

## TABLE OF CONTENTS

### Unaudited Condensed Consolidated Financial Statements

|    |  |
|----|--|
| 16 | Condensed Consolidated Statements of Financial Position                                  |
| 17 | Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss) |
| 18 | Condensed Consolidated Statements of Changes in Shareholders' Equity                     |
| 19 | Condensed Consolidated Statements of Cash Flows  |

### Notes to the Unaudited Condensed Consolidated Financial Statements

|    |   |
|----|---|
| 20 | Note 1: General information   |
| 20 | Note 2: Significant accounting policies   |
| 21 | Note 3: Issued standards not yet adopted  |
| 22 | Note 4: Critical accounting judgments and key sources of estimation uncertainty |
| 23 | Note 5: Cash and cash equivalents and interest income                           |
| 23 | Note 6: Inventories   |
| 23 | Note 7: Long-term obligations and finance costs                                 |
| 24 | Note 8: Capital stock   |
| 24 | Note 9: Revenue   |
| 24 | Note 10: Retirement benefit plans expense                                       |
| 25 | Note 11: Depreciation and amortization expense                                  |
| 25 | Note 12: Financial instruments  |
| 28 | Note 13: Contingent liabilities   |
| 28 | Note 14: Net (loss) earnings per share  |
| 29 | Note 15: Income taxes   |
| 29 | Note 16: IFRS 1 reconciliations   |
| 34 | Note 17: 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<br>July 30, 2011 | As at<br>January 29, 2011 | As at<br>July 31, 2010 |
|---|-------|------------------------|---------------------------|------------------------|
| <b>ASSETS</b>   |       |                        |                           |                        |
| <b>Current assets</b>   |       |                        |                           |                        |
| Cash and cash equivalents                                       | 5, 12 | \$ 192.9               | \$ 432.3                  | \$ 214.5               |
| Short-term investments  | 12    | —                      | —                         | 501.5                  |
| Accounts receivable, net  |       | 130.5                  | 144.0                     | 131.5                  |
| Income taxes recoverable  |       | 15.6                   | 4.5                       | 41.2                   |
| Inventories   |       | 913.5                  | 953.2                     | 910.9                  |
| Prepaid expenses  |       | 45.2                   | 31.8                      | 48.3                   |
| Derivative financial assets                                     | 12    | —                      | —                         | 3.0                    |
|   |       | <b>1,297.7</b>         | <b>1,565.8</b>            | <b>1,850.9</b>         |
| <b>Non-current assets</b>                                       |       |                        |                           |                        |
| Property, plant & equipment                                     |       | 883.9                  | 900.7                     | 912.7                  |
| Investment property   |       | 21.7                   | 21.7                      | 21.7                   |
| Retirement benefit asset  |       | 190.3                  | 197.4                     | 204.0                  |
| Intangible assets   |       | 22.7                   | 23.5                      | 23.2                   |
| Goodwill  |       | 11.2                   | 11.2                      | 11.2                   |
| Investment in joint ventures                                    |       | 306.0                  | 309.7                     | 318.3                  |
| Deferred income tax assets                                      |       | 0.5                    | 0.5                       | 0.6                    |
| Other long-term assets  | 12    | 50.8                   | 38.1                      | 39.8                   |
|   |       | <b>\$ 2,784.8</b>      | <b>\$ 3,068.6</b>         | <b>\$ 3,382.4</b>      |
| <b>LIABILITIES</b>  |       |                        |                           |                        |
| <b>Current liabilities</b>                                      |       |                        |                           |                        |
| Accounts payable and accrued liabilities                        | 12    | \$ 625.3               | \$ 665.6                  | \$ 685.7               |
| Deferred revenue  |       | 206.8                  | 224.0                     | 223.1                  |
| Provisions  |       | 63.4                   | 65.3                      | 65.8                   |
| Income and other taxes payable                                  |       | 38.6                   | 66.3                      | 40.6                   |
| Derivative financial liabilities                                | 12    | 9.8                    | 3.0                       | —                      |
| Principal payments on long-term obligations due within one year | 7, 12 | 5.6                    | 4.7                       | 105.1                  |
|   |       | <b>949.5</b>           | <b>1,028.9</b>            | <b>1,120.3</b>         |
| <b>Non-current liabilities</b>                                  |       |                        |                           |                        |
| Long-term obligations   | 7, 12 | 26.9                   | 124.4                     | 29.3                   |
| Deferred revenue  |       | 78.1                   | 77.4                      | 70.6                   |
| Retirement benefit liability                                    |       | 132.6                  | 120.9                     | 109.8                  |
| Deferred income tax liabilities                                 |       | 38.7                   | 74.8                      | 84.2                   |
| Other long-term liabilities                                     |       | 88.4                   | 84.7                      | 88.5                   |
|   |       | <b>1,314.2</b>         | <b>1,511.1</b>            | <b>1,502.7</b>         |
| <b>SHAREHOLDERS' EQUITY</b>                                     |       |                        |                           |                        |
| Capital stock   |       | 15.2                   | 15.4                      | 15.7                   |
| Retained earnings   |       | 1,464.3                | 1,544.9                   | 1,862.7                |
| Accumulated other comprehensive (loss) income                   |       | (8.9)                  | (2.8)                     | 1.3                    |
|   |       | <b>1,470.6</b>         | <b>1,557.5</b>            | <b>1,879.7</b>         |
|   |       | <b>\$ 2,784.8</b>      | <b>\$ 3,068.6</b>         | <b>\$ 3,382.4</b>      |

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 INCOME (LOSS)**  
For the 13 and 26-week periods ended July 30, 2011 and July 31, 2010

Unaudited

| <i>(in CAD millions, except per share amounts)</i>   | Notes  | 13-Week Period |            | 26-Week Period |            |
|--|--------|----------------|------------|----------------|------------|
|  |        | 2011           | 2010       | 2011           | 2010       |
| <b>Revenue</b>   | 9      | \$ 1,147.7     | \$ 1,212.3 | \$ 2,140.2     | \$ 2,280.5 |
| Cost of goods and services sold  | 6      | 715.0          | 735.3      | 1,340.4        | 1,375.1    |
| Gross profit   |        | 432.7          | 477.0      | 799.8          | 905.4      |
| Selling, administrative and other expenses   | 10, 11 | 435.2          | 441.6      | 856.5          | 869.5      |
| Finance costs  | 7, 15  | 2.8            | 2.7        | 9.6            | 8.8        |
| Interest income  | 5      | (0.3)          | (0.9)      | (0.9)          | (1.6)      |
| Share of (income) loss from joint ventures   |        | (3.5)          | 1.6        | (5.4)          | 3.4        |
| (Loss) earnings before income taxes  |        | (1.5)          | 32.0       | (60.0)         | 25.3       |
| Income tax expense (recovery)  |        |                |            |                |            |
| Current  | 15     | 5.1            | 17.3       | 26.3           | 24.2       |
| Deferred   |        | (3.9)          | (5.8)      | (34.1)         | (10.6)     |
|  |        | 1.2            | 11.5       | (7.8)          | 13.6       |
| <b>Net (loss) earnings</b>   |        | \$ (2.7)       | \$ 20.5    | \$ (52.2)      | \$ 11.7    |
| Basic net (loss) earnings per share  | 14     | \$ (0.03)      | \$ 0.19    | \$ (0.50)      | \$ 0.11    |
| Diluted net (loss) earnings per share  | 14     | \$ (0.03)      | \$ 0.19    | \$ (0.50)      | \$ 0.11    |
| Net (loss) earnings  |        | \$ (2.7)       | \$ 20.5    | \$ (52.2)      | \$ 11.7    |
| Other comprehensive income (loss), net of taxes:   |        |                |            |                |            |
| Mark-to-market adjustment related to short-term investments,<br>net of income tax recovery of less than \$0.1 and less<br>than \$0.1 (2010: Nil and \$0.1)   |        | (0.1)          | —          | (0.1)          | (0.2)      |
| Gain (loss) on foreign exchange derivatives designated as cash<br>flow hedges, net of income tax expense of \$0.9 and income<br>tax recovery of \$3.7 (2010: expense of \$2.3 and recovery<br>of \$1.7)          |        | 2.3            | 4.9        | (9.9)          | (3.8)      |
| Reclassification to net (loss) earnings of loss (gain) on foreign<br>exchange derivatives designated as cash flow hedges, net of<br>income tax recovery of \$1.1 and \$1.5 (2010: expense of<br>\$0.3 and \$0.9) |        | 2.9            | (0.6)      | 3.9            | (1.9)      |
| Other comprehensive income (loss)  |        | 5.1            | 4.3        | (6.1)          | (5.9)      |
| Comprehensive income (loss)  |        | \$ 2.4         | \$ 24.8    | \$ (58.3)      | \$ 5.8     |

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 July 30, 2011 and July 31, 2010

Unaudited

| <i>(in CAD millions)</i>       | Notes      | Capital<br>stock | Retained<br>earnings | Accumulated other<br>comprehensive<br>(loss) income | Shareholders'<br>equity |
|--------------------------------|------------|------------------|----------------------|---|-------------------------|
| Balance as at April 30, 2011   |            | \$ 15.4          | \$ 1,494.5           | \$ (14.0)   | \$ 1,495.9              |
| Net loss                       |            | –                | (2.7)                | –   | (2.7)                   |
| Repurchases of common shares   | 8          | (0.2)            | (27.5)               | –   | (27.7)                  |
| Other comprehensive income     |            | –                | –                    | 5.1   | 5.1                     |
| Balance as at July 30, 2011    |            | \$ 15.2          | \$ 1,464.3           | \$ (8.9)  | \$ 1,470.6              |
| Balance as at May 1, 2010      |            | \$ 15.7          | \$ 2,218.9           | \$ (3.0)  | \$ 2,231.6              |
| Net earnings                   | 16.2, 16.4 | –                | 20.5                 | –   | 20.5                    |
| Dividends declared             |            | –                | (376.7)              | –   | (376.7)                 |
| Other comprehensive income     | 16.2, 16.4 | –                | –                    | 4.3   | 4.3                     |
| Balance as at July 31, 2010    | 16.1, 16.3 | \$ 15.7          | \$ 1,862.7           | \$ 1.3  | \$ 1,879.7              |
| Balance as at January 29, 2011 |            | \$ 15.4          | \$ 1,544.9           | \$ (2.8)  | \$ 1,557.5              |
| Net loss                       |            | –                | (52.2)               | –   | (52.2)                  |
| Repurchases of common shares   | 8          | (0.2)            | (28.4)               | –   | (28.6)                  |
| Other comprehensive loss       |            | –                | –                    | (6.1)   | (6.1)                   |
| Balance as at July 30, 2011    |            | \$ 15.2          | \$ 1,464.3           | \$ (8.9)  | \$ 1,470.6              |
| Balance as at January 30, 2010 |            | \$ 15.7          | \$ 2,227.7           | \$ 7.2  | \$ 2,250.6              |
| Net earnings                   | 16.2, 16.4 | –                | 11.7                 | –   | 11.7                    |
| Dividends declared             |            | –                | (376.7)              | –   | (376.7)                 |
| Other comprehensive loss       | 16.2, 16.4 | –                | –                    | (5.9)   | (5.9)                   |
| Balance as at July 31, 2010    | 16.1, 16.3 | \$ 15.7          | \$ 1,862.7           | \$ 1.3  | \$ 1,879.7              |

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 July 30, 2011 and July 31, 2010

Unaudited

| <i>(in CAD millions)</i>  | Notes | 13-Week Period  |                  | 26-Week Period    |                  |
|---|-------|-----------------|------------------|-------------------|------------------|
|   |       | 2011            | 2010             | 2011              | 2010             |
| <b>Cash flow generated from (used for) operating activities</b>       |       |                 |                  |                   |                  |
| Net (loss) earnings   |       | \$ (2.7)        | \$ 20.5          | \$ (52.2)         | \$ 11.7          |
| Adjustments for:  |       |                 |                  |                   |                  |
| Depreciation and amortization   | 11    | 29.2            | 33.1             | 57.8              | 67.6             |
| Finance costs   | 7     | 2.8             | 2.7              | 9.6               | 8.8              |
| Interest income   | 5     | (0.3)           | (0.9)            | (0.9)             | (1.6)            |
| Share of (income) loss from joint ventures                            |       | (3.5)           | 1.6              | (5.4)             | 3.4              |
| Pension expenses  | 10    | 11.0            | 10.1             | 22.0              | 19.7             |
| Income tax expense (recovery)   |       | 1.2             | 11.5             | (7.8)             | 13.6             |
| Income and other taxes paid, net of receipts                          | 15    | (20.7)          | (28.9)           | (40.4)            | (67.3)           |
| Net interest (paid) received  | 5, 7  | 1.1             | (5.8)            | 1.0               | (9.6)            |
| Changes in non-cash working capital                                   |       | 13.2            | (14.4)           | (27.3)            | (103.7)          |
| Other   |       | 0.4             | (11.0)           | (37.7)            | (17.7)           |
|   |       | <b>31.7</b>     | <b>18.5</b>      | <b>(81.3)</b>     | <b>(75.1)</b>    |
| <b>Cash flow generated from (used for) investing activities</b>       |       |                 |                  |                   |                  |
| Purchase of property, plant & equipment and intangible assets         |       | (18.3)          | (13.3)           | (37.6)            | (25.0)           |
| Changes in short-term investments                                     |       | —               | 557.7            | —                 | 664.0            |
| Proceeds from sale of capital assets                                  |       | —               | 0.1              | 0.3               | 0.3              |
| Dividends received from joint ventures                                |       | 2.4             | 1.8              | 9.1               | 4.9              |
|   |       | <b>(15.9)</b>   | <b>546.3</b>     | <b>(28.2)</b>     | <b>644.2</b>     |
| <b>Cash flow generated from (used for) financing activities</b>       |       |                 |                  |                   |                  |
| Interest paid on finance lease obligations                            | 7     | (0.5)           | (0.4)            | (1.1)             | (1.0)            |
| Repayment of long-term obligations                                    |       | (2.5)           | (207.6)          | (113.3)           | (209.0)          |
| Proceeds from long-term obligations                                   |       | 1.5             | 5.8              | 6.5               | 5.8              |
| Dividend payments   |       | —               | (376.7)          | —                 | (376.7)          |
| Repurchases of common shares  | 8     | (20.2)          | —                | (21.1)            | —                |
|   |       | <b>(21.7)</b>   | <b>(578.9)</b>   | <b>(129.0)</b>    | <b>(580.9)</b>   |
| <b>Decrease in cash and cash equivalents</b>                          |       | <b>\$ (5.9)</b> | <b>\$ (14.1)</b> | <b>\$ (238.5)</b> | <b>\$ (11.8)</b> |
| Effect of exchange rate on cash and cash equivalents at end of period |       | 0.4             | (1.4)            | (0.9)             | (0.6)            |
| <b>Cash and cash equivalents at beginning of period</b>               |       | <b>\$ 198.4</b> | <b>\$ 230.0</b>  | <b>\$ 432.3</b>   | <b>\$ 226.9</b>  |
| <b>Cash and cash equivalents at end of period</b>                     |       | <b>\$ 192.9</b> | <b>\$ 214.5</b>  | <b>\$ 192.9</b>   | <b>\$ 214.5</b>  |

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 addresses of its registered office and principal place of business and the principal activities of Sears Canada Inc. and its subsidiaries (the "Company") are disclosed in the Management's Discussion and Analysis. The immediate 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 Delaware) 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 periods ended July 30, 2011 (the "Financial Statements"), have been prepared in accordance with International Financial Reporting Standards ("IFRS"), under IAS 34, *Interim Financial Reporting* ("IAS 34"). These Financial Statements, therefore, do not contain all disclosures required by IFRS for annual financial statements. Accordingly, these Financial Statements should be read in conjunction with the Company's most recently prepared audited annual consolidated financial statements for the 52-weeks ended January 29, 2011 (the "2010 Annual Financial Statements"), with consideration given to the impact of the transition to IFRS, explained in the Company's first unaudited interim consolidated IFRS financial statements for the period ended April 30, 2011 (the "Q1 2011 Financial Statements").

The Company's consolidated financial statements for the year ending January 28, 2012 (the "2011 Annual Financial Statements") will be the first annual financial statements prepared in accordance with IFRS. Under IFRS, IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1") requires an entity to include an explicit and unreserved statement of compliance with IFRS in its first annual financial statements prepared in accordance with IFRS. The Company will include this statement of compliance at the time it issues its 2011 Annual Financial Statements.

#### 2.2 Basis of preparation

The principal accounting policies of the Company have been applied consistently in the preparation of these Financial Statements for all periods presented, including the 2011 opening Condensed Consolidated Statement of Financial Position, as at January 29, 2011.

The accounting policies applied in the preparation of these Financial Statements are based on the IFRS standards and International Financial Reporting Interpretations Committee ("IFRIC") interpretations that the Company expects to be applicable for the period ending January 28, 2012. These Financial Statements follow the same accounting policies and methods of application as those used in the preparation of the Q1 2011 Financial Statements. The Company's significant accounting policies are described in Note 2 of the Q1 2011 Financial Statements.

The impact of transition to IFRS on the Company's opening 2010 (as at January 30, 2010) and opening 2011 statements of financial position, and the impact on the Company's financial performance and cash flows for the 52-weeks ended January 29, 2011, are described and reconciled in Note 17 of the Q1 2011 Financial Statements. IFRS 1 optional exemptions and mandatory exceptions applied at transition are also detailed in Note 17.

The fiscal year of the Company consists of a 52 or 53-week period ending on the Saturday closest to January 31. The fiscal year for the transitional impact of IFRS on 2010 presented in Note 16 of these Financial Statements is the 52-week period ended January 29, 2011 ("Fiscal 2010").

The Company's Financial Statements are presented in Canadian dollars, which is the Company's functional currency.

#### 2.3 Basis of measurement

These Financial Statements have been prepared on the historical cost basis with the exception of certain financial instruments that are measured at fair value, and the retirement benefit asset which is the net total of plan assets, plus unamortized prior service cost and unamortized actuarial losses, less unamortized actuarial gains and the present value

of the retirement benefit liability. On transition to IFRS, the Company elected to measure its property, plant & equipment, including the property, plant & equipment of its real estate joint ventures, and its investment property, at fair value. The fair value was set as the deemed cost, in accordance with IFRS 1, as at that date, and represents the historical cost basis for measurement. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

## **2.4 Basis of consolidation**

These Financial Statements incorporate the financial statements of the Company as well as all of its subsidiaries. Real estate joint venture investments are accounted for using the equity method of accounting (described in Note 2.14 of the Q1 2011 Financial Statements).

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.

## **2.5 Seasonality**

The Company's operations are seasonal in nature. Accordingly, merchandise and service revenues, as well as performance payments received from JPMorgan Chase & Co, N.A. (Toronto Branch) ("JP Morgan Chase") under the long-term 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 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.

On June 16, 2011, the IASB issued amendments to two previously released standards. They are as follows:

### *IAS 1, Presentation of Financial Statements ("IAS 1")*

The IASB has amended IAS 1 to require additional disclosures for items presented in other comprehensive income ("OCI") on a before-tax basis and requires items to be grouped and presented in OCI based on whether they are potentially reclassifiable to profit or loss subsequently (i.e. items that may be reclassified and those that will not be reclassified to profit or loss). This amendment is effective for annual periods beginning on or after July 1, 2012 and requires full retrospective application. The Company will apply this amendment beginning the first quarter of its 2013 fiscal year and has yet to assess the impact to its consolidated financial statements.

### *IAS 19, Employee Benefits ("IAS 19")*

IAS 19 was amended to eliminate the option to defer the recognition of gains and losses (known as the 'corridor approach'), to streamline the presentation of changes in assets and liabilities arising from defined benefit plans and to require enhanced disclosures. This amendment is effective for annual periods beginning on or after January 1, 2013. The Company currently uses the 'corridor approach' and will apply this amendment beginning the first quarter of its 2013 fiscal year. The Company has yet to assess the impact of this amendment to its consolidated financial statements.

On May 12, 2011, the IASB issued four new standards, all of which are applicable to annual reporting periods beginning on or after January 1, 2013. The Company has yet to assess the impact of these standards on its consolidated financial statements and related note disclosures. The following is a list and description of these standards:

*IFRS 10, Consolidated Financial Statements ("IFRS 10")*

IFRS 10 establishes the standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities;

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

IFRS 11 replaces IAS 31, *Interests in Joint Ventures* ("IAS 31") and requires that a party in a joint arrangement assess its rights and obligations to determine the type of joint arrangement and account for those rights and obligations accordingly;

*IFRS 12, Disclosure of Involvement with Other Entities ("IFRS 12")*

IFRS 12, along with IFRS 11 described above, replaces IAS 31. IFRS 12 requires the disclosure of information that enables users of financial statements to evaluate the nature of and the risks associated with, the entity's interests in joint ventures and the impact of those interests on its financial position, financial performance and cash flows; and

*IFRS 13, Fair Value Measurement ("IFRS 13")*

IFRS 13 provides guidance to improve consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. This standard applies when another IFRS requires or permits fair value measurements or disclosures. IFRS 13 does not apply for share-based payment transactions, leasing transactions and measurements that are similar to, but are not fair value.

*IFRS 7, Financial Instruments: Disclosures ("IFRS 7")*

On October 7, 2010, the IASB amended IFRS 7 to require additional disclosures regarding transfers of financial assets. This amendment is effective for annual periods beginning on or after July 1, 2011. The Company will apply this amendment beginning the first quarter of its 2012 fiscal year and has yet to assess the impact on the Company's disclosures.

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

On November 12, 2009, the IASB issued IFRS 9 to replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 addresses the classification and measurement of financial assets. IFRS 9 was subsequently reissued on October 28, 2010, incorporating new requirements on accounting for financial liabilities.

On August 4, 2011, the IASB published an exposure draft proposing an adjustment to the mandatory effective date of IFRS 9 from January 1, 2013 to January 1, 2015. The Company is monitoring the impact of the proposed standard change and the initial application of this IFRS is expected to impact the classification of a number of financial assets which will require disclosure in the financial statement notes.

#### **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 about 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 4 of the Q1 2011 Financial Statements. The critical accounting judgments and key sources of estimation uncertainty used in the preparation of these Financial Statements are consistent with those described in Note 4 of the Q1 2011 Financial Statements and are expected to be consistent with those applied in the Company's 2011 Annual 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<br>July 30, 2011 | As at<br>January 29, 2011 | As at<br>July 31, 2010 |
|--------------------------------------|------------------------|---------------------------|------------------------|
| Cash                                 | \$ 54.4                | \$ 46.3                   | \$ 41.3                |
| Cash equivalents                     |                        |                           |                        |
| Government treasury bills            | 60.0                   | 323.8                     | 109.9                  |
| Bank term deposits                   | 38.0                   | 26.9                      | 57.5                   |
| Investment accounts                  | 20.0                   | 20.0                      | —                      |
| Restricted cash and cash equivalents | 20.5                   | 15.3                      | 5.8                    |
| Total cash and cash equivalents      | \$ 192.9               | \$ 432.3                  | \$ 214.5               |

The components of restricted cash and cash equivalents are further discussed in Note 13.1.

### *Interest income*

Interest income primarily relating to cash and cash equivalents and short-term investments for the 13 and 26-week periods ended July 30, 2011, totaled \$0.3 million (2010: \$0.9 million) and \$0.9 million (2010: \$1.6 million), respectively. For the 13 and 26-week periods ended July 30, 2011, the Company received \$0.3 million (2010: \$0.9 million) and \$1.0 million (2010: \$1.4 million) in cash related to interest income.

## 6. Inventories

The amount of inventories recognized as an expense during the 13 and 26-week periods ended July 30, 2011 was \$661.0 million (2010: \$676.0 million) and \$1,227.8 million (2010: \$1,257.5 million), respectively, including \$19.0 million (2010: \$20.0 million) and \$46.7 million (2010: \$41.7 million), related to write-downs. These expenses are included in "Cost of goods and services sold" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss). Inventory is pledged as collateral under the Company's revolving credit facility. There were no reversals of inventory write-downs during the 13 and 26-week periods ended July 30, 2011 (2010: less than \$0.1 million for both the 13 and 26-weeks ended July 31, 2010).

## 7. Long-term obligations and finance costs

The Company's debt consists of a secured credit facility and finance lease 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. The Credit Facility is secured with a first lien on inventory and credit card receivables. Availability under the Credit Facility is determined pursuant to a borrowing base formula. The Credit Facility contains covenants which are customary for facilities of this nature and the Company was in compliance with all covenants as at July 30, 2011.

As at July 30, 2011, the Company had no borrowings drawn (January 29, 2011: \$107.5 million, net of unamortized transaction costs of \$10.1 million, included in "Long-term obligations" in the unaudited Condensed Consolidated Statements of Financial Position, July 31, 2010: Nil) and had \$6.3 million (January 29, 2011: \$6.7 million, July 31, 2010: Nil) of standby letters of credit outstanding under the Credit Facility. Availability under the Credit Facility was \$662.5 million as at July 30, 2011.

As at July 30, 2011 the Company also had outstanding merchandise letters of credit of U.S. \$6.3 million (January 29, 2011: U.S. \$6.6 million, July 31, 2010: U.S. \$9.3 million) used to support the Company's offshore merchandise purchasing program with restricted cash and cash equivalents pledged as collateral.

As at July 30, 2011, the amounts outstanding in "Long-term obligations" and "Principal payments on long-term obligations due within one year" in the unaudited Condensed Consolidated Statements of Financial Position, represent the Company's finance lease obligations of \$32.5 million (January 29, 2011: \$31.7 million related to finance lease

obligations and \$97.4 million related to borrowings under the Credit Facility, July 31, 2010: \$34.4 million related to finance lease obligations and \$100.0 million related to outstanding medium-term notes).

Interest expense on long-term obligations including finance lease obligations and the current portion of debt, amortization of transaction costs and commitment fees on the unused portion of the Credit Facility for the 13 and 26-week periods ended July 30, 2011 totaled \$2.2 million (2010: \$2.7 million) and \$5.0 million (2010: \$8.8 million), respectively. Included in "Finance Costs" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss) for the 26-week period ended July 30, 2011, is \$4.6 million (2010: Nil) for potential interest on estimated exposure to uncertain tax positions.

The Company's cash payments for interest on long-term obligations including finance lease obligations, the current portion of debt and commitment fees on the unused portion of the Credit Facility for the 13 and 26-week periods ended July 30, 2011 totaled \$0.5 million (2010: \$7.9 million) and \$1.1 million (2010: \$12.0 million), respectively.

## 8. Capital stock

On May 18, 2010, the Company filed a Normal Course Issuer Bid with the Toronto Stock Exchange ("TSX") that permitted the Company to purchase for cancellation up to 5% of its issued and outstanding common shares ("2010 NCIB"). Under the 2010 NCIB, purchases were allowed to commence on May 25, 2010 and terminated on May 24, 2011. On May 24, 2011, the Company renewed the Normal Course Issuer Bid with the TSX for the period of May 25, 2011 to May 24, 2012 ("2011 NCIB"). Pursuant to the 2011 NCIB, the Company is permitted to purchase for cancellation up to 5% of its issued and outstanding common shares, equivalent to 5,268,599 common shares based on the common shares issued and outstanding as at May 9, 2011. The Company may not purchase common shares under the 2011 NCIB if such shares cannot be purchased at prices that the Company considers attractive. Decisions regarding the timing of purchases are based on market conditions and other factors.

During the 13 and 26-week periods ended July 30, 2011, 1,544,700 and 1,589,800 shares (2010: Nil and Nil) were purchased for \$27.7 million and \$28.6 million (2010: Nil and Nil), respectively, and were cancelled under the 2010 and 2011 NCIB. As at July 30, 2011, a total of 3,794,300 shares had been purchased for \$71.6 million, and cancelled under the 2010 and 2011 NCIB.

As at July 30, 2011, 103,827,295 common shares (January 29, 2011: 105,417,095, July 31, 2010: 107,620,995) were issued and outstanding. Sears Holdings, the controlling shareholder of the Company, is the beneficial holder of 97,341,670 or 93.8%, of the common shares of the Company as at July 30, 2011 (January 29, 2011: 97,341,670 or 92.3%, July 31, 2010: 97,341,670, or 90.4%). The issued and outstanding shares are fully paid and have no par value.

## 9. Revenue

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

| <i>(in CAD millions)</i> | 13-Week<br>Period Ended<br>July 30, 2011 | 13-Week<br>Period Ended<br>July 31, 2010 | 26-Week<br>Period Ended<br>July 30, 2011 | 26-Week<br>Period Ended<br>July 31, 2010 |
|--------------------------|--|--|--|--|
| Sale of goods            | \$ 1,026.6                               | \$ 1,083.6                               | \$ 1,900.4                               | \$ 2,022.8                               |
| Service revenue          | 81.5                                     | 83.9                                     | 160.8                                    | 163.8                                    |
| Commission revenue       | 27.5                                     | 32.2                                     | 55.4                                     | 65.8                                     |
| Licensee fee revenue     | 6.8                                      | 7.5                                      | 14.4                                     | 16.0                                     |
| Other                    | 5.3                                      | 5.1                                      | 9.2                                      | 12.1                                     |
| Total revenue            | \$ 1,147.7                               | \$ 1,212.3                               | \$ 2,140.2                               | \$ 2,280.5                               |

## 10. Retirement benefit plans expense

The expense for the defined benefit, defined contribution and other benefit plans for the 13-week period ended July 30, 2011 was \$4.4 million (2010: \$3.4 million), \$2.7 million (2010: \$2.9 million) and \$3.9 million (2010: \$3.8 million), respectively. The expense for the defined benefit, defined contribution and other benefit plans for the 26-week period ended July 30, 2011 was \$8.8 million (2010: \$6.7 million), \$5.3 million (2010: \$5.3 million) and \$7.9 million (2010: \$7.7 million), respectively. The retirement benefit plans expense for the 13 and 26-weeks ended July 30, 2011 and

July 31, 2010, is included in "Selling, administrative and other expenses" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss).

Total payments relating to cash contributed by the Company to its defined benefit, defined contribution and other benefit plans for the 13 and 26-week periods ended July 30, 2011 were \$4.3 million (2010: \$4.5 million) and \$7.0 million (2010: \$7.9 million), respectively.

## 11. Depreciation and amortization expense

The components of the Company's depreciation and amortization expense, included in "Selling, administrative and other expenses", are as follows:

| <i>(in CAD millions)</i>                    | 13-Week<br>Period Ended<br>July 30, 2011 | 13-Week<br>Period Ended<br>July 31, 2010 | 26-Week<br>Period Ended<br>July 30, 2011 | 26-Week<br>Period Ended<br>July 31, 2010 |
|---|--|--|--|--|
| Property, plant & equipment                 | \$ 27.2                                  | \$ 31.0                                  | \$ 53.9                                  | \$ 63.5                                  |
| Intangible assets                           | 2.0                                      | 2.1                                      | 3.9                                      | 4.1                                      |
| Total depreciation and amortization expense | \$ 29.2                                  | \$ 33.1                                  | \$ 57.8                                  | \$ 67.6                                  |

## 12. 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.

### 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, short-term investments, accounts receivable and other long-term assets.

Cash and cash equivalents, short-term investments and other long-term assets of \$194.2 million (January 29, 2011: \$433.6 million, July 31, 2010: \$717.3 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 customers as a result of ongoing credit evaluations and review of accounts receivable collectability. As at July 30, 2011, approximately 29.9% (January 29, 2011: 38.9%, July 31, 2010: 47.0%) of the Company's accounts receivable is due from one customer (Comparative periods: two customers) who is current on their account.

### 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 July 30, 2011:

| (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               | \$ 625.3        | \$ 625.3                         | \$ 625.3        | \$ —              | \$ —               | \$ —            |
| Long-term obligations and payments due within one year | 32.5            | 42.3                             | 7.6             | 11.9              | 7.0                | 15.8            |
| Operating lease obligations <sup>1</sup>               | n/a             | 534.3                            | 99.6            | 160.7             | 101.5              | 172.5           |
|  | <b>\$ 657.8</b> | <b>\$ 1,201.9</b>                | <b>\$ 732.5</b> | <b>\$ 172.6</b>   | <b>\$ 108.5</b>    | <b>\$ 188.3</b> |

<sup>1</sup> Operating lease obligations are not reported in the unaudited Condensed Consolidated Statements of Financial Position.

Management believes that cash on hand, future cash flows generated from operations and availability of current and future funding will be adequate to support these financial liabilities.

### 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.

### 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 July 30, 2011, there were option contracts with a notional value of U.S. \$181.0 million (January 29, 2011: U.S. \$372.0 million, July 31, 2010: U.S. \$429.0 million) and a carrying value of \$9.7 million included in "Derivative financial liabilities" (January 29, 2011: \$3.0 million, July 31, 2010: \$3.0 million included in "Derivative financial assets") in the unaudited Condensed Consolidated Statements of Financial Position. 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 July 30, 2011, the designated portion of these hedges was considered effective.
- As at July 30, 2011, there were swap contracts outstanding with a notional value of U.S. \$6.5 million (January 29, 2011: U.S. \$6.8 million, July 31, 2010: U.S. \$1.0 million) and a carrying value of \$0.1 million included in "Derivative financial liabilities" (January 29, 2011: less than \$0.1 million, July 31, 2010: Nil) in the unaudited Condensed Consolidated Statements of Financial Position. These contracts are intended to reduce the foreign exchange risk on U.S. dollar denominated short-term investments pledged as collateral for letter of credit obligations issued under the Company's offshore merchandise purchasing program.

While the notional principal of these outstanding financial instruments is not recorded on the unaudited Condensed Consolidated Statements of Financial Position, the fair value of the contracts is included in the "Derivative financial assets" or "Derivative financial liabilities" line, depending on 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 continue to be effective, with the ineffective portion included in "Cost of goods and services sold" in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss). 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 earnings (loss).

For the 13 and 26-week periods ended July 30, 2011, the Company recorded a gain of \$0.6 million (2010: loss of \$0.9 million) and a gain of \$3.2 million (2010: loss of \$1.0 million), respectively, relating to the translation or settlement of U.S. dollar denominated monetary items consisting of cash and cash equivalents, accounts receivable and accounts payable, excluding the reclassification from OCI of the gain (loss) on foreign exchange derivatives designated as cash flow hedges.

The period end exchange rate was 1.0466 U.S. dollar to Canadian dollar. A 10% appreciation or depreciation of the U.S. and or the Canadian dollar exchange rate was determined to have an impact on net earnings (loss) of \$2.4 million for U.S. dollar denominated balances included in cash and cash equivalents (other than those which are hedged under swap contracts), derivative contracts that have not been designated as cash flow hedges, accounts receivable and the unhedged portion of accounts payable.

### 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 July 30, 2011, the Company had no interest rate swap contracts in place.

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 secured Credit Facility are subject to interest rate risk. The total subject to interest rate risk as at July 30, 2011 was \$192.3 million (January 29, 2011: \$430.5 million, July 31, 2010: \$714.1 million). A movement in interest rate of +/-0.25% would cause an immaterial variance on net (loss) earnings.

### 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 aforementioned 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>1</sup> | As at July 30, 2011 | As at January 29, 2011 | As at July 31, 2010 |
|-----------------------------------|--|-----------------------------------|---------------------|------------------------|---------------------|
| Loans and receivables             |  |                                   |                     |                        |                     |
| Cash equivalents                  | Cash and cash equivalents <sup>2</sup> | Level 2                           | \$ 80.0             | \$ 343.8               | \$ 109.9            |
| Available for Sale                |  |                                   |                     |                        |                     |
| Short-term investments            | Short-term investments <sup>2</sup>    | Level 2                           | —                   | —                      | 501.5               |
| Fair value through profit or loss |  |                                   |                     |                        |                     |
| U.S. \$ derivative contracts      | Derivative financial assets            | Level 2                           | —                   | —                      | 3.0                 |
| U.S. \$ derivative contracts      | Derivative financial liabilities       | Level 2                           | 9.8                 | 3.0                    | —                   |
| Long-term investments             | Other long-term assets                 | Level 3                           | 1.3                 | 1.3                    | 1.3                 |

<sup>1</sup> Classification of fair values relates to 2011.

<sup>2</sup> Interest income related to cash and cash equivalents and short-term investments is disclosed in Note 5.

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 as they are short-term in nature.

### 13. Contingent liabilities

In addition to the class action lawsuits described in the 2010 Annual Financial Statements, the Company is involved in various legal proceedings incidental to the normal course of business. 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 Company's unaudited Condensed Consolidated Statements of Financial Position or results of operations.

#### 13.1 Commitments and guarantees

##### Commitments

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 \$6.4 million (January 29, 2011: \$7.1 million, July 31, 2010: \$1.3 million), the Canadian equivalent of U.S. \$6.7 million (January 29, 2011: U.S. \$7.0 million, July 31, 2010: U.S. \$1.2 million), current cash deposits pledged as collateral with counterparties relating to outstanding derivative contracts of \$12.2 million (January 29, 2011: \$5.1 million, July 31, 2010: \$1.3 million) and funds held in trust in accordance with regulatory requirements governing advance ticket sales related to Sears Travel of \$1.9 million (January 29, 2011: \$3.1 million, July 31, 2010: \$3.2 million).

##### 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 are \$2.0 million as at July 30, 2011 (January 29, 2011: \$2.4 million, July 31, 2010: \$3.2 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, director and officer indemnification agreements and indemnification of trustees under indentures for outstanding public debt. 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 amount has been accrued in the Financial Statements with respect to these indemnification commitments.

### 14. Net (loss) earnings per share

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

|   | 13-Week<br>Period Ended<br>July 30, 2011 | 13-Week<br>Period Ended<br>July 31, 2010 | 26-Week<br>Period Ended<br>July 30, 2011 | 26-Week<br>Period Ended<br>July 31, 2010 |
|---|--|--|--|--|
| <i>(Number of shares)</i>   |  |  |  |  |
| Weighted average number of shares per basic net (loss) earnings per share calculation   | 105,006,395                              | 107,620,995                              | 105,016,524                              | 107,620,995                              |
| Effect of dilutive instruments outstanding  | 23                                       | 9,285                                    | 724                                      | 9,965                                    |
| Weighted average number of shares per diluted net (loss) earnings per share calculation | 105,006,418                              | 107,630,280                              | 105,017,248                              | 107,630,960                              |

“Net (loss) earnings” as disclosed in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss) was used as the numerator in calculating the basic and diluted net (loss) earnings per share. For both the 13 and 26-weeks ended July 30, 2011, the Company had a net loss and therefore, all potential common shares were anti-dilutive. For both the 13 and 26-week periods ended July 31, 2010, 31,740 options were included in the calculation of diluted net earnings per share as they were dilutive.

## **15. Income taxes**

The Company’s total net cash payments of income taxes in the 13 and 26-week periods ended July 30, 2011 were \$20.7 million (2010: \$28.9 million) and \$40.4 million (2010: \$67.3 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 26-week period ended July 30, 2011, the Company recorded a charge of \$9.7 million for estimated exposure to uncertain tax provisions, comprised of \$4.6 million of potential interest in “Finance costs” and \$5.1 million of tax exposure in “Income tax expense (recovery) – Current” in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss). As the Company routinely evaluates and provides for potentially unfavourable outcomes with respect to any tax audits, the Company believes that, other than as noted above, the final disposition of tax audits will not have a material adverse effect on its liquidity, the unaudited Condensed Consolidated Statements of Financial Position or results of operations. Included in other long-term assets, as at July 30, 2011, are receivables of \$19.0 million (January 29, 2011: \$20.9 million, July 31, 2010: \$20.9 million) related to payments made by the Company for tax assessments that are being disputed.

## **16. IFRS 1 reconciliations**

These Financial Statements were prepared in accordance with IAS 34 and IFRS 1. IFRS 1 requires retrospective application of IFRS standards as at the reporting date, but contains certain optional exemptions and mandatory exceptions from this requirement.

IFRS 1 optional exemptions allow companies to elect non-retrospective or other treatments at transition, for cases where retrospective application is deemed to be overly burdensome or impracticable. The voluntary exemptions which were elected by the Company at transition are detailed in Note 17 of the Q1 2011 Financial Statements.

The general premise of IFRS 1 mandatory exceptions is to prevent companies from using hindsight in adopting IFRS’s retrospectively. The mandatory exceptions applicable to the Company are also detailed in Note 17 of the Q1 2011 Financial Statements.

In addition to the above, IFRS 1 requires that the Company prepare reconciliations between Canadian Generally Accepted Accounting Principles (“GAAP”) and IFRS equity and comprehensive income for the comparative reporting periods in Fiscal 2010. The IFRS 1 reconciliations relating to the opening IFRS adjustments on transition (for the 52-week period ended January 30, 2010) and for the opening IFRS adjustments for fiscal 2011 (for the 52-week period ended January 29, 2011) are presented in Note 17 of the Q1 2011 Financial Statements.

Presented below are the IFRS 1 reconciliations for the 13 and 26-week periods ended July 31, 2010.

### 16.1 Reconciliation of Canadian GAAP to IFRS 2010 unaudited Condensed Consolidated Statements of Financial Position

As at July 31, 2010

| (in CAD millions)                         | Ref | Canadian<br>GAAP | Reclassifications<br>(i) | Canadian<br>GAAP<br>Reclassified | Property, Plant<br>& Equipment<br>(a) | Investment<br>Property<br>(a) | Joint<br>Ventures<br>(b) | Leases<br>(c) | Financial<br>Instruments<br>(d) | Provisions<br>(e) | Employee<br>Benefits<br>(f) | Intangible<br>Assets<br>(g) | Loyalty<br>Program<br>(h) | Income<br>Tax<br>(i) | IFRS           |
|---|-----|------------------|--------------------------|----------------------------------|---------------------------------------|-------------------------------|--------------------------|---------------|---------------------------------|-------------------|-----------------------------|-----------------------------|---------------------------|----------------------|----------------|
| Current assets                            |     | \$ 1,916.8       | \$ (27.0)                | \$ 1,889.8                       | \$ —                                  | \$ —                          | \$ (5.9)                 | \$ (0.1)      | \$ —                            | \$ —              | \$ —                        | \$ (32.9)                   | \$ —                      | \$ —                 | \$ 1,850.9     |
| Property, plant & equipment               |     | 583.6            | —                        | 583.6                            | 383.9                                 | (5.1)                         | (82.7)                   | 33.0          | —                               | —                 | —                           | —                           | —                         | —                    | 912.7          |
| Investment property                       |     | —                | —                        | —                                | —                                     | 21.7                          | —                        | —             | —                               | —                 | —                           | —                           | —                         | —                    | 21.7           |
| Investment in joint ventures              |     | —                | —                        | —                                | —                                     | —                             | 318.3                    | —             | —                               | —                 | —                           | —                           | —                         | —                    | 318.3          |
| Other long-term assets                    |     | 294.4            | 29.7                     | 324.1                            | —                                     | —                             | (7.8)                    | (0.1)         | —                               | —                 | 34.5                        | (7.2)                       | —                         | (64.7)               | 278.8          |
|   |     | <b>2,794.8</b>   | <b>2.7</b>               | <b>2,797.5</b>                   | <b>383.9</b>                          | <b>16.6</b>                   | <b>221.9</b>             | <b>32.8</b>   | <b>—</b>                        | <b>—</b>          | <b>34.5</b>                 | <b>(40.1)</b>               | <b>—</b>                  | <b>(64.7)</b>        | <b>3,382.4</b> |
| Current liabilities                       |     | 1,103.0          | 2.7                      | 1,105.7                          | —                                     | —                             | (8.8)                    | 4.5           | —                               | 0.7               | —                           | —                           | 18.2                      | —                    | 1,120.3        |
| Other long-term liabilities               |     | 377.2            | —                        | 377.2                            | —                                     | —                             | (35.7)                   | 28.0          | —                               | —                 | (67.1)                      | —                           | —                         | 80.0                 | 382.4          |
|   |     | <b>1,480.2</b>   | <b>2.7</b>               | <b>1,482.9</b>                   | <b>—</b>                              | <b>—</b>                      | <b>(44.5)</b>            | <b>32.5</b>   | <b>—</b>                        | <b>0.7</b>        | <b>(67.1)</b>               | <b>—</b>                    | <b>18.2</b>               | <b>80.0</b>          | <b>1,502.7</b> |
| Capital stock                             |     | 15.7             | —                        | 15.7                             | —                                     | —                             | —                        | —             | —                               | —                 | —                           | —                           | —                         | —                    | 15.7           |
| Retained earnings                         |     | 1,296.2          | —                        | 1,296.2                          | 383.9                                 | 16.6                          | 266.4                    | 0.3           | 2.0                             | (0.7)             | 101.6                       | (40.1)                      | (18.2)                    | (145.3)              | 1,862.7        |
| Accumulated other<br>comprehensive income |     | 2.7              | —                        | 2.7                              | —                                     | —                             | —                        | —             | (2.0)                           | —                 | —                           | —                           | —                         | 0.6                  | 1.3            |
|   |     | <b>2,794.8</b>   | <b>2.7</b>               | <b>2,797.5</b>                   | <b>383.9</b>                          | <b>16.6</b>                   | <b>221.9</b>             | <b>32.8</b>   | <b>—</b>                        | <b>—</b>          | <b>34.5</b>                 | <b>(40.1)</b>               | <b>—</b>                  | <b>(64.7)</b>        | <b>3,382.4</b> |



## 16.2 Reconciliation of Canadian GAAP to IFRS 2010 unaudited Condensed Consolidated Statements of Net Earnings and Comprehensive Income

For the 13-week period ended July 31, 2010

| (in CAD millions)                           | Ref | Canadian GAAP | Reclassifications (j) | Canadian GAAP Reclassified | Property, Plant & Equipment (a) | Joint Ventures (b) | Leases (c)   | Financial Instruments (d) | Provisions (e) | Employee Benefits (f) | Intangible Assets (g) | Loyalty Program (h) | Income Tax (i) | IFRS        |
|---|-----|---------------|-----------------------|----------------------------|---------------------------------|--------------------|--------------|---------------------------|----------------|-----------------------|-----------------------|---------------------|----------------|-------------|
| Revenue                                     |     | \$ 1,212.8    | \$ 5.7                | \$ 1,218.5                 | \$ —                            | \$ (11.5)          | \$ —         | \$ —                      | \$ —           | \$ —                  | \$ —                  | \$ 5.3              | \$ —           | \$ 1,212.3  |
| Cost of goods and services sold*            |     | 1,138.5       | (416.1)               | 722.4                      | —                               | —                  | —            | —                         | —              | —                     | —                     | 12.9                | —              | 735.3       |
| Gross profit                                |     | 74.3          | 421.8                 | 496.1                      | —                               | (11.5)             | —            | —                         | —              | —                     | —                     | (7.6)               | —              | 477.0       |
| Selling, administrative and other expenses* |     | —             | 446.9                 | 446.9                      | 7.8                             | (7.3)              | (0.1)        | (1.4)                     | (0.1)          | 2.1                   | 1.3                   | (7.6)               | —              | 441.6       |
| Depreciation and amortization**             |     | 25.1          | (25.1)                | —                          | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | —           |
| Finance costs                               |     | 1.8           | 0.9                   | 2.7                        | —                               | (0.5)              | 0.5          | —                         | —              | —                     | —                     | —                   | —              | 2.7         |
| Interest income                             |     | —             | (0.9)                 | (0.9)                      | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | (0.9)       |
| Unusual gains**                             |     | —             | —                     | —                          | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | —           |
| Share of loss (income) in joint ventures    |     | —             | —                     | —                          | —                               | 1.6                | —            | —                         | —              | —                     | —                     | —                   | —              | 1.6         |
| Earnings before income taxes                |     | 47.4          | —                     | 47.4                       | (7.8)                           | (5.3)              | (0.4)        | 1.4                       | 0.1            | (2.1)                 | (1.3)                 | —                   | —              | 32.0        |
| Income tax expense (recovery)               |     |               |                       |                            |                                 |                    |              |                           |                |                       |                       |                     |                |             |
| Current                                     |     | 17.3          | —                     | 17.3                       | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | 17.3        |
| Deferred                                    |     | (1.8)         | —                     | (1.8)                      | —                               | (0.1)              | —            | —                         | —              | —                     | —                     | —                   | (3.9)          | (5.8)       |
|   |     | 15.5          | —                     | 15.5                       | —                               | (0.1)              | —            | —                         | —              | —                     | —                     | —                   | (3.9)          | 11.5        |
| <b>Net earnings</b>                         |     | <b>31.9</b>   | <b>—</b>              | <b>31.9</b>                | <b>(7.8)</b>                    | <b>(5.2)</b>       | <b>(0.4)</b> | <b>1.4</b>                | <b>0.1</b>     | <b>(2.1)</b>          | <b>(1.3)</b>          | <b>—</b>            | <b>3.9</b>     | <b>20.5</b> |
| Other comprehensive income                  |     | 5.3           | —                     | 5.3                        | —                               | —                  | —            | (1.4)                     | —              | —                     | —                     | —                   | 0.4            | 4.3         |
| <b>Comprehensive income</b>                 |     | <b>37.2</b>   | <b>—</b>              | <b>37.2</b>                | <b>(7.8)</b>                    | <b>(5.2)</b>       | <b>(0.4)</b> | <b>—</b>                  | <b>0.1</b>     | <b>(2.1)</b>          | <b>(1.3)</b>          | <b>—</b>            | <b>4.3</b>     | <b>24.8</b> |

For the 26-week period ended July 31, 2010

| (in CAD millions)                           | Ref | Canadian GAAP | Reclassifications (j) | Canadian GAAP Reclassified | Property, Plant & Equipment (a) | Joint Ventures (b) | Leases (c)   | Financial Instruments (d) | Provisions (e) | Employee Benefits (f) | Intangible Assets (g) | Loyalty Program (h) | Income Tax (i) | IFRS        |
|---|-----|---------------|-----------------------|----------------------------|---------------------------------|--------------------|--------------|---------------------------|----------------|-----------------------|-----------------------|---------------------|----------------|-------------|
| Revenue                                     |     | \$ 2,279.8    | \$ 13.5               | \$ 2,293.3                 | \$ —                            | \$ (24.4)          | \$ —         | \$ —                      | \$ —           | \$ —                  | \$ —                  | \$ 11.6             | \$ —           | \$ 2,280.5  |
| Cost of goods and services sold*            |     | 2,158.9       | (808.3)               | 1,350.6                    | —                               | —                  | —            | —                         | —              | —                     | —                     | 24.5                | —              | 1,375.1     |
| Gross profit                                |     | 120.9         | 821.8                 | 942.7                      | —                               | (24.4)             | —            | —                         | —              | —                     | —                     | (12.9)              | —              | 905.4       |
| Selling, administrative and other expenses* |     | —             | 872.5                 | 872.5                      | 16.5                            | (14.3)             | (0.3)        | (0.9)                     | (0.2)          | 4.2                   | 6.4                   | (14.4)              | —              | 869.5       |
| Depreciation and amortization**             |     | 50.8          | (50.8)                | —                          | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | —           |
| Finance costs                               |     | 7.7           | 1.6                   | 9.3                        | —                               | (1.5)              | 1.0          | —                         | —              | —                     | —                     | —                   | —              | 8.8         |
| Interest income                             |     | —             | (1.6)                 | (1.6)                      | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | (1.6)       |
| Unusual gains**                             |     | —             | —                     | —                          | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | —           |
| Share of loss (income) in joint ventures    |     | —             | —                     | —                          | —                               | 3.4                | —            | —                         | —              | —                     | —                     | —                   | —              | 3.4         |
| Earnings before income taxes                |     | 62.4          | 0.1                   | 62.5                       | (16.5)                          | (12.0)             | (0.7)        | 0.9                       | 0.2            | (4.2)                 | (6.4)                 | 1.5                 | —              | 25.3        |
| Income tax expense (recovery)               |     |               |                       |                            |                                 |                    |              |                           |                |                       |                       |                     |                |             |
| Current                                     |     | 24.2          | —                     | 24.2                       | —                               | —                  | —            | —                         | —              | —                     | —                     | —                   | —              | 24.2        |
| Deferred                                    |     | (0.9)         | 0.1                   | (0.8)                      | —                               | (0.1)              | —            | —                         | —              | —                     | —                     | —                   | (9.7)          | (10.6)      |
|   |     | 23.3          | 0.1                   | 23.4                       | —                               | (0.1)              | —            | —                         | —              | —                     | —                     | —                   | (9.7)          | 13.6        |
| <b>Net earnings</b>                         |     | <b>39.1</b>   | <b>—</b>              | <b>39.1</b>                | <b>(16.5)</b>                   | <b>(11.9)</b>      | <b>(0.7)</b> | <b>0.9</b>                | <b>0.2</b>     | <b>(4.2)</b>          | <b>(6.4)</b>          | <b>1.5</b>          | <b>9.7</b>     | <b>11.7</b> |
| Other comprehensive loss                    |     | (5.3)         | —                     | (5.3)                      | —                               | —                  | —            | (0.9)                     | —              | —                     | —                     | —                   | 0.3            | (5.9)       |
| <b>Comprehensive income</b>                 |     | <b>33.8</b>   | <b>—</b>              | <b>33.8</b>                | <b>(16.5)</b>                   | <b>(11.9)</b>      | <b>(0.7)</b> | <b>—</b>                  | <b>0.2</b>     | <b>(4.2)</b>          | <b>(6.4)</b>          | <b>1.5</b>          | <b>10.0</b>    | <b>5.8</b>  |

\* Note: Under Canadian GAAP, "Cost of goods and services sold" and "Selling, administrative and other expenses" were reported in total under "Cost of merchandise sold, operating, administrative and selling expenses."

\*\* Under IFRS, "Depreciation and amortization expense" and "Unusual gains" are included in "Selling, administrative and other expenses."

### 16.3 Reconciliation of Canadian GAAP to IFRS 2010 equity

| <i>(in CAD millions)</i>                | Ref | As at<br>July 31, 2010 |
|---|-----|------------------------|
| <b>Total equity under Canadian GAAP</b> |     | <b>\$ 1,314.6</b>      |
| Property, plant & equipment             | a   | 383.9                  |
| Investment property                     | a   | 16.6                   |
| Joint ventures                          | b   | 266.4                  |
| Leases                                  | c   | 0.3                    |
| Provisions                              | e   | (0.7)                  |
| Employee benefits                       | f   | 101.6                  |
| Intangible assets                       | g   | (40.1)                 |
| Loyalty program                         | h   | (18.2)                 |
| Total IFRS adjustments before taxes     |     | 709.8                  |
| Income taxes                            | i   | (144.7)                |
| Total adjustment to equity              |     | 565.1                  |
| <b>Total equity under IFRS</b>          |     | <b>1,879.7</b>         |

### 16.4 Reconciliation of Canadian GAAP to IFRS 2010 comprehensive income

| <i>(in CAD millions)</i>                                     | Ref | 13-Week<br>Period Ended<br>July 31, 2010 | 26-Week<br>Period Ended<br>July 31, 2010 |
|--|-----|--|--|
| <b>Net earnings under Canadian GAAP</b>                      |     | <b>\$ 31.9</b>                           | <b>\$ 39.1</b>                           |
| Property, plant & equipment                                  | a   | (7.8)                                    | (16.5)                                   |
| Joint ventures   | b   | (5.2)                                    | (11.9)                                   |
| Leases   | c   | (0.4)                                    | (0.7)                                    |
| Financial instruments  | d   | 1.4                                      | 0.9                                      |
| Provisions   | e   | 0.1                                      | 0.2                                      |
| Employee benefits  | f   | (2.1)                                    | (4.2)                                    |
| Intangible assets  | g   | (1.3)                                    | (6.4)                                    |
| Loyalty program  | h   | —  | 1.5                                      |
| Total IFRS adjustments before taxes                          |     | (15.3)                                   | (37.1)                                   |
| Income taxes   | i   | 3.9                                      | 9.7                                      |
| <b>Net earnings under IFRS</b>                               |     | <b>\$ 20.5</b>                           | <b>\$ 11.7</b>                           |
| <b>Other comprehensive income (loss) under Canadian GAAP</b> |     | <b>5.3</b>                               | <b>(5.3)</b>                             |
| Financial instruments  | d   | (1.0)                                    | (0.6)                                    |
| <b>Other comprehensive income (loss) under IFRS</b>          |     | <b>4.3</b>                               | <b>(5.9)</b>                             |
| <b>Comprehensive income under IFRS</b>                       |     | <b>\$ 24.8</b>                           | <b>\$ 5.8</b>                            |

### 16.5 Explanation of significant IFRS adjustments to equity and comprehensive income

The following is an explanation of the adjustments disclosed in the reconciliations in Note 16.1 to 16.4:

- (a) **Property, plant & equipment and investment property:** On transition, the Company elected to measure its land and buildings at fair value, and set the fair value as the deemed cost at that date, in accordance with the IFRS 1 fair value as deemed cost election option. As a result, the cost of the Company's property, plant & equipment and its investment property increased materially on transition. Due to the increased building cost, subsequent building depreciation also increased. The adjustment made to equity represents the increase to the cost of the land and

buildings. The adjustment to net earnings represents the increase in depreciation in the period due to the increased building cost.

Investment property has been recognized at fair value at the date of transition. Under Canadian GAAP, investment property was previously measured on a depreciated cost basis and classified as property, plant & equipment.

The adjustment to fair value for property, plant & equipment and investment property was based on third party valuations, performed using various valuation methods.

- (b) **Joint ventures:** The Company selected the equity method to account for its joint ventures. As such, the difference between the end of the reporting periods of the joint ventures and that of the Company can be no more than three months. As a result, the Company has advanced the joint venture reporting periods used in applying the equity method of accounting. In addition, on transition, the Company elected to measure its investments in the joint venture land and buildings at fair value and set the fair value as deemed cost at that date in accordance with the IFRS 1 fair value as deemed cost election option. The adjustment to equity is the result of the advancement of the joint venture reporting periods and the increase to the cost of the land and buildings is due to the application of the IFRS 1 election. The adjustment to net earnings represents the increased depreciation in the period due to the increase made to the joint venture buildings cost.
- (c) **Leases:** There are minor differences in the criteria used to evaluate whether a lease is a finance lease between IAS 17, *Leases* ("IAS 17"), and the Canadian GAAP equivalent. Under IFRS, minimum lease payments are allocated between land and building components for leases which contain both. Under IFRS, professional judgment is required to assess the facts and circumstances of a lease to determine if the lease transfers substantially all the risks and rewards incidental to ownership of assets, in which case, the lease would be accounted for as a finance lease. As a result of these differences, a number of leases classified as operating leases under Canadian GAAP were reclassified as finance leases under IFRS. In addition, on transition, the Company elected to measure certain of its finance leased assets at fair value and set the fair value as deemed cost at that date in accordance with the IFRS 1 fair value as deemed cost election option. The adjustment to equity results from the reclassification of these leases to finance leases and the IFRS 1 fair value as deemed cost election. The adjustment to net earnings represents the difference between the depreciation and interest expense under IFRS and the rental expense recognized under Canadian GAAP for the leases classified as finance leases under IFRS.
- (d) **Financial instruments:** The Company holds foreign exchange option contracts. Under Canadian GAAP, these derivatives were fully designated for hedge accounting. Under IAS 39, only the intrinsic portion of these contracts can be designated for hedge accounting. As a result, changes in the value of the undesignated component of these derivatives are required to be recognized in the unaudited Condensed Consolidated Statements of Net (Loss) Earnings and Comprehensive Income (Loss). The adjustment to retained earnings represents the recognition of the value of the undesignated portion of the outstanding derivatives. The adjustment to net earnings represents the recognition of the change in value of the undesignated portion of the outstanding derivatives in the period.
- (e) **Provisions:** IAS 37, *Provisions, contingent liabilities and contingent assets* ("IAS 37"), requires onerous contracts to be recognized as liabilities. The Company has onerous contracts relating to leased space that is not fully occupied by a company store or a subtenant. The adjustment to equity reduces equity by the outstanding onerous contract liabilities. The adjustment to net earnings represents the unwinding of the onerous contracts liabilities recorded on transition.
- (f) **Employee benefits:** The Company has selected the corridor method to recognize actuarial gains and losses on its defined benefit plans under IAS 19. This selection requires the Company to apply the corridor method retrospectively from each plan's inception date. Equity is increased due to adjusted plan asset and obligation values resulting from the retrospective application of IAS 19. The adjustment to net earnings represents the change required to the pension expense resulting from the application of the corridor approach under IAS 19.
- (g) **Intangible assets:** Under IAS 38, *Intangible Assets* ("IAS 38"), costs related to internally generated intangible assets may only be capitalized if they meet specific criteria. The adjustments to equity represent the recognition of expenses that had previously been deferred under Canadian GAAP but do not meet the criteria of intangible assets under IFRS. The adjustment to net earnings represents the recognition of expenses incurred in the period that were deferred under Canadian GAAP.

- (h) **Loyalty program:** Under Canadian GAAP, loyalty points granted under the Sears Club program were expensed at issuance. Under IFRIC 13, *Customer Loyalty Programs* ("IFRIC 13"), the fair value of the consideration received or receivable at the initial sale is allocated between the merchandise sold and the Sears Club points granted. Revenue related to the fair value of the points granted is deferred at the time of the initial sale transaction and is recognized when the points have been redeemed and the Company's obligations have been fulfilled. The adjustment to equity as well as net earnings reflects the difference between the policy followed under Canadian GAAP and the policy required by IFRIC 13.
- (i) **Income taxes:** Under Canadian GAAP and IFRS, deferred income tax assets and liabilities are recorded for temporary differences, which are the differences between when an amount is recognized for accounting and tax purposes. The adjustment to equity as well as net earnings reflects changes to temporary differences, and thus the deferred income tax assets and liabilities, required by adjustments (a) to (h) listed above.
- (j) **Reclassifications:** The following reclassifications have been made for the unaudited Condensed Consolidated Statements of Financial Position:
- a. Deferred tax balances recorded in current assets under Canadian GAAP were reclassified to non-current, as deferred taxes are not permitted to be classified as current under IFRS; and
  - b. Reimbursements from manufacturers relating to the warranty liability were reclassified from current liabilities to accounts receivable.

The following reclassifications have been made for the unaudited Condensed Consolidated Statements of Net Earnings and Comprehensive Income:

- c. Revenue offset against "Selling, administrative and other expenses" prior to IFRS were reclassified to "Revenue";
- d. "Cost of goods and services sold" were disaggregated from "Selling, administrative and other expenses";
- e. "Depreciation and amortization" were aggregated to "Selling, administrative and other expenses", as the Company selected the function classification method;
- f. "Interest income" was separately presented from "Finance costs" under IFRS; and
- g. "Unusual gains and losses" are not permitted under IFRS and have been reclassified to "Selling, administrative and other expenses."

#### **16.6 Explanation of significant changes to the statement of cash flows**

Under Canadian GAAP, the cash flows relating to joint ventures were proportionately consolidated into the Company's unaudited Condensed Consolidated Statements of Cash Flows. Under IFRS, given the Company is applying the equity method of accounting for joint ventures, adjustments have been made to eliminate any joint venture cash flows.

#### **17. Approval of unaudited condensed consolidated financial statements**

The unaudited Condensed Consolidated Financial Statements were approved by the Board of Directors and authorized for issue on August 30, 2011.