

J C PENNEY CO INC

Form 10-Q

June 04, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended May 2, 2015

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission File Number: 1-15274

J. C. PENNEY COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware

26-0037077

(State or other jurisdiction of incorporation or
organization)

(I.R.S. Employer Identification No.)

6501 Legacy Drive, Plano, Texas
(Address of principal executive offices)

75024 - 3698
(Zip Code)

(972) 431-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 305,429,334 shares of Common Stock of 50 cents par value, as of June 1, 2015.

J. C. PENNEY COMPANY, INC.
FORM 10-Q
For the Quarterly Period Ended May 2, 2015
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Part I. Financial Information

Item 1. Unaudited Interim Consolidated Financial Statements

J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions, except per share data)	Three Months Ended	
	May 2, 2015	May 3, 2014
Total net sales	\$2,857	\$2,801
Cost of goods sold	1,816	1,875
Gross margin	1,041	926
Operating expenses/(income):		
Selling, general and administrative (SG&A)	965	1,009
Pension	10	1
Depreciation and amortization	154	158
Real estate and other, net	(35	) (17
Restructuring and management transition	22	22
Total operating expenses	1,116	1,173
Operating income/(loss)	(75	) (247
Net interest expense	98	97
Income/(loss) before income taxes	(173	) (344
Income tax expense/(benefit)	(6	) 8
Net income/(loss)	\$(167	) \$(352
Earnings/(loss) per share:		
Basic	\$(0.55	) \$(1.15
Diluted	\$(0.55	) \$(1.15
Weighted average shares – basic	305.5	305.0
Weighted average shares – diluted	305.5	305.0

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(Unaudited)

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Net income/(loss)	\$(167	) \$(352
Other comprehensive income/(loss), net of tax:		
Retirement benefit plans		
Reclassification for amortization of net actuarial (gain)/loss	17	11
Reclassification for amortization of prior service (credit)/cost	—	(1
Total other comprehensive income/(loss), net of tax	17	10
Total comprehensive income/(loss), net of tax	\$(150	) \$(342
See the accompanying notes to the unaudited Interim Consolidated Financial Statements.		

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CONSOLIDATED BALANCE SHEETS

	May 2, 2015 (Unaudited)	May 3, 2014 (Unaudited)	January 31, 2015
(In millions, except per share data)			
Assets			
Current assets:			
Cash in banks and in transit	\$175	\$176	\$119
Cash short-term investments	869	994	1,199
Cash and cash equivalents	1,044	1,170	1,318
Merchandise inventory	2,811	2,835	2,652
Deferred taxes	176	178	172
Prepaid expenses and other	226	212	189
Total current assets	4,257	4,395	4,331
Property and equipment (net of accumulated depreciation of \$3,669, \$3,439 and \$3,617)	5,049	5,510	5,148
Prepaid pension	243	682	220
Other assets	690	705	705
Total Assets	\$10,239	\$11,292	\$10,404
Liabilities and Stockholders' Equity			
Current liabilities:			
Merchandise accounts payable	\$1,063	\$841	\$997
Other accounts payable and accrued expenses	1,028	1,087	1,103
Short-term borrowings	—	650	—
Current portion of capital leases and note payable	40	30	28
Current maturities of long-term debt	28	23	28
Total current liabilities	2,159	2,631	2,156
Long-term capital leases and note payable	22	57	38
Long-term debt	5,315	4,834	5,322
Deferred taxes	369	365	363
Other liabilities	599	652	611
Total Liabilities	8,464	8,539	8,490
Stockholders' Equity			
Common stock ⁽¹⁾	153	152	152
Additional paid-in capital	4,616	4,579	4,606
Reinvested earnings/(accumulated deficit)	(1,946)	(1,360)	(1,779)
Accumulated other comprehensive income/(loss)	(1,048)	(618)	(1,065)
Total Stockholders' Equity	1,775	2,753	1,914
Total Liabilities and Stockholders' Equity	\$10,239	\$11,292	\$10,404

1,250 million shares of common stock are authorized with a par value of \$0.50 per share. The total shares issued (1) and outstanding were 305.3 million, 304.8 million and 304.9 million as of May 2, 2015, May 3, 2014 and January 31, 2015, respectively.

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Cash flows from operating activities		
Net income/(loss)	\$(167	) \$(352
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:		
Restructuring and management transition	3	2
Asset impairments and other charges	1	2
Net gain on sale of non-operating assets	(2	) (12
Net gain on sale of operating assets	(8	) (1
Depreciation and amortization	154	158
Benefit plans	4	(9
Stock-based compensation	10	7
Deferred taxes	(11	) (5
Change in cash from:		
Inventory	(159	) 100
Prepaid expenses and other assets	(37	) (27
Merchandise accounts payable	66	(107
Current income taxes	4	10
Accrued expenses and other	(84	) (37
Net cash provided by/(used in) operating activities	(226	) (271
Cash flows from investing activities		
Capital expenditures	(46	) (80
Net proceeds from sale of non-operating assets	6	15
Net proceeds from sale of operating assets	5	2
Net cash provided by/(used in) investing activities	(35	) (63
Cash flows from financing activities		
Payments of capital leases and note payable	(5	) (5
Payments of long-term debt	(6	) (5
Tax withholding payments for vested restricted stock	(2	) (1
Net cash provided by/(used in) financing activities	(13	) (11
Net increase/(decrease) in cash and cash equivalents	(274	) (345
Cash and cash equivalents at beginning of period	1,318	1,515
Cash and cash equivalents at end of period	\$1,044	\$1,170
Supplemental cash flow information		
Income taxes received/(paid), net	—	(3
Interest received/(paid), net	(126	) (126
Supplemental non-cash investing and financing activity		
Property contributed to joint venture	—	30
Increase/(decrease) in other accounts payable related to purchases of property and equipment	11	1

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Consolidation

Basis of Presentation

J. C. Penney Company, Inc. is a holding company whose principal operating subsidiary is J. C. Penney Corporation, Inc. (JCP). JCP was incorporated in Delaware in 1924, and J. C. Penney Company, Inc. was incorporated in Delaware in 2002, when the holding company structure was implemented. The holding company has no independent assets or operations, and no direct subsidiaries other than JCP. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this quarterly report as “we,” “us,” “our,” “ourselves” or the “Company,” unless otherwise indicated.

J. C. Penney Company, Inc. is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP’s outstanding debt securities. The guarantee of certain of JCP’s outstanding debt securities by J. C. Penney Company, Inc. is full and unconditional.

These unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The accompanying unaudited Interim Consolidated Financial Statements, in our opinion, include all material adjustments necessary for a fair presentation and should be read in conjunction with the audited Consolidated Financial Statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015 (2014 Form 10-K). We follow substantially the same accounting policies to prepare quarterly financial statements as are followed in preparing annual financial statements. A description of such significant accounting policies is included in the 2014 Form 10-K. The January 31, 2015 financial information was derived from the audited Consolidated Financial Statements, with related footnotes, included in the 2014 Form 10-K. Because of the seasonal nature of the retail business, operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

Fiscal Year

Our fiscal year ends on the Saturday closest to January 31. As used herein, “three months ended May 2, 2015” and “three months ended May 3, 2014” refer to the 13-week periods ended May 2, 2015 and May 3, 2014, respectively. Fiscal years 2015 and 2014 contain 52 weeks.

Basis of Consolidation

All significant intercompany transactions and balances have been eliminated in consolidation. Certain reclassifications were made to prior period amounts to conform to the current period presentation. None of the reclassifications affected our net income/(loss) in any period.

Use of Estimates and Assumptions

The preparation of unaudited Interim Consolidated Financial Statements, in conformity with GAAP, requires us to make assumptions and use estimates that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to: inventory valuation under the retail method, specifically permanent reductions to retail prices (markdowns), permanent devaluation of inventory (markdown accruals) and adjustments for shortages (shrinkage); valuation of long-lived assets and indefinite-lived intangible assets for impairments; reserves for closed stores, workers’ compensation and general liability (insurance), environmental contingencies, income taxes and litigation; and pension and other postretirement benefits accounting. Such estimates and assumptions are subject to inherent uncertainties, which may result in actual amounts differing from reported amounts.

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2. Earnings/(Loss) per Share

Net income/(loss) and shares used to compute basic and diluted earnings/(loss) per share (EPS) are reconciled below:

(in millions, except per share data)	Three Months Ended	
	May 2, 2015	May 3, 2014
Earnings/(loss)		
Net income/(loss)	\$(167)	\$(352)
Shares		
Weighted average common shares outstanding (basic shares)	305.5	305.0
Adjustment for assumed dilution:		
Stock options, restricted stock awards and warrant	—	—
Weighted average shares assuming dilution (diluted shares)	305.5	305.0
EPS		
Basic	\$(0.55)	\$(1.15)
Diluted	\$(0.55)	\$(1.15)

The following average potential shares of common stock were excluded from the diluted EPS calculation because their effect would have been anti-dilutive:

(Shares in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Stock options, restricted stock awards and warrant	31.6	24.7

3. Credit Facility

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million asset-based senior credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and a \$500 million term loan (2014 Term Loan). As of the end of the first quarter of 2015, we had \$496 million outstanding on the 2014 Term Loan and no borrowings outstanding under the Revolving Facility. In addition, as of the end of the first quarter of 2015, based on our borrowing base, we had \$1,529 million available for borrowing, of which \$318 million was reserved for outstanding standby and import letters of credit, none of which have been drawn on, leaving \$1,211 million for future borrowings. The applicable rate for standby and import letters of credit was 2.50% and 1.25%, respectively, while the commitment fee was 0.375% for the unused portion of the Revolving Facility.

4. Fair Value Disclosures

Other Financial Instruments

Carrying values and fair values of financial instruments that are not carried at fair value in the unaudited Interim Consolidated Balance Sheets are as follows:

(\$ in millions)	May 2, 2015		May 3, 2014		January 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	\$5,343	\$5,028	\$4,857	\$4,363	\$5,350	\$4,834

The fair value of long-term debt was estimated by obtaining quotes from brokers or was based on current rates offered for similar debt. As of May 2, 2015, May 3, 2014 and January 31, 2015, the fair values of cash and cash equivalents, accounts payable and short-term borrowings approximated their carrying values due to the short-term nature of these instruments. In

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addition, the fair values of capital lease commitments and the note payable approximated their carrying values. These items have been excluded from the table above.

Concentrations of Credit Risk

We have no significant concentrations of credit risk.

5. Stockholders' Equity

The following table shows the change in the components of stockholders' equity for the three months ended May 2, 2015:

(in millions)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Reinvested Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
January 31, 2015	304.9	\$ 152	\$4,606	\$(1,779)	\$(1,065)	\$1,914
Net income/(loss)	—	—	—	(167)	—	(167)
Other comprehensive income/(loss)	—	—	—	—	17	17
Stock-based compensation	0.6	1	10	—	—	11
May 2, 2015	305.5	\$ 153	\$4,616	\$(1,946)	\$(1,048)	\$1,775

Comprehensive Income

The tax effects allocated to each component of other comprehensive income/(loss) are as follows:

(\$ in millions)	Three Months Ended May 2, 2015			May 3, 2014		
	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount
Retirement benefit plans						
Reclassification for amortization of net actuarial (gain)/loss	\$29	\$(12)	\$17	\$17	\$(6)	\$11
Reclassification for amortization of prior service (credit)/cost	—	—	—	(1)	—	(1)
Total	\$29	\$(12)	\$17	\$16	\$(6)	\$10

The following table shows the changes in accumulated other comprehensive income/(loss) balances for the three months ended May 2, 2015:

(\$ in millions)	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Foreign Currency Translation	Accumulated Other Comprehensive Income/(Loss)
January 31, 2015	\$(1,023)	\$(40)	\$(2)	\$(1,065)
Amounts reclassified from accumulated other comprehensive income	17	—	—	17
May 2, 2015	\$(1,006)	\$(40)	\$(2)	\$(1,048)

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Reclassifications out of accumulated other comprehensive income/(loss) are as follows:

(\$ in millions)	Amount Reclassified from Accumulated Other Comprehensive Income/(Loss) Three Months Ended		Line Item in the Unaudited Interim Consolidated Statements of Operations
	May 2, 2015	May 3, 2014	
Amortization of retirement benefit plans			
Actuarial loss/(gain) ⁽¹⁾	\$29	\$17	Pension
Prior service cost/(credit) ⁽¹⁾	2	1	Pension
Prior service cost/(credit) ⁽¹⁾	(2	) (2	) SG&A
Tax (expense)/benefit	(12	) (6	) Income tax expense/(benefit)
Total, net of tax	17	10	
Total reclassifications	\$17	\$10	

⁽¹⁾ These accumulated other comprehensive income/(loss) components are included in the computation of net periodic benefit expense/(income). See Note 7 for additional details.

6. Stock-Based Compensation

We grant stock-based compensation awards to employees and non-employee directors under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan (2014 Plan). As of May 2, 2015, a maximum of 11.0 million shares of stock were available for future grant under the 2014 Plan.

Stock-based compensation expense for the three months ended May 2, 2015 and May 3, 2014 was \$15 million and \$10 million, respectively. Through the first three months of 2015, the Company granted the following stock-based compensation awards:

Grant Date	Restricted Stock Units (RSU)		Stock Options		Weighted Average Grant Date Fair Value
	Time-based	Performance-based	Time-based	Weighted Average Exercise Price	
March 3, 2015	28,554	—	—	\$—	\$7.88
March 19, 2015	2,135,177	1,534,754	4,294,885	\$7.77	\$5.36
Total	2,163,731	1,534,754	4,294,885	\$7.77	\$5.36

Performance-based awards that ultimately vest are dependent on market performance targets measured by the achievement of internal profitability targets for 2015 through 2017 (performance condition).

In addition to the grants above, on March 19, 2015, we granted approximately 2.5 million phantom units as part of our management incentive compensation plan, which are similar to RSUs in that the number of units granted was based on the price of our stock, but the units will be settled in cash based on the value of our stock on the vesting date, up to a maximum of \$15.54 per phantom unit. The fair value of the awards is remeasured at each reporting period and was \$8.43 per share as of May 2, 2015. Compensation expense, which is variable, is recognized over the vesting period with a corresponding liability, which is recorded in Other liabilities in our unaudited Interim Consolidated Balance Sheets.

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7. Retirement Benefit Plans

The components of net periodic benefit expense/(income) for our non-contributory qualified defined benefit pension plan (Primary Pension Plan), non-contributory supplemental pension plans and contributory postretirement health and welfare plan were as follows:

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Primary Pension Plan		
Service cost	\$17	\$15
Interest cost	49	53
Expected return on plan assets	(89)	) (87
Amortization of actuarial loss/(gain)	26	13
Amortization of prior service cost/(credit)	2	1
Net periodic benefit expense/(income)	\$5	\$(5)
Supplemental Pension Plans		
Service cost	\$—	\$—
Interest cost	2	2
Amortization of actuarial loss/(gain)	3	4
Amortization of prior service cost/(credit)	—	—
Net periodic benefit expense/(income)	\$5	\$6
Primary and Supplemental Pension Plans Total		
Service cost	\$17	\$15
Interest cost	51	55
Expected return on plan assets	(89)	) (87
Amortization of actuarial loss/(gain)	29	17
Amortization of prior service cost/(credit)	2	1
Net periodic benefit expense/(income)	\$10	\$1
Postretirement Health and Welfare Plan		
Service cost	\$—	\$—
Interest cost	—	—
Amortization of actuarial loss/(gain)	—	—
Amortization of prior service cost/(credit)	(2)	) (2
Net periodic benefit expense/(income)	\$(2)	) \$(2)
Retirement Benefit Plans Total		
Service cost	\$17	\$15
Interest cost	51	55
Expected return on plan assets	(89)	) (87
Amortization of actuarial loss/(gain)	29	17
Amortization of prior service cost/(credit)	—	(1)
Net periodic benefit expense/(income)	\$8	\$(1)
Net periodic benefit expense/(income) for our noncontributory postretirement health and welfare plan was predominantly included in SG&A expense in the unaudited Interim Consolidated Statements of Operations.		

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Defined Contribution Plans

Our defined contribution plans include a qualified Savings, Profit-Sharing and Stock Ownership Plan (401(k) plan), which includes a non-contributory retirement account, and a non-qualified contributory unfunded mirror savings plan offered to certain members of management. Total expense for our defined contribution plans for each of the first quarters of 2015 and 2014 was \$13 million and \$13 million, respectively, and was predominantly included in SG&A expenses in the unaudited Interim Consolidated Statements of Operations.

8. Restructuring and Management Transition

The composition of restructuring and management transition charges was as follows:

(\$ in millions)	Three Months Ended		Cumulative Amount From Program Inception Through May 2, 2015
	May 2, 2015	May 3, 2014	
Home office and stores	\$14	\$12	\$261
Management transition	6	7	230
Other	2	3	151
Total	\$22	\$22	\$642

Home Office and Stores

During the three months ended May 2, 2015 and May 3, 2014, we recorded \$14 million and \$12 million, respectively, of charges for actions taken to reduce our home office and store expenses. In January 2015, we announced the closing of 40 department stores, and as a result, during the first quarter of 2015, we incurred charges of \$14 million related to employee termination benefits and lease termination costs associated with the closure of 35 of the 40 stores.

Last year we also closed stores as part of our turnaround efforts. During the first quarter of 2014, we incurred charges of \$12 million for employee termination benefits and lease termination costs associated with the closure of 31 of the 33 stores that closed during 2014.

Management Transition

During the three months ended May 2, 2015 and May 3, 2014, we implemented changes within our management leadership team that resulted in management transition costs of \$6 million and \$7 million, respectively, for both incoming and outgoing members of management.

Other

During the three months ended May 2, 2015 and May 3, 2014, we recorded \$2 million and \$3 million, respectively, of miscellaneous restructuring charges. The 2015 charges were related to costs associated with the closure of our Sumner, Washington store merchandise distribution center. The 2014 charges were primarily related to contract termination costs associated with our previous shops strategy.

Activity for the restructuring and management transition liability for the three months ended May 2, 2015 was as follows:

(\$ in millions)	Home Office and Stores	Management Transition	Other	Total
January 31, 2015	\$9	\$—	\$17	\$26
Charges	14	6	2	22
Cash payments	(6)	(4)	(3)	(13)
Non-cash	—	(2)	(1)	(3)
May 2, 2015	\$17	\$—	\$15	\$32

The non-cash amounts represent charges primarily for stock-based compensation expense in conjunction with accelerated vesting related to terminations and for the write-off of store merchandise distribution center fixtures.

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9. Real Estate and Other, Net

Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments and other non-operating charges and credits. In addition, during the first quarter of 2014, we entered into a joint venture in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture). The new joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities is recorded in Real estate and other, net. For the three months ended May 2, 2015 and May 3, 2014, Real estate and other, net was income of \$35 million and \$17 million, respectively. Real estate and other, net was comprised primarily of sales of non-operating and operating assets and our proportional share of net income from the Home Office Land Joint Venture as detailed below.

Non-Operating Assets

During the first quarter of 2015, we sold two properties used in our former auto center operations and two former outlet store locations for net proceeds of \$6 million, resulting in net gains totaling \$2 million.

During the first quarter of 2014, we sold four properties used in our former auto center operations and excess property adjacent to our home office facility not contributed to the Home Office Land Joint Venture for net proceeds of \$15 million, resulting in net gains totaling \$12 million.

Operating Assets

During the first quarter of 2015, we sold a former furniture store location and recognized a net gain on payments received from landlords to terminate two existing leases prior to the original expiration date for net proceeds of \$5 million, realizing a net gain of \$8 million.

During the first quarter of 2014, we sold a former department store location with a net book value of \$1 million for net proceeds of \$2 million, realizing a gain of \$1 million.

Other

During the first quarter of 2015, the Company recorded \$22 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$22 million.

10. Income Taxes

Income taxes for the three months ended May 2, 2015 was a benefit of \$6 million compared to an expense of \$8 million for the three months ended May 3, 2014. The effective tax rate for the three months ended May 2, 2015 was (3.5)% as compared to 2.3% for the three months ended May 3, 2014. Our effective tax rate for the three months ended May 2, 2015 was impacted by a net increase to the tax valuation allowance for deferred tax assets of \$44 million.

In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our assessment, we concluded that, beginning in the second quarter of 2013, our estimate of the realization of deferred tax assets would be based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring carryforwards. Accordingly, in the first quarter of 2015, the valuation allowance was increased to offset the net deferred tax assets created in the quarter relating primarily to the increase in net operating loss (NOL) carryforwards. A valuation allowance of \$828 million has been recorded against our deferred tax assets as of May 2, 2015, which resulted in an increase to the valuation allowance during the quarter ended May 2, 2015 of \$44 million.

The net tax benefit of \$6 million for the three months ended May 2, 2015 consisted of state and foreign tax expenses of \$4 million and \$2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$12 million benefit relating to other comprehensive income. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating

losses and accumulated other comprehensive income. Application of this guidance required the recognition of an income tax benefit of \$12 million in operating results, offset by a \$12 million charge to other comprehensive income for the quarter.

As of May 2, 2015, we have approximately \$2.7 billion of net operating losses available for U.S. federal income tax purposes, which expire in 2032 through 2034 and \$53 million of tax credit carryforwards that expire at various dates through 2034. For these NOL and tax credit carryforwards a net deferred tax asset of \$325 million has been recorded, net of a valuation allowance

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of \$622 million. A valuation allowance of \$206 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034.

11. Litigation, Other Contingencies and Guarantees

Litigation

Macy's Litigation

On August 16, 2012, Macy's, Inc. and Macy's Merchandising Group, Inc. (together the Plaintiffs) filed suit against J. C. Penney Corporation, Inc. in the Supreme Court of the State of New York, County of New York, alleging that the Company tortiously interfered with, and engaged in unfair competition relating to a 2006 agreement between Macy's and Martha Stewart Living Omnimedia, Inc. (MSLO) by entering into a partnership agreement with MSLO in December 2011. The Plaintiffs sought primarily to prevent the Company from implementing our partnership agreement with MSLO as it related to products in the bedding, bath, kitchen and cookware categories. The suit was consolidated with an already-existing breach of contract lawsuit by the Plaintiffs against MSLO, and a bench trial commenced on February 20, 2013. On October 21, 2013, the Company and MSLO entered into an amendment of the partnership agreement, providing in part that the Company will not sell MSLO-designed merchandise in the bedding, bath, kitchen and cookware categories. On January 2, 2014, MSLO and Macy's announced that they had settled the case as to each other, and MSLO was subsequently dismissed as a defendant. On June 16, 2014, the Court issued a ruling against JCPenney on the remaining claim of intentional interference, and held that Macy's is not entitled to punitive damages. The Court referred other issues related to damages to a Judicial Hearing Officer. On June 30, 2014, JCPenney appealed the Court's decision, and Macy's cross-appealed a portion of the decision. On February 26, 2015, the appellate court affirmed the trial court's rulings concerning the claim of intentional interference and lack of punitive damages, and reinstated Macy's claims for intentional interference and unfair competition that had been dismissed during trial. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Other Legal Proceedings

We are subject to various other legal and governmental proceedings involving routine litigation incidental to our business. Reserves have been established based on our best estimates of our potential liability in certain of these matters. These estimates were developed in consultation with in-house and outside counsel. While no assurance can be given as to the ultimate outcome of these matters, management currently believes that the final resolution of these actions, individually or in the aggregate, will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Contingencies

As of May 2, 2015, we estimated our total potential environmental liabilities to range from \$19 million to \$25 million and recorded our best estimate of \$22 million in Other accounts payable and accrued expenses and Other liabilities in the unaudited Interim Consolidated Balance Sheet as of that date. This estimate covered potential liabilities primarily related to underground storage tanks, remediation of environmental conditions involving our former drugstore locations and asbestos removal in connection with approved plans to renovate or dispose of our facilities. We continue to assess required remediation and the adequacy of environmental reserves as new information becomes available and known conditions are further delineated. If we were to incur losses at the upper end of the estimated range, we do not believe that such losses would have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Guarantees

In connection with the sale of the operations of our outlet stores, we assigned leases on certain outlet store locations to the purchaser. In the event that the purchaser fails to make the required lease payments, we continue for a period of time to be liable for lease payments to the landlords of several of the leased stores. The purchaser's obligations under the lease are guaranteed to us by certain principals and affiliates of the purchaser. However, the purchaser has elected to exit the outlet business and has successfully negotiated termination of all but two of the leases with the landlords. As of May 2, 2015, our maximum liability in connection with the assigned leases was \$3 million.

12. Effect of New Accounting Standards

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying value of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by ASU 2015-03. The amendments in this ASU are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted. The Company does not expect the impact of adopting this ASU to be material to the Company's financial statements and related disclosures.

13. Subsequent Event

Subsequent to the end of the first quarter of 2015, we entered into interest rate swap agreements with notional amounts totaling \$1,250 million to fix a portion of our variable LIBOR-based interest payments. The interest rate swap agreements, which were effective May 7, 2015, have a weighted-average fixed rate of 2.04%, mature on May 7, 2020 and have been designated as cash flow hedges.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

J. C. Penney Company, Inc. is a holding company whose principal operating subsidiary is J. C. Penney Corporation, Inc. (JCP). JCP was incorporated in Delaware in 1924, and J. C. Penney Company, Inc. was incorporated in Delaware in 2002, when the holding company structure was implemented. The holding company has no independent assets or operations and no direct subsidiaries other than JCP. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this quarterly report as "we," "us," "our," "ourselves" or the "Company," unless otherwise indicated.

The holding company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP's outstanding debt securities. The guarantee of certain of JCP's outstanding debt securities by the holding company is full and unconditional.

This discussion is intended to provide information that will assist the reader in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, how operating results affect the financial condition and results of operations of our Company as a whole, as well as how certain accounting principles affect the financial statements. It should be read in conjunction with our consolidated financial statements as of January 31, 2015, and for the year then ended, and related Notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), all contained in the Annual Report on Form 10-K for the fiscal year ended January 31, 2015 (2014 Form 10-K). Unless otherwise indicated, all references to earnings/(loss) per share (EPS) are on a diluted basis and all references to years relate to fiscal years rather than to calendar years.

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First Quarter Summary and Key Developments

Sales were \$2,857 million with a comparable store sales increase of 3.4%.

Gross margin as a percentage of sales increased to 36.4% compared to 33.1% in the same period last year and was positively impacted by significant improvement in our sales mix and margin on clearance sales and increased sales of higher margin private brand merchandise compared to the prior year quarter.

Selling, general and administrative (SG&A) expenses decreased \$44 million, or 4.4%, for the first quarter of 2015 as compared to the corresponding quarter in 2014. These savings were primarily driven by lower store controllable costs, advertising and improved credit income.

Earnings before interest expense, income tax (benefit)/expense and depreciation and amortization (EBITDA) was \$79 million, a \$168 million improvement from the same period last year.

Our net loss was \$167 million, or \$0.55 per share, compared to a net loss of \$352 million, or \$1.15 per share, for the corresponding prior year quarter. Results for this quarter included the following amounts that are not directly related to our ongoing core business operations:

\$22 million, or \$0.07 per share, of restructuring and management transition charges;
\$5 million, or \$0.02 per share, of expense from our qualified defined benefit pension plan (Primary Pension Plan);
\$2 million, or \$0.01 per share, for the net gain on the sale of non-operating assets;
\$22 million, or \$0.07 per share, for our proportional share of net income from our joint venture formed to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture); and
\$11 million, or \$0.04 per share, of tax benefit related to the qualified defined benefit pension plan (Primary Pension Plan) that resulted from our other comprehensive income allocation between our operating loss and the amortization of net actuarial losses and prior service credits from Accumulated other comprehensive income.

We opened 23 new Sephora inside JCPenney locations and expanded 6 existing locations, bringing the total to 515.

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Results of Operations

(\$ in millions, except EPS)	Three Months Ended			
	May 2, 2015		May 3, 2014	
Total net sales	\$2,857		\$2,801	
Percent increase/(decrease) from prior year	2.0	%	6.3	%
Comparable store sales increase/(decrease) ⁽¹⁾	3.4	%	7.4	%
Gross margin	1,041		926	
Operating expenses/(income):				
Selling, general and administrative	965		1,009	
Primary pension plan	5		(5)
Supplemental pension plans	5		6	
Total pension	10		1	
Depreciation and amortization	154		158	
Real estate and other, net	(35	)	(17)
Restructuring and management transition	22		22	
Total operating expenses	1,116		1,173	
Operating income/(loss)	(75	)	(247)
Net interest expense	98		97	
Income/(loss) before income taxes	(173	)	(344)
Income tax expense/(benefit)	(6	)	8	
Net income/(loss)	\$(167	)	\$(352)
EBITDA (non-GAAP) ⁽²⁾	\$79		\$(89)
Adjusted EBITDA (non-GAAP) ⁽²⁾	\$82		\$(84)
Adjusted net income/(loss) (non-GAAP) ⁽²⁾	\$(175	)	\$(353)
Diluted EPS	\$(0.55	)	\$(1.15)
Adjusted diluted EPS (non-GAAP) ⁽²⁾	\$(0.57	)	\$(1.16)
Ratios as a percent of sales:				
Gross margin	36.4	%	33.1	%
SG&A	33.8	%	36.0	%
Total operating expenses	39.1	%	41.9	%
Operating income/(loss)	(2.6	)%	(8.8)%

Comparable store sales include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales

(1) through jcp.com. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation.

(2) See "Non-GAAP Financial Measures" below for a discussion of this non-GAAP measure and reconciliation to its most directly comparable GAAP financial measure and further information on its uses and limitations.

Non-GAAP Financial Measures

We report our financial information in accordance with generally accepted accounting principles in the United States (GAAP). However, we present certain financial measures and ratios identified as non-GAAP under the rules of the Securities and Exchange Commission (SEC) to assess our results. We believe the presentation of these non-GAAP financial measures and ratios is useful in order to better understand our financial performance as well as to facilitate the comparison of our results to the results of our peer companies. In addition, management uses these non-GAAP financial measures and ratios to assess the results of our operations. It is important to view non-GAAP financial measures in addition to, rather than as a substitute for, those measures and ratios prepared in accordance with GAAP. We have provided reconciliations of the most directly comparable GAAP measures to our non-GAAP financial measures presented.

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The following non-GAAP financial measures are adjusted to exclude restructuring and management transition charges, the impact of our Primary Pension Plan, the net gain on the sale of non-operating assets, the proportional share of net income from our Home Office Land Joint Venture and the tax impact for the allocation of tax expense to other comprehensive income items related to our Primary Pension Plan. Unlike other operating expenses, restructuring and management transition charges, the net gain on the sale of non-operating assets, the proportional share of net income from the Home Office Land Joint Venture and the tax impact for the allocation of tax expense to other comprehensive income items related to our Primary Pension Plan are not directly related to our ongoing core business operations. Primary Pension Plan expense/(income) is determined using numerous complex assumptions about changes in pension assets and liabilities that are subject to factors beyond our control, such as market volatility. Accordingly, we eliminate our Primary Pension Plan expense/(income) in its entirety as we view all components of net periodic benefit expense/(income) as a single, net amount, consistent with its presentation in our Consolidated Financial Statements. We believe it is useful for investors to understand the impact of restructuring and management transition charges, Primary Pension Plan expense/(income), the net gain on the sale of non-operating assets, the proportional share of net income from the Home Office Land Joint Venture and the tax impact for the allocation of tax expense to other comprehensive income items related to our Primary Pension Plan on our financial results and therefore are presenting the following non-GAAP financial measures: (1) adjusted EBITDA; (2) adjusted net income/(loss); and (3) adjusted earnings/(loss) per share-diluted.

In addition, we believe that EBITDA is a useful measure in assessing our operating performance and are therefore presenting this non-GAAP financial measure in addition to the non-GAAP financial measures listed above.

EBITDA and Adjusted EBITDA. The following table reconciles net income/(loss), the most directly comparable GAAP measure, to EBITDA and adjusted EBITDA, which are non-GAAP financial measures:

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Net income/(loss)	\$(167	) \$(352
Add: Net interest expense	98	97
Add: Income tax expense/(benefit)	(6	) 8
Add: Depreciation and amortization	154	158
EBITDA (non-GAAP)	79	(89
Add: Restructuring and management transition charges	22	22
Add: Primary pension plan expense/(income)	5	(5
Less: Net gain on the sale of non-operating assets	(2	) (12
Less: Proportional share of net income from joint venture	(22) —
Adjusted EBITDA (non-GAAP)	\$82	\$(84

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Adjusted Net Income/(Loss) and Adjusted Diluted EPS. The following table reconciles net income/(loss) and diluted EPS, the most directly comparable GAAP financial measures, to adjusted net income/(loss) and adjusted diluted EPS, which are non-GAAP financial measures:

(\$ in millions, except per share data)	Three Months Ended	
	May 2, 2015	May 3, 2014
Net income/(loss)	\$ (167)	\$ (352)
Diluted EPS	\$ (0.55)	\$ (1.15)
Add: Restructuring and management transition charges, net of tax of \$- and \$-(⁽¹⁾)	22	22
Add: Primary pension plan expense/(income), net of tax of \$- and \$-(⁽²⁾)	5	(5)
Less: Net gain on sale of non-operating assets, net of tax of \$- and \$-(⁽³⁾)	(2)	(12)
Less: Proportional share of net income from joint venture, net of tax of \$- and \$-(⁽¹⁾)	(22)	—
Less: Tax benefit resulting from other comprehensive income allocation(⁽⁴⁾)	(11)	(6)
Adjusted net income/(loss) (non-GAAP)	\$ (175)	\$ (353)
Adjusted diluted EPS (non-GAAP)	\$ (0.57)	\$ (1.16)

(1) Reflects no tax effect due to the impact of the Company's tax valuation allowance.

(2) The tax effect is included in the line item Tax benefit resulting from other comprehensive income allocation. See footnote 4 below.

(3) Tax effect was calculated using the effective tax rate for the transactions.

(4) Represents the tax benefit that resulted from our other comprehensive income allocation between our operating loss and the amortization of net actuarial losses and prior service credits related to the Primary Pension Plan from Accumulated other comprehensive income.

Total Net Sales

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Total net sales	\$2,857	\$2,801
Sales percent increase/(decrease):		
Total net sales	2.0	% 6.3 %
Comparable store sales	3.4	% 7.4 %

For the first three months of 2015, total net sales increased \$56 million from the same period last year. The following table provides the components of the net sales increase/(decrease):

(\$ in millions)	Three Months Ended	
	May 2, 2015	
Comparable store sales increase/(decrease)	\$92	
New and closed stores, net	(46)	
Other revenues and sales adjustments	10	
Total net sales increase/(decrease)	\$56	

As our omnichannel strategy continues to mature, it is increasingly difficult to distinguish between a store sale and an Internet sale. Because we no longer have a clear distinction between store sales and Internet sales, we do not separately report Internet sales. Below is a list of some of our omnichannel activities:

• Stores increase Internet sales by providing customers opportunities to view, touch and/or try on physical merchandise before ordering online.

• Our website increases store sales as in-store customers have often pre-shopped online before shopping in the store, including verification of which stores have online merchandise in stock.

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Most Internet purchases are easily returned in our stores.

JCP Rewards can be earned and redeemed online or in stores regardless of where they were earned.

In-store customers can order from our website with the assistance of associates in our stores ("Find it Keep it") or they can shop our website from the JCPenney App while inside the store.

Customers who utilize our mobile application may receive mobile coupons to use when they check out both online or in our stores.

Internet orders may be shipped from a dedicated jcpenney.com fulfillment center, a store, a store merchandise distribution center, a regional warehouse, direct shipment from vendors or any combination of the above.

Certain categories of store inventory can be accessed and purchased by jcpenney.com customers and shipped directly to the customer's home from the store.

Internet orders can be shipped to stores for customer pick up.

Order online and "pick-up in store same day" is planned to roll out to our stores beginning in the second half of 2015.

Store Count

The following table compares the number of stores and gross selling space for the three months ended May 2, 2015 and May 3, 2014:

	Three Months Ended	
	May 2, 2015	May 3, 2014
JCPenney department stores		
Beginning of period	1,062	1,094
Closed stores	(35	) (31
End of period ⁽¹⁾	1,027	1,063
The Foundry Big and Tall Supply Co. ⁽²⁾	—	9

⁽¹⁾ Gross selling space, including selling space allocated to services and licensed departments, was 105 million square feet as of May 2, 2015 and 108 million square feet as of May 3, 2014.

⁽²⁾ All stores closed during 2014. Gross selling space was 46 thousand square feet as of May 3, 2014.

For the three months ended May 2, 2015, comparable store sales increased 3.4%, while total net sales increased 2.0% to \$2,857 million compared with \$2,801 million for the three months ended May 3, 2014. The increase resulted from customers responding favorably to our offerings, including a positive response to strategic investments we made to improve our assortment in several categories, including handbags.

For the first quarter of 2015, our conversion rate and our average unit retail increased, while the average transaction value and units per transaction decreased as compared to the corresponding prior year period. Women's apparel, Men's and Home merchandise divisions experienced the highest sales gains during the first quarter of 2015. Sephora inside JCPenney also continued its strong performance during the period. Geographically, all regions of the country saw sales gains during the first quarter with the western and central regions of the country delivering the best performance during the quarter.

During the first quarter of 2015, private brand merchandise comprised 42.8% of total merchandise sales as compared to 41.0% in the corresponding prior year quarter. For the first quarters of 2015 and 2014, exclusive brand merchandise comprised 6.9% and 10.5%, respectively, of total merchandise sales.

Gross Margin

Gross margin for the three months ended May 2, 2015 was \$1,041 million, an increase of \$115 million compared to \$926 million for the three months ended May 3, 2014. Gross margin as a percentage of sales for the three months ended May 2, 2015 was 36.4% compared to 33.1% for the three months ended May 3, 2014. The 330 basis point increase resulted primarily from significant improvement in our mix and margin on clearance sales and increased

private brands penetration and margins. These benefits were offset by port issues on the west coast which impacted the timeliness and the cost of the delivery of merchandise to our stores.

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SG&A Expenses

Through the first three months of 2015, SG&A expenses were \$44 million lower than the corresponding period of 2014. Through the first three months of 2015, as a percent of sales, SG&A expenses decreased to 33.8% compared to 36.0% in the corresponding period of 2014, reflecting how we effectively managed SG&A expenses throughout the first three months of 2015. The net decrease in SG&A expenses for the first three months of 2015 as compared to the corresponding prior year period was driven primarily by reductions in store controllable expenses and advertising and higher credit card income.

Our private label credit card and co-branded MasterCard® programs are owned and serviced by Synchrony Financial (Synchrony). Under our agreement with Synchrony, we receive cash payments from Synchrony based upon the performance of the credit card portfolio. We participate in the programs by providing marketing promotions designed to increase the use of each card, including enhanced marketing offers for cardholders. Additionally, we accept payments in our stores from cardholders who prefer to pay in person when they are shopping in our locations. The income we earn under our agreement with Synchrony is included as an offset to Selling, general and administrative expenses. Through the first three months of 2015 and 2014, we recognized income of \$56 million and \$44 million, respectively, pursuant to our agreement with Synchrony.

Pension Expense

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Primary Pension Plan	\$5	\$(5)
Supplemental pension plans	5	6
Total pension expense	\$10	\$1

Total pension expense, which consists of expense/(income) from our Primary Pension Plan and our supplemental pension plans, is based on our 2014 year-end measurement of pension plan assets and benefit obligations. For the first three months of 2015, we had expense of \$5 million compared to income of \$5 million in the prior year corresponding period. The change to expense for our Primary Pension Plan was primarily driven by a 102 basis point decline in our discount rate; the adoption of new mortality tables for the majority of the plan participants which reflect longer life expectations and anticipated rates of improvement in life expectancy compared to previous mortality assumptions; and lowering the expected return on plan assets from 7.0% to 6.75%. These negative impacts were partially offset by strong asset performance in 2014. For the first three months of 2015, our supplemental pension plans expense decreased \$1 million to \$5 million.

Depreciation and Amortization Expense

For the first three months of 2015, depreciation and amortization expense decreased \$4 million to \$154 million from \$158 million last year. The decrease for the first three months of 2015 is primarily a result of closing several store locations since the beginning of 2014.

Restructuring and Management Transition

The composition of restructuring and management transition charges was as follows:

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Home office and stores	\$14	\$12
Management transition	6	7
Other	2	3
Total	\$22	\$22

Home Office and Stores

During the three months ended May 2, 2015 and May 3, 2014, we recorded \$14 million and \$12 million, respectively, of charges for actions taken to reduce our home office and store expenses. In January 2015, we announced the closing of 40 department stores, and as a result, during the first quarter of 2015, we incurred charges of \$14 million related to employee termination benefits costs and lease termination costs associated with the closure of 35 of the 40 stores.

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Last year we also closed stores as part of our turnaround efforts. During the first quarter of 2014, we incurred charges of \$12 million for employee termination benefits and lease termination costs associated with the closure of 31 of the 33 stores that closed during 2014.

Management Transition

During the three months ended May 2, 2015 and May 3, 2014, we implemented changes within our management leadership team that resulted in management transition costs of \$6 million and \$7 million, respectively, for both incoming and outgoing members of management.

Other

During the three months ended May 2, 2015 and May 3, 2014, we recorded \$2 million and \$3 million, respectively, of miscellaneous restructuring charges. The 2015 charges were related to costs associated with the closure of our Sumner, Washington store merchandise distribution center. The 2014 charges were primarily related to contract termination costs associated with our previous shops strategy.

Real Estate and Other, Net

Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments and other non-operating charges and credits. In addition, during the first quarter of 2014, we entered into the Home Office Land Joint Venture in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas. The new joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities is recorded in Real estate and other, net. For the three months ended May 2, 2015 and May 3, 2014, Real estate and other, net was income of \$35 million and \$17 million, respectively.

Real estate and other, net was comprised primarily of sales of non-operating and operating assets and our proportional share of net income from the Home Office Land Joint Venture as detailed below.

Non-Operating Assets

During the first quarter of 2015, we sold 2 properties used in our former auto center operations and 2 former outlet store locations for net proceeds of \$6 million, resulting in net gains totaling \$2 million.

During the first quarter of 2014, we sold four properties used in our former auto center operations and excess property adjacent to our home office facility not contributed to the Home Office Land Joint Venture for net proceeds of \$15 million, resulting in net gains totaling \$12 million.

Operating Assets

During the first quarter of 2015, we sold a former furniture store location and recognized a net gain on payments received from landlords to terminate two existing leases prior to the original expiration date for net proceeds of \$5 million, realizing a net gain of \$8 million.

During the first quarter of 2014, we sold a former department store location with a net book value of \$1 million for net proceeds of \$2 million, realizing a gain of \$1 million.

Other

During the first quarter of 2015, the Company recorded \$22 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$22 million.

Operating Income/(Loss)

For the three months ended May 2, 2015, we reported an operating loss of \$75 million compared to an operating loss of \$247 million in the prior year corresponding period, reflecting better operating performance achieved by the Company.

Net Interest Expense

For the three months ended May 2, 2015, net interest expense was \$98 million compared to \$97 million in the prior year corresponding period, reflecting similar debt levels between the two periods.

Income Taxes

Income taxes for the three months ended May 2, 2015 was a benefit of \$6 million compared to an expense of \$8 million for the three months ended May 3, 2014. Income taxes for the three months ended May 2, 2015 were impacted by a net increase to the tax valuation allowance for deferred tax assets of \$44 million.

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In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. Beginning in the second quarter of 2013 and for each quarter thereafter, our estimate of the realization of deferred tax assets was based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring net operating loss (NOL) and tax credit carryforwards. Accordingly, in the first quarter of 2015, the valuation allowance was increased to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards. As of May 2, 2015, a valuation allowance of \$828 million has been recorded against our deferred tax assets.

The net tax benefit of \$6 million for the three months ended May 2, 2015 consisted of state and foreign tax expenses of \$4 million and \$2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$12 million benefit relating to other comprehensive income. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. Application of this guidance required the recognition of an income tax benefit of \$12 million in operating results, offset by a \$12 million charge to other comprehensive income for the quarter.

EBITDA and Adjusted EBITDA (non-GAAP)

For the three months ended May 2, 2015, EBITDA was a positive \$79 million, an improvement of \$168 million compared to a negative EBITDA of \$89 million in the prior year corresponding period. Excluding restructuring and management transition charges, the impact of our Primary Pension Plan expense/(income), the net gain on the sale of non-operating assets and the proportional share of net income from the Home Office Land Joint Venture, adjusted EBITDA improved \$166 million to a positive adjusted EBITDA of \$82 million for the three months ended May 2, 2015 compared to a negative adjusted EBITDA of \$84 million for the prior year corresponding period.

Overall, EBITDA and adjusted EBITDA improved significantly for the three months ended May 2, 2015 as compared to the corresponding prior year periods as we were able to improve sales, achieve higher margins and reduce our operating costs.

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Liquidity and Capital Resources

Overview

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our revolving credit facility. Our cash flows may be impacted by many factors including the economic environment, consumer confidence, competitive conditions in the retail industry and the success of our strategies. We ended the first quarter of 2015 with \$1,044 million of cash and cash equivalents. As of the end of the first quarter of 2015, based on our borrowing base and amounts reserved for outstanding standby and import letters of credit, we had \$1,211 million available for future borrowings, providing a total available liquidity of \$2,255 million. Subsequent to the end of the first quarter of 2015, we entered into interest rate swap agreements with notional amounts totaling \$1,250 million to fix a portion of our variable LIBOR-based interest payments. The interest rate swap agreements, which were effective May 7, 2015, have a weighted-average fixed rate of 2.04%, mature on May 7, 2020 and have been designated as cash flow hedges.

The following table provides a summary of our key components and ratios of financial condition and liquidity:

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Cash and cash equivalents	\$1,044	\$1,170
Merchandise inventory	2,811	2,835
Property and equipment, net	5,049	5,510
 Total debt ⁽¹⁾	 5,405	 5,594
Stockholders' equity	1,775	2,753
Total capital	7,180	8,347
Maximum capacity under our revolving facility	1,850	1,850
Short-term borrowings under our revolving facility	—	650
Cash flow from operating activities	(226)	(271)
Free cash flow (non-GAAP) ⁽²⁾	(267)	(349)
Capital expenditures ⁽³⁾	46	80
Ratios:		
Total debt-to-total capital ⁽⁴⁾	75	% 67
Cash-to-total debt ⁽⁵⁾	19	% 21

(1) Total debt includes long-term debt, including current maturities, capital leases, note payable and any current borrowings under our revolving credit facility.

(2) See "Free Cash Flow" below for a reconciliation of this non-GAAP financial measure to its most directly comparable GAAP financial measure and further information on its uses and limitations.

(3) As of the end of the first quarters of 2015 and 2014, we had accrued capital expenditures of \$22 million and \$26 million, respectively.

(4) Total debt divided by total capitalization.

(5) Cash and cash equivalents divided by total debt.

Free Cash Flow (Non-GAAP)

Free cash flow is a key financial measure of our ability to generate additional cash from operating our business and in evaluating our financial performance. We define free cash flow as cash flow from operating activities, less capital expenditures plus the proceeds from the sale of operating assets. Free cash flow is a relevant indicator of our ability to repay maturing debt, revise our dividend policy or fund other uses of capital that we believe will enhance stockholder value. Free cash flow is considered a non-GAAP financial measure under the rules of the SEC. Free cash flow is limited and does not represent remaining cash flow available for discretionary expenditures due to the fact that the measure does not deduct payments required for debt maturities, pay-down of pension debt, and other obligations or

payments made for business acquisitions. Therefore, it is important to view free cash flow in addition to, rather than as a substitute for, our entire statement of cash flows and those measures prepared in accordance with GAAP.

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The following table reconciles net cash provided by/(used in) operating activities, the most directly comparable GAAP financial measure, to free cash flow, a non-GAAP financial measure:

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
Net cash provided by/(used in) operating activities (GAAP)	\$(226	) \$(271
Add:		
Proceeds from sale of operating assets	5	2
Less:		
Capital expenditures ⁽¹⁾	(46	) (80
Free cash flow (non-GAAP)	\$(267	) \$(349

(1) As of the end of the first quarters of 2015 and 2014, we had accrued capital expenditures of \$22 million and \$26 million, respectively.

Free cash flow for the three months ended May 2, 2015 improved \$82 million to an outflow of \$267 million compared to an outflow of \$349 million in the same period last year. This improvement was driven primarily by the increase in sales and operating performance of the Company. In addition, free cash flow was positively impacted by a decrease in capital expenditures and an increase in proceeds from the sale of operating assets during the first three months of 2015 when compared to the corresponding prior year period.

Operating Activities

While a significant portion of our sales, profit and operating cash flows have historically been realized in the fourth quarter, our quarterly results of operations may fluctuate significantly as a result of many factors, including seasonal fluctuations in customer demand, product offerings, inventory levels and promotional activity.

Cash flow from operating activities for the three months ended May 2, 2015 improved \$45 million to an outflow of \$226 million compared to an outflow of \$271 million for the same period in 2014. Our net loss of \$167 million for the three months ended May 2, 2015 includes significant income and expense items that do not impact operating cash flow including depreciation and amortization, the gain on the sale of assets and deferred taxes. The overall decrease in cash used in operations was driven primarily by the increase in sales and operating performance of the Company, including higher margins and effective expense management. Cash flows from operating activities also included construction allowances from landlords of \$3 million, which funded a portion of our capital expenditures in investing activities.

Merchandise inventory decreased \$24 million to \$2,811 million, or 0.8%, as of the end of the first quarter of 2015 compared to \$2,835 million as of the end of the first quarter last year and increased \$159 million from year-end.

Merchandise accounts payable increased \$222 million as of the end of the first quarter of 2015 compared to the corresponding prior year period and increased \$66 million from year-end.

Investing Activities

Investing activities through the first three months of 2015 was a cash outflow of \$35 million compared to an outflow of \$63 million for the same three month period of 2014. The decrease in the cash outflow from investing activities was primarily a result of decreased capital expenditures partially offset by proceeds from the sale of operating and non-operating assets.

Cash capital expenditures were \$46 million for the three months ended May 2, 2015 compared to \$80 million for the three months ended May 3, 2014. In addition, as of the end of the first quarter of 2015 and 2014, we had \$22 million and \$26 million, respectively, of accrued capital expenditures. Through the first three months of 2015, capital expenditures related primarily to the opening of 23 Sephora inside JCPenney stores, investments in information technology in both our home office and stores and investments in our store environment. We received construction allowances from landlords of \$3 million in the first quarter of 2015, which are classified as operating activities, to fund a portion of the capital expenditures related to store leasehold improvements. These funds have been recorded as deferred rent credits in the Consolidated Balance Sheets and are amortized as an offset to rent expense.

For the three months ended May 3, 2014, capital expenditures related primarily to the opening of 30 Sephora inside JCPenney stores.

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Full year 2015 capital expenditures are expected to be approximately \$250 to \$300 million. Capital expenditures for the remainder of 2015 include accrued expenditures of \$22 million at the end of the first quarter.

Financing Activities

Financing activities for the three months ended May 2, 2015 resulted in an outflow of \$13 million compared to an outflow of \$11 million for the same period last year.

During the first three months of 2015, we repaid \$5 million on our capital leases, \$5 million on our \$2.25 billion five-year senior secured term loan that was entered in in May 2013 (2013 Term Loan) and \$1 million on our \$500 million term loan entered into in June 2014 (2014 Term Loan).

Cash Flow Outlook

For the remainder of 2015, we believe that our existing liquidity will be adequate to fund our capital expenditures and working capital needs; however, in accordance with our long-term financing strategy, we may access the capital markets opportunistically. We believe that our current financial position will provide us the financial flexibility to support our growth initiatives.

2014 Credit Facility

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million asset-based senior credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and the \$500 million 2014 Term Loan. As of the end of the first quarter of 2015, we had \$496 million outstanding on the 2014 Term Loan and no borrowings outstanding under the Revolving Facility. In addition, as of the end of the first quarter of 2015, based on our borrowing base, we had \$1,529 million available for borrowing, of which \$318 million was reserved for outstanding standby and import letters of credit, none of which have been drawn on, leaving \$1,211 million for future borrowings. The applicable rate for standby and import letters of credit was 2.50% and 1.25%, respectively, while the commitment fee was 0.375% for the unused portion of the Revolving Facility.

Credit Ratings

Our credit ratings and outlook as of June 1, 2015 were as follows:

	Corporate	Outlook
Fitch Ratings	CCC	Positive
Moody's Investors Service, Inc.	Caa1	Stable
Standard & Poor's Ratings Services	CCC+	Positive

Credit rating agencies periodically review our capital structure and the quality and stability of our earnings. Rating agencies consider, among other things, changes in operating performance, comparable store sales, the economic environment, conditions in the retail industry, financial leverage and changes in our business strategy in their rating decisions. Downgrades to our long-term credit ratings could result in reduced access to the credit and capital markets and higher interest costs on future financings. On April 22, 2015, Standard & Poor's Rating Services raised our outlook to positive from stable.

Contractual Obligations and Commitments

Aggregate information about our obligations and commitments to make future payments under contractual or contingent arrangements was disclosed in the 2014 Form 10-K. Our unrecorded contractual obligations related to merchandise have increased approximately 8% since year end primarily due to the seasonality of our business and updates to our supplier base in the ordinary course of business.

Inflation

Our business is affected by general economic conditions, including changes in prices for labor and commodities such as

petroleum, energy and cotton. In the fall of 2014, the overall cost of goods benefited modestly from the reduction to the price of cotton, improved freight rates due to increased vessel capacity and lower fuel cost offset slightly by minimum wage increases in Asian countries. For spring 2015 goods, we anticipate that we will continue to benefit

from these lower costs offset by freight premiums to ship goods to East and Gulf Coast ports and increased air shipments due to disruptions in the operations of West Coast ports.

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Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations is based upon our unaudited Interim Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and use judgments that affect reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on other assumptions that are believed to be reasonable under the circumstances. On an ongoing basis, we evaluate estimates used, including those related to inventory valuation under the retail method, valuation of long-lived assets, estimation of reserves and valuation allowances specifically related to closed stores, insurance, income taxes, litigation and environmental contingencies and pension accounting. While actual results could differ from these estimates, we do not expect the differences, if any, to have a material effect on the unaudited Interim Consolidated Financial Statements. There were no changes to our critical accounting policies during the three months ended May 2, 2015. For a further discussion of the judgments we make in applying our accounting policies, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our 2014 Form 10-K.

Recently Issued Accounting Pronouncements

Recently issued accounting pronouncements are discussed in Note 12 to the unaudited Interim Consolidated Financial Statements.

Seasonality

While a significant portion of our sales, profit and operating cash flows have historically been realized in the fiscal fourth quarter, our quarterly results of operations may fluctuate significantly as a result of many factors, including seasonal fluctuations in customer demand, product offerings, inventory levels and our promotional activity. The results of operations and cash flows for the three months ended May 2, 2015 are not necessarily indicative of the results for future quarters or the entire year.

Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements made within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current view of future events and financial performance. Words such as "expect" and similar expressions identify forward-looking statements, which include, but are not limited to, statements regarding sales, gross margin, selling, general and administrative expenses, cash flows and liquidity. Forward-looking statements are based only on the Company's current assumptions and views of future events and financial performance. They are subject to known and unknown risks and uncertainties, many of which are outside of the Company's control, that may cause the Company's actual results to be materially different from planned or expected results. Those risks and uncertainties include, but are not limited to, general economic conditions, including inflation, recession, unemployment levels, consumer confidence and spending patterns, credit availability and debt levels, changes in store traffic trends, the cost of goods, more stringent or costly payment terms and/or the decision by a significant number of vendors not to sell us merchandise on a timely basis or at all, trade restrictions, the ability to monetize non-core assets on acceptable terms, the ability to implement our strategic plan, customer acceptance of our strategies, our ability to attract, motivate and retain key executives and other associates, the impact of cost reduction initiatives, our ability to generate or maintain liquidity, implementation of new systems and platforms, changes in tariff, freight and shipping rates, changes in the cost of fuel and other energy and transportation costs, disruptions and congestion at ports through which we import goods, increases in wage and benefit costs, competition and retail industry consolidations, interest rate fluctuations, dollar and other currency valuations, the impact of weather conditions, risks associated with war, an act of terrorism or pandemic, the ability of the federal government to fund and conduct its operations, a systems failure and/or security breach that results in the theft, transfer or unauthorized disclosure of customer, employee or Company information, legal and regulatory proceedings and the Company's ability to access the debt or equity markets on favorable terms or at all. There can be no assurances that the Company will achieve expected results, and actual results may be materially less than expectations. While we believe that our assumptions are reasonable, we caution that it is impossible to predict the degree to which any such factors could cause actual results to differ materially from predicted results.

For additional discussion on risks and uncertainties, see Part II, Item 1A, Risk Factors, below. We intend the forward-looking statements in this Quarterly Report on Form 10-Q to speak only as of the date of this report and do not undertake to update or revise these projections as more information becomes available.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks in the normal course of business due to changes in interest rates. Our market risks related to interest rates at May 2, 2015 are similar to those disclosed in the 2014 Form 10-K. Subsequent to the end of the first quarter of 2015, we entered into interest rate swap agreements with notional amounts totaling \$1,250 million to fix a portion of our variable LIBOR-based interest payments. The interest rate swap agreements, which were effective May 7, 2015, have a weighted-average fixed rate of 2.04%, mature on May 7, 2020 and have been designated as cash flow hedges.

Item 4. Controls and Procedures

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (the Exchange Act)) as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer concluded our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. There were no changes in our internal control over financial reporting during the first quarter ended May 2, 2015, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

Macy's Litigation

On August 16, 2012, Macy's, Inc. and Macy's Merchandising Group, Inc. (together the Plaintiffs) filed suit against J. C. Penney Corporation, Inc. in the Supreme Court of the State of New York, County of New York, alleging that the Company tortiously interfered with, and engaged in unfair competition relating to a 2006 agreement between Macy's and Martha Stewart Living Omnimedia, Inc. (MSLO) by entering into a partnership agreement with MSLO in December 2011. The Plaintiffs sought primarily to prevent the Company from implementing our partnership agreement with MSLO as it related to products in the bedding, bath, kitchen and cookware categories. The suit was consolidated with an already-existing breach of contract lawsuit by the Plaintiffs against MSLO, and a bench trial commenced on February 20, 2013. On October 21, 2013, the Company and MSLO entered into an amendment of the partnership agreement, providing in part that the Company will not sell MSLO-designed merchandise in the bedding, bath, kitchen and cookware categories. On January 2, 2014, MSLO and Macy's announced that they had settled the case as to each other, and MSLO was subsequently dismissed as a defendant. On June 16, 2014, the Court issued a ruling against JCPenney on the remaining claim of intentional interference, and held that Macy's is not entitled to punitive damages. The Court referred other issues related to damages to a Judicial Hearing Officer. On June 30, 2014, JCPenney appealed the Court's decision, and Macy's cross-appealed a portion of the decision. On February 26, 2015, the appellate court affirmed the trial court's rulings concerning the claim of intentional interference and lack of punitive damages, and reinstated Macy's claims for intentional interference and unfair competition that had been dismissed during trial. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Ozenne Derivative Lawsuit

On January 19, 2012, a purported shareholder of the Company, Everett Ozenne, filed a shareholder derivative lawsuit in the 193rd District Court of Dallas County, Texas, against certain of the Company's Board of Directors and executives. The Company is a nominal defendant in the suit. The lawsuit alleged breaches of fiduciary duties, corporate waste and unjust enrichment involving decisions regarding executive compensation, specifically that compensation paid to certain executive officers from 2008 to 2011 was too high in light of the Company's financial performance. The suit sought damages including unspecified compensatory damages, disgorgement by the former officers of allegedly excessive compensation, and equitable relief to reform the Company's compensation practices. The Company and the named individuals filed an Answer and Special Exceptions to the lawsuit, arguing primarily that the plaintiff could not proceed with his suit because he failed to make demand on the Company's Board of Directors, and that because demand on the Board would not be futile, demand was not excused. The trial court heard arguments on the Special Exceptions on June 25, 2012 and denied them. The Company and named individuals filed a mandamus proceeding in the Fifth District Court of Appeals challenging the trial court's decision. The parties then settled the litigation and the appellate court stayed the appeal so that the trial court could review the proposed settlement. The trial court approved the settlement at a hearing on October 28, 2013 and, despite objection, awarded the plaintiff \$3.1 million in attorneys' fees and costs. Following the Company's appeal of the award of attorneys' fees and costs, the Fifth District Court of Appeals affirmed the award on December 19, 2014. The Company has filed a Petition for Review with the Texas Supreme Court. We believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Class Action Securities Litigation

The Company, Myron E. Ullman, III and Kenneth H. Hannah are parties to the Marcus consolidated purported class action lawsuit in the U.S. District Court, Eastern District of Texas, Tyler Division. The Marcus consolidated complaint is purportedly brought on behalf of persons who acquired our common stock during the period from August 20, 2013 through September 26, 2013, and alleges claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiff claims that the defendants made false and

misleading statements and/or omissions regarding the Company's financial condition and business prospects that caused our common stock to trade at artificially inflated prices. The consolidated complaint seeks class certification, unspecified compensatory damages, including interest, reasonable costs and expenses, and other relief as the court may deem just and proper. Defendants have filed a motion to dismiss the consolidated complaint. Briefing on the motion to dismiss was completed in November, 2014. Plaintiff has moved to amend the consolidated complaint to include the members of the purported class in the Johnson case discussed below.

Also, on August 26, 2014, plaintiff Nathan Johnson filed a purported class action lawsuit against the Company, Myron E. Ullman, III and Kenneth H. Hannah in the U.S. District Court, Eastern District of Texas, Tyler Division. The suit is purportedly brought on behalf of persons who acquired our securities other than common stock during the period from August 20, 2013 through September 26, 2013, and alleges claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiff's lawsuit generally mirrors the allegations contained in the Marcus

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lawsuit discussed above, and seeks similar relief. On November 11, 2014, defendants filed an unopposed motion to consolidate this lawsuit with the Marcus lawsuit. On November 18, 2014, plaintiff filed a motion for appointment of lead plaintiff. On December 5, 2014, the lead plaintiff in the Marcus lawsuit filed an opposition to the plaintiff's motion for appointment of lead plaintiff.

We believe these lawsuits are without merit and we intend to vigorously defend them. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Shareholder Derivative Litigation

In October, 2013, two purported shareholder derivative actions were filed against certain present and former members of the Company's Board of Directors and executives by the following parties in the U.S. District Court, Eastern District of Texas, Sherman Division: Weitzman (filed October 2, 2013) and Zauderer (filed October 3, 2013). The Company is named as a nominal defendant in both suits. The lawsuits assert claims for breaches of fiduciary duties and unjust enrichment based upon alleged false and misleading statements and/or omissions regarding the Company's financial condition. The lawsuits seek unspecified compensatory damages, restitution, disgorgement by the defendants of all profits, benefits and other compensation, equitable relief to reform the Company's corporate governance and internal procedures, reasonable costs and expenses, and other relief as the court may deem just and proper. On October 28, 2013, the Court consolidated the two cases into the Weitzman lawsuit. On January 15, 2014, the Court entered an order staying the derivative suits pending certain events in the class action securities litigation described above. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

ERISA Class Action Litigation

The Company's wholly owned subsidiary, J. C. Penney Corporation, Inc., and certain present and former members of Corporation's Board of Directors have been sued in a purported class action complaint by plaintiffs Roberto Ramirez and Thomas Ihle, individually and on behalf of all others similarly situated, which was filed on July 8, 2014 in the U.S. District Court, Eastern District of Texas, Tyler Division. The suit alleges that the defendants violated Section 502 of the Employee Retirement Income Security Act (ERISA) by breaching fiduciary duties relating to the J. C. Penney Corporation, Inc. Savings, Profit-Sharing and Stock Ownership Plan (the "Plan"). The class period is alleged to be between November 1, 2011 and September 27, 2013. Plaintiffs allege that they and others who invested in or held Company stock in the Plan during this period were injured because defendants allegedly made false and misleading statements and/or omissions regarding the Company's financial condition and business prospects that caused the Company's common stock to trade at artificially inflated prices. The complaint seeks class certification, declaratory relief, a constructive trust, reimbursement of alleged losses to the Plan, actual damages, attorneys' fees and costs, and other relief. Defendants filed a motion to dismiss the complaint on November 7, 2014. We believe the lawsuit is without merit and we intend to vigorously defend it. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Employment Class Action Litigation

The Company's wholly owned subsidiary, J. C. Penney Corporation, Inc., is a defendant in a class action proceeding entitled Tschudy v. JCPenney Corporation filed on April 15, 2011 in the U.S. District Court, Southern District of California. The lawsuit alleges that JCP violated the California Labor Code in connection with the alleged forfeiture of accrued and vested vacation time under its "My Time Off" policy. The class consists of all JCP employees who worked in California from April 5, 2007 to the present. Plaintiffs amended the complaint to assert additional claims under the Illinois Wage Payment and Collection Act on behalf of all JCP employees who worked in Illinois from January 1, 2004 to the present. After the court granted JCP's motion to transfer the Illinois claims, those claims are

now pending in a separate action in the U.S. District Court, Northern District of Illinois, entitled Garcia v. JCPenney Corporation. The lawsuits seek compensatory damages, penalties, interest, disgorgement, declaratory and injunctive relief, and attorney's fees and costs. Plaintiffs in both lawsuits filed motions, which the Company opposed, to certify these actions on behalf of all employees in California and Illinois based on the specific claims at issue. On December 17, 2014, the California court granted plaintiffs' request for class certification. The Illinois court denied without prejudice plaintiffs' motion for class certification pending the filing of an amended complaint. Plaintiffs recently filed their amended complaint in the Illinois lawsuit and the Company has answered. We believe these lawsuits are without merit and we intend to continue to vigorously defend these lawsuits. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

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Pricing Class Action Litigation

The Company's wholly-owned subsidiary, J. C. Penney Corporation, Inc., is a defendant in a class action proceeding entitled *Spann v. J. C. Penney Corporation, Inc.* filed on February 8, 2012 in the U.S. District Court, Central District of California. The lawsuit alleges that JCP violated California's Unfair Competition Law and related state statutes in connection with its advertising of sale prices for private label apparel and accessories. The lawsuit seeks restitution, damages, injunctive relief, and attorney's fees and costs. On May 18, 2015, the court granted plaintiff's request for certification of a class consisting of all people who, between November 5, 2010 and January 31, 2012, made purchases in California of JCP private or exclusive label apparel or accessories advertised at a discount of at least 30% off the stated original or regular price (excluding those who only received such discount by using coupon(s)), and who have not received a refund or credit for their purchases. We believe this lawsuit is without merit and we intend to continue to vigorously defend this lawsuit. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Other Legal Proceedings

On January 3, 2014, the Company received a demand for production of the Company's books and records pursuant to Section 220 of the Delaware General Corporation Law from the law firm Wolf Haldenstein Adler Freeman & Herz LLP on behalf of Bruce Murphy as Trustee of the Bruce G. Murphy Trust. The alleged purpose of the demand is to investigate potential mismanagement and breaches of fiduciary duties by the Company's senior officers and directors in connection with their oversight of the Company's operations and business prospects, including the Company's liquidity profile and capital requirements. The Company has exchanged correspondence with the law firm concerning the demand.

Item 1A. Risk Factors

The risk factors listed below update and supersede the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

Our ability to return to profitable growth is subject to both the risks affecting our business generally and the inherent difficulties associated with implementing our strategic plan.

As we position the Company for long-term growth, it may take longer than expected to achieve our objectives, and actual results may be materially less than planned. Our ability to improve our operating results depends upon a significant number of factors, some of which are beyond our control, including:

- customer response to our marketing and merchandise strategies;
- our ability to achieve profitable sales and to make adjustments in response to changing conditions;
- our ability to respond to competitive pressures in our industry;
- our ability to effectively manage inventory;
- the success of our omnichannel strategy;
- our ability to benefit from capital improvements made to our store environment;
- our ability to respond to any unanticipated changes in expected cash flows, liquidity and cash needs, including our ability to obtain any additional financing or other liquidity enhancing transactions, if and when needed;

•our ability to achieve positive cash flow;

•our ability to access adequate and uninterrupted supply of merchandise from suppliers at expected levels and on acceptable terms; and