SEARS HOLDINGS

**Sears Holdings' Fourth Quarter and Full Year 2017**
**Pre-Recorded Conference Call Transcript**
**March 14, 2018**

**Operator:**

Good day, ladies and gentlemen, and welcome to the Sears Holdings Corp. fourth quarter 2017 earnings conference call. [Operator instructions]

**Chris Brathwaite:**

Thank you, Operator. Ladies and gentlemen, welcome to the Sears Holdings earnings call. I am Chris Brathwaite, Vice President of Corporate Communications for Sears Holdings, and I am joined today by Rob Riecker, our Chief Financial Officer. Today, we released our fourth quarter and full year results for 2017, which are available on the investors section of our website under Events and Presentations. You can access the accompanying slide presentation for our call today through the same section of the website.

Moving to slide 2, I would like to remind you that today's discussion will contain forward-looking statements related to future events and expectations. These statements are based on current expectations and the current economic environment or are based on potential opportunities and actual results may differ materially from those expressed or implied in the forward-looking statements. Factors that could cause the Company's actual results to differ materially from those listed in today's press release can be found in the presentation for today's call that is posted at the Investor Information section of searsholdings.com and in our most recent Annual Report on Form 10-K and other SEC filings. Finally, we assume no obligation to update the information presented on this call, except as required by law.

In addition, as noted on slide 3, our discussion will include certain non-GAAP financial measures. Reconciliations to the most directly comparable GAAP financial measures can be found in the presentation and today's earnings release. Any reference in our discussion today to EBITDA means Adjusted EBITDA, as defined in the presentation.

I will now hand off the call to Rob.

**Rob Riecker:**

Thanks, Chris.

Thank you for joining our call. Let's turn to slide 4.

I am pleased to report that in the fourth quarter of 2017, our net income attributable to Sears Holdings' shareholders was $182 million, compared to a net loss attributable to Holdings' shareholders of $607 million in the fourth quarter of 2016. Additionally, Adjusted EBITDA was $2 million for the fourth quarter of 2017 compared to a loss of $(61) million in the prior year fourth quarter. This marks the first positive Adjusted EBITDA quarterly result since 2014 and the third consecutive quarter of year-over-year progress in our efforts to return Sears Holdings to profitability. We are pleased with the positive trend we have established over the last few quarters, and we are seeing this level of improvement in year-over-year performance continue in the first quarter of 2018 to date.

The improvement in Adjusted EBITDA for the quarter was supported by a $451 million reduction in comparable year-over-year SG&A expenses, which helped to offset a $584 million decline in revenues on a comparable store sales basis. Total revenues were $4.4 billion in the fourth quarter of 2017, compared to $6.1 billion in the corresponding quarter last year, with over half of the decline attributable to strategic store closures.

While we are encouraged by the improvement in our operational performance in the fourth quarter, it is important that we continue to take action to restore the company's profitability. We intend to build on this momentum as we seek to generate profit and raise additional liquidity in order to strengthen Sears Holdings' financial position over the long term.

From an operational perspective, we are making significant progress on – and remain fully committed to – our transformation.

In December, we announced the launch of DieHard products on Amazon.com, building on the success of our earlier agreement with Amazon to significantly expand the reach and unlock further value from our Kenmore brand. As we have previously stated, we are fully committed to expanding the distribution and availability of our iconic brands.

We also continued to expand our category-focused and smaller concept store footprint. In the fourth quarter, we opened two new Sears Appliances & Mattress stores in Pennsylvania and Hawaii that feature two of our strongest categories while offering the unparalleled expertise of our associates. We also built on the momentum of DieHard's 50th anniversary to open two new DieHard Auto Centers in the Detroit area. These exciting store openings clearly demonstrate our commitment to leveraging our company's strengths and valuable assets to best meet the ever-changing needs and preferences of our members. We look forward to building on this momentum in 2018 by opening additional smaller concept stores.

Most importantly, we remain committed to supporting and serving our members in the communities impacted by hurricanes Harvey, Irma and Maria last year. As rebuilding efforts continue in Puerto Rico, our Shop Your Way membership platform and our 28 Kmart and Sears stores on the island have partnered with Major League Baseball player René Rivera to support ongoing relief efforts, including a holiday toy drive that gave affected families and children a merrier holiday after the devastating storms. We care deeply about our members and their communities and are proud to be able to help them recover and rebuild in times of need.

I would like to take a minute to share the key priorities that guided our Company's transformative actions in 2017 and will shape our strategy as we move into 2018.

As we've stated before, our top priority is successfully executing our transformation to return to profitability and remain a competitive retailer for years to come. To that end, we are focused on improving our financial performance and enhancing our liquidity, both of which are critical for our long-term success.

Our transformation strategy is designed to make Sears Holdings a new kind of retailer – one that is innovative, truly integrated and optimally positioned to meet the needs and preferences of today's shoppers. As we move toward this goal, we will continue to explore creative ways to unlock value from our company's many assets, such as our game-changing partnerships with Amazon to sell Kenmore and DieHard on the Amazon platform.

As I'll explain in greater detail later in the call, Shop Your Way is a significant driver of our transformation, and we are focused on continuing to expand its ecosystem of services and offerings. Through Shop Your Way and the strategic actions we are taking through our transformation, we are able to offer our members a uniquely tailored shopping experience.

Moving to slide 6, we continue to achieve material progress on our transformation.

We took a number of actions during the fourth quarter of 2017 and into the first quarter of 2018 to improve our financial flexibility and support our operations.

We have identified an incremental $200 million of annualized cost savings for 2018 unrelated to store closures as part of our continued efforts to further streamline our operations to become a more agile and competitive retailer and drive profitability. We ended the year with over 1,000 full-line and specialty retail stores, and after giving effect to previously-announced store closures, we will still operate nearly 900 full-line and specialty retail stores. We will continue to drive improvements in our organization throughout the coming year by focusing on our best members, best categories and best stores.

In addition, we have initiated a series of financial transactions to adjust our capital structure in order to increase our financial flexibility.

We recently raised $250 million in new financing, with $60 million received from certain unaffiliated lenders and $40 million received subsequent to our fiscal year end. This new financing was supported by ground leases and select intellectual property and we retain the ability to raise an additional $50 million against the same collateral.

In February, we further increased our financial flexibility by securing an amendment to our Second Lien Credit Agreement to increase the maximum aggregate principal of the uncommitted line to $600 million and extend the maximum duration of line of credit loans to 270 days. We also amended our existing second lien notes, maturing October 15, 2018, to increase their borrowing base advance rate for inventory from 65% to 75%, and to defer the collateral coverage test to restart with the second quarter of 2018, such that no collateral coverage event can occur until the end of the third quarter of 2018. In addition, we increased our short-term borrowing basket capacity by $250 million to $1.25 billion.

On March 8th, we also secured an additional $100 million incremental real estate loan secured by the same real estate properties as our 2017 Secured Loan Facility, and today we closed on a secured loan and mezzanine loan, pursuant to which we received aggregate gross proceeds of $440 million. The Secured Loan is secured by properties that were previously subject to a ring-fence arrangement with the PBGC. Pursuant to our November 2017 agreement with the PBGC, we will contribute $407 million of the proceeds into the Sears pension plans, which relieves the Company of contributions to its pension plans for approximately two years (other than a $20 million supplemental payment due in the second quarter of 2018), further reducing our pension liability. We expect to pay down a substantial portion of the Secured

Loan over the next three to six months using proceeds generated from the sale of the underlying properties, which have an aggregate appraised value of nearly $980 million.

In February, we commenced private exchange offers for our outstanding 8% Senior Unsecured Notes due 2019 and 6 5/8% Senior Secured Notes due 2018 to improve the terms of our non-first lien debt.

All of these actions build on our earlier progress to enhance our financial flexibility and liquidity, including the extension of the maturity of our June 2018 term loan to January 2019, with the option to further extend to July 2019.

However, as I mentioned earlier, our transformation is certainly not complete and we still have work to do. While we are pleased with the financial progress we have made so far, we need to continue focusing on ways to improve our profitability and generate liquidity.

On slide 7, I will provide more detail around the operational progress we have made toward our transformation. As I mentioned before, we at Sears Holdings are fully committed to transforming our Company to become an integrated, member-centric ecosystem of products and services.

A key element of this transformation is Shop Your Way, and we are focused on ensuring the platform offers each member a tailored, personalized experience. To that end, I am pleased to report that in 2017, we delivered 60 million personalized incentives and rewards to deliver money-saving benefits to our members on the products and services they use every day.

We also delivered a personalized experience to the millions of members who shop at our traditional store locations. We are proud to have Kmart Pharmacy recognized – for the second year in a row – as number one in customer service, with our talented pharmacists conducting personal consultations every day for our members across the country. We further offer personalized service to our members through our experienced in-store associates, who provided their expert guidance on over 3 million appliance and mattress consultations in 2017 to help ensure our members leave our stores with the products that are exactly right for them.

We helped to make our members' shopping experience as convenient as possible through a continued and growing emphasis on value-adds such as our Buy Online / Pick-Up In Store services as well as local pick-up and local delivery.

We are pleased with the success we saw in Shop Your Way in 2017. Our relentless focus on our members helped them earn over $800 million in Shop Your Way Points, save over 8 million minutes and save $31 million in shipping costs. But the highlight we are proudest of is how Shop Your Way enabled us to support our local communities: by engaging directly with our members, Sears Holdings was able to collect and distribute over $12 million to local communities and charities to support disaster relief efforts.

Turning to slide 8, I'll review the various ways we enhanced and expanded our integrated retail offering this year.

Since its launch in February 2017, the Sears MasterCard has offered its cardholders an industry-leading 5-3-2-1 rewards offer, enabling them to earn rewards points on all purchases everywhere they shop – and we recently announced that we are extending this exciting offer into 2018.

As I mentioned before, we continue to focus on developing Shop Your Way by growing our portfolio of partners. Our members have benefitted from our strategic partnerships with well-known brands like Uber and Time Inc. – and they engaged more with our partners by a significant factor of 10 times more this year compared to the prior year.

We also enhanced our service offerings in our traditional store formats by launching Member Centers and installing Member Service Leads in stores across our key markets – offering our members all the in-store support they need to have a tailored, successful experience in our stores.

The partnerships we announced with Amazon in 2017 to launch Kenmore and DieHard products on their platforms also highlight our focus on expanding our integrated retail offerings. Through these creative arrangements, we have enabled the millions of Americans who shop on Amazon every day to purchase the items they want and need from two of America's most trusted and iconic brands.

As we transform into a truly member-centric organization, we will continuously look for new ways to better serve our members and offer them industry-leading savings and convenience.

Moving to the next slide, I would like to review our financial position in light of the various actions we have taken during the quarter.

At the end of the fourth quarter, we had total liquid availability of approximately $353 million, including availability on our credit facility and availability under the short-term borrowing basket.

At February 3, 2018, the amount available to borrow under our revolving credit facility was approximately $69 million, compared to $165 million at the end of the prior year fourth quarter.

We ended the quarter with $102 million of availability under our short-term borrowing basket, compared to $250 million at January 28, 2017. This availability is stated less certain real estate and Line of Credit loans outstanding.

Lastly, subsequent to the close of the fourth quarter of 2017, we amended our short-term borrowing basket to increase availability by $250 million, resulting in year-end pro-forma liquid availability of $603 million.

So, to conclude, let's move on to slide 10.

In summary, we are making significant progress on our transformation and remain fully committed to returning Sears Holdings to profitability. We continue to focus on improving our financial flexibility and operational effectiveness in order to increase our competitiveness in today's difficult retail environment.

The progress we have made in our operational performance is evident in our return to positive Adjusted EBITDA in the fourth quarter of 2017. This substantial improvement marks the third consecutive quarter of year-over-year improvement in Adjusted EBITDA and shows continued progress in our efforts to return the Company to profitability.

To support this progress, we will continue to take decisive actions to improve our performance, including further reductions to our cost structure. To this end, we plan to action an additional $200 million in annualized cost reductions in fiscal year 2018, independent of store closures.

We enhanced our liquidity position in recent months by taking decisive action to improve our financial flexibility. We will look to progress additional transactions in the coming months.

We also continued to execute on our strategy of providing a truly integrated retail experience to our members. As we enter fiscal year 2018, we will build on the success of our Kenmore and DieHard partnerships with Amazon as we evaluate new strategic options to unlock value from our assets and business across our portfolio.

We further sharpened our focus on our best categories, best stores and best members in the fourth quarter by pursuing promising and innovative opportunities in our enterprise, including new Shop Your Way partnerships.

We are encouraged by the progress we are seeing and remain committed to our strategy to restore Sears Holdings to profitability. However, it is critical that we continue to take decisive – and, at times, difficult – action in the coming quarters to improve our company's financial position so we remain a competitive retailer for years to come. We look forward to building on the progress we made in the fourth quarter and continuing to report progress on our transformation.