

*Sears\**

**SEARS CANADA INC.**

SECOND QUARTER REPORT  
for the period ended August 2, 2014

## **Management's Discussion and Analysis**

### **Table of Contents**

- 1. Company Performance**
- 2. Segment Performance**
- 3. Consolidated Financial Position, Liquidity and Capital Resources**
- 4. Financial Instruments**
- 5. Funding Costs**
- 6. Related Party Transactions**
- 7. Shareholders' Equity**
- 8. Events After the Reporting Period**
- 9. Accounting Policies and Estimates**
- 10. Disclosure Controls and Procedures**
- 11. Risks and Uncertainties**

## **Management's Discussion and Analysis**

"Sears", "Sears Canada", "we", "us", "our" or "the Company" refers to Sears Canada Inc. and its subsidiaries, together with its investments in real estate joint arrangements.

This quarterly report to Shareholders, which includes the Management's Discussion and Analysis ("MD&A"), current as at September 2, 2014 unless otherwise stated, and the unaudited condensed consolidated financial statements for the 13-week period ended August 2, 2014 ("Q2 2014 financial statements") (together, the "Quarterly Report"), contains commentary from the Company's management regarding strategy, operating results and financial position. Management is responsible for its accuracy, integrity and objectivity, and develops, maintains and supports the necessary systems and controls to provide reasonable assurance as to the accuracy of the comments contained herein.

The second quarter ("Q2") unaudited results for the 52-week period ending January 31, 2015 ("Fiscal 2014" or "2014") and the 52-week period ended February 1, 2014 ("Fiscal 2013" or "2013") reflect the 13-week periods ended August 2, 2014 ("Q2 2014") and August 3, 2013 ("Q2 2013"), respectively. The 2012 fiscal year refers to the 53-week period ended February 2, 2013 ("Fiscal 2012" or "2012").

This Quarterly Report should be read in conjunction with the Consolidated Financial Statements, and Notes to the Consolidated Financial Statements for Fiscal 2013. These items are contained in the Company's 2013 Annual Report, which can be obtained by contacting Sears Canada's Corporate Communications department at 416-941-4428. The 2013 Annual Report has also been filed electronically with securities regulators in Canada through the System for Electronic Document Analysis and Retrieval ("SEDAR") and can be accessed on the SEDAR website at [www.sedar.com](http://www.sedar.com). Additional information relating to the Company is also available online at [www.sedar.com](http://www.sedar.com) and on the U.S. Securities Exchange Commission ("SEC") website at [www.sec.gov](http://www.sec.gov). Information contained in, or otherwise accessible through, websites mentioned in this Quarterly Report do not form a part of this document. All references in this Quarterly Report to websites are inactive textual references only.

Additional information relating to the Company, including the Company's Annual Information Form ("AIF") dated March 13, 2014 and the Management Proxy Circular dated March 13, 2014, can be obtained by contacting Sears Canada's Corporate Communications department at 416-941-4428. The 2013 Annual Report, together with the AIF and Management Proxy Circular, have been filed electronically with securities regulators in Canada and the United States and can be accessed on the SEDAR website at [www.sedar.com](http://www.sedar.com) and on the SEC website at [www.sec.gov](http://www.sec.gov).

The Q2 2014 financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). Management uses IFRS, non-IFRS and operating performance measures as key performance indicators to better assess the Company's underlying performance and provides this additional information in this MD&A so that readers may do the same. See Section 1.e. "Use of Non-IFRS Measures, Measures of Operating Performance and Reconciliation of Net (Loss) Earnings to Adjusted EBITDA" for additional information.

Unless otherwise indicated, all amounts are expressed in Canadian dollars.

### **Cautionary Statement Regarding Forward-Looking Information**

Certain information in the Quarterly Report is forward-looking and is subject to important risks and uncertainties. Forward-looking information concerns, among other things, the Company's future financial performance, business strategy, plans, expectations, goals and objectives, and includes statements concerning possible or assumed future results set out under Section 1 "Company Performance", Section 3 "Consolidated Financial Position, Liquidity and Capital Resources", Section 4 "Financial Instruments", Section 8 "Events After the Reporting Period", Section 9 "Accounting Policies and Estimates" and Section 11 "Risks and Uncertainties". Often, but not always, forward-looking information can be identified by the use of words such as "plans", "expects" or "does not expect", "is expected", "scheduled", "estimates", "intends", "anticipates" or "does not anticipate" or "believes", or variations of such words and phrases, or statements that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved. Although the Company believes that the estimates reflected in such forward-looking information are reasonable, such forward-looking information involves known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking information, and undue reliance should not be placed on such information.

Factors which could cause actual results to differ materially from current expectations include, but are not limited to: possible changes in the Company's ownership by Sears Holdings Corporation ("Sears Holdings") and other significant shareholders; the possible future termination of certain intellectual property rights associated with the "Sears" name and brand names if Sears Holdings reduces its interest in the Company to less than 25%; the ability of the Company to successfully implement its strategic initiatives; productivity improvement and cost reduction initiatives and whether such initiatives will yield the expected benefits; the results achieved pursuant to the Company's credit card marketing and servicing alliance with JPMorgan Chase Bank, N.A. (Toronto Branch), ("JPMorgan Chase"); general economic conditions; competitive conditions in the businesses in which the Company participates; changes in consumer spending; seasonal weather patterns; weaker business performance in the subsequent quarter; customer preference toward product offerings; ability to retain senior management and key personnel; ability of the Company to successfully manage its inventory levels; disruptions to the Company's computer systems; economic, social, and political instability in jurisdictions where suppliers are located; the Company's reliance on third parties in outsourcing arrangements; structural integrity and fire safety of foreign factories; increased shipping costs, potential transportation delays and interruptions; damage to the reputations of the brands the Company sells; changes in the Company's relationship with its suppliers; the outcome of product liability claims; any significant security compromise or breach of the Company's customer, associate or Company information; the credit worthiness and financial stability of tenants, partners and co-arrangers, with respect to the Company's real estate joint arrangements; the credit worthiness and financial stability of the Company's licensees and business partners; possible limits on our access to capital markets and other financing sources; interest rate fluctuations and other changes in funding costs and investment income; fluctuations in foreign currency exchange rates; the possibility of negative investment returns in the Company's pension plan or an increase to the defined benefit obligation; the impairment of goodwill and other assets; new accounting pronouncements, or changes to existing pronouncements, that impact the methods we use to report our financial position and results from operations; uncertainties associated with critical accounting assumptions and estimates; the outcome of pending legal proceedings; compliance costs associated with environmental laws and regulations; maintaining adequate insurance coverage; and changes in laws, rules and regulations applicable to the Company. Information about these factors, other material factors that could cause actual results to differ materially from expectations and about material factors or assumptions applied in preparing forward-looking information, may be found in this MD&A and in the Company's 2013 Annual Report under Section 11 "Risks and Uncertainties" and elsewhere in the Company's filings with securities regulators. The forward-looking information in the Quarterly Report is, unless otherwise indicated, stated as of the date hereof and are presented for the purpose of assisting investors and others in understanding our financial position and results of operations as well as our objectives and strategic priorities, and may not be appropriate for other purposes. The Company does not undertake any obligation to update publicly or to revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

## 2014 Second Quarter Highlights

For the 13 and 26-week periods ended August 2, 2014 and August 3, 2013  
(unaudited)

<i>(in CAD millions, except per share amounts)</i>	Second Quarter			Year-to-Date		
	2014	% Chg 2014 vs 2013	2013	2014	% Chg 2014 vs 2013	2013
Total revenue	\$ 845.8	(11.9)%	\$ 960.1	\$ 1,617.5	(11.5)%	\$ 1,827.2
Same store sales (%) <sup>1</sup>	(6.8)%		(2.5)%	(7.1)%		(2.5)%
Adjusted EBITDA <sup>1</sup>	(16.1)	(179.7)%	20.2	(74.2)	(813.5)%	10.4
Net (loss) earnings	(21.3)	(113.9)%	152.8	(96.5)	(179.4)%	121.6
Basic net (loss) earnings per share	(0.21)	(114.0)%	1.50	(0.95)	(179.8)%	1.19

  

<i>(in CAD millions)</i>	As at August 2, 2014	% Chg 2014 vs 2013	As at August 3, 2013	As at August 2, 2014	% Chg 2014 vs 2013	As at February 1, 2014
Cash and cash equivalents	\$ 266.1	(16.6)%	\$ 319.1	\$ 266.1	(48.2)%	\$ 513.8
Inventories	732.0	(20.0)%	915.3	732.0	(5.5)%	774.6
Total assets	2,116.3	(19.1)%	2,616.7	2,116.3	(11.5)%	2,392.3
Shareholders' equity	976.1	(18.6)%	1,199.1	976.1	(9.1)%	1,073.8

<sup>1</sup> Same store sales and Adjusted EBITDA are operating performance and non-IFRS measures, respectively. See Section 1.e. "Use of Non-IFRS Measures, Measures of Operating Performance and Reconciliation of Net (Loss) Earnings to Adjusted EBITDA".

## Common Share Market Information

(Toronto Stock Exchange - Trading Symbol SCC)

	Second Quarter		Year-to-Date	
	2014	2013	2014	2013
High	\$ 16.45	\$ 13.25	\$ 17.12	\$ 13.25
Low	\$ 13.51	\$ 8.96	\$ 12.31	\$ 8.85
Close	\$ 14.02	\$ 12.92	\$ 14.02	\$ 12.92
Average daily trading volume	15,501	146,327	17,895	90,326

- Revenue was \$845.8 million in Q2 2014, a decrease of 11.9% compared to Q2 2013. The decrease was primarily attributable to sales declines in Craftsman<sup>®</sup>, Air & Water Products, electronics, home décor, major appliances, women's apparel and cosmetics, and included a decrease of \$35.0 million attributable to the closure of full-line stores announced during Fiscal 2013 and \$9.7 million related to certain joint arrangements sold during the fourth quarter of Fiscal 2013.
- Same store sales for Q2 2014 decreased 6.8% compared to the same period last year.
- Cost management resulted in selling, administrative and other expenses decreasing by \$18.3 million in Q2 2014 compared to Q2 2013. Excluding transformation expenses and non-recurring items included in selling, administrative and other expenses in both periods, cost management resulted in operating expense reductions of \$49.1 million in Q2 2014 compared to the same period last year.
- The Company continued to make progress on its transformation, having executed the following initiatives in Q2 2014:
  - Continued to implement an inventory reduction program that has successfully decreased inventory by \$183.3 million since Q2 2013, which included \$35.3 million related to the closure of full-line stores;
  - Introduced a new line of Jessica<sup>®</sup> Intimates, including bras, panties, shapewear and sleepwear, that features fashion-forward designs in order to increase its appeal to a broader range of customers;
  - Extended the term of its senior secured revolving credit facility to May 28, 2019 and reduced the total credit limit from \$800.0 million to \$300.0 million (the "Amended Credit Facility"). The Amended Credit Facility

better reflects the Company's current borrowing base, which has decreased due to lower inventory levels than those experienced prior to the Amended Credit Facility. The Amended Credit Facility is expected to reduce our ongoing financing costs by lowering the annual fees on the undrawn facility by over 70%;

- On June 16, 2014, entered into a binding agreement with the Concord Pacific Group of Companies ("Concord") to pursue the development of the 12-acre Sears site located at the North Hill Shopping Centre in Calgary, Alberta; and
- Sold its 15% joint arrangement interest in the Les Rivières Shopping Centre for total proceeds of \$33.5 million.
- The Company's gross margin rate was 33.3% in Q2 2014 compared to 37.4% in Q2 2013. The decrease in Q2 2014 was primarily due to reduced margins in home décor, home furnishings, major appliances, footwear, children's wear and women's intimates as a result of increased clearance and promotional activities. The decrease in Q2 2014 was also related to certain joint arrangements sold during the fourth quarter of Fiscal 2013.
- Adjusted net (loss) earnings before interest, taxes, depreciation and amortization ("Adjusted EBITDA") in Q2 2014 was \$(16.1) million compared to \$20.2 million in Q2 2013, a decrease of \$36.3 million. Adjusted EBITDA in Q2 2014 was impacted by the loss of rental income of \$5.8 million from the sale of shopping centre joint arrangements with The Westcliff Group of Companies during the fourth quarter of Fiscal 2013, \$4.7 million attributable to the closure of full-line stores announced during Fiscal 2013 and \$4.1 million due to the discontinuation of the licensing arrangement with SHS Services Management Inc. ("SHS"), partially offset by \$2.4 million in incremental foreign exchange gain compared to Q2 2013. Excluding the impact of these items, Adjusted EBITDA in Q2 2014 decreased by \$24.1 million compared to the same period last year.
- Basic net loss per common share was \$0.21 for Q2 2014 compared to a basic net earnings per common share of \$1.50 for the same period last year. Excluding transformation expenses and non-recurring items included in net loss, net loss per common share was \$0.25 for Q2 2014 compared to a net earnings per common share of \$0.13 for the same period last year.
- The Company's balance sheet continues to be strong with total cash and cash equivalents of \$266.1 million and no cash drawings on the \$300.0 million Amended Credit Facility as at August 2, 2014. Refer to Note 9 "Long-term obligations and finance costs" in the Q2 2014 financial statements for additional information.

## **1. Company Performance**

### **a. Business Segments**

Sears classifies its operations in two reportable business segments: merchandising and real estate joint arrangements.

#### **Merchandising Operations**

The Company's merchandising segment includes the sale of goods and services through the Company's Retail channels, which includes its Full-line, Sears Home, Hometown Dealer, Outlet, Appliances and Mattresses, Corbeil Electric Inc. ("Corbeil") stores and its Direct (catalogue/internet) channel. It also includes service revenue related primarily to product repair. Commission revenue includes travel, home improvement services, insurance and performance payments received from JPMorgan Chase under the Company's credit card marketing and servicing alliance with JPMorgan Chase. The Company has a multi-year licensing arrangement with TravelBrands Inc. ("TravelBrands") (formerly known as Thomas Cook Canada Inc.), under which TravelBrands manages the day-to-day operations of all Sears Travel offices and provides commissions to the Company. The Company also entered in a multi-year licensing agreement with SHS, under which SHS oversaw the day-to-day operations of all Sears Home Installed Products and Services business ("HIPS"). On December 13, 2013, SHS announced it was in receivership, and all offers of services provided by SHS ceased. Refer to Note 17 "Financial instruments" in the Q2 2014 financial statements for additional information. Licensee fee revenues are comprised of payments received from licensees, including TravelBrands, that operate within the Company's stores.

#### **Real Estate Joint Arrangements**

Sears has joint arrangement interests in two shopping centres in Canada and records these interests in the Company's Q2 2014 financial statements. For recent developments with the Company's joint arrangement interests, refer to Section 8 "Events After the Reporting Period". Joint arrangement interests in the shopping centres range from 15% to 20%, and are co-owned with Ivanhoé Cambridge Properties ("Ivanhoé"). Sears is not involved in the day-to-day management of

the shopping centres, but the major decisions regarding these joint arrangements require the unanimous consent of Ivanhoé and the Company.

The primary objective of the Company's real estate joint arrangements is to maximize the returns on its investment in shopping centre real estate. Sears reviews the performance of these joint arrangements on a regular basis. Shopping centres are considered non-core assets.

## **b. Strategic Initiatives**

The overarching goal of the Company is to maximize shareholder value by using three value levers as follows:

1. **Merchandising Value:** Establishing a focus on the Sears value proposition that provides customers with a balance of quality, price, and service. The Company's buying and marketing strategies are designed to deliver the value proposition consistently across all products, stores and formats.
2. **Operating Efficiency Value:** Managing expenses prudently and identifying inefficiencies within the business. The Company has undertaken "right-sizing" and outsourcing initiatives and will modify business models when appropriate to ensure the size of the Company is aligned to the current volume of business.
3. **Network Optimization Value:** Maximizing return on assets such as real estate and non-core businesses. The Company will evaluate opportunities to monetize non-core assets when the market value of those assets exceeds the retailing value, while seeking ways to optimize and unlock the value of the network.

In the second quarter of Fiscal 2014, the Company undertook or continued to progress on a number of strategic initiatives to continue trying to improve the financial and operational performance of the Company:

### **Merchandising Value**

- Continued to establish the Sears-exclusive Craftsman<sup>®</sup> name as a leader in outdoor power equipment with the launch of the first Quiet Power Technology lawn mower. The new Craftsman 22" 3-in-1 mower is 55% quieter than comparable Craftsman<sup>®</sup> mowers with the same power output;
- Introduced a new line of Jessica<sup>®</sup> Intimates, including bras, panties, shapewear and sleepwear, that features improved product quality. The new line also features both versatility and fashion, with availability in various sizes and focuses on product fit, fabric and functionality. The new line includes fashion-forward designs in order to increase its appeal to a broader range of customers; and
- Launched a golf getaway contest in conjunction with the timing of Father's Day, to support sales of PGA TOUR<sup>®</sup> brand apparel, which is available exclusively in Canada at Sears. PGA TOUR<sup>®</sup> apparel has been available in Sears stores and through the Direct channel since 2013 and is one of the Company's fastest growing brands.

### **Operating Efficiency Value**

- Extended the term of its senior secured revolving credit facility to May 28, 2019 and reduced the total credit limit from \$800.0 million to \$300.0 million. The Amended Credit Facility better reflects the Company's current borrowing base, which has decreased due to lower inventory levels than those experienced prior to the Amended Credit Facility, and reduces financing costs by lowering the annual fees on the undrawn facility by over 70%. The Amended Credit Facility is held by a syndicate of lenders arranged and administered by Wells Fargo Capital Finance, part of Wells Fargo & Company; and
- Continued to implement an inventory reduction program that has successfully decreased inventory by \$183.3 million since Q2 2013, which included \$35.3 million related to the closure of full-line stores. Sears continued to implement new operating procedures which ensured merchandise received at a store was moved directly to the selling floor, and better receipt planning, while maintaining an adequate supply of high-demand products.

### **Network Optimization Value**

- On June 16, 2014, entered into a binding agreement with Concord to pursue the development of the 12-acre Sears site located at the North Hill Shopping Centre in Calgary, Alberta. The arrangement contemplates the sale of a 50%

interest in the site for a value of approximately \$15.0 million, subject to adjustments, and the retention of Concord, on customary terms, to manage most facets of the development. Following the transfer of the 50% interest, the parties would enter into a co-ownership joint arrangement. The vision of the redevelopment is an infill project consisting of residential high-rises, with a potential retail component. In 2013, Sears and Concord entered into a similar agreement regarding land adjacent to the Sears store at Metropolis at Metrotown in Burnaby, British Columbia. Closing under the agreement is conditional upon satisfaction of conditions such as site investigations and obtaining the approval from the City of Calgary for the project, which management expects to take some time (see Note 24 “North Hill and Burnaby agreements” in the Q2 2014 financial statements for additional information); and

- On June 2, 2014, closed the transaction for the sale of its 15% joint arrangement interest in the Les Rivières Shopping Centre for total proceeds of \$33.5 million, pursuant to an agreement entered into on May 16, 2014. The centre, located in Trois-Rivières, Québec, was a joint arrangement the Company held with affiliates of Ivanhoé. Sears will continue to operate its department store in the shopping centre, and Ivanhoé will continue to manage the property. This transaction will have no effect on associates employed at the store or on the operation of the store, and Sears will continue to serve the residents of Trois-Rivières as it has proudly done since since 1971.

### **c. Corporate Social Responsibility**

The following is a summary of the results of the Company and its associates’ corporate social responsibility efforts during Q2 2014:

- Commenced a new month-long ‘Round Up Your Bill’ fundraising campaign supported by *Sears Canada Charitable Foundation* in-stores in May. Sears stores provided a point-of-sale opportunity for shoppers to support national pediatric cancer initiatives such as the Sears Childhood Cancer Fellowship. Stores across the country also engaged in local fundraising activities to help support the national ‘Round Up Your Bill’ initiative;
- Québec retail stores participated in an additional province-wide ‘Round Up Your Bill’ campaign in June to raise funds for Québec charity partner Opération Enfant Soleil. Opération Enfant Soleil is a major charity partner celebrating its 27<sup>th</sup> year in Québec. It is committed to raising funds for the development of high-quality pediatrics;
- Sponsored the 19<sup>th</sup> annual *Sears Canadian High School Design Competition* which aims to promote the study and awareness of various design disciplines in schools across Canada. The winning students and their entries were unveiled and celebrated at a Reception at Toronto’s Design Exchange (DX) in June and the students participated in a ‘Mentorship Day’ at Sears Retail Support Centre, touring various design and buying departments, for a glimpse of how design manifests itself in the real world work environment. The winning entries will also be presented ‘on the road’ in satellite physical and virtual exhibitions at select Sears stores across Canada; and
- Celebrated significant store anniversaries in three Sears stores: Burnaby (60<sup>th</sup>), Brantford and Sudbury (both 40<sup>th</sup>). Sears invited government dignitaries, former and current associates, and local media to attend a ceremony celebrating Sears longstanding commitment to customers in those communities, and presented each of the store’s local charitable partner (The Boys & Girls Club of Greater Vancouver, the Children’s Aid Society of Brantford and Better Beginnings Better Futures, respectively) with a \$10,000 donation to assist with after-school programs. The three stores held public events over the Father’s Day weekend that included music, food and gift card giveaways for customers.

#### **“Live Green” Initiatives**

The Company conducts its operations with a commitment to achieving success on economic, social and environmental levels. The Company continues to build upon the following three-point plan on environmental sustainability:

1. Enable customers to “Live Green”, reduce their energy bills and create a healthy home;
2. Reduce the environmental impact of Sears Canada’s operations; and
3. Nurture a culture of sustainability among the Company’s associates, customers and the communities in which the Company operates.

Sears Canada continued to focus on these three priorities by implementing or continuing the following initiatives during Q2 2014:



- Sears Canada participated in the 2014 CN Tower Climb in support of the World Wildlife Fund Canada (“WWF”). 43 Sears associates participated in the event in support of WWF environmental programs; and
- The Retail Support Centre Live Green Captain Network, which has approximately 70 ambassadors. This internal community network is vital in our efforts to promote sustainability initiatives by providing associates with leadership and communication skills, opportunities to meet colleagues outside of their business team, and a sense of pride in the Company.

#### d. Quarterly Performance

There is seasonal variability in the Company’s financial performance and in the products and services we offer. Accordingly, merchandise and service revenue, as well as performance payments received from JPMorgan Chase, referred to as commission revenue, will vary by quarter based upon consumer spending behaviour. Historically, the Company’s revenue and earnings are higher in the fourth quarter than in any of the other three quarters due to the holiday season. The Company is able to adjust certain variable costs in response to seasonal revenue patterns; however, costs such as occupancy are fixed, causing the Company to report a disproportionate level of earnings in the fourth quarter. This business seasonality results in quarterly performance that is not necessarily indicative of annual performance.

In addition, the Company offers seasonal goods and services. The Company sets inventory levels and promotional activity to be in accordance with its strategic initiatives and expected consumer demands. Businesses that generate revenue from the sale of seasonal merchandise and services are subject to the risk of changes in consumer spending behaviour as a result of unseasonable weather patterns.

Other factors that affect the Company’s sales and results of operations include actions by its competitors, timing of its promotional events, and changes in population and other demographics. Accordingly, the Company’s results for any one fiscal quarter are not necessarily indicative of the results to be expected for any other quarter, or the full year, and comparable store sales for any particular period may increase or decrease.

The table below outlines select financial data for the eight most recently completed quarters. The quarterly results are unaudited and have been prepared under IFRS.

<i>(in CAD millions, except per share amounts)</i>	Second Quarter		First Quarter		Fourth Quarter		Third Quarter	
	2014	2013	2014	2013	2013	2012	2013	2012
Total revenue	\$ 845.8	\$ 960.1	\$ 771.7	\$ 867.1	\$1,182.3	\$1,307.2	\$ 982.3	\$1,049.4
Net (loss) earnings	\$ (21.3)	\$ 152.8	\$ (75.2)	\$ (31.2)	\$ 373.7	\$ 39.9	\$ (48.8)	\$ (21.9)
Basic net (loss) earnings per share	\$ (0.21)	\$ 1.50	\$ (0.74)	\$ (0.31)	\$ 3.67	\$ 0.39	\$ (0.48)	\$ (0.22)
Diluted net (loss) earnings per share	\$ (0.21)	\$ 1.50	\$ (0.74)	\$ (0.31)	\$ 3.67	\$ 0.39	\$ (0.48)	\$ (0.22)

#### e. Use of Non-IFRS Measures, Measures of Operating Performance and Reconciliation of Net (Loss) Earnings to Adjusted EBITDA

The Company’s consolidated financial statements are prepared in accordance with IFRS. Management uses IFRS, non-IFRS and operating performance measures as key performance indicators to better assess the Company’s underlying performance and provides this additional information in this MD&A.

Same store sales is a measure of operating performance used by management, the retail industry and investors to compare retail operations, excluding the impact of store openings and closures. The same store sales metric excludes the Direct channel. Same store sales represents merchandise sales generated through operations in the Company’s Full-line, Sears Home, Hometown Dealer, Outlet and Corbeil stores that were continuously open during both of the periods being compared. More specifically, the same store sales metric compares the same calendar weeks for each period and represents the 13 and 26-week periods ended August 2, 2014 and August 3, 2013. The calculation of same store sales is a performance metric and may be impacted by store space expansion and contraction.

A reconciliation of the Company's total merchandising revenue to same store sales is outlined in the following table:

<i>(in CAD millions)</i>	Second Quarter		Year-to-Date	
	2014	2013	2014	2013
Total merchandising revenue	\$ 844.4	\$ 949.0	\$ 1,614.4	\$ 1,805.4
Non-comparable store sales	197.7	226.0	401.3	443.0
Same store sales	646.7	723.0	1,213.1	1,362.4
Percentage change in same store sales	(6.8)%	(2.5)%	(7.1)%	(2.5)%
Percentage change in same store sales by category				
Apparel & Accessories	(2.9)%	4.1 %	(1.5)%	4.3 %
Home & Hardlines	(9.3)%	(6.6)%	(10.7)%	(6.7)%

Adjusted EBITDA is a non-IFRS measure and excludes finance costs, interest income, income tax expense or recovery, depreciation and amortization and income or expenses of a non-recurring, unusual or one-time nature. Adjusted EBITDA is a measure used by management, the retail industry and investors as an indicator of the Company's operating performance, ability to incur and service debt, and as a valuation metric. The Company uses Adjusted EBITDA to evaluate the operating performance of its business as well as an executive compensation metric. While Adjusted EBITDA is a non-IFRS measure, management believes that it is an important indicator of operating performance because it excludes the effect of financing and investing activities by eliminating the effects of interest and depreciation and removes the impact of certain non-recurring items that are not indicative of our ongoing operating performance. Therefore, management believes Adjusted EBITDA gives investors greater transparency in assessing the Company's results of operations.

These measures do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other reporting issuers. Adjusted EBITDA should not be considered in isolation or as an alternative to measures prepared in accordance with IFRS.

A reconciliation of the Company's net (loss) earnings to Adjusted EBITDA is outlined in the following table:

<i>(in CAD millions, except per share amounts)</i>	Second Quarter		Year-to-Date	
	2014	2013	2014	2013
Net (loss) earnings	\$ (21.3)	\$ 152.8	\$ (96.5)	\$ 121.6
Transformation expense <sup>1</sup>	7.9	—	15.5	1.5
Gain on lease terminations and lease amendments <sup>2</sup>	—	(185.7)	—	(185.7)
Gain on sale of interest in joint arrangements <sup>3</sup>	(20.5)	—	(20.5)	—
Goodwill impairment <sup>4</sup>	2.6	—	2.6	—
Other asset impairment <sup>5</sup>	15.7	—	15.7	—
Accelerated tenant inducement amortization <sup>6</sup>	—	(4.5)	—	(4.5)
Lease exit costs <sup>7</sup>	0.1	—	3.9	—
SHS warranty and other costs <sup>8</sup>	—	—	6.6	—
Gain on settlement of retirement benefits <sup>9</sup>	(11.4)	—	(10.6)	—
Depreciation and amortization expense	21.8	30.0	45.4	60.2
Finance costs	1.7	2.8	4.2	5.1
Interest income	(0.7)	(0.4)	(1.4)	(0.8)
Income tax (recovery) expense	(12.0)	25.2	(39.1)	13.0
Adjusted EBITDA <sup>10</sup>	(16.1)	20.2	(74.2)	10.4
Basic net (loss) earnings per share	\$ (0.21)	\$ 1.50	\$ (0.95)	\$ 1.19

- 1 Transformation expense during 2014 and 2013 relates primarily to severance costs incurred during the period.
- 2 Gain on lease terminations and lease amendments represents the pre-tax gain on the early vacating of properties described in Note 15 of the Company's Q2 2014 financial statements.
- 3 Gain on sale of interest in joint arrangements represents the gain associated with selling the Company's interest in certain properties co-owned with Ivanhoe Cambridge described in Note 16 of the Company's Q2 2014 financial statements.
- 4 Goodwill impairment represents the charge related to the writeoff of goodwill related to the Corbeil cash generating unit described in Note 8 of the Company's Q2 2014 financial statements.
- 5 Other asset impairment represents the charge related to writing down the carrying value of the property, plant and equipment of certain cash generating units described in Note 7 of the Company's Q2 2014 financial statements.
- 6 Accelerated tenant inducement amortization represents the accelerated amortization of lease inducements relating to the properties referred to in footnote 2 above.
- 7 Lease exit costs relate primarily to costs incurred to exit certain properties during 2014.
- 8 SHS warranty and other costs represent the estimated costs to the Company related to potential claims for work that had been performed, prior to SHS announcing it was in receivership described in Note 17 of the Company's Q2 2014 financial statements.
- 9 Gain on settlement of retirement benefits represents the settlement of retirement benefits of eligible members covered under the non-pension retirement plan described in Note 12 of the Company's Q2 2014 financial statements.
- 10 Adjusted EBITDA is a measure used by management, the retail industry and investors as an indicator of the Company's performance, ability to incur and service debt, and as a valuation metric. Adjusted EBITDA is a non-IFRS measure.

## f. Consolidated Financial Results

(in CAD millions)	Second Quarter			Year-to-Date		
	2014	% Chg 2014 vs 2013	2013	2014	% Chg 2014 vs 2013	2013
Revenue	\$ 845.8	(11.9)%	\$ 960.1	\$1,617.5	(11.5)%	\$1,827.2
Cost of goods and services sold	564.2	(6.2)%	601.3	1,082.7	(4.9)%	1,139.0
Selling, administrative and other expenses	345.8	(5.0)%	364.1	698.7	(4.9)%	735.0
<b>Operating loss</b>	<b>(64.2)</b>	<b>(1,111.3)%</b>	<b>(5.3)</b>	<b>(163.9)</b>	<b>(250.2)%</b>	<b>(46.8)</b>
Gain on lease terminations and lease amendments	—	(100.0)%	185.7	—	(100.0)%	185.7
Gain on sale of interest in joint arrangements	20.5	100.0 %	—	20.5	100.0 %	—
Gain on settlement of retirement benefits	11.4	100.0 %	—	10.6	100.0 %	—
Finance costs	1.7	(39.3)%	2.8	4.2	(17.6)%	5.1
Interest income	0.7	75.0 %	0.4	1.4	75.0 %	0.8
<b>(Loss) earnings before income taxes</b>	<b>(33.3)</b>	<b>(118.7)%</b>	<b>178.0</b>	<b>(135.6)</b>	<b>(200.7)%</b>	<b>134.6</b>
Income tax recovery (expense)	12.0	147.6 %	(25.2)	39.1	400.8 %	(13.0)
<b>Net (loss) earnings</b>	<b>\$ (21.3)</b>	<b>(113.9)%</b>	<b>152.8</b>	<b>\$ (96.5)</b>	<b>(179.4)%</b>	<b>\$ 121.6</b>

Total revenue decreased by 11.9% to \$845.8 million in Q2 2014 and decreased by 11.5% to \$1,617.5 million in the first half of Fiscal 2014, as compared to the same periods in Fiscal 2013. Same store sales declined 6.8% in Q2 2014 and 7.1% in the first half of Fiscal 2014. The revenue in Q2 2014 and the first half of Fiscal 2014 relating to Home & Hardlines decreased by \$58.2 million and \$115.5 million, respectively, primarily due to sales volume declines in Craftsman<sup>®</sup>, Air & Water Products, electronics, floorcare, sewing, home décor, home furnishings and major appliances. The revenue in Q2 2014 relating to Apparel & Accessories decreased by \$31.4 million compared to Q2 2013, primarily due to sales volume declines in children's wear, women's apparel, cosmetics, jewellery, footwear and women's intimates. The revenue in the first half of Fiscal 2014 relating to Apparel and Accessories decreased \$47.6 million, primarily due to sales volume declines in women's apparel, cosmetics, jewellery and women's intimates. Included in the total revenue decrease in Q2 2014 and the first half of Fiscal 2014 was the impact of the closure of full-line stores previously announced during Fiscal 2013, which negatively impacted revenue by \$35.0 million and \$58.7 million, respectively, as compared to the same periods in Fiscal 2013. Also included in the total revenue decrease in Q2 2014 and the first half of Fiscal 2014 was a decrease in Services and other revenue of \$19.2 million and \$28.6 million, respectively, as compared to the same periods in Fiscal 2013. This decrease was primarily related to certain joint arrangements sold in the fourth quarter of Fiscal 2013, as described in Note 11 "Joint arrangements" of the Consolidated Financial Statements for Fiscal 2013.

In Q2 2014, total revenue recognized from points redemption under the loyalty program was \$11.1 million (Q2 2013: \$8.4 million) and total revenue deferred related to points issuances in Q2 2014 was \$11.2 million (Q2 2013: \$9.0 million).

Total revenue recognized in Q2 2014 for unredeemed points (by exclusion from deferral in the loyalty point redemption rate) increased to \$2.4 million (Q2 2013: \$1.6 million) due to an overall increase in points issuance. The increase in total revenue deferred related to increased points issuance was primarily due to higher new account volumes compared to 2013 as well as a higher expected redemption rate.

In the first half of Fiscal 2014, total revenue recognized from points redemption under the loyalty program was \$23.4 million (in the first half of Fiscal 2013: \$16.4 million) and total revenue deferred related to points issuances was \$23.1 million (in the first half of Fiscal 2013: \$16.4 million). Total revenue recognized in the first half of Fiscal 2014 for unredeemed points (by exclusion from deferral in the loyalty point redemption rate) increased to \$4.6 million (in the first half of Fiscal 2013: \$2.8 million) due to an overall increase in points issuance. The increase in total revenue deferred related to increased points issuance was primarily due to a combination of the recently introduced points-based acquisition bonus and higher new account volumes compared to 2013.

Cost of goods and services sold was 6.2% lower in Q2 2014 and 4.9% lower in the first half of Fiscal 2014, as compared to the same periods in Fiscal 2013. The decrease was primarily attributable to lower sales volumes, which included the impact of the closure of full-line stores announced during Fiscal 2013.

The Company's gross margin rate was 33.3% in Q2 2014 compared to 37.4% in Q2 2013. The gross margin rate in the first half of Fiscal 2014 was 33.1% compared to 37.7% for the same period in Fiscal 2013. The decrease in Q2 2014 and in the first half of Fiscal 2014 was primarily due to reduced margins in home décor, home furnishings, major appliances, footwear, children's wear and women's intimates, as a result of increased clearance or promotional activities.

Selling, administrative and other expenses, including depreciation and amortization expenses decreased by \$18.3 million or 5.0% to \$345.8 million in Q2 2014, compared to the same period in Fiscal 2013. Excluding transformation expenses of \$7.9 million in Q2 2014 (Q2 2013: nil) and non-recurring items such as impairment and lease exit costs of \$18.4 million (Q2 2013: nil) and accelerated tenant inducement amortization of nil (Q2 2013: \$4.5 million), selling, administrative and other expenses declined by \$49.1 million or 13.3% in Q2 2014 compared to Q2 2013. The decrease in expenses, excluding non-recurring items, was attributable to lower spending on advertising and payroll. Advertising expense decreased primarily due to reductions in flyers and catalogue circulations. Payroll expense decreased primarily due to a reduced number of associates, as a result of previously announced transformation actions.

Selling, administrative and other expenses, including depreciation and amortization expenses decreased by \$36.3 million or 4.9% to \$698.7 million in the first half of Fiscal 2014, compared to the same period in Fiscal 2013. Excluding transformation expenses of \$15.5 million in the first half of Fiscal 2014 (in the first half of Fiscal 2013: \$1.5 million) and non-recurring items such as impairment and lease exit costs of \$22.2 million (in the first half of Fiscal 2013: nil), accelerated tenant inducement amortization of nil (in the first half of Fiscal 2013: \$4.5 million) and SHS warranty and other costs of \$6.6 million (in the first half of Fiscal 2013: nil), selling, administrative and other expenses declined by \$83.6 million or 11.3% in the first half of Fiscal 2014 compared to the first half of Fiscal 2013. The decrease in expenses, excluding non-recurring items, was attributable to lower spending on advertising and payroll. Advertising expense decreased primarily due to reductions in flyers and catalogue circulations. Payroll expense decreased primarily due to a reduced number of associates, as a result of previously announced transformation actions.

Depreciation and amortization expense in Q2 2014 and in the first half of Fiscal 2014 decreased by \$8.2 million and \$14.8 million, respectively, as compared to the same periods in Fiscal 2013, primarily due to the disposal of assets relating to the closure of full-line stores previously announced during Fiscal 2013, the disposal of assets related to certain joint arrangements sold during the fourth quarter of Fiscal 2013, the impairment of certain assets during the fourth quarter of Fiscal 2013, and the impairment of the assets of one of the Regina logistics centres during the third quarter of Fiscal 2013. The Company regularly monitors the business for indicators of impairment, and assesses the potential impact to the carrying value of our assets on a quarterly basis, as described in Note 7 "Property, plant and equipment" and Note 8 "Goodwill" of the Q2 2014 financial statements.

Finance costs in Q2 2014 and in the first half of Fiscal 2014 decreased by \$1.1 million and \$0.9 million, respectively, as compared to the same periods in Fiscal 2013, primarily related to the sale of certain joint arrangements in the fourth quarter of Fiscal 2013.

Interest income in Q2 2014 and in the first half of Fiscal 2014 was comparable to the same periods in Fiscal 2013.

Income tax recovery in Q2 2014 increased to \$12.0 million compared to an income tax expense of \$25.2 million in Q2 2013, and income tax recovery increased to \$39.1 million in the first half of Fiscal 2014 compared to an income tax expense of \$13.0 million in the first half of Fiscal 2013 due to higher losses in Q2 2014 and in the first half of Fiscal 2014, respectively.

Adjusted EBITDA in Q2 2014 was \$(16.1) million compared to \$20.2 million in Q2 2013, a decrease of \$36.3 million. Adjusted EBITDA in the first half of Fiscal 2014 was \$(74.2) million compared to \$10.4 million in the same period last year, a decrease of \$84.6 million. Adjusted EBITDA in Q2 2014 was impacted by the loss of rental income of \$5.8 million from the sale of shopping centre joint arrangements with The Westcliff Group of Companies during the fourth quarter of Fiscal 2013, \$4.7 million related to the closure of full-line stores previously announced during Fiscal 2013, and \$4.1 million due to the discontinuation of the licensing arrangement with SHS, partially offset by \$2.4 million in incremental foreign exchange gain compared to in Q2 2013. Adjusted EBITDA in the first half of Fiscal 2014 was impacted by \$12.4 million related to the closure of full-line stores previously announced during Fiscal 2013, the loss of rental income of \$10.6 million from the sale of shopping centre joint arrangements with The Westcliff Group of Companies during the fourth quarter of Fiscal 2013, and \$3.4 million due to the discontinuation of the licensing arrangement with SHS, partially offset by \$3.2 million in incremental foreign exchange gain compared to in the first half of Fiscal 2013. Excluding the impact of these items, Adjusted EBITDA would have been \$(3.9) million and \$(51.0) million in Q2 2014 and in the first half of Fiscal 2014, respectively.

## 2. Segment Performance

As at the dates noted below, the Company's locations were distributed across the country as follows:

	Atlantic	Québec	Ontario	Prairies	Pacific	As at August 2, 2014 Total	As at February 1, 2014 Total	As at August 3, 2013 Total
Full-line department stores	12	27	40	20	14	113	118	118
Sears Home stores	2	12	19	10	5	48	48	48
Outlet stores	1	1	6	1	2	11	11	11
Specialty type: Appliances and Mattresses stores	—	—	3	1	—	4	4	4
<b>Corporate stores</b>	15	40	68	32	21	176	181	181
<b>Hometown Dealer stores</b>	47	23	48	62	42	222	234	246
<b>Sears Home Services Showrooms</b>	—	2	3	1	2	8	8	9
Corbeil Franchise stores	—	13	2	—	—	15	16	16
Corbeil Corporate stores	—	13	6	—	—	19	18	18
<b>Corbeil</b>	—	26	8	—	—	34	34	34
<b>National Logistics Centres<sup>1</sup></b>	—	1	2	2	1	6	6	6
<b>Travel offices</b>	7	22	37	16	14	96	97	101
<b>Catalogue merchandise pick-up locations</b>	197	321	392	348	135	1,393	1,446	1,479

<sup>1</sup> Sears operates six logistics centres strategically located across the country. The logistics centres are comprised of seven owned and three leased warehouse facilities which serve all channels of the business.

## Results of Merchandising Operations

(in CAD millions)	Second Quarter			Year-to-Date		
	2014	% Chg 2014 vs 2013	2013	2014	% Chg 2014 vs 2013	2013
<b>Total Revenue</b>	\$ 844.4	(11.0)%	\$ 949.0	\$ 1,614.4	(10.6)%	\$ 1,805.4
Cost of goods and services sold, operating, administrative and selling expenses <sup>1</sup>	861.2	(7.9)%	935.3	1,690.2	(6.5)%	1,807.2
<b>Adjusted EBITDA</b>	\$ (16.8)	(222.6)%	\$ 13.7	\$ (75.8)	nm	\$ (1.8)

<sup>1</sup> "nm" means "not meaningful"

<sup>1</sup> Excludes depreciation and amortization, transformation expenses and non-recurring items.

**Comparative Analysis** - Revenue for the Company's merchandise operations decreased by 11.0% in Q2 2014 and 10.6% in the first half of Fiscal 2014, as compared to the same period in Fiscal 2013. Adjusted EBITDA decreased to \$(16.8) million in Q2 2014 and \$(75.8) million in the first half of Fiscal 2014, as compared to \$13.7 million and \$(1.8) million for the same periods in Fiscal 2013. Refer to Section 1f "Consolidated Financial Results" for additional information.

## Results from Real Estate Joint Arrangements

(in CAD millions)	Second Quarter			Year-to-Date		
	2014	% Chg 2014 vs 2013	2013	2014	% Chg 2014 vs 2013	2013
<b>Total Revenue</b>	\$ 1.4	(87.4)%	\$ 11.1	\$ 3.1	(85.8)%	\$ 21.8
Cost of goods and services sold, operating, administrative and selling expenses <sup>1</sup>	0.7	(84.8)%	4.6	1.5	(84.4)%	9.6
<b>Adjusted EBITDA</b>	\$ 0.7	(89.2)%	\$ 6.5	\$ 1.6	(86.9)%	\$ 12.2

<sup>1</sup> Excludes depreciation and amortization, transformation expenses and non-recurring items.

**Comparative Analysis** - Revenue for the Company's real estate joint arrangements in Q2 2014 and in the first half of Fiscal 2014 decreased by 87.4% and 85.8%, respectively, as compared to the same periods in Fiscal 2013, primarily related to certain joint arrangements sold during the fourth quarter of Fiscal 2013. Adjusted EBITDA decreased to \$0.7 million in Q2 2014 and \$1.6 million in the first half of Fiscal 2014, as compared to \$6.5 million and \$12.2 million for the same periods in Fiscal 2013.

## 3. Consolidated Financial Position, Liquidity and Capital Resources

Current assets as at August 2, 2014 were \$1,162.3 million, which was \$254.5 million lower than as at February 1, 2014. The decrease was primarily due to a \$247.7 million decrease in cash and cash equivalents, and a \$42.6 million decrease in inventories due to clearance activities and reduced receipts in the first half of Fiscal 2014. This decrease was partially offset by a \$19.8 million increase in income taxes recoverable primarily due to the utilization of loss carrybacks in certain subsidiaries of the Company, and a \$16.1 million increase to assets classified as held for sale due to the Kildonan Place Shopping Centre ("Kildonan") announcement as described in Section 8 "Events After the Reporting Period", compared to February 1, 2014.

Current liabilities as at August 2, 2014 were \$702.2 million, which was \$147.6 million lower than as at February 1, 2014, primarily due to decreases in income taxes payable and other taxes payable of \$81.4 million from tax payments made in the first half of 2014 for taxable income earned in the fourth quarter of Fiscal 2013. Current liabilities were also lower compared to February 1, 2014, due to a \$27.1 million decrease in provisions from severance payments related to previously announced transformation actions, a \$20.8 million decrease in deferred revenue primarily related to a reduction in goods ordered but not yet delivered and reduced sales of gift cards and extended warranty service contracts and a \$15.2 million decrease in accounts payable and accrued liabilities due to expense reductions and the timing and reduction of inventory receipts during the first half of Fiscal 2014.

Inventories were \$732.0 million as at August 2, 2014 compared to \$774.6 million as at February 1, 2014. The \$42.6 million decrease in the inventory balance was primarily due to clearance activities and reduced receipts in the period.

Total cash and cash equivalents was \$266.1 million as at August 2, 2014 compared to \$513.8 million as at February 1, 2014. The decrease of \$247.7 million was primarily due to cash used for operating activities.

Total assets and liabilities as at the end of Q2 2014, Fiscal 2013, and Q2 2013 were as follows:

<i>(in CAD millions, at period end)</i>	<b>As at August 2, 2014</b>	<b>As at February 1, 2014</b>	<b>As at August 3, 2013</b>
Total assets	<b>\$ 2,116.3</b>	\$ 2,392.3	\$ 2,616.7
Total liabilities	<b>1,140.2</b>	1,318.5	1,417.6

Total assets as at August 2, 2014 decreased by \$276.0 million to \$2,116.3 million compared to \$2,392.3 million at the end of Fiscal 2013, primarily due to lower cash and cash equivalents and inventories, and depreciation and amortization of property, plant and equipment and intangible assets, partially offset by increases in income taxes recoverable and deferred tax assets.

Total liabilities as at August 2, 2014 decreased by \$178.3 million to \$1,140.2 million compared to \$1,318.5 million at the end of Fiscal 2013, primarily due to decreases in deferred revenue, provisions, income and other taxes payable, and retirement benefit liability.

#### **Cash flow (used for) generated from operating activities**

Cash flow used for operating activities increased by \$56.5 million in Q2 2014 to \$24.7 million compared to cash flow generated from operating activities of \$31.8 million in Q2 2013. The Company's primary source of operating cash flow is the sale of goods and services to customers and the primary use of cash in operating activities is the purchase of merchandise inventories. The increase in cash used for operating activities was primarily attributable to a higher net loss, and a decrease in accounts payable and accrued liabilities due to payments for merchandise inventories and expenses, partially offset by a decrease in inventories.

#### **Cash flow generated from investing activities**

Cash flow generated from investing activities was \$23.7 million in Q2 2014 compared to cash flow generated from investing activities of \$180.2 million in Q2 2013. The \$156.5 million decrease in cash generated from investing activities was primarily due to proceeds received from lease terminations and lease amendments of \$190.5 million in Q2 2013.

#### **Cash flow used for financing activities**

Cash flow used for financing activities of \$3.0 million in Q2 2014 was comparable to Q2 2013 and included \$1.0 million for transaction fees associated with the Amended Credit Facility.

#### **Contractual Obligations**

Contractual obligations, including payments due over the next five fiscal years and thereafter, are shown in the following table:

<i>(in CAD millions)</i>	Carrying Amount	Contractual Cash Flow Maturities				
		Total	Within 1 year	1 year to 3 years	3 years to 5 years	Beyond 5 years
Accounts payable and accrued liabilities	\$ 423.5	\$ 423.5	\$ 423.5	\$ —	\$ —	\$ —
Finance lease obligations including payments due within one year <sup>1</sup>	30.2	39.2	6.3	10.8	10.1	12.0
Operating lease obligations <sup>2</sup>	n/a	469.1	99.4	154.6	106.6	108.5
Royalties <sup>2</sup>	n/a	3.0	0.3	1.4	1.3	—
Purchase agreements <sup>2,4</sup>	n/a	14.3	8.3	6.0	—	—
Retirement benefit plans obligations <sup>3</sup>	267.5	87.9	12.1	40.5	32.4	2.9
	<b>\$ 721.2</b>	<b>\$ 1,037.0</b>	<b>\$ 549.9</b>	<b>\$ 213.3</b>	<b>\$ 150.4</b>	<b>\$ 123.4</b>

- 1 Cash flow maturities related to finance lease obligations, including payments due within one year, include annual interest on finance lease obligations at a weighted average rate of 7.6%. The Company had no borrowings on the Amended Credit Facility as at August 2, 2014.*
- 2 Operating lease obligations, royalties and some purchase agreements are not reported in the unaudited Condensed Consolidated Statements of Financial Position.*
- 3 Payments are based on a funding valuation as at December 31, 2013 which was completed on June 30, 2014.*
- 4 Certain vendors require minimum purchase commitment levels over the term of the contract.*

## **Retirement Benefit Plans**

At the end of Q2 2014, the Company's retirement benefit plan obligations decreased by \$18.5 million to \$267.5 million compared to the end of Fiscal 2013.

In the fourth quarter of Fiscal 2013, the Company amended the early retirement provision of its pension plan to eliminate a benefit for associates who voluntarily resign prior to age of retirement, effective January 1, 2015. In addition, the Company amended its pension plan for improvements that increase portability of associates' benefits, effective March 1, 2014, and implemented fixed indexing at 0.5% per annum for eligible retirees, effective January 1, 2014. The Company also froze the benefits offered under the non-pension retirement plan to benefit levels as at January 1, 2015. In the fourth quarter of Fiscal 2013, the Company recorded a pre-tax gain on amendments to retirement benefits of \$42.5 million (\$42.8 million net of \$0.3 million of expenses). Refer to Note 20 "Retirement benefit plans" of the Consolidated Financial Statements for Fiscal 2013 for more details.

During the first half of Fiscal 2014, the Company offered lump sum settlements to those terminated associates who previously elected to defer the payment of the defined benefit pension until retirement. The Company expects to settle accepted offers by the end of October 2014. In addition, the Company made a voluntary offer to settle health and dental benefits of eligible members covered under the non-pension retirement plan. The Company incurred expenses of \$0.8 million related to these offers, during the first half of Fiscal 2014. These expenses were included in "Selling, administrative and other expenses" for the 13-week period ended May 3, 2014. The Company paid \$13.8 million to settle acceptances from the non-pension retirement plan offer and recorded a gain of \$10.6 million (\$11.4 million settlement gain less fees of \$0.8 million) during the first half of Fiscal 2014 related to these offers. To determine the settlement gain, the non-pension retirement plan was remeasured as at the date of settlement, which also resulted in a \$2.0 million adjustment to "Other comprehensive income (loss), net of taxes" ("OCI").

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at January 31. The most recent actuarial valuation of the pension plan for funding purposes is dated December 31, 2013, and was filed on June 30, 2014. An actuarial valuation of the health and welfare trust is performed at least every three years, with the last valuation completed as of January 31, 2014.

The Company's target asset allocation for the registered and non-registered pension plans is 55-75% fixed income and 25-45% equity. For the assets in the health and welfare trust, included in the non-pension retirement plan, the Company's target asset allocation is 100% fixed income. As at the end of Fiscal 2013, the assets were in line with the target allocation range. The asset allocation may change from time to time in terms of weighting between fixed income, equity and other asset classes as well as within the asset classes themselves.

The plan's target allocation is determined by taking into consideration the amounts and timing of projected liabilities, the Company's funding policies and expected returns on various asset classes. To develop the expected long-term rate of return on assets assumption, the Company considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

## **Capital Resources**

The Company's capital expenditures, working capital needs, debt repayment and other financing needs are funded primarily through cash generated from operations and existing cash on hand. In selecting appropriate funding choices, the Company's objective is to manage its capital structure in such a way as to diversify its funding sources, while minimizing its funding costs and risks. Sears expects to be able to satisfy all of its financing requirements through cash on hand, cash generated by operations and, if necessary, availability under the Company's credit facility as described below. The Company's cost of funding is affected by general economic conditions, including the overall interest rate environment, as well as the Company's financial performance, credit ratings and fluctuations of its credit spread over applicable reference rates.



The Company's debt consists of a secured credit facility and finance lease obligations and the Company's share of its real estate joint arrangement obligations. In September 2010, the Company entered into an \$800.0 million senior secured revolving credit facility (the "Credit Facility") with a syndicate of lenders with a maturity date of September 10, 2015. On May 28, 2014, the Company announced that it had extended the term of the Credit Facility to May 28, 2019 and reduced the total credit limit to \$300.0 million. The Amended Credit Facility is secured with a first lien on inventory and credit card receivables. The Company incurred additional transaction costs of \$1.0 million in the 13 and 26-week period ended August 2, 2014 (August 3, 2013: nil) related to the Amended Credit Facility. The Company's annual commitment fees on the unused portion of the Amended Credit Facility (included in "Finance costs"), are expected to decrease to \$1.1 million per year, compared to the \$4.0 million fees payable previously, a savings of over 70%.

Availability under the Amended Credit Facility is determined pursuant to a borrowing base formula, up to a maximum availability of \$300.0 million. Availability under the Amended Credit Facility was \$268.3 million as at August 2, 2014 (February 1, 2014: \$374.0 million, August 3, 2013: \$550.9 million). The borrowing base formula may be reduced by reserves currently estimated by the Company to be approximately \$133.1 million, which may be applied by the lenders at their discretion pursuant to the Amended Credit Facility agreement. In 2013, as a result of judicial developments relating to the priorities of pension liability relative to certain secured obligations, the Company provided additional security to the lenders by pledging certain real estate assets as collateral, thereby partially reducing the potential reserve amount the lenders could apply. As at August 2, 2014, three properties in Ontario have been registered under the Amended Credit Facility. The additional reserve amount may increase or decrease in the future based on changes in estimated net pension deficits in the event of a wind-up, and based on the amount of real estate assets pledged as additional collateral.

The Amended Credit Facility contains covenants which are customary for facilities of this nature and the Company was in compliance with all covenants as at August 2, 2014.

The proceeds of \$590.5 million received by the Company in Fiscal 2013 for the lease terminations and lease amendments were used towards the distribution of an extraordinary cash dividend of \$509.4 million in the fourth quarter of 2013. The remaining proceeds in addition to the \$348.9 million of proceeds received by the Company for the sale of its interest in certain joint arrangements in the fourth quarter of 2013 and Q2 2014 will be used for general corporate purposes, the settlement of retirement benefits, upgrades to the IT infrastructure and other capital expenditures. The Company regularly monitors its sources and uses of cash and its level of cash on hand, and considers the most effective use of cash on hand, including stock purchases and dividends.

As at August 2, 2014, the Company had no borrowings on the Amended Credit Facility and had unamortized transaction costs associated with the Amended Credit Facility of \$4.6 million included in "Other long-term assets" in the unaudited Condensed Consolidated Statements of Financial Position (February 1, 2014: no borrowings and unamortized transaction costs of \$4.4 million included in "Other long-term assets", August 3, 2013: no borrowings and unamortized transaction costs of \$5.4 million included in "Other long-term assets"). In addition, the Company had \$31.7 million (February 1, 2014: \$24.0 million, August 3, 2013: \$24.2 million) of standby letters of credit outstanding against the Amended Credit Facility. These letters of credit cover various payment obligations. Interest on drawings under the Amended Credit Facility is determined based on bankers' acceptance rates for one to three month terms or the prime rate plus a spread. Interest amounts on the Amended Credit Facility are due monthly and are added to principal amounts outstanding.

As at August 2, 2014, the Company had outstanding merchandise letters of credit of U.S. \$4.8 million (February 1, 2014: U.S. \$9.0 million, August 3, 2013: U.S. \$9.1 million) used to support the Company's offshore merchandise purchasing program with restricted cash and cash equivalents pledged as collateral.

The Company has entered into a mortgage on land that it owns in Burnaby, British Columbia. In accordance with the Burnaby development project with Concord, the land has been allocated as security for future borrowings (see Note 24 "North Hill and Burnaby agreements" of the Q2 2014 financial statements for additional information on the mortgage).

#### **4. Financial Instruments**

The Company is exposed to credit, liquidity and market risk as a result of holding financial instruments. Market risk consists of foreign exchange and interest rate risk. See Note 17 "Financial instruments" in the Q2 2014 financial statements for additional information.

### **Credit risk**

Credit risk refers to the possibility that the Company can suffer financial losses due to the failure of the Company's counterparties to meet their payment obligations. Exposure to credit risk exists for derivative instruments, cash and cash equivalents, accounts receivable and other long-term assets.

Cash and cash equivalents, accounts receivable, derivative instruments and investments included in other long-term assets totaling \$345.6 million as at August 2, 2014 (February 1, 2014: \$605.8 million, August 3, 2013: \$399.3 million) expose the Company to credit risk should the borrower default on maturity of the investment. The Company manages this exposure through policies that require borrowers to have a minimum credit rating of A, and limiting investments with individual borrowers at maximum levels based on credit rating.

The Company is exposed to minimal credit risk from third parties as a result of ongoing credit evaluations and review of accounts receivable collectability. As at August 2, 2014, one party represented 14.7% of the Company's accounts receivable (February 1, 2014: one party represented 11.3% of the Company's accounts receivable, August 3, 2013: two parties represented 29.0% of the Company's accounts receivable).

### **Liquidity risk**

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they come due. The Company actively maintains access to adequate funding sources to seek to ensure it has sufficient available funds to meet current and foreseeable financial requirements at a reasonable cost.

### **Market risk**

Market risk exists as a result of the potential for losses caused by changes in market factors such as foreign currency exchange rates, interest rates and commodity prices.

Periodically, the Company enters into foreign exchange contracts to reduce the foreign exchange risk with respect to U.S. dollar denominated assets and liabilities and purchases of goods or services. As at August 2, 2014, there were forward contracts outstanding with a notional value of U.S. \$205.0 million (February 1, 2014: U.S. \$90.0 million, August 3, 2013: U.S. \$165.0 million) and a fair value of \$3.8 million included in "Derivative financial assets" (February 1, 2014: \$7.2 million, August 3, 2013: \$1.5 million) in the unaudited Condensed Consolidated Statements of Financial Position. These derivative contracts have settlement dates extending to February 2015. The intrinsic value portion of these derivatives has been designated as a cash flow hedge for hedge accounting treatment under International Accounting Standards ("IAS") 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). These contracts are intended to reduce the foreign exchange risk with respect to anticipated purchases of U.S. dollar denominated goods and services, including goods purchased for resale ("hedged item"). As at August 2, 2014, the designated portion of these hedges was considered by the Company to be effective.

During the 13 and 26-week period ended August 2, 2014, the Company recorded a gain of \$0.2 million and a gain of \$0.1 million (2013: loss of \$2.3 million and a loss of \$3.1 million), respectively, in "Selling, administrative and other expenses", relating to the translation or settlement of U.S. dollar denominated monetary items consisting of cash and cash equivalents, accounts receivable and accounts payable.

The Q2 2014 period end exchange rate was 0.9152 U.S. dollars to one Canadian dollar. A 10% appreciation or depreciation of the U.S. and/or the Canadian dollar exchange rate was determined to have an after-tax impact on net (loss) earnings of \$0.1 million for U.S. dollar denominated balances included in cash and cash equivalents, accounts receivable and accounts payable.

### **Interest rate risk**

Periodically, the Company enters into interest rate swap contracts with approved financial institutions to manage exposure to interest rate risks. As at August 2, 2014, the Company had no interest rate swap contracts in place (February 1, 2014: nil, August 3, 2013: nil).

Interest rate risk reflects the sensitivity of the Company's financial condition to movements in interest rates. Financial assets and liabilities which do not bear interest or bear interest at fixed rates are classified as non-interest rate sensitive.

Cash and cash equivalents and borrowings under the Amended Credit Facility, when applicable, are subject to interest rate risk. The total subject to interest rate risk as at August 2, 2014 was a net asset of \$267.4 million (February 1, 2014: net asset of \$515.1 million, August 3, 2013: net asset of \$320.4 million). An increase or decrease in interest rates of 25 basis points would cause an immaterial after-tax impact on net (loss) earnings for net assets subject to interest rate risk included in cash and cash equivalents and other long-term assets as at August 2, 2014.

## 5. Funding Costs

The funding costs for the Company in Q2 2014 and Q2 2013 are outlined in the table below:

<i>(in CAD millions)</i>	Second Quarter		Year-to-Date	
	2014	2013	2014	2013
<b>Interest costs</b>				
Total long-term obligations at end of period <sup>1</sup>	\$ 30.2	\$ 55.2	\$ 30.2	\$ 55.2
Average long-term obligations for period <sup>2</sup>	30.9	56.1	32.6	57.2
Long-term funding costs <sup>3</sup>	0.6	1.0	1.2	2.0
Average rate of long-term funding	7.8%	7.1%	7.4%	7.0%

<sup>1</sup> Includes current portion of long-term obligations.

<sup>2</sup> The average long-term obligations is calculated as an average of the opening and ending balances as at each reporting date throughout the period.

<sup>3</sup> Excludes standby fee on the unused portion of the Amended Credit Facility, amortization of debt issuance costs, interest accrued related to uncertain tax positions and sales tax assessments.

See Section 3 “Consolidated Financial Position, Liquidity and Capital Resources” for a description of the Company’s funding sources.

## 6. Related Party Transactions

As at September 2, 2014, ESL Investments, Inc., and investment affiliates including Edward S. Lampert, collectively “ESL”, was the beneficial holder of 28,158,368 or 27.6%, of the common shares of the Company. Sears Holdings was the beneficial holder of 51,962,391 common shares, representing approximately 51.0% of the Company’s total outstanding common shares.

In the ordinary course of business, the Company and Sears Holdings periodically share selected services, associates, and tangible and intangible assets. Transactions between the Company and Sears Holdings are recorded either at fair market value or the exchange amount, which was established and agreed to by the related parties. See Section 6 “Related Party Transactions” of the 2013 Annual Report and Note 31 “Related party transactions” in the 2013 Annual Consolidated Financial Statements for further information about these transactions.

## 7. Shareholders’ Equity

As at September 2, 2014, the total number of common shares issued and outstanding of the Company were 101,877,662 (February 1, 2014: 101,877,662, August 3, 2013: 101,877,662).

## 8. Events After the Reporting Period

On August 6, 2014, the Company announced that it had entered into an agreement for the sale of its 20% joint arrangement interest in Kildonan that it owns with Ivanhoé for pre-tax consideration of \$27.7 million. The purchaser, H&R Real Estate Investment Trust, is also purchasing the remaining 80% ownership interest from Ivanhoé. The joint arrangement interest had a net carrying value of approximately \$15.6 million as at August 2, 2014. The agreement is subject to customary closing conditions including representations and warranties given on signing of the agreement continuing to be true on closing. The transaction is expected to close on September 17, 2014, and the ultimate amount of gain to be recognized will be determined during the third quarter of Fiscal 2014. Following the sale, the Company will continue to operate its store in the shopping centre.

On August 26, 2014, Ivanhoé announced that it had entered into an agreement for the sale of a number of its properties, including its 85% joint arrangement interest in Les Galeries de Hull (“Hull”) that it owns with the Company. The Company may choose to sell its 15% joint arrangement interest in Hull to the same buyer or may choose to retain its interest in Hull.

## 9. Accounting Policies and Estimates

### a. Issued Standards Not Yet Adopted

The Company monitors the standard setting process for new standards and interpretations issued by the International Accounting Standards Board (“IASB”) that the Company may be required to adopt in the future. Since the impact of a proposed standard may change during the review period, the Company does not comment publicly until the standard has been finalized and the effects have been determined.

In May 2014, the IASB issued new standards as follows:

#### *IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)*

IFRS 15 replaces IAS 11, *Construction Contracts*, and IAS 18, *Revenue*, as well as various interpretations regarding revenue. This standard introduces a single model for recognizing revenue that applies to all contracts with customers, except for contracts that are within the scope of standards on leases, insurance and financial instruments. This standard also requires enhanced disclosures. Adoption of IFRS 15 is mandatory and will be effective for annual periods beginning on or after January 1, 2017, with earlier adoption permitted. The Company is currently assessing the impact of adopting this standard on the Company’s consolidated financial statements and related note disclosures.

In May 2014, the IASB issued amendments to a previously released standard as follows:

#### *IFRS 11, Joint Arrangements (“IFRS 11”)*

The IASB has amended IFRS 11 to require business combination accounting to be applied to acquisitions of interests in a joint operation that constitute a business. The amendments will be effective for annual periods beginning on or after January 1, 2016, with earlier adoption permitted. The Company is currently assessing the impact of these amendments on the Company’s consolidated financial statements and related note disclosures.

On December 16, 2011, the IASB issued amendments to a previously released standard as follows:

#### *IFRS 9, Financial Instruments (“IFRS 9”)*

This standard will ultimately replace IAS 39 in phases. The first phase of IFRS 9 was issued on November 12, 2009 and addresses the classification and measurement of financial assets. The second phase of IFRS 9 was issued on October 28, 2010 incorporating new requirements on accounting for financial liabilities. On December 16, 2011, the IASB amended the mandatory effective date of IFRS 9 to fiscal years beginning on or after January 1, 2015. The amendment also provides relief from the requirement to recast comparative financial statements for the effect of applying IFRS 9. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. In November 2013, the IASB withdrew the mandatory effective date of IFRS 9. The Company will evaluate the overall impact on the Company’s consolidated financial statements when the final standard, including all phases, is issued.

### b. Critical Accounting Judgments and Key Sources of Estimation Uncertainty

In the application of the Company’s accounting policies, management is required to make judgments, estimates and assumptions with regards to the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods, if the revision affects both current and future periods.

Critical judgments that management has made in the process of applying the Company’s accounting policies, key assumptions concerning the future and other key sources of estimation uncertainty that have the potential to materially impact the carrying amounts of assets and liabilities within the next financial year are described in Note 2 “Significant accounting policies” and Note 4 “Critical accounting judgments and key sources of estimation uncertainty” of the 2013 Annual Consolidated Financial Statements and are consistent with those used in the preparation of these Financial Statements.

## **10. Disclosure Controls and Procedures**

### ***Disclosure Controls and Procedures***

Management of the Company is responsible for establishing and maintaining a system of disclosure controls and procedures (“DC&P”) that are designed to provide reasonable assurance that information required to be disclosed by the Company in its public disclosure documents, including its Annual and Interim MD&A, Annual and Interim Financial Statements, and Annual Information Form is recorded, processed, summarized and reported within required time periods and includes controls and procedures designed to ensure that the information required to be disclosed by the Company in its public disclosure documents is accumulated and communicated to the Company’s management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), to allow timely decisions regarding required DC&P.

Management of the Company, including the CEO and CFO, has caused to be evaluated under their supervision, the Company’s DC&P, and has concluded that the Company’s DC&P was effective for the period ended August 2, 2014.

### ***Internal Control over Financial Reporting***

Management of the Company is also responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Management of the Company, including the CEO and CFO, has caused to be evaluated the internal control over financial reporting and has concluded, based on that evaluation, that the Company’s internal control over financial reporting was effective as at August 2, 2014. Additionally, Management of the Company evaluated whether there were changes in the internal control over financial reporting during Q2 2014 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting and has determined that no material changes occurred during this period.

Internal control systems, regardless of superiority in design, have inherent limitations. Therefore, even those systems that have been determined to have been designed effectively can only provide reasonable assurance with respect to financial reporting and financial statement preparation.

## **11. Risks and Uncertainties**

Please also see Section 11 “Risks and Uncertainties” of the Company’s 2013 Annual Report for a detailed description of the risks and uncertainties faced by the Company.

On May 14, 2014, the Company acknowledged the press release issued by Sears Holdings announcing its intention to explore strategic alternatives, including the potential divestiture of its 51% interest in Sears Canada and/or the sale of Sears Canada as a whole. The Company’s board of directors and management agreed to cooperate with Sears Holdings in its efforts relating to the consideration of strategic alternatives and/or potential divestiture.

The Company’s right to use the “Sears” name, including, as part of the Company’s corporate and commercial name, and certain other brand names was granted to the Company pursuant to a license agreement with Sears Holdings. In the event Sears Holdings’ ownership interest is reduced to less than 25%, the license agreement would remain in effect for a period of three years after such reduction in ownership, after which the Company would no longer be permitted to use the “Sears” name and certain other brand names. Losing the Company’s right to use these intellectual properties could significantly diminish the Company’s competitiveness and could materially harm its business. If the license agreement is terminated, the Company may attempt to renegotiate the license agreement although the terms of any renegotiated agreement may be less favorable to the Company.

## TABLE OF CONTENTS

### Unaudited Condensed Consolidated Financial Statements

Condensed Consolidated Statements of Financial Position

Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income

Condensed Consolidated Statements of Changes in Shareholders' Equity

Condensed Consolidated Statements of Cash Flows

### Notes to the Unaudited Condensed Consolidated Financial Statements

- Note 1: General information
- Note 2: Significant accounting policies
- Note 3: Issued standards not yet adopted
- Note 4: Critical accounting judgments and key sources of estimation uncertainty
- Note 5: Cash and cash equivalents and interest income
- Note 6: Inventories
- Note 7: Property, plant and equipment
- Note 8: Goodwill
- Note 9: Long-term obligations and finance costs
- Note 10: Capital stock
- Note 11: Revenue
- Note 12: Retirement benefit plans
- Note 13: Depreciation and amortization expense
- Note 14: Assets and liabilities classified as held for sale
- Note 15: Gain on lease terminations and lease amendments
- Note 16: Gain on sale of interest in joint arrangements
- Note 17: Financial instruments
- Note 18: Contingent liabilities
- Note 19: Net (loss) earnings per share
- Note 20: Income taxes
- Note 21: Segmented information
- Note 22: Changes in non-cash working capital balances
- Note 23: Changes in long-term assets and liabilities
- Note 24: North Hill and Burnaby agreements
- Note 25: Events after the reporting period
- Note 26: Approval of unaudited condensed consolidated financial statements

**SEARS CANADA INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

Unaudited

<i>(in CAD millions)</i>	Notes	As at August 2, 2014	As at February 1, 2014	As at August 3, 2013
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents	5	\$ 266.1	\$ 513.8	\$ 319.1
Accounts receivable, net	17	74.2	83.3	77.2
Income taxes recoverable		20.6	0.8	7.0
Inventories	6	732.0	774.6	915.3
Prepaid expenses		36.2	23.8	37.0
Derivative financial assets	17	3.8	7.2	1.5
Assets classified as held for sale	14	29.4	13.3	—
<b>Total current assets</b>		<b>1,162.3</b>	1,416.8	1,357.1
<b>Non-current assets</b>				
Property, plant and equipment	7	725.3	785.5	1,078.5
Investment property		19.3	19.3	21.7
Intangible assets		26.5	28.2	24.6
Goodwill	8	—	2.6	8.7
Deferred tax assets		132.5	88.7	77.0
Other long-term assets	9, 17, 20	50.4	51.2	49.1
<b>Total assets</b>		<b>\$ 2,116.3</b>	\$ 2,392.3	\$ 2,616.7
<b>LIABILITIES</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	15, 17	\$ 423.5	\$ 438.7	\$ 505.7
Deferred revenue		166.9	187.7	182.3
Provisions		82.3	109.4	50.8
Income taxes payable		0.3	52.2	—
Other taxes payable		24.4	53.9	50.2
Current portion of long-term obligations	9, 17	4.3	7.9	9.3
Liabilities classified as held for sale	14	0.5	—	—
<b>Total current liabilities</b>		<b>702.2</b>	849.8	798.3
<b>Non-current liabilities</b>				
Long-term obligations	9, 17	25.9	28.0	45.9
Deferred revenue		78.7	87.3	86.9
Retirement benefit liability	12	267.5	286.0	414.5
Deferred tax liabilities		3.8	4.2	5.0
Other long-term liabilities		62.1	63.2	67.0
<b>Total liabilities</b>		<b>1,140.2</b>	1,318.5	1,417.6
<b>SHAREHOLDERS' EQUITY</b>				
Capital stock	10	14.9	14.9	14.9
Retained earnings		1,048.8	1,145.3	1,329.8
Accumulated other comprehensive loss		(87.6)	(86.4)	(145.6)
<b>Total shareholders' equity</b>		<b>976.1</b>	1,073.8	1,199.1
<b>Total liabilities and shareholders' equity</b>		<b>\$ 2,116.3</b>	\$ 2,392.3	\$ 2,616.7

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

## SEARS CANADA INC.

## CONDENSED CONSOLIDATED STATEMENTS OF NET (LOSS) EARNINGS AND COMPREHENSIVE (LOSS) INCOME

For the 13 and 26-week periods ended August 2, 2014 and August 3, 2013

Unaudited

<i>(in CAD millions, except per share amounts)</i>	Notes	13-Week Period		26-Week Period	
		2014	2013	2014	2013
Revenue	11	\$ 845.8	\$ 960.1	\$ 1,617.5	\$ 1,827.2
Cost of goods and services sold	6, 17	564.2	601.3	1,082.7	1,139.0
Selling, administrative and other expenses	7,8,12,13,17	345.8	364.1	698.7	735.0
<b>Operating loss</b>		<b>(64.2)</b>	<b>(5.3)</b>	<b>(163.9)</b>	<b>(46.8)</b>
Gain on lease terminations and lease amendments	15	—	185.7	—	185.7
Gain on sale of interest in joint arrangements	16	20.5	—	20.5	—
Gain on settlement of retirement benefits	12	11.4	—	10.6	—
Finance costs	9,20	1.7	2.8	4.2	5.1
Interest income	5	0.7	0.4	1.4	0.8
<b>(Loss) earnings before income taxes</b>		<b>(33.3)</b>	<b>178.0</b>	<b>(135.6)</b>	<b>134.6</b>
Income tax (expense) recovery					
Current	20	(2.5)	(4.4)	(4.7)	(7.3)
Deferred	20	14.5	(20.8)	43.8	(5.7)
		12.0	(25.2)	39.1	(13.0)
<b>Net (loss) earnings</b>		<b>\$ (21.3)</b>	<b>\$ 152.8</b>	<b>\$ (96.5)</b>	<b>\$ 121.6</b>
Basic net (loss) earnings per share	19	\$ (0.21)	\$ 1.50	\$ (0.95)	\$ 1.19
Diluted net (loss) earnings per share	19	\$ (0.21)	\$ 1.50	\$ (0.95)	\$ 1.19
Net (loss) earnings		\$ (21.3)	\$ 152.8	\$ (96.5)	\$ 121.6
Other comprehensive income (loss), net of taxes:					
Items that may subsequently be reclassified to net (loss) income:					
Gain on foreign exchange derivatives	17	2.0	1.1	1.6	1.1
Reclassification to net loss of gain on foreign exchange derivatives		(1.6)	—	(4.8)	—
Items that will not be subsequently reclassified to net (loss) income:					
Remeasurement gain on net defined retirement benefit liability	12	2.0	—	2.0	—
<b>Total other comprehensive income (loss)</b>		<b>2.4</b>	<b>1.1</b>	<b>(1.2)</b>	<b>1.1</b>
<b>Total comprehensive (loss) income</b>		<b>\$ (18.9)</b>	<b>\$ 153.9</b>	<b>\$ (97.7)</b>	<b>\$ 122.7</b>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



**SEARS CANADA INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the 13 and 26-week periods ended August 2, 2014 and August 3, 2013**

Unaudited

<i>(in CAD millions)</i>	Notes	Capital stock	Retained earnings	Accumulated other comprehensive (loss) income			Shareholders' equity
				<i>Foreign exchange derivatives designated as cash flow hedges</i>	<i>Remeasurement (loss) gain</i>	Total accumulated other comprehensive (loss) income	
<b>Balance as at May 3, 2014</b>		\$ 14.9	\$ 1,070.1	\$ 2.4	\$ (92.4)	\$ (90.0)	\$ 995.0
Net loss			(21.3)	—	—	—	(21.3)
<i>Other comprehensive income (loss)</i>							
Gain on foreign exchange derivatives, net of income tax expense of \$0.8	17			2.0	—	2.0	2.0
Reclassification of gain on foreign exchange derivatives, net of income tax expense of \$0.5				(1.6)	—	(1.6)	(1.6)
Remeasurement gain on net defined retirement benefit liability, net of income tax expense of \$0.7	12			—	2.0	2.0	2.0
<i>Total other comprehensive income</i>		—	—	0.4	2.0	2.4	2.4
<i>Total comprehensive (loss) income</i>		—	(21.3)	0.4	2.0	2.4	(18.9)
<b>Balance as at August 2, 2014</b>		\$ 14.9	\$ 1,048.8	\$ 2.8	\$ (90.4)	\$ (87.6)	\$ 976.1
<b>Balance as at May 4, 2013</b>							
Net earnings			152.8	—	—	—	152.8
<i>Other comprehensive income</i>							
Gain on foreign exchange derivatives, net of income tax expense of \$0.4	17			1.1	—	1.1	1.1
<i>Total other comprehensive income</i>		—	—	1.1	—	1.1	1.1
<i>Total comprehensive income</i>		—	152.8	1.1	—	1.1	153.9
<b>Balance as at August 3, 2013</b>		\$ 14.9	\$ 1,329.8	\$ 1.1	\$ (146.7)	\$ (145.6)	\$ 1,199.1
<b>Balance as at February 1, 2014</b>							
Net loss			(96.5)	—	—	—	(96.5)
<i>Other comprehensive income (loss)</i>							
Gain on foreign exchange derivatives, net of income tax expense of \$0.6	17			1.6	—	1.6	1.6
Reclassification of gain on foreign exchange derivatives, net of income tax expense of \$1.7				(4.8)	—	(4.8)	(4.8)
Remeasurement gain on net defined retirement benefit liability, net of income tax expense of \$0.7	12			—	2.0	2.0	2.0
<i>Total other comprehensive (loss) income</i>		—	—	(3.2)	2.0	(1.2)	(1.2)
<i>Total comprehensive (loss) income</i>		—	(96.5)	(3.2)	2.0	(1.2)	(97.7)
<b>Balance as at August 2, 2014</b>		\$ 14.9	\$ 1,048.8	\$ 2.8	\$ (90.4)	\$ (87.6)	\$ 976.1
<b>Balance as at February 2, 2013</b>							
Net earnings			121.6	—	—	—	121.6
<i>Other comprehensive income</i>							
Gain on foreign exchange derivatives, net of income tax expense of \$0.4	17			1.1	—	1.1	1.1
<i>Total other comprehensive income</i>		—	—	1.1	—	1.1	1.1
<i>Total comprehensive income</i>		—	121.6	1.1	—	1.1	122.7
<b>Balance as at August 3, 2013</b>		\$ 14.9	\$ 1,329.8	\$ 1.1	\$ (146.7)	\$ (145.6)	\$ 1,199.1

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

**SEARS CANADA INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the 13 and 26-week periods ended August 2, 2014 and August 3, 2013

Unaudited

<i>(in CAD millions)</i>	Notes	13-Week Period		26-Week Period	
		2014	2013	2014	2013
<b>Cash flow (used for) generated from operating activities</b>					
Net (loss) earnings		\$ (21.3)	\$ 152.8	\$ (96.5)	\$ 121.6
Adjustments for:					
Depreciation and amortization expense	13	21.8	30.0	45.4	60.2
Gain on disposal of property, plant and equipment		(0.1)	(1.3)	(0.5)	(1.5)
Impairment losses	7, 8	18.3	—	18.3	—
Gain on sale of interest in joint arrangements	16	(20.5)	—	(20.5)	—
Gain on lease terminations and lease amendments	15	—	(185.7)	—	(185.7)
Finance costs	9, 20	1.7	2.8	4.2	5.1
Interest income	5	(0.7)	(0.4)	(1.4)	(0.8)
Retirement benefit plans expense	12	4.6	6.9	10.0	13.8
Gain on settlement of retirement benefits	12	(11.4)	—	(10.6)	—
Short-term disability expense	12	1.2	1.8	3.3	4.3
Income tax (recovery) expense	20	(12.0)	25.2	(39.1)	13.0
Interest received	5	0.2	0.6	0.7	1.1
Interest paid	9	(0.9)	(1.5)	(2.1)	(3.0)
Retirement benefit plans contributions	12	(16.0)	(9.7)	(18.2)	(19.4)
Income tax payments, net	20	(1.7)	(0.9)	(66.1)	(8.9)
Other income tax deposits	20	—	(6.1)	(10.3)	(6.1)
Changes in non-cash working capital	22	15.1	19.7	(70.9)	(72.8)
Changes in long-term assets and liabilities	23	(3.0)	(2.4)	1.2	(8.7)
		(24.7)	31.8	(253.1)	(87.8)
<b>Cash flow generated from investing activities</b>					
Purchases of property, plant and equipment and intangible assets		(10.0)	(11.4)	(20.5)	(18.1)
Proceeds from sale of property, plant and equipment		0.2	1.1	0.8	1.4
Proceeds from lease terminations	15	—	190.5	—	190.5
Proceeds from sale of interest in joint arrangements	16	33.5	—	33.5	—
		23.7	180.2	13.8	173.8
<b>Cash flow used for financing activities</b>					
Interest paid on finance lease obligations	9	(0.5)	(0.7)	(1.1)	(1.3)
Repayment of long-term obligations		(2.4)	(3.5)	(8.2)	(6.9)
Proceeds from long-term obligations		0.9	1.2	2.4	2.3
Transaction fees associated with amended credit facility	9	(1.0)	—	(1.0)	—
		(3.0)	(3.0)	(7.9)	(5.9)
<b>Effect of exchange rate on cash and cash equivalents at end of period</b>					
		(0.1)	0.4	(0.5)	0.5
<b>(Decrease) increase in cash and cash equivalents</b>					
		(4.1)	209.4	(247.7)	80.6
<b>Cash and cash equivalents at beginning of period</b>					
		\$ 270.2	\$ 109.7	\$ 513.8	\$ 238.5
<b>Cash and cash equivalents at end of period</b>					
		\$ 266.1	\$ 319.1	\$ 266.1	\$ 319.1

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. General information

Sears Canada Inc. is incorporated in Canada. The address of its registered office and principal place of business is 290 Yonge Street, Suite 700, Toronto, Ontario, Canada M5B 2C3. The principal activities of Sears Canada Inc. and its subsidiaries (the “Company”) include the sale of goods and services through the Company’s Retail channels, which includes its Full-line, Sears Home, Hometown Dealer, Outlet, Appliances and Mattresses, Corbeil Electrique Inc. (“Corbeil”) stores, and its Direct (catalogue/ internet) channel. It also includes service revenue related to product repair and logistics. Commission revenue includes travel, home improvement services, insurance, and performance payments received from JPMorgan Chase Bank, N.A. (Toronto Branch) (“JPMorgan Chase”) under the Company’s credit card marketing and servicing alliance with JPMorgan Chase. The Company has a multi-year licensing arrangement with TravelBrands Inc. (“TravelBrands”) (formerly known as Thomas Cook Canada Inc.), under which TravelBrands manages the day-to-day operations of all Sears Travel offices and provides commissions to the Company. The Company also entered in a multi-year licensing agreement with SHS Services Management Inc. (“SHS”), under which SHS oversaw the day-to-day operations of all Sears Home Installed Products and Services business (“HIPS”). On December 13, 2013, SHS announced it was in receivership, and all offers of services provided by SHS ceased (see Note 17). Licensee fee revenues are comprised of payments received from licensees, including TravelBrands, that operate within the Company’s stores. The Company is a party to a number of real estate joint arrangements which have been classified as joint operations and accounted for by recognizing the Company’s share of joint arrangements’ assets, liabilities, revenues and expenses for financial reporting purposes.

The indirect parent of the Company is Sears Holdings Corporation (“Sears Holdings”), incorporated in the U.S. in the state of Delaware. The ultimate controlling party of the Company is ESL Investments, Inc. (incorporated in the U.S. in the state of Florida) through Sears Holdings.

### 2. Significant accounting policies

#### 2.1 Statement of compliance

The unaudited condensed consolidated financial statements of the Company for the 13 and 26-week period ended August 2, 2014 (the “Financial Statements”) have been prepared in accordance with IAS 34, *Interim Financial Reporting* issued by the International Accounting Standards Board (“IASB”), and therefore, do not contain all disclosures required by International Financial Reporting Standards (“IFRS”) for annual financial statements. Accordingly, these Financial Statements should be read in conjunction with the Company’s most recently prepared annual consolidated financial statements for the 52-week period ended February 1, 2014 (the “2013 Annual Consolidated Financial Statements”), prepared in accordance with IFRS.

#### 2.2 Basis of preparation and presentation

The principal accounting policies of the Company have been applied consistently in the preparation of these Financial Statements for all periods presented. These Financial Statements follow the same accounting policies and methods of application as those used in the preparation of the 2013 Annual Consolidated Financial Statements, except as noted below. The Company’s significant accounting policies are described in Note 2 of the 2013 Annual Consolidated Financial Statements.

The Company adopted the following amendments and interpretations which became effective “in” or “for” the 26-week period ended August 2, 2014:

- *IAS 32, Financial Instruments: Presentation (“IAS 32”)*

The IASB has amended IAS 32 to provide clarification on the requirements for offsetting financial assets and liabilities. These amendments are effective for annual periods beginning on or after January 1, 2014. Based on the Company’s assessment of these amendments, there is no impact on its Financial Statements; and

- *IFRIC 21, Levies (“IFRIC 21”)*

IFRIC 21 provides guidance on when to recognize a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* and those where the timing and amount of the levy is certain. This interpretation is applicable for annual periods on or after January 1, 2014. Based on the Company’s assessment of this interpretation, there is no impact on its Financial Statements.

### 2.2.1 Basis of consolidation

The Financial Statements incorporate the financial statements of the Company as well as all of its subsidiaries. Real estate joint arrangements are accounted for by recognizing the Company's share of the joint arrangements' assets, liabilities, revenues and expenses. Subsidiaries include all entities where the Company has the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities. All intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in the preparation of these Financial Statements.

The fiscal year of the Company consists of a 52 or 53-week period ending on the Saturday closest to January 31. The 13 and 26-week periods presented in these Financial Statements are for the periods ended August 2, 2014 and August 3, 2013.

These Financial Statements are presented in Canadian dollars, which is the Company's functional currency. The Company is comprised of two reportable segments, Merchandising and Real Estate Joint Arrangements (see Note 21).

### 2.3 Seasonality

The Company's operations are seasonal in nature. Accordingly, merchandise and service revenues, as well as performance payments received from JPMorgan Chase under the credit card marketing and servicing alliance, will vary by quarter based on consumer spending behaviour. Historically, the Company's revenues and earnings are highest in the fourth quarter due to the holiday season. The Company is able to adjust certain variable costs in response to seasonal revenue patterns; however, costs such as occupancy are fixed, causing the Company to report a disproportionate level of earnings in the fourth quarter. This business seasonality results in quarterly performance that is not necessarily indicative of the year's performance.

## 3. Issued standards not yet adopted

The Company monitors the standard setting process for new standards and interpretations issued by the IASB that the Company may be required to adopt in the future. Since the impact of a proposed standard may change during the review period, the Company does not comment publicly until the standard has been finalized and the effects have been determined.

In May 2014, the IASB issued new standards as follows:

#### *IFRS 15, Revenue from Contracts with Customers ("IFRS 15")*

IFRS 15 replaces IAS 11, *Construction Contracts*, and IAS 18, *Revenue*, as well as various interpretations regarding revenue. This standard introduces a single model for recognizing revenue that applies to all contracts with customers, except for contracts that are within the scope of standards on leases, insurance and financial instruments. This standard also requires enhanced disclosures. Adoption of IFRS 15 is mandatory and will be effective for annual periods beginning on or after January 1, 2017, with earlier adoption permitted. The Company is currently assessing the impact of adopting this standard on the Company's consolidated financial statements and related note disclosures.

In May 2014, the IASB issued amendments to a previously released standard as follows:

#### *IFRS 11, Joint Arrangements ("IFRS 11")*

The IASB has amended IFRS 11 to require business combination accounting to be applied to acquisitions of interests in a joint operation that constitute a business. The amendments will be effective for annual periods beginning on or after January 1, 2016, with earlier adoption permitted. The Company is currently assessing the impact of these amendments on the Company's consolidated financial statements and related note disclosures.

On December 16, 2011, the IASB issued amendments to a previously released standard as follows:

#### *IFRS 9, Financial Instruments ("IFRS 9")*

This standard will ultimately replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") in phases. The first phase of IFRS 9 was issued on November 12, 2009 and addresses the classification and measurement of financial assets. The second phase of IFRS 9 was issued on October 28, 2010 incorporating new requirements on accounting for financial liabilities. On December 16, 2011, the IASB amended the mandatory effective date of IFRS 9 to fiscal years beginning on or after January 1, 2015. The amendment also provides relief from the requirement to recast comparative financial statements for the effect of applying IFRS 9. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. In November 2013, the IASB withdrew the mandatory effective date of IFRS 9. The Company will evaluate the overall impact on the Company's consolidated financial statements when the final standard, including all phases, is issued.

#### 4. Critical accounting judgments and key sources of estimation uncertainty

In the application of the Company's accounting policies, management is required to make judgments, estimates and assumptions with regards to the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods, if the revision affects both current and future periods.

Critical judgments that management has made in the process of applying the Company's accounting policies, key assumptions concerning the future and other key sources of estimation uncertainty that have the potential to materially impact the carrying amounts of assets and liabilities within the next financial year are described in Note 2 and Note 4 of the 2013 Annual Consolidated Financial Statements and are consistent with those used in the preparation of these Financial Statements.

#### 5. Cash and cash equivalents and interest income

##### *Cash and cash equivalents*

The components of cash and cash equivalents were as follows:

<i>(in CAD millions)</i>	As at August 2, 2014	As at February 1, 2014	As at August 3, 2013
Cash	\$ 194.8	\$ 192.4	\$ 89.8
Cash equivalents			
Government treasury bills	50.0	299.9	—
Bank term deposits	—	—	209.0
Investment accounts	10.4	10.4	10.3
Restricted cash and cash equivalents	10.9	11.1	10.0
Total cash and cash equivalents	\$ 266.1	\$ 513.8	\$ 319.1

The components of restricted cash and cash equivalents are further discussed in Note 18.

##### *Interest income*

Interest income related primarily to cash and cash equivalents for the 13 and 26-week period ended August 2, 2014 totaled \$0.7 million and \$1.4 million (2013: \$0.4 million and \$0.8 million), respectively. For the same 13 and 26-week periods, the Company received \$0.2 million and \$0.7 million (2013: \$0.6 million and \$1.1 million), respectively, in cash related to interest income.

#### 6. Inventories

The amount of inventory recognized as an expense during the 13 and 26-week period ended August 2, 2014 was \$519.8 million (2013: \$550.6 million) and \$988.6 million (2013: \$1,039.6 million), respectively, which included \$20.7 million (2013: \$19.1 million) and \$49.3 million (2013: \$43.5 million) of inventory write-downs. These expenses were included in "Cost of goods and services sold" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income. There were no reversals of prior period inventory write-downs for the 13 and 26-week period ended August 2, 2014 (2013: \$0.4 million and \$3.9 million), respectively.

Inventory is pledged as collateral under the Company's revolving credit facility (see Note 9).

## **7. Property, plant and equipment**

During the 13 and 26-week period ended August 2, 2014, the Company recognized an impairment loss of \$12.9 million (2013: nil) on a number of Sears Home stores and an impairment loss of \$2.8 million (2013: nil) on a number of Hometown Dealer stores. The impairment loss was due to indicators (such as a decrease in revenue or decrease in EBITDA) that the recoverable amount was less than the carrying value. The recoverable amounts of the cash generating units (“CGUs”) tested were based on the present value of the estimated cash flow over the lease term for Sears Home stores and five years for Hometown Dealer stores. A pre-tax discount rate of 10.2% was based on management’s best estimate of the CGUs’ weighted average cost of capital considering the risks facing the CGUs. There was no significant impact from a one percentage point increase or decrease in the applied discount rate. There was no significant impact from a ten percentage point increase or decrease in estimated cash flows. The impairment loss of \$15.7 million was included in “Selling, administrative and other expenses” in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income.

## **8. Goodwill**

Goodwill related to the Corbeil CGU. In the assessment of impairment, management used historical data and past experience as the key assumptions used in the determination of the recoverable amount. The Company completed a test for goodwill impairment during the 13-week period ended August 2, 2014.

The recoverable amount of the Corbeil CGU was determined based on its estimated fair value less costs to sell. The fair value was determined based on the present value of the estimated free cash flows over a 10 year period. Cost to sell was estimated to be 2% of the fair value of the business, which reflected management’s best estimate of the potential costs associated with divesting of the business. A pre-tax discount rate of 10.2% per annum was used, based on management’s best estimate of the Company’s weighted average cost of capital adjusted for the risks facing the Corbeil CGU. Annual growth rates of 5% for the first 2 years and 2% for the subsequent 8 years were used for Corbeil given the businesses' historical growth experience and anticipated growth. The recoverable amount was determined to be less than the carrying value including the goodwill of \$2.6 million related to the Corbeil CGU in the 13 and 26-week period ended August 2, 2014, resulting in a goodwill impairment of \$2.6 million (2013: Nil). Impairment losses were included in “Selling, administrative and other expenses” in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income. This impairment loss was attributable to revenue declines experienced in the Corbeil business.

## 9. Long-term obligations and finance costs

### Long-term obligations

Total outstanding long-term obligations were as follows:

<i>(in CAD millions)</i>	As at August 2, 2014	February 1, 2014	As at August 3, 2013
Real estate joint arrangement obligations - Current	\$ —	\$ 2.9	\$ 4.2
Finance lease obligations - Current	4.3	5.0	5.1
Total current portion of long-term obligations	\$ 4.3	\$ 7.9	\$ 9.3
Real estate joint arrangement obligations - Non-current	\$ —	\$ —	\$ 17.2
Finance lease obligations - Non-current	25.9	28.0	28.7
Total non-current long-term obligations	\$ 25.9	\$ 28.0	\$ 45.9

The Company's debt consists of a secured credit facility, finance lease obligations and the Company's share of its real estate joint arrangement obligations. In September 2010, the Company entered into an \$800.0 million senior secured revolving credit facility (the "Credit Facility") with a syndicate of lenders with a maturity date of September 10, 2015.

On May 28, 2014, the Company announced that it had extended the term of the Credit Facility (the "Amended Credit Facility") to May 28, 2019 and reduced the total credit limit to \$300.0 million. The Amended Credit Facility is secured with a first lien on inventory and credit card receivables. The Company incurred additional transaction costs of \$1.0 million in the 13 and 26-week period ended August 2, 2014 (August 3, 2013: Nil) related to the Amended Credit Facility.

Availability under the Amended Credit Facility is determined pursuant to a borrowing base formula, up to a maximum availability of \$300.0 million. Availability under the Amended Credit Facility was \$268.3 million as at August 2, 2014 (February 1, 2014: \$374.0 million, August 3, 2013: \$550.9 million). The borrowing base formula may be reduced by reserves currently estimated by the Company to be approximately \$133.1 million, which may be applied by the lenders at their discretion pursuant to the Amended Credit Facility agreement. In 2013, as a result of judicial developments relating to the priorities of pension liability relative to certain secured obligations, the Company provided additional security to the lenders by pledging certain real estate assets as collateral, thereby partially reducing the potential reserve amount the lenders could apply. As at August 2, 2014, three properties in Ontario have been registered under the Amended Credit Facility. The additional reserve amount may increase or decrease in the future based on changes in estimated net pension deficits in the event of a wind-up, and based on the amount of real estate assets pledged as additional collateral.

The Amended Credit Facility contains covenants which are customary for facilities of this nature and the Company was in compliance with all covenants as at August 2, 2014.

As at August 2, 2014, the Company had no borrowings on the Amended Credit Facility and had unamortized transaction costs associated with the Amended Credit Facility of \$4.6 million included in "Other long-term assets" in the unaudited Condensed Consolidated Statements of Financial Position (February 1, 2014: no borrowings and unamortized transaction costs of \$4.4 million included in "Other long-term assets", August 3, 2013: no borrowings and unamortized transaction costs of \$5.4 million included in "Other long-term assets"). In addition, the Company had \$31.7 million (February 1, 2014: \$24.0 million, August 3, 2013: \$24.2 million) of standby letters of credit outstanding against the Amended Credit Facility. These letters of credit cover various payment obligations. Interest on drawings under the Amended Credit Facility is determined based on bankers' acceptance rates for one to three month terms or the prime rate plus a spread. Interest amounts on the Amended Credit Facility are due monthly and are added to principal amounts outstanding.

As at August 2, 2014, the Company had outstanding merchandise letters of credit of U.S. \$4.8 million (February 1, 2014: U.S. \$9.0 million, August 3, 2013: U.S. \$9.1 million) used to support the Company's offshore merchandise purchasing program with restricted cash and cash equivalents pledged as collateral.

The Company has entered into a mortgage on land that it owns in Burnaby, British Columbia. In accordance with the Burnaby development project with Concord, the land has been allocated as security for future borrowings (see Note 24).

## Finance costs

Interest expense on long-term obligations, including the Company's share of interest on long-term obligations of its real estate joint arrangements, finance lease obligations, the current portion of long-term obligations, amortization of transaction costs and commitment fees on the unused portion of the Amended Credit Facility for the 13 and 26-week period ended August 2, 2014 totaled \$1.8 million (2013: \$2.7 million) and \$4.1 million (2013: \$5.4 million), respectively. Interest expense is included in "Finance costs" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income. Also included in "Finance costs" for the 13 and 26-week period ended August 2, 2014 was a recovery of \$0.1 million and \$0.1 million (2013: expense of \$0.1 million and a recovery of \$0.3 million), respectively, for interest on accruals for uncertain tax positions, and an expense of nil and \$0.2 million (2013: nil), respectively, for interest on the settlement of a sales tax assessment.

The Company's cash payments for interest on long-term obligations, including the Company's share of interest on long-term obligations of its real estate joint arrangements, finance lease obligations, the current portion of long-term obligations and commitment fees on the unused portion of the Credit Facility for the 13 and 26-week period ended August 2, 2014 totaled \$1.4 million (2013: \$2.2 million) and \$3.2 million (2013: \$4.3 million).

## 10. Capital stock

On May 22, 2013, the Toronto Stock Exchange ("TSX") accepted the Company's Notice of Intention to make a Normal Course Issuer Bid ("2013 NCIB") and permitted the Company to purchase for cancellation its common shares. Purchases were allowed to commence on May 24, 2013 and were to be terminated by May 23, 2014. Refer to Note 8 in the unaudited condensed consolidated financial statements of the Company for the 13-week period ended May 3, 2014 for additional information on the 2013 NCIB. There were no share purchases made under the 2013 NCIB. The Company did not renew the Normal Course Issuer Bid subsequent to May 23, 2014.

During the 52-week period ended February 1, 2014 ("Fiscal 2013"), the Company distributed \$509.4 million to holders of common shares as an extraordinary cash dividend. Payment in the amount of \$5.00 per common share was made on December 6, 2013.

ESL Investments, Inc., and investment affiliates including Edward S. Lampert, collectively "ESL", together form the ultimate controlling party of the Company. ESL is the beneficial holder of 28,158,368 or 27.6%, of the common shares of the Company as at August 2, 2014 (February 1, 2014: 28,158,368 or 27.6%, August 3, 2013: 28,158,368 or 27.6%). Sears Holdings, the controlling shareholder of the Company, is the beneficial holder of 51,962,391 or 51.0%, of the common shares of the Company as at August 2, 2014 (February 1, 2014: 51,962,391 or 51.0%, August 3, 2013: 51,962,391 or 51.0%). The issued and outstanding shares are fully paid and have no par value.

The authorized common share capital of the Company consists of an unlimited number of common shares without nominal or par value and an unlimited number of class 1 preferred shares, issuable in one or more series (the "Class 1 Preferred Shares"). As at August 2, 2014, the only shares outstanding were common shares of the Company.

## 11. Revenue

The components of the Company's revenue were as follows:

<i>(in CAD millions)</i>	13-Week Period Ended August 2, 2014	13-Week Period Ended August 3, 2013	26-Week Period Ended August 2, 2014	26-Week Period Ended August 3, 2013
Apparel & Accessories <sup>1</sup>	\$ 288.3	\$ 319.7	\$ 552.4	\$ 600.0
Home & Hardlines <sup>1</sup>	404.3	462.5	760.3	875.8
Other merchandise revenue	53.2	56.5	99.8	113.6
Services and other	69.2	88.4	143.5	172.1
Commission and licensee revenue	30.8	33.0	61.5	65.7
	<b>\$ 845.8</b>	<b>\$ 960.1</b>	<b>\$ 1,617.5</b>	<b>\$ 1,827.2</b>

<sup>1</sup> Certain product lines have been reclassified from the Apparel & Accessories category, to the Home & Hardlines category. Also, the Major Appliances category is now included in the Home & Hardlines category. Prior year comparative figures have been restated to reflect these changes.



## 12. Retirement benefit plans

In July 2008, the Company amended its defined benefit plan by introducing a defined contribution component and closing the defined benefit component to new participants. As such, the defined benefit plan continues to accrue benefits related to future compensation increases but no further service credit is earned, and no contributions are made by employees.

The expense for the defined benefit, defined contribution and other benefit plans for the 13-week period ended August 2, 2014 was \$0.7 million (2013: \$2.0 million), \$1.7 million (2013: \$2.1 million) and \$2.2 million (2013: \$2.8 million), respectively. The expense for the defined benefit, defined contribution and other benefit plans for the 26-week period ended August 2, 2014 was \$1.8 million (2013: \$4.0 million), \$3.6 million (2013: \$4.3 million) and \$4.6 million (2013: \$5.5 million), respectively. Not included in total retirement benefit plans expense for the 13 and 26-week period are short-term disability expenses of \$1.2 million and \$3.3 million (2013: \$1.8 million and \$4.3 million), respectively, that were paid from the other benefit plan. These expenses are included in “Selling, administrative and other expenses” in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income.

Total cash contributions by the Company to its defined benefit, defined contribution and other benefit plans for the 13 and 26-week period ended August 2, 2014 were \$16.0 million and \$18.2 million (2013: \$9.7 million and \$19.4 million) which included \$13.8 million to settle acceptances from the non-pension retirement plan offer mentioned below.

In the fourth quarter of Fiscal 2013, the Company amended the early retirement provision of its pension plan to eliminate a benefit for associates who voluntarily resign prior to age of retirement, with effect January 1, 2015. In addition, the Company amended its pension plan for improvements that increase portability of associates’ benefits, with effect March 1, 2014, and implemented fixed indexing at 0.5% per annum for eligible retirees, with effect January 1, 2014. The Company also froze the benefits offered under the non-pension retirement plan to benefit levels as at January 1, 2015. In the fourth quarter of Fiscal 2013, the Company recorded a pre-tax gain on amendments to retirement benefits of \$42.5 million (\$42.8 million net of \$0.3 million of expenses). Refer to the 2013 Annual Consolidated Financial Statements for more details.

During the 26-week period ended August 2, 2014, the Company offered lump sum settlements to those terminated associates who previously elected to defer the payment of the defined benefit pension until retirement. The Company expects to settle accepted offers by the end of October 2014. In addition, the Company made a voluntary offer to settle health and dental benefits of eligible members covered under the non-pension retirement plan. The Company incurred expenses of \$0.8 million related to these offers, during the 26-week period ended August 2, 2014. These expenses were included in “Selling, administrative and other expenses” for the 13-week period ended May 3, 2014. The Company paid \$13.8 million to settle acceptances from the non-pension retirement plan offer and recorded a gain of \$10.6 million (\$11.4 million settlement gain less fees of \$0.8 million) during the 26-week period ended August 2, 2014 related to these offers. To determine the settlement gain, the non-pension retirement plan was remeasured as at the date of settlement, which also resulted in a \$2.0 million adjustment to “Other comprehensive income (loss), net of taxes” (“OCI”).

## 13. Depreciation and amortization expense

The components of the Company’s depreciation and amortization expense, included in “Selling, administrative and other expenses”, were as follows:

<i>(in CAD millions)</i>	<b>13-Week Period Ended August 2, 2014</b>	13-Week Period Ended August 3, 2013	<b>26-Week Period Ended August 2, 2014</b>	26-Week Period Ended August 3, 2013
Depreciation of property, plant and equipment	\$ 19.1	\$ 27.5	\$ 40.0	\$ 54.9
Amortization of intangible assets	2.7	2.5	5.4	5.3
Total depreciation and amortization expense	\$ 21.8	\$ 30.0	\$ 45.4	\$ 60.2

#### 14. Assets and liabilities classified as held for sale

On October 29, 2013, the Company announced the future closure of one of its Regina Logistics Centres (“RLC”). The RLC including the adjacent vacant property, which are owned by the Company, is being marketed for sale and if a buyer is identified that will purchase the RLC at a price acceptable to the Company, then the RLC will be sold. This process has been approved by senior management of the Company, and based on these factors, the Company has concluded that the sale is highly probable.

On August 6, 2014, the Company announced that it had entered into an agreement for the sale of its 20% joint arrangement interest in the Kildonan Place Shopping Centre (“Kildonan”) it owns with Ivanhoé Cambridge II Inc. (“Ivanhoé”) for pre-tax consideration of \$27.7 million. The purchaser, H&R Real Estate Investment Trust, is also purchasing the remaining 80% ownership interest from Ivanhoé. The joint arrangement interest had a net carrying value of approximately \$15.6 million as at August 2, 2014. The agreement is subject to customary closing conditions including representations and warranties given on signing of the agreement continuing to be true on closing. The transaction is expected to close on September 17, 2014, and the ultimate amount of gain to be recognized will be determined during the third quarter of the 52-week period ended January 31, 2015. Following the sale, the Company will continue to operate its store in the shopping centre.

As at August 2, 2014, the assets of RLC and the assets and liabilities of the property owned with Ivanhoé were separately classified as held for sale on the Company's unaudited Condensed Consolidated Statements of Financial Position. The major classes of assets and liabilities classified as held for sale were as follows:

<i>(in CAD millions)</i>		<b>RLC</b>		<b>Kildonan</b>		<b>Total</b>
Accounts receivable, net	\$	—	\$	0.1	\$	0.1
Prepaid expenses		—		0.9		0.9
<i>Current assets classified as held for sale</i>		—		1.0		1.0
Property, plant and equipment		10.9		14.8		25.7
Investment property		2.4		—		2.4
Other long-term assets		—		0.3		0.3
<i>Non-current assets classified as held for sale</i>		13.3		15.1		28.4
Assets classified as held for sale	\$	13.3	\$	16.1	\$	29.4
Accounts payable and accrued liabilities	\$	—	\$	0.5	\$	0.5
Liabilities classified as held for sale	\$	—	\$	0.5	\$	0.5

The major classes of assets classified as held for sale as of February 1, 2014 were as follows:

<i>(in CAD millions)</i>		<b>RLC</b>
Property, plant and equipment	\$	10.9
Investment property		2.4
Assets classified as held for sale	\$	13.3

There were no assets classified as held for sale as at August 3, 2013.

The operations of the RLC and Kildonan are not presented as discontinued operations on the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income as they do not represent a separate geographical area of operations or a separate major line of business.

## **15. Gain on lease terminations and lease amendments**

On June 14, 2013, the Company announced its intention to enter into a series of transactions related to its leases on two properties: Yorkdale Shopping Centre (Toronto) and Square One Shopping Centre (Mississauga). The landlords approached the Company with a proposal to enter into a series of lease amendments for a total consideration of \$191.0 million, being the amount the landlords were willing to pay for the right to require the Company to vacate the two locations.

On June 24, 2013, the Company received proceeds of \$191.0 million upon closing of the transaction which gave the landlords the right to require the Company to vacate the two locations by March 31, 2014. The landlords exercised such right on July 25, 2013. The transaction resulted in a pre-tax gain of \$185.7 million, net of legal costs and the de-recognition of leasehold improvements of \$5.3 million.

The Company also granted the owners of the Scarborough Town Centre (Toronto) property an option to enter into certain lease amendments in exchange for \$1.0 million, which was paid on June 24, 2013. The option may be exercised at any time up to and including June 20, 2018, and would require the Company to complete certain lease amendments in exchange for \$53.0 million. Such lease amendments would allow the owners to require the Company to close its store. As of August 2, 2014, the option had not been exercised and was included in "Accounts payable and accrued liabilities" in the unaudited Condensed Consolidated Statements of Financial Position.

## **16. Gain on sale of interest in joint arrangements**

During the 13 and 26-week period ended August 2, 2014, the Company sold its 15% joint arrangement interest in Les Rivières Shopping Centre that it co-owned with Ivanhoé for total proceeds of \$33.5 million, recognizing a pre-tax gain of \$20.5 million on the sale. The sale closed on June 2, 2014, pursuant to an agreement entered into on May 16, 2014. In connection with this transaction, the Company determined that because it had surrendered substantially all of its rights and obligations and had transferred substantially all of the risks and rewards of ownership related to the property, immediate gain recognition was appropriate.

## **17. Financial instruments**

In the ordinary course of business, the Company enters into financial agreements with banks and other financial institutions to reduce underlying risks associated with interest rates and foreign currency. The Company does not hold or issue derivative financial instruments for trading or speculative purposes.

### **Financial instrument risk management**

The Company is exposed to credit, liquidity and market risk as a result of holding financial instruments. Market risk consists of foreign exchange and interest rate risk.

#### *17.1 Credit risk*

Credit risk refers to the possibility that the Company can suffer financial losses due to the failure of the Company's counterparties to meet their payment obligations. Exposure to credit risk exists for derivative instruments, cash and cash equivalents, accounts receivable and other long-term assets.

Cash and cash equivalents, accounts receivable, derivative instruments and investments included in other long-term assets totaling \$345.6 million as at August 2, 2014 (February 1, 2014: \$605.8 million, August 3, 2013: \$399.3 million) expose the Company to credit risk should the borrower default on maturity of the instruments. The Company manages this exposure through policies that require borrowers to have a minimum credit rating of A, and limiting investments with individual borrowers at maximum levels based on credit rating.

The Company is exposed to minimal credit risk from third parties as a result of ongoing credit evaluations and review of accounts receivable collectability. As at August 2, 2014, one party represented 14.7% of the Company's net accounts receivable (February 1, 2014: one party represented 11.3% of the Company's accounts receivable, August 3, 2013: two parties represented 29.0% of the Company's accounts receivable).

#### *17.2 Liquidity risk*

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they come due. The Company actively maintains access to adequate funding sources to ensure it has sufficient available funds to meet current and foreseeable financial requirements at a reasonable cost.

The following table summarizes the carrying amount and the contractual maturities of both the interest and principal portion of significant financial liabilities as at August 2, 2014:

(in CAD millions)	Carrying Amount	Contractual Cash Flow Maturities				
		Total	Within 1 year	1 year to 3 years	3 years to 5 years	Beyond 5 years
Accounts payable and accrued liabilities	\$ 423.5	\$ 423.5	\$ 423.5	\$ —	\$ —	\$ —
Finance lease obligations including payments due within one year <sup>1</sup>	30.2	39.2	6.3	10.8	10.1	12.0
Operating lease obligations <sup>2</sup>	n/a	469.1	99.4	154.6	106.6	108.5
Royalties <sup>2</sup>	n/a	3.0	0.3	1.4	1.3	—
Purchase agreements <sup>2,4</sup>	n/a	14.3	8.3	6.0	—	—
Retirement benefit plans obligations <sup>3</sup>	267.5	87.9	12.1	40.5	32.4	2.9
	<b>\$ 721.2</b>	<b>\$ 1,037.0</b>	<b>\$ 549.9</b>	<b>\$ 213.3</b>	<b>\$ 150.4</b>	<b>\$ 123.4</b>

<sup>1</sup> Cash flow maturities related to finance lease obligations, including payments due within one year, include annual interest on finance lease obligations at a weighted average rate of 7.6%. The Company had no borrowings on the Amended Credit Facility as at August 2, 2014.

<sup>2</sup> Operating lease obligations, royalties and some purchase agreements are not reported in the unaudited Condensed Consolidated Statements of Financial Position.

<sup>3</sup> Payments are based on a funding valuation as at December 31, 2013 which was completed on June 30, 2014.

<sup>4</sup> Certain vendors require minimum purchase commitment levels over the term of the contract.

Management believes that cash on hand, future cash flow generated from operations and availability of current and future funding will be adequate to support these financial liabilities. As at August 2, 2014, the Company does not have any significant capital expenditure commitments.

## Market risk

Market risk exists as a result of the potential for losses caused by changes in market factors such as foreign currency exchange rates, interest rates and commodity prices.

### 17.3 Foreign exchange risk

The Company enters into foreign exchange contracts to reduce the foreign exchange risk with respect to U.S. dollar denominated assets and liabilities and purchases of goods or services. As at August 2, 2014, there were forward contracts outstanding with a notional value of U.S. \$205.0 million (February 1, 2014: U.S. \$90.0 million, August 3, 2013: U.S. \$165.0 million) and a fair value of \$3.8 million included in “Derivative financial assets” (February 1, 2014: \$7.2 million, August 3, 2013: \$1.5 million) in the unaudited Condensed Consolidated Statements of Financial Position. These derivative contracts have settlement dates extending to February 2015. The intrinsic value portion of these derivatives has been designated as a cash flow hedge for hedge accounting treatment under IAS 39. These contracts are intended to reduce the foreign exchange risk with respect to anticipated purchases of U.S. dollar denominated goods and services, including goods purchased for resale (“hedged item”). As at August 2, 2014, the designated portion of these hedges was considered by the Company to be effective.

While the notional principal of these outstanding financial instruments is not recorded in the unaudited Condensed Consolidated Statements of Financial Position, the fair value of the contracts is included in “Derivative financial assets” or “Derivative financial liabilities”, depending on the fair value, and classified as current or long-term, depending on the maturities of the outstanding contracts. Changes in the fair value of the designated portion of contracts are included in OCI for cash flow hedges, to the extent the designated portion of the hedges continues to be effective, with any ineffective portion included in “Cost of goods and services sold” in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income. Amounts previously included in OCI are reclassified to “Cost of goods and services sold” in the same period in which the hedged item impacts Net (Loss) Earnings.

During the 13 and 26-week period ended August 2, 2014, the Company recorded a gain of \$0.2 million and a gain of \$0.1 million (2013: loss of \$2.3 million and a loss of \$3.1 million), respectively, in “Selling, administrative and other expenses”, relating to the translation or settlement of U.S. dollar denominated monetary items consisting of cash and cash equivalents, accounts receivable and accounts payable.

The period end exchange rate was 0.9152 U.S. dollar to Canadian dollar. A 10% appreciation or depreciation of the U.S. dollar and/or the Canadian dollar exchange rate was determined to have an after-tax impact on net (loss) earnings of \$0.1 million for U.S. dollar denominated balances included in cash and cash equivalents, accounts receivable and accounts payable.

#### 17.4 Interest rate risk

From time to time, the Company enters into interest rate swap contracts with approved financial institutions to manage exposure to interest rate risks. As at August 2, 2014, the Company had no interest rate swap contracts in place (February 1, 2014: nil, August 3, 2013: nil).

Interest rate risk reflects the sensitivity of the Company's financial condition to movements in interest rates. Financial assets and liabilities which do not bear interest or bear interest at fixed rates are classified as non-interest rate sensitive.

Cash and cash equivalents and borrowings under the Amended Credit Facility, when applicable, are subject to interest rate risk. The total subject to interest rate risk as at August 2, 2014 was a net asset of \$267.4 million (February 1, 2014: net asset of \$515.1 million, August 3, 2013: net asset of \$320.4 million). An increase or decrease in interest rates of 25 basis points would cause an immaterial after-tax impact on net (loss) earnings for net assets subject to interest rate risk included in cash and cash equivalents and other long-term assets as at August 2, 2014.

#### 17.5 Classification and fair value of financial instruments

The estimated fair values of financial instruments presented are based on relevant market prices and information available at those dates. The following table summarizes the classification and fair value of certain financial instruments as at the specified dates. The Company determines the classification of a financial instrument when it is initially recorded, based on the underlying purpose of the instrument. As a significant number of the Company's assets and liabilities, including inventories and capital assets, do not meet the definition of financial instruments, values in the tables below do not reflect the fair value of the Company as a whole.

The fair value of financial instruments are classified and measured according to the following three levels, based on the fair value hierarchy.

- Level 1: Quoted prices in active markets for identical assets or liabilities
- Level 2: Inputs other than quoted prices in active markets that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: Inputs for the asset or liability that are not based on observable market data

(in CAD millions)

Classification	Balance Sheet Category	Fair Value Hierarchy <sup>2</sup>	As at August 2, 2014	As at February 1, 2014	As at August 3, 2013
Available for sale					
Cash equivalents	Cash and cash equivalents <sup>1</sup>	Level 1	60.4	310.3	10.3
Fair value through profit or loss					
Long-term investments	Other long-term assets	Level 1	0.2	0.2	0.2
U.S. \$ derivative contracts	Derivative financial assets	Level 2	3.8	7.2	1.5
Long-term investments	Other long-term assets	Level 3	1.3	1.3	1.3

<sup>1</sup> Interest income related to cash and cash equivalents is disclosed in Note 5.

<sup>2</sup> Classification of fair values relates to 2014

All other assets that are financial instruments not listed in the chart above have been classified as "Loans and receivables". All other financial instrument liabilities have been classified as "Other liabilities" and are measured at amortized cost in the unaudited Condensed Consolidated Statements of Financial Position. The carrying value of these financial instruments approximate fair value given that they are short-term in nature.

Effective March 3, 2013, the Company finalized an exclusive, multi-year licensing arrangement with SHS, which resulted in SHS overseeing the day-to-day operations of HIPS. The Company provided SHS an interest-bearing loan which allowed SHS to pay the final purchase price of \$5.3 million over 6 years. SHS repaid this loan on September 30, 2013, and shortly afterwards, issued the Company an interest-bearing promissory note for \$2.0 million, secured by certain assets of SHS, repayable by July 16, 2015. The promissory note asset is included in "Other long-term assets" in the unaudited Condensed Consolidated Statements of Financial Position as at August 2, 2014.

On December 13, 2013, SHS announced that it was in receivership. All offers of services provided by SHS ceased, and the Company is working with the Receiver, PricewaterhouseCoopers Inc., on options for completing pending orders. As a result of the announcement, the Company recorded a warranty provision of \$2.0 million in the fourth quarter of Fiscal 2013 related to potential future claims for work that had been performed by SHS, as well as assuming the warranty obligations with respect to work previously performed by the Company which had been assumed by SHS.

As a result of an announcement made by the Company on March 21, 2014 regarding certain obligations of SHS, the Company recorded an additional provision of \$4.4 million for warranty, and a \$2.2 million allowance for doubtful accounts against the net receivable (including outstanding commissions receivable) for the 26-week period ended August 2, 2014.

## **18. Contingent liabilities**

### *18.1 Legal proceedings*

The Company is involved in various legal proceedings incidental to the normal course of business. The Company takes into account all available information, including guidance from experts (such as internal and external legal counsel) at the time of reporting to determine if it is probable that a present obligation (legal or constructive) exists, if it is probable that an outflow of resources embodying economic benefit will be required to settle such obligation and whether the Company can reliably measure such obligation at the end of the reporting period. The Company is of the view that, although the outcome of such legal proceedings cannot be predicted with certainty, the final disposition is not expected to have a material adverse effect on the Financial Statements.

### *18.2 Commitments and guarantees*

#### *Commitments*

As at August 2, 2014, cash and cash equivalents that are restricted represent cash and investments pledged as collateral for letter of credit obligations issued under the Company's offshore merchandise purchasing program of \$10.9 million (February 1, 2014: \$11.1 million, August 3, 2013: \$10.0 million), which is the Canadian equivalent of U.S. \$10.0 million (February 1, 2014: U.S. \$10.0 million, August 3, 2013: U.S. \$9.6 million).

The Company has certain vendors which require minimum purchase commitment levels over the term of the contract. Refer to Note 17.2 "Liquidity risk".

#### *Guarantees*

The Company has provided the following significant guarantees to third parties:

#### *Royalty License Agreements*

The Company pays royalties under various merchandise license agreements, which are generally based on the sale of products. Certain license agreements require a minimum guaranteed payment of royalties over the term of the contract, regardless of sales. Total future minimum royalty payments under such agreements were \$3.0 million as at August 2, 2014 (February 1, 2014: \$3.5 million, August 3, 2013: \$1.4 million).

#### *Other Indemnification Agreements*

In the ordinary course of business, the Company has provided indemnification commitments to counterparties in transactions such as leasing transactions, royalty agreements, service arrangements, investment banking agreements and director and officer indemnification agreements. The Company has also provided certain indemnification agreements in connection with the sale of the credit and financial services operations in November 2005. The foregoing indemnification agreements require the Company to compensate the counterparties for costs incurred as a result of changes in laws and regulations, or as a result of litigation or statutory claims, or statutory sanctions that may be suffered by a counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based on the contract and typically do not provide for any limit on the maximum potential liability. Historically, the Company has not made any significant payments under such indemnifications and no amounts have been accrued in the Financial Statements with respect to these indemnification commitments.

## 19. Net (loss) earnings per share

A reconciliation of the number of shares used in the net (loss) earnings per share calculation is as follows:

<i>(Number of shares)</i>	<b>13-Week Period Ended August 2, 2014</b>	13-Week Period Ended August 3, 2013	<b>26-Week Period Ended August 2, 2014</b>	26-Week Period Ended August 3, 2013
Weighted average number of shares per basic net (loss) earnings per share calculation	<b>101,877,662</b>	101,877,662	<b>101,877,662</b>	101,877,662
Effect of dilutive instruments outstanding	—	—	—	—
Weighted average number of shares per diluted net (loss) earnings per share calculation	<b>101,877,662</b>	101,877,662	<b>101,877,662</b>	101,877,662

“Net (loss) earnings” as disclosed in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income was used as the numerator in calculating the basic and diluted net (loss) earnings per share. For the 13 and 26-week period ended August 2, 2014, there were no outstanding dilutive instruments. For the 13 and 26-week period ended August 3, 2013, 5,080 outstanding options were excluded from the calculation of diluted net (loss) earnings per share as they were anti-dilutive.

## 20. Income taxes

The Company’s total net cash payments of income taxes for the 13 and 26-week period ended August 2, 2014 were \$1.7 million and \$76.4 million (2013: \$7.0 million and \$15.0 million).

In the ordinary course of business, the Company is subject to ongoing audits by tax authorities. While the Company believes that its tax filing positions are appropriate and supportable, periodically, certain matters are challenged by tax authorities. During the 13 and 26-week period ended August 2, 2014, the Company recorded benefits for interest on prior period tax re-assessments and accruals for uncertain tax positions as described in the table below, all included in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive (Loss) Income as follows:

<i>(in CAD millions)</i>	<b>13-Week Period Ended August 2, 2014</b>	13-Week Period Ended August 3, 2013	<b>26-Week Period Ended August 2, 2014</b>	26-Week Period Ended August 3, 2013
Finance costs recovery (increase)	<b>\$ 0.1</b>	\$ (0.1)	<b>\$ 0.1</b>	\$ 0.3
Income tax recovery (expense):				
Current	<b>0.4</b>	(0.1)	<b>0.5</b>	0.5
Deferred	—	0.1	<b>(0.1)</b>	(0.1)
Net benefits (charges) on uncertain tax positions	<b>\$ 0.5</b>	\$ (0.1)	<b>\$ 0.5</b>	\$ 0.7

The Company routinely evaluates and provides for potentially unfavourable outcomes with respect to any tax audits, and believes that the final disposition of tax audits will not have a material adverse effect on its liquidity.

Included in “Other long-term assets” in the unaudited Condensed Consolidated Statements of Financial Position as at August 2, 2014, were receivables of \$32.5 million (February 1, 2014: \$32.5 million, August 3, 2013: \$19.9 million) related to payments made by the Company for disputed tax assessments.

## 21. Segmented information

In order to identify the Company's reportable segments, the Company uses the process outlined in IFRS 8, *Operating Segments* which includes the identification of the Chief Operating Decision Maker, the identification of operating segments, which has been done based on Company formats, and the aggregation of operating segments. The Company has aggregated its operating segments into two reportable segments: Merchandising and Real Estate Joint Arrangements. The Merchandising segment includes revenues from the sale of merchandise and related services to customers. The Real Estate Joint Arrangement segment includes income from the Company's joint arrangement interests in shopping centres across Canada, all of which contain a Sears store.

### 21.1 Segmented statements of (loss) earnings

<i>(in CAD millions)</i>	13-Week Period Ended August 2, 2014	13-Week Period Ended August 3, 2013	26-Week Period Ended August 2, 2014	26-Week Period Ended August 3, 2013
<b>Total revenue</b>				
Merchandising	\$ 844.4	\$ 949.0	\$ 1,614.4	\$ 1,805.4
Real Estate Joint Arrangements	1.4	11.1	3.1	21.8
<b>Total revenue</b>	<b>\$ 845.8</b>	<b>\$ 960.1</b>	<b>\$ 1,617.5</b>	<b>\$ 1,827.2</b>
<b>Segmented operating (loss) income</b>				
Merchandising	\$ (64.3)	\$ (8.8)	\$ (164.2)	\$ (53.2)
Real Estate Joint Arrangements	0.1	3.5	0.3	6.4
<b>Total segmented operating loss</b>	<b>\$ (64.2)</b>	<b>\$ (5.3)</b>	<b>\$ (163.9)</b>	<b>\$ (46.8)</b>
<b>Finance costs</b>				
Merchandising	\$ 1.7	\$ 2.5	\$ 4.2	\$ 4.4
Real Estate Joint Arrangements	—	0.3	—	0.7
<b>Total finance costs</b>	<b>\$ 1.7</b>	<b>\$ 2.8</b>	<b>\$ 4.2</b>	<b>\$ 5.1</b>
<b>Interest income</b>				
Merchandising	\$ 0.7	\$ 0.5	\$ 1.4	\$ 0.7
Real Estate Joint Arrangements	—	(0.1)	—	0.1
<b>Total interest income</b>	<b>\$ 0.7</b>	<b>\$ 0.4</b>	<b>\$ 1.4</b>	<b>\$ 0.8</b>
<b>Gain on lease terminations and lease amendments</b>				
Merchandising	\$ —	\$ 185.7	\$ —	\$ 185.7
Real Estate Joint Arrangements	—	—	—	—
<b>Total gain on lease terminations and lease amendments</b>	<b>\$ —</b>	<b>\$ 185.7</b>	<b>\$ —</b>	<b>\$ 185.7</b>
<b>Gain on sale of interest in joint arrangements</b>				
Merchandising	\$ —	\$ —	\$ —	\$ —
Real Estate Joint Arrangements	20.5	—	20.5	—
<b>Total gain on sale of interest in joint arrangements</b>	<b>\$ 20.5</b>	<b>\$ —</b>	<b>\$ 20.5</b>	<b>\$ —</b>
<b>Gain on settlement of retirement benefits</b>				
Merchandising	\$ 11.4	\$ —	\$ 10.6	\$ —
Real Estate Joint Arrangements	—	—	—	—
<b>Total gain on settlement of retirement benefits</b>	<b>\$ 11.4</b>	<b>\$ —</b>	<b>\$ 10.6</b>	<b>\$ —</b>
<b>Income tax recovery (expense)</b>				
Merchandising	\$ 14.1	\$ (25.2)	\$ 41.2	\$ (13.0)
Real Estate Joint Arrangements	(2.1)	—	(2.1)	—
<b>Total income tax recovery (expense)</b>	<b>\$ 12.0</b>	<b>\$ (25.2)</b>	<b>\$ 39.1</b>	<b>\$ (13.0)</b>
<b>Net (loss) earnings</b>	<b>\$ (21.3)</b>	<b>\$ 152.8</b>	<b>\$ (96.5)</b>	<b>\$ 121.6</b>



## 21.2 Segmented statements of total assets

<i>(in CAD millions)</i>	As at August 2, 2014	February 1, 2014	As at August 3, 2013
Merchandising	\$ 2,092.0	\$ 2,354.2	\$ 2,320.2
Real Estate Joint Arrangements	24.3	38.1	296.5
<b>Total assets</b>	<b>\$ 2,116.3</b>	<b>\$ 2,392.3</b>	<b>\$ 2,616.7</b>

## 21.3 Segmented statements of total liabilities

<i>(in CAD millions)</i>	As at August 2, 2014	February 1, 2014	As at August 3, 2013
Merchandising	\$ 1,139.2	\$ 1,314.4	\$ 1,388.1
Real Estate Joint Arrangements	1.0	4.1	29.5
<b>Total liabilities</b>	<b>\$ 1,140.2</b>	<b>\$ 1,318.5</b>	<b>\$ 1,417.6</b>

## 22. Changes in non-cash working capital balances

Cash generated from (used for) non-cash working capital balances were comprised of the following:

<i>(in CAD millions)</i>	13-Week Period Ended August 2, 2014	13-Week Period Ended August 3, 2013	26-Week Period Ended August 2, 2014	26-Week Period Ended August 3, 2013
Accounts receivable, net	\$ (3.3)	\$ 2.5	\$ 8.9	\$ 1.0
Inventories	60.1	(24.2)	42.6	(63.9)
Prepaid expenses	(7.6)	(8.5)	(13.2)	(8.4)
Accounts payable and accrued liabilities	(3.2)	39.7	(22.1)	13.8
Deferred revenue	(14.7)	(17.8)	(20.8)	(15.5)
Provisions	(18.2)	(2.0)	(27.1)	(15.5)
Income and other taxes payable and recoverable	1.9	30.4	(39.7)	16.2
Effect of foreign exchange rates	0.1	(0.4)	0.5	(0.5)
<b>Cash generated from (used for) non-cash working capital balances</b>	<b>\$ 15.1</b>	<b>\$ 19.7</b>	<b>\$ (70.9)</b>	<b>\$ (72.8)</b>

## 23. Changes in long-term assets and liabilities

Cash (used for) generated from long-term assets and liabilities were comprised of the following:

<i>(in CAD millions)</i>	13-Week Period Ended August 2, 2014	13-Week Period Ended August 3, 2013	26-Week Period Ended August 2, 2014	26-Week Period Ended August 3, 2013
Other long-term assets	\$ 0.4	\$ 2.8	\$ 11.9	\$ 3.0
Other long-term liabilities	(2.2)	(5.6)	(9.7)	(11.5)
Other	(1.2)	0.4	(1.0)	(0.2)
<b>Cash (used for) generated from long-term assets and liabilities</b>	<b>\$ (3.0)</b>	<b>\$ (2.4)</b>	<b>\$ 1.2</b>	<b>\$ (8.7)</b>

## **24. North Hill and Burnaby agreements**

On June 16, 2014, the Company announced that it entered into a binding agreement with Concord Pacific Group of Companies (“Concord”) to pursue the development of the 12-acre Sears site located at the North Hill Shopping Centre in Calgary, Alberta (the “North Hill Project”). Closing under the agreement is conditional upon satisfaction of conditions such as obtaining re-zoning approval from the City of Calgary for the North Hill Project, which management expects to occur over an extended period of time.

This agreement contemplates the sale of a 50% interest in the site for a value of approximately \$15.0 million, subject to adjustments, and the retention of Concord or its affiliates, on customary terms, to manage most facets of the development. The purchase price is to be satisfied by an interest-free long-term note secured by Concord’s 50% interest in the property, the principal of which is expected to be repaid out of cash flow generated from the North Hill Project over time. It is contemplated that this note will be subordinated to other debt financing expected to be raised and used to develop the North Hill Project. The note will be guaranteed by a Concord affiliate. Following the sale of the 50% interest, it is contemplated that the parties will enter into a co-ownership arrangement. Concord would be responsible for arranging debt financing to develop the North Hill Project through the arrangement. On closing, Concord would also be jointly responsible for any costs incurred to remediate on-site environmental issues associated with the North Hill Project, through their interest in the arrangement, as contained in the environmental provision described in Note 16(vi) of the 2013 Annual Consolidated Financial Statements. The estimated cost to build out the North Hill Project into a residential development as contemplated, is currently \$680.0 million. Completion of the North Hill Project as contemplated is subject to strategic considerations, including, but not limited to, potential shifts in the Canadian economy and the condition of the real estate market now and in the future.

On October 11, 2013, the Company announced that it entered into a binding agreement with Concord to pursue the development of nine acres of the Company’s property on and adjacent to the Company’s store located at the Metropolis at Metrotown in Burnaby, British Columbia (the “Burnaby Project”). Closing under the agreement is conditional upon satisfaction of conditions such as obtaining the approval from the City of Burnaby for the Burnaby Project, which management expects to occur over an extended period of time.

This agreement contemplates the sale of a 50% interest in the site for a value of approximately \$140.0 million subject to adjustments, and the retention of Concord on customary terms to manage the development. \$15.0 million of the purchase price is to be paid in cash on closing, with the balance to be satisfied by an interest-free long-term note secured by Concord’s 50% interest in the property, the principal of which is expected to be repaid out of cash flow generated from the Burnaby Project over time. It is contemplated that this note will be subordinated to other debt financing expected to be raised and used to develop the Burnaby Project. The note will be guaranteed by a Concord affiliate. Following the sale of the 50% interest, it is contemplated that the parties will enter into a co-ownership arrangement. If third party debt financing cannot be obtained, Concord would be responsible for providing debt financing to develop the Burnaby Project (which would, with certain exceptions, be subordinated to the long-term note held by the Company). The estimated cost to build out the Burnaby Project into a mixed-use residential, office and retail shopping centre development as contemplated, is currently in excess of \$1.0 billion. Completion of the Burnaby Project as contemplated is subject to strategic considerations, including, but not limited to, potential shifts in the Canadian economy and the condition of the real estate market now and in the future.

In January 2014, in conjunction with Concord obtaining financing to develop the Burnaby Project, the Company entered into a demand mortgage for \$25.0 million, secured by the Burnaby Project property. Interest on drawings under the mortgage is determined based on the prime rate plus a spread, and is due monthly. As at August 2, 2014, the Company had no borrowings on the mortgage. In January 2014, Concord entered into a demand loan agreement for \$20.0 million. The loan is guaranteed by Concord’s parent company, One West Holdings Ltd., and the Company’s undrawn \$25.0 million mortgage has been pledged as collateral. As at August 2, 2014, Concord has borrowed \$13.1 million against the available demand loan.

**25. Events after the reporting period**

On August 6, 2014, the Company announced that it had entered into an agreement for the sale of its 20% joint arrangement interest in Kildonan that it owns with Ivanhoé for pre-tax consideration of \$27.7 million. The purchaser, H&R Real Estate Investment Trust, is also purchasing the remaining 80% ownership interest from Ivanhoé. The joint arrangement interest had a net carrying value of approximately \$15.6 million as at August 2, 2014. The agreement is subject to customary closing conditions including representations and warranties given on signing of the agreement continuing to be true on closing. The transaction is expected to close on September 17, 2014, and the ultimate amount of gain to be recognized will be determined during the third quarter of the 52-week period ended January 31, 2015. Following the sale, the Company will continue to operate its store in the shopping centre.

On August 26, 2014, Ivanhoé announced that it had entered into an agreement for the sale of a number of its properties, including its 85% joint arrangement interest in Les Galeries de Hull (“Hull”) that it owns with the Company. The Company may choose to sell its 15% joint arrangement interest in Hull to the same buyer or may choose to retain its interest in Hull.

**26. Approval of the unaudited condensed consolidated financial statements**

The Financial Statements were approved by the Board of Directors and authorized for issue on September 2, 2014.

This page intentionally left blank

This page intentionally left blank

This page intentionally left blank

This page intentionally left blank

## CORPORATE INFORMATION

### Head Office

Sears Canada Inc.  
290 Yonge Street  
Suite 700  
Toronto, Ontario  
M5B 2C3

Website: [www.sears.ca](http://www.sears.ca)  
E-mail: [home@sears.ca](mailto:home@sears.ca)

For more information about the Company, or for additional copies of the Annual Report, write to the Corporate Communications Department at the Head Office of Sears Canada Inc., or call 416-941-4428.

The Company's regulatory filings can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com) and on the U.S. Securities Exchange Commission (SEC) website at [www.sec.gov](http://www.sec.gov).

### Stock Exchange Listing

Toronto Stock Exchange  
Trading symbol: SCC

### Transfer Agent and Registrar

CST Trust Company  
P.O. Box 700, Station B  
Montreal, Québec  
H3B 3K3

Answerline: 416-682-3860  
1-800-387-0825  
Fax: 1-888-249-6189  
Website: [www.canstockta.com](http://www.canstockta.com)  
E-Mail: [inquiries@canstockta.com](mailto:inquiries@canstockta.com)

### Édition française du Rapport annuel

On peut se procurer l'édition française de ce rapport en écrivant au:

Service de Communications de l'entreprise  
Sears Canada Inc.  
290 Yonge Street  
Suite 700  
Toronto, Ontario  
M5B 2C3

Pour de plus amples renseignements au sujet de la Société, veuillez écrire au service national de communication, ou composer le 416-941-4428.

Les dépôts réglementaires de la Société figurent sur le site Web de SEDAR à l'adresse [www.sedar.com](http://www.sedar.com) et sur le site Web de la Securities and Exchange Commission des États-Unis (la « SEC ») à l'adresse [www.sec.gov](http://www.sec.gov).