424 | 2,730 | 386 |
| Net Increase in Investments and Restricted Cash | 8 | 37 | (2) | — | — | — |
| Purchases of Property and Equipment | (432) | (378) | (329) | (270) | (211) | (142) |
| Re-Consolidation (De-consolidation) of Sears Canada Cash | — | — | — | (207) | — | — |
| Proceeds from Sears Canada Rights Offering | — | — | — | 380 | — | — |
| **Net Cash Used in Investing Activities—Continuing Operations** | **(352)** | **191** | **664** | **327** | **2,519** | **244** |
| Net Cash Provided by (Used in) Investing Activities—Continuing Operations | 43 | — | — | — | — | — |
| **Net Cash Used in Investing Activities** | **(309)** | **191** | **664** | **327** | **2,519** | **244** |
| **Cash Flows from Financing Activities** |  |  |  |  |  |  |
| Proceeds from Debt Issuances | 104 | 5 | 994 | 1,025 | — | 2,028 |
| Repayments of Long-Term Debt | (611) | (335) | (83) | (80) | (1,405) | (66) |
| Increase (Decrease) in Short-Term Borrowings, Primarily 90 Days or Less | 815 | (81) | 238 | (1,117) | 583 | (797) |
| Proceeds from Sales Leaseback Financing | — | — | — | — | 508 | 71 |
| Lands’ End Inc. Pre-separation Funding | — | — | — | 515 | — | — |
| Separation of Lands’ End Inc. | — | — | — | (31) | — | — |
| Debt Issuance Costs | (35) | (3) | (14) | (27) | (50) | (51) |
| Sears Hometown and Outlet Store Inc. Pre–separation Funding | — | 100 | — | — | — | — |
| Proceeds from Sale of Hometown and Outlet Store Inc. | — | 347 | — | — | — | — |
| Purchase of Sears Canada Shares | (43) | (10) | — | — | — | — |
| Sears Canada Dividends Paid to  Non-controlling Interest | — | (50) | (233) | — | — | — |
| Purchase of Treasury Stock | (183) | — | — | — | — | — |

Exhibit 5 (Continued)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Fiscal Year Ends in January** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| **Net Cash Provided by (Used in) Financing Activities—Continuing Operations** | **47** | **(27)** | **902** | **285** | **(364)** | **1,185** |
| Net Cash Used in Financing Activities—Discontinued Operations | (75) | — | — | — | — | — |
| **Net Cash Provided by (Used in) Financing Activities** | **(28)** | **(27)** | **902** | **285** | **(364)** | **1,185** |
| Effect of Exchange Rate Changes on Cash and Cash Equivalents | — | 1 | (38) | (3) | — | — |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | **(612)** | **(138)** | **419** | **(778)** | **(12)** | **48** |
| Cash and Cash Equivalents, Beginning of Year | 1,359 | 747 | 609 | 1,028 | 250 | 238 |
| **Cash and Cash Equivalents, End of Year** | **747** | **609** | **1,028** | **250** | **238** | **286** |

Source: Compiled by the case authors, based on Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2017,” 61, accessed April 8, 2017, https:// searsholdings.com/docs/investor /SHC\_2016\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 30, 2016,” 59, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2015\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 31, 2015,” 67, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2014\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 1, 2014,” 66, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2013\_Form\_10-K.pdf; Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended February 2, 2013,” 59, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2012\_Form \_10-K.pdf; and Sears Holdings Corporation, “Form 10-K for the Fiscal Year Ended January 28, 2012,” 56, accessed March 21, 2017, https://searsholdings.com/docs/investor/SHC\_2011\_Form\_10-K.pdf.

EXHIBIT 6: Altman Z-score

Z-score = (1.2×A) + (1.4×B) + (3.3×C) + (0.6×D) + (1.0×E)

where,

A = working capital ÷ total assets (liquidity)

B = retained earnings ÷ total assets (solvency)

C = earnings before interest and taxes ÷ total assets (profitability)

D = market value of equity ÷ total liabilities (leverage)

E = sales ÷ total assets (activity)

Source: Edward I. Altman, “Financial Ratios, Discriminant Analysis and the Prediction of Corporate Bankruptcy,” *Journal of Finance* 23, no. 4 (1968): 589–609, doi:10.2307/2978933; “The Altman Z-Score: Is It Possible to Predict Corporate Bankruptcy Using a Formula?,” Business Insider, April 13, 2011, accessed April 14, 2017, www.businessinsider.com/the-altman-z-score-is-it-possible-to-predict-corporate-bankruptcy-using-a-formula-2011-4.

ENDNOTES

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