J C PENNEY CO INC
Form 10-K
March 20, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended February 2, 2013

or

o 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: 001-15274

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 75024-3698

(Address of principal executive offices)

(Zip Code)

(972)-431-1000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock of 50 cents par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10 K or any amendment to this Form 10 K. x

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 x Accelerated filer o Non-accelerated filer o Smaller reporting company o

(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 o No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter (July 28, 2012). $3,570,280,064

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

219,754,016 shares of Common Stock of 50 cents par value, as of March 18, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Documents from which portions are incorporated by reference	Parts of the Form 10-K into which incorporated
J. C. Penney Company, Inc. 2013 Proxy Statement	Part III

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PART I

Item 1. Business

Business Overview

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 new holding company assumed the name J. C. Penney Company, Inc. (Company). The holding company has no independent assets or operations, and no direct subsidiaries other than JCP. Common stock of the Company is publicly traded under the symbol "JCP" on the New York Stock Exchange. The Company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP's outstanding debt securities. The guarantee by the Company of certain of JCP's outstanding debt securities is full and unconditional. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this Annual Report on Form 10-K as "we," "us," "our," "ourselves," "Company" or "jcpenney."

Since our founding by James Cash Penney in 1902, we have grown to be a major retailer, operating 1,104 department stores in 49 states and Puerto Rico as of February 2, 2013. Our fiscal year ends on the Saturday closest to January 31. Unless otherwise stated, references to years in this report relate to fiscal years, rather than to calendar years. Fiscal year 2012 ended on February 2, 2013; fiscal year 2011 ended on January 28, 2012; and fiscal year 2010 ended on January 29, 2011. Fiscal year 2012 consisted of 53 weeks and fiscal years 2011 and 2010 consisted of 52 weeks.

Our business consists of selling merchandise and services to consumers through our department stores and through our Internet website at jcp.com. Department stores and Internet generally serve the same type of customers and provide virtually the same mix of merchandise, and department stores accept returns from sales made in stores and via the Internet. We sell family apparel and footwear, accessories, fine and fashion jewelry, beauty products through Sephora inside jcpenney and home furnishings. In addition, our department stores provide our customers with services such as styling salon, optical, portrait photography and custom decorating.

Our merchandise mix of total net sales over the last three years was as follows:

	2012	2011	2010
Women's apparel	23%	25%	24%

Men’s apparel and accessories	21%	20%	20%
Home	12%	15%	18%
Women’s accessories, including Sephora	13%	12%	12%
Children’s apparel	12%	12%	11%
Family footwear	7%	7%	7%
Fine jewelry	7%	4%	4%
Services and other	5%	5%	4%
	100%	100%	100%

Business Strategy

At the beginning of 2012, we announced our plans to become America’s favorite store by creating a specialty department store experience. During our first year of transformation, we focused on building a new foundation for the future by reimagining all aspects of our business, including product, presentation, pricing and promotion.

We are making substantial changes in our merchandise and continue to edit and introduce more global brands into our merchandise assortment. We are re-organizing our department stores into separately curated unique specialty stores known as The Shops. The Shops will be organized around a pathway through our stores known as The Street™, a bold new interface for retail, which includes places to relax, refresh, engage and check out. The Street will surround The Square™, a dynamic seasonal space that will provide engaging experiences for our customers. Our pricing strategy is founded on providing merchandise at low everyday prices and delivering even more exciting value through sales, promotions and rewards.

During the first year of transformation we opened shops under the Levi's ®, Izod®, Liz Claiborne®, The Original Arizona Jean Co.®, and jcp™ brands. We also opened 78 Sephora inside jcpenney stores, bringing the total to 386.

Competition and Seasonality

The business of marketing merchandise and services is highly competitive. We are one of the largest department store and e-commerce retailers in the United States, and we have numerous competitors, as further described in Item 1A, Risk Factors. Many factors enter into the competition for the consumer’s patronage, including price, quality, style, service, product mix, convenience and credit availability. Our annual earnings depend to a great extent on the results of operations for the last quarter of the fiscal year, which includes the holiday season, when a significant portion of our sales and profits are recorded.

Trademarks

The jcpenney®, Fair and Square™, jcp®, monet®, Liz Claiborne®, Okie Dokie®, Worthington®, a.n.a®, St. John’s Bay®, The Original Arizona Jean Company®, Ambrielle®, Decree®, Linden Street™, Stafford®, J. Ferrar®, jcpenney Home Collection® and Studio by jcpenney Home Collection® trademarks, as well as certain other trademarks, have been registered, or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law. We consider our marks and the accompanying name recognition to be valuable to our business.

Website Availability

We maintain an Internet website at www.jcp.com and make available free of charge through this website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all related amendments to those reports, as soon as reasonably practicable after the materials are electronically filed with or furnished to the Securities and Exchange Commission. In addition, our website provides press releases, access to webcasts of management presentations and other materials useful in evaluating our Company.

Suppliers

We have a diversified supplier base, both domestic and foreign, and are not dependent to any significant degree on any single s over 2,500 domestic and foreign suppliers, many of which have done business with us for many years. In addition to our Plano, Texas home office, we, through our international purchasing subsidiary, maintained buying and quality assurance offices in 12 foreign countries as of February 2, 2013.

Employment

The Company and its consolidated subsidiaries employed approximately 116,000 full-time and part-time employees as of February 2, 2013.

Environmental Matters

Environmental protection requirements did not have a material effect upon our operations during 2012. It is possible that compliance with such requirements (including any new requirements) would lengthen lead time in expansion or renovation plans and increase construction costs, and therefore operating costs, due in part to the expense and time required to conduct environmental and ecological studies and any required remediation.

As of February 2, 2013, we estimated our total potential environmental liabilities to range from $30 million to $36 million and recorded our best estimate of $30 million in other liabilities in the 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 effect on our financial condition, results of operations or liquidity.

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Executive Officers of the Registrant

The following is a list, as of March 5, 2013, of the names and ages of the executive officers of J. C. Penney Company, Inc. and of the offices and other positions held by each such person with the Company. These officers hold identical positions with JCP. There is no family relationship between any of the named persons.

Name	Offices and Other Positions Held With the Company	Age
Ronald B. Johnson	Chief Executive Officer	54
Michael W. Kramer	Chief Operating Officer	48
Daniel E. Walker	Chief Talent Officer	62
Kenneth H. Hannah	Executive Vice President and Chief Financial Officer	44
Janet Dhillon	Executive Vice President, General Counsel and Secretary	50
Mark R. Sweeney	Senior Vice President and Controller	51

Mr. Johnson has served as Chief Executive Officer of the Company since November 2011. He previously served as Senior Vice President, Retail of Apple, Inc. Prior to joining Apple in 2000, he held a variety of positions with Target Corporation, including Senior Vice President of Merchandising. During his tenure at Target, Mr. Johnson had responsibility for such categories as Men's Apparel, Women's Apparel and Accessories, Children's and Home. He has served as a director of the Company and as a director of JCP since 2011.

Mr. Kramer has served as Chief Operating Officer of the Company since December 2011. Prior to joining the Company, he was President and Chief Executive Officer of Kellwood Company. From 2005 to 2008, Mr. Kramer was Executive Vice President and Chief Financial Officer at Abercrombie & Fitch. From 2000 to 2005, he was at Apple, Inc., where he served as Chief Financial Officer of Apple retail. Mr. Kramer previously held key financial leadership roles with The Limited, Pizza Hut and Einstein Noah Bagel Corporation.

Mr. Walker has served as Chief Talent Officer of the Company since November 2011. He served as Chief Talent Officer for Apple, Inc. from 2000 to 2004 and as Vice President of Human Resources at Gap from 1986 to 1992. Mr. Walker founded and led The Human Revolution Studios prior to joining the Company, and Daniel Walker and Associates, an executive search and consulting firm, prior to joining Apple. Prior to joining Gap, he was Director of Human Resources for the Specialty Retail Group at General Mills and worked for Lazarus Department Stores, a division of Federated Department Stores.

Mr. Hannah has served as Executive Vice President and Chief Financial Officer since May 2012. Prior to joining the Company, he was Executive Vice President and President-Solar Energy of MEMC Electronic Materials, Inc. and had previously served as Executive Vice President and President-Solar Materials from 2009 to 2012 and Senior Vice President and Chief Financial Officer from 2006 to 2009. Mr. Hannah previously held key financial leadership positions at The Home Depot, Inc., The Boeing Company and General Electric Company. He has served as a director of JCP since 2012.

Ms. Dhillon has served as Executive Vice President, General Counsel and Secretary of the Company since 2009. Prior to joining the Company, she served as Senior Vice President and General Counsel and Chief Compliance Officer of US Airways Group, Inc. and US Airways, Inc. from 2006 to 2009. Ms. Dhillon joined US Airways, Inc. in 2004 as Managing Director and Associate General Counsel and served as Vice President and Deputy General Counsel of US Airways Group, Inc. and US Airways, Inc. from 2005 to 2006. Ms. Dhillon was with the law firm of Skadden, Arps, Slate, Meagher & Flom LLP from 1991 to 2004. She has served as a director of JCP since 2009.

Mr. Sweeney has served as Senior Vice President and Controller since September 2012. Prior to joining the Company, he was Vice President and Operational Controller of General Electric Company from 2008 to 2012. He previously served as Chief Financial Officer of GE-Hitachi Nuclear Energy, LLC from 2004 to 2008 and Global Controller of General Electric's Energy Division from 1997 to 2004. Prior to joining General Electric, Mr. Sweeney held financial leadership positions with PepsiCo, Inc. from 1995 to 1997 and previously was a senior manager with KPMG LLP.

Item 1A. Risk Factors

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking information contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, operating results, financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

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The success of our transformation is subject to both the risks affecting our business generally and the inherent difficulties associated with implementing our new strategies.

Our ability to improve our operating results depends upon a significant number of factors, some of which are beyond our control, including:

- customer acceptance of our marketing and merchandise strategies;
- our ability to respond to any increased competitive pressures in our industry;
- the extent to which our management team has properly understood the dynamics and demands of our market in crafting the transformation;
- our ability to achieve profitable sales and to make adjustments in response to changing conditions;
- our ability to effectively manage inventory;
- the success of our strategic initiatives and cost reduction initiatives;
- the time to complete, and cost increases associated with, the Company's capital improvements;
- our ability to respond to any unanticipated changes in expected cash flows, liquidity, cash needs and cash expenditures, including our ability to obtain any additional financing or other liquidity enhancing transactions, if and when needed;
- our ability to achieve positive cash flow, particularly during our peak inventory build-ups in advance of principal selling seasons;
- our employees' ability to adapt to our new strategic initiatives and organizational structure;
- our management team's ability to execute our new strategic initiatives in a cost-effective manner;
- our ability to access adequate and uninterrupted supply of merchandise from suppliers at expected levels and on acceptable terms; and
- general economic conditions.

There is no assurance that we will be able to successfully implement our strategic initiatives, which could have an adverse impact on our results of operations.

Our strategies to transform our business may not achieve the improvements we expect in our operating results.

We are executing a number of strategic initiatives as part of our transformation, including changes in our pricing strategy, corporate branding, marketing, store layout and merchandise assortments. During this transition period, changes to our pricing and marketing strategies have resulted in a prolonged decline in sales and our results of operations have been significantly below our expectations. It may take longer than expected or planned to recover from our negative sales trends and operating results, and actual results may be materially less than planned. As certain of these strategic initiatives such as the Shops and the Street are focused on our largest stores, they may not have the same impact on all of our stores. We may need to adjust any one or more of these strategic initiatives depending upon our customers' reactions to and acceptance of these initiatives. Any changes to our strategies could be substantial, and if implemented, could result in significant additional costs. Adjustments may also create confusion among our customers, divert management and employees' attention from other business concerns or otherwise disrupt our business. There is no assurance that our pricing, branding, store layout, marketing and merchandising strategies, or any future adjustments to our strategies, will improve our operating results.

We operate in a highly competitive industry that includes significant promotional activity, which could adversely impact our sales and profitability.

The retail industry is highly competitive, with few barriers to entry. We compete with many other local, regional and national retailers for customers, employees, locations, merchandise, services and other important aspects of our business. Those competitors include other department stores, discounters, home furnishing stores, specialty retailers, wholesale clubs, direct-to-consumer businesses, including the Internet, and other forms of retail commerce. Some competitors are larger than jcpenney, and/or have greater financial resources available to them, and, as a result, may be able to devote greater resources to sourcing, promoting and selling their products. Competition is characterized by many factors, including merchandise assortment, advertising, price, quality, service, location, reputation and credit availability. During the first year of our transformation, we discontinued our former promotional strategy and encountered difficulties in communicating our value proposition. Although we have re-introduced certain promotional activities, there can be no assurance that increased promotional activity will result in increased sales and profitability. We have experienced, and anticipate that we will continue to experience for at least the foreseeable future, significant competition from promotional activities of our competitors. The performance of competitors as well as changes in their pricing and promotional policies, marketing activities, new store openings, launches of Internet websites, brand launches and other merchandise and operational strategies could cause us to have lower sales, lower gross margin and/or higher operating expenses such as marketing costs and other selling, general and administrative expenses, which in turn could have an adverse impact on our profitability.

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Our sales and operating results depend on our ability to develop merchandise offerings that resonate with our existing customers and help to attract new customers.

Our sales and operating results depend in part on our ability to predict and respond to changes in fashion trends and customer preferences in a timely manner by consistently offering stylish, quality merchandise assortments at competitive prices. We continuously assess emerging styles and trends and focus on developing a merchandise assortment to meet customer preferences. Even with these efforts, we cannot be certain that we will be able to successfully meet constantly changing customer demands. One of our strategic initiatives is to transform our largest stores into a collection of Shops showcasing major apparel and brands. Our goal is for our transformed merchandise and brand image to expand our customer base while continuing to appeal to our traditional, core customer. To the extent our predictions regarding our merchandise or the vendors selected for our Shops differ from our customers' preferences, we may be faced with reduced sales and excess inventories for some products and/or missed opportunities for others. Any sustained failure to identify and respond to emerging trends in lifestyle and customer preferences and buying trends could have an adverse impact on our business. In addition, merchandise misjudgments may adversely impact the perception or reputation of our Company, which could result in declines in customer loyalty and vendor relationship issues, and ultimately have a material adverse effect on our business, financial condition and results of operations.

Our ability to increase sales and store productivity is largely dependent upon our ability to increase customer traffic.

Customer traffic depends upon our ability to successfully market compelling merchandise assortments as well as present an appealing shopping environment and experience to existing customers and new customers. In the first year of our transformation, our store customer traffic significantly decreased compared to the prior year. As part of the re-imagination of our stores, we are changing our merchandise assortment, building new Shops and creating the Street in our largest stores. These changes are designed to increase customer traffic and the amount of time that our customers spend in our stores. There can be no assurance that our efforts to increase customer traffic and visit time in our stores will be successful or will result in increased sales. We may need to respond to any declines in customer traffic by increasing markdowns or changing marketing strategies to attract customers to our stores, which could adversely impact our gross margins, operating results and cash flows from operating activities.

If we are unable to manage our inventory effectively, our gross margins could be adversely affected.

Our profitability depends upon our ability to manage appropriate inventory levels and respond quickly to shifts in consumer demand patterns. We must properly execute our inventory management strategies by appropriately allocating merchandise among our stores, timely and efficiently distributing inventory to stores, maintaining an appropriate mix and level of inventory in stores, appropriately changing the allocation of floor space of stores among product categories to respond to customer demand and effectively managing pricing and markdowns. If we overestimate customer demand for our merchandise, we will likely need to record inventory markdowns and move the excess inventory to be sold at clearance prices which would negatively impact our gross margins and operating results. If we underestimate customer demand for our merchandise, we may experience inventory shortages which may result in missed sales opportunities and have a negative impact on customer loyalty.

The implementation of our new store layout may result in reduced sales or profitability.

Our new store layout is focused on presenting a streamlined visual display for our customers. A number of strategic initiatives related to our store layout have the effect of reducing the amount of merchandise displayed in our stores. Our Shops initiative showcases a curated selection of merchandise, which will require us to promptly replenish inventory and maintain the Shops' distinctive, organized appearance. Our Street initiative will devote significant space to customer experiences, which will decrease the square footage allocated to merchandise in our stores. During the transformation, a portion of our stores will be under construction, which could also reduce the amount of space available to display merchandise and have an adverse impact on our appealing shopping environment. There is no assurance that the execution of strategies to transform our new store layout will result in increased sales or profitability.

We cannot assure that our internal and external sources of liquidity will at all times be sufficient for our cash requirements.

We must have sufficient sources of liquidity to fund our working capital requirements, capital improvement plans, service our outstanding indebtedness and finance investment opportunities. The principal sources of our liquidity are funds generated from operating activities, available cash and cash equivalents, borrowings under our credit facilities, other debt financings and sales of non-operating assets. Our operating losses during the first year of our transformation have limited our capital resources. Our ability to achieve our business and cash flow plans is based on a number of assumptions which involve significant judgments and estimates of future performance, borrowing capacity and credit availability, which cannot at all times be assured. In addition, we are seeking a declaratory judgment that we are not in breach of our Indenture dated April 1, 1994, which if decided unfavorably, could have an adverse impact on our liquidity. See "Risk Factors – Legal and regulatory proceedings could have an adverse impact on our results of operations" Accordingly, we cannot assure that cash flows and other internal and external sources of liquidity will at all times be sufficient for our cash requirements. If necessary, we may need to consider actions and steps to improve our cash position and mitigate any potential liquidity shortfall, such as modifying our business plan, pursuing additional financing to the extent available, reducing capital expenditures, pursuing and evaluating other alternatives and opportunities to obtain additional sources of liquidity and other potential actions seeking to reduce costs, which we cannot assure would be successful. We cannot assure that any of these actions would be sufficient or available or available on favorable terms. Any inability to generate or obtain sufficient levels of liquidity to meet our cash requirements at the level and times needed could have a material adverse impact on our business, liquidity and financial position.

Our ability to obtain any additional financing or any refinancing of our debt, if needed at any time, depends upon many factors, including our existing level of indebtedness and restrictions in our debt facilities, historical business performance, financial projections, prospects and creditworthiness and external economic conditions and general liquidity in the credit and capital markets. Any additional debt, equity or equity-linked financing may require modification of our existing debt agreements, which we cannot assure would be obtainable. Any additional financing or refinancing could also be at higher costs and require us to satisfy more restrictive covenants, which could further limit or restrict our business and results of operations, or be dilutive to our stockholders.

The failure to retain, attract and motivate our employees, including employees in key positions, could have an adverse impact on our results of operations.

Our results depend on the contributions of our employees, including our senior management team and other key employees. This depends to a great extent on our ability to retain, attract and motivate talented employees throughout the organization, many of whom, particularly in the stores, are in entry level or part-time positions with historically high rates of turnover. The transformational changes to our business model will require new competencies in some positions, which may be difficult to obtain at a reasonable cost, if at all. Our ability to meet our changing labor needs while controlling our costs is also subject to external factors such as unemployment levels, competing wages and potential union organizing efforts. Because of our lower than expected operating results during the first year of our transformation, we have not generally paid bonuses, and salary increases and incentive compensation opportunities could be limited. Any prolonged inability to provide salary increases or incentive compensation opportunities during our transformation could have an adverse impact on our ability to attract, retain and motivate our employees. If we are unable to retain, attract and motivate talented employees with the appropriate skill sets for our new business model, or if the changes to our organizational structure or business model adversely affect morale or retention, we may not achieve our objectives and our results of operations could be adversely impacted. In addition, the loss of one or more of our key personnel or the inability to effectively identify a suitable successor to a key role in our senior management could have a material adverse effect on our business.

The reduction and restructuring of our workforce may adversely impact our operating efficiency.

As part of our cost reduction initiatives, we have significantly reduced our corporate and operations headcount, including management level employees, and distribution and field employees. These reductions, combined with our voluntary early retirement plan initiated in 2011 and voluntary departures of employees, have resulted in a substantial amount of turnover of officers and line managers with specific knowledge relating to us, our operations and our industry that could be difficult to replace. We now operate with significantly fewer individuals who have assumed additional duties and responsibilities and we could have additional workforce reductions in the future. In addition, our business has shifted towards a decentralized management structure that distributes significant control and decision-making powers among our senior management team and other key employees, some of whom are located in satellite offices. These workforce changes may negatively impact communication, morale, management cohesiveness and effective decision-making, which could have an adverse impact on our operating efficiency.

Actions taken under our cost reduction initiatives may not produce the savings expected.

As part of our transformation, we have implemented cost reduction initiatives, including significant workforce reductions, significant reductions in projected marketing spend and other cost and spend reductions. We have forecasted substantial cost savings from these initiatives based on a number of assumptions and expectations which, if achieved, would improve our profitability and cash flows from operating activities. There can be no assurance that actual results achieved will not vary materially from what we have assumed and forecasted, which could have a material adverse impact on our results of operations, liquidity and financial position.

We must protect against security breaches or other disclosures of private data of our customers as well as of our employees and other third parties.

As part of our normal operations, we receive and maintain personal information about our customers, our employees and other third parties. The confidentiality of all of our internal private data must at all times be protected against security breaches or other disclosure. We have systems and processes in place that are designed to protect information and protect against security and data breaches as well as fraudulent transactions and other activities. Despite our safeguards and security processes and protections, we cannot be assured that all of our systems and processes are free from vulnerability to security breaches or inadvertent data disclosure by third parties or us. Any failure to protect the confidential data of our customers or of our employees or other third parties could materially damage our brand and reputation as well as result in significant damage claims, any of which could have a material adverse impact on our business and results of operations.

Our operations are dependent on information technology systems; disruptions in those systems or increased costs relating to their implementation could have an adverse impact on our results of operations.

Our operations are dependent upon the integrity, security and consistent operation of various systems and data centers, including the point-of-sale systems in the stores, our Internet website, data centers that process transactions, communication systems and various software applications used throughout our Company to track inventory flow, process transactions and generate performance and financial reports.

In July 2012, we announced plans to implement an integrated suite of products from a third party vendor to simplify our processes and reduce our use of customized existing legacy systems. We expect to implement the initial phase of these systems in May 2013. Implementing new systems carries substantial risk, including implementation delays, cost overruns, disruption of operations, potential loss of data or information, lower customer satisfaction resulting in lost customers or sales, inability to deliver merchandise to our stores or our customers, and the potential inability to meet reporting requirements. There can be no assurances that we will successfully launch the new systems as planned, that the new systems will perform as expected or that the new systems will be implemented without disruptions to our operations, any of which may cause critical information upon which we rely to be delayed, unreliable, corrupted, insufficient or inaccessible.

We also outsource various information technology functions to third party service providers and may outsource other functions in the future. We rely on those third party service providers to provide services on a timely and effective basis and their failure to perform as expected or as required by contract could result in disruptions and costs to our operations.

We are also implementing other technologies including programs that enable our employees to provide high quality service to our customers and to provide our customers a better experience, including the use of mobile point-of-service and an enhanced standard point-of-service technology. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Our new or upgraded technology might not provide the anticipated benefits, it might take longer than expected to realize the anticipated benefits, may cost more than the expected costs to implement or the technology might fail altogether.

Disruptions in our Internet website could have an adverse impact on our sales and results of operations.

We sell merchandise over the Internet through our website, www.jcp.com. Our Internet operations are subject to numerous risks, including rapid technological change and the implementation of new systems and platforms; liability for online content; violations of state or federal laws, including those relating to online privacy; credit card fraud; problems associated with the operation of our website and related support systems; computer viruses; telecommunications failures; electronic break-ins and similar disruptions; and the allocation of inventory between our website and department stores. The failure of our website to perform could result in disruptions and costs to our operations and make it more difficult for customers to purchase merchandise online, which could have an adverse impact on our sales and results of operations.

Changes in our credit ratings may limit our access to capital markets and adversely affect our liquidity.

The credit rating agencies periodically review our capital structure and the quality and stability of our earnings, as a result of which we have experienced multiple corporate credit ratings downgrades. These downgrades, and any future 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. The future availability of financing will depend on a variety of factors, such as economic and market conditions, the availability of credit and our credit ratings, as well as the possibility that lenders could develop a negative perception of us. If required, we may not be able to obtain additional financing, on favorable terms or at all.

Our profitability depends on our ability to source merchandise and deliver it to our customers in a timely and cost-effective manner.

Our merchandise is sourced from a wide variety of suppliers, and our business depends on being able to find qualified suppliers and access products in a timely and efficient manner. Inflationary pressures on commodity prices and other input costs could increase our cost of goods, and an inability to pass such cost increases on to our customers or a change in our merchandise mix as a result of such cost increases could have an adverse impact on our profitability. Additionally, the impact of current and future economic conditions on our suppliers cannot be predicted and may cause our suppliers to be unable to access financing or become insolvent and thus become unable to supply us with products.

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Our arrangements with our suppliers and vendors may be impacted by our financial results or financial position.

Substantially all of our merchandise suppliers and vendors sell to us on open account purchase terms. There is a risk that our suppliers and vendors could respond to any actual or apparent decrease in or any concern with our financial results or liquidity by requiring or conditioning their sale of merchandise to us on more stringent payment terms, such as by requiring standby letters of credit, earlier or advance payment of invoices, payment upon delivery or other assurances or credit support or by choosing not to sell merchandise to us at all. There can be no assurance that one or more of our suppliers may not slow or cease merchandise shipments or require or condition their sale or shipment of merchandise on more stringent payment terms. If any of the above circumstances were to occur, our need for additional liquidity in the near term could significantly increase. Such circumstances, if they were to occur, could materially disrupt our supply of merchandise which could have a material adverse effect on our sales, customer satisfaction, cash flows, liquidity and financial position.

Our revolving credit facility limits our borrowing capacity to the value of certain of our assets and contains provisions that could restrict our operations.

Our borrowing capacity under our revolving credit facility varies according to the Company's inventory levels, accounts receivable and credit card receivables, net of certain reserves. In the event of any material decrease in the amount of or appraised value of these assets, our borrowing capacity would similarly decrease, which could adversely impact our business and liquidity.

Our revolving credit facility contains customary affirmative and negative covenants and certain restrictions on operations become applicable if our availability falls below certain thresholds. These covenants could impose significant operating and financial limitations and restrictions on us, including restrictions on our ability to enter into particular transactions and to engage in other actions that we may believe are advisable or necessary for our business. In addition, the revolving credit facility provides for a springing fixed charge coverage ratio if our availability falls below a specified threshold.

In the event of a default that is not cured or waived within any applicable cure periods, the lenders' commitment to extend further credit under our revolving credit facility could be terminated, our outstanding obligations could become immediately due and payable, outstanding letters of credit may be required to be cash collateralized and remedies may be exercised against the collateral, which generally consists of the Company's inventory, accounts receivable and deposit accounts and cash credited thereto. If we are unable to borrow under our revolving credit facility, we may not have the necessary cash resources for our operations and, if any event of default occurs, there is no assurance that we would have the cash resources available to repay such accelerated obligations or cash collateralize our letters of credit, which would have a material adverse effect on our business, financial condition and liquidity.

Operating results and cash flows at the store level may cause us to incur asset impairment charges.

Long-lived assets, primarily property and equipment, are reviewed at the store level at least annually for impairment, or whenever changes in circumstances indicate that a full recovery of net asset values through future cash flows is in question. Our impairment review requires us to make estimates and projections regarding, but not limited to, sales, operating profit and future cash flows. If these estimates or projections change or prove incorrect, we may be required to record asset impairment charges on certain store locations and other property and equipment. In fiscal 2012, we began shifting our business model from a promotional department store to a specialty department store and our sales and operating profit declined significantly. If our operating performance begins to reflect a sustained decline and actual results are not consistent with our estimates and projections, we may be exposed to significant asset impairment charges in the future, which could be material to our results of operations.

We are subject to risks associated with importing merchandise from foreign countries.

A substantial portion of our merchandise is sourced by our vendors and by us outside of the United States. All of our suppliers must comply with our supplier legal compliance program and applicable laws, including consumer and product safety laws. Although we diversify our sourcing and production by country and supplier, the failure of a supplier to produce and deliver our goods on time, to meet our quality standards and adhere to our product safety requirements or to meet the requirements of our supplier compliance program or applicable laws, or our inability to flow merchandise to our stores or through the Internet channel in the right quantities at the right time could adversely affect our profitability and could result in damage to our reputation.

Although we have implemented policies and procedures designed to facilitate compliance with laws and regulations relating to doing business in foreign markets and importing merchandise from abroad, there can be no assurance that suppliers and other third parties with whom we do business will not violate such laws and regulations or our policies, which could subject us to liability and could adversely affect our results of operations.

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We are subject to the various risks of importing merchandise from abroad and purchasing product made in foreign countries, such as

- potential disruptions in manufacturing, logistics and supply;
- changes in duties, tariffs, quotas and voluntary export restrictions on imported merchandise;
- strikes and other events affecting delivery;
- consumer perceptions of the safety of imported merchandise;
- product compliance with laws and regulations of the destination country;
- product liability claims from customers or penalties from government agencies relating to products that are recalled, defective or otherwise noncompliant or alleged to be harmful;
- concerns about human rights, working conditions and other labor rights and conditions and environmental impact in foreign countries where merchandise is produced and raw materials or components are sourced, and changing labor, environmental and other laws in these countries;
- compliance with laws and regulations concerning ethical business practices, such as the U.S. Foreign Corrupt Practices Act; and
- economic, political or other problems in countries from or through which merchandise is imported.

Political or financial instability, trade restrictions, tariffs, currency exchange rates, labor conditions, transport capacity and costs, systems issues, problems in third party distribution and warehousing and other interruptions of the supply chain, compliance with U.S. and foreign laws and regulations and other factors relating to international trade and imported merchandise beyond our control could affect the availability and the price of our inventory. A significant amount of merchandise we offer for sale is made in China and accordingly, a revaluation of the Chinese currency, or increased market flexibility in the exchange rate for that currency, increasing its value relative to the U.S. dollar, could potentially result in a significant increase in the cost of inventory. These risks and other factors relating to foreign trade could subject us to liability or hinder our ability to access suitable merchandise on acceptable terms, which could adversely impact our results of operations.

Our Company’s growth and profitability depend on the levels of consumer confidence and spending.

Our results of operations are sensitive to changes in overall economic and political conditions that impact consumer spending, including discretionary spending. Many economic factors outside of our control, including the housing market, interest rates, recession, inflation and deflation, energy costs and availability, consumer credit availability and terms, consumer debt levels, tax rates and policy, and unemployment trends influence consumer confidence and spending. The domestic and international political situation and actions also affect consumer confidence and spending. Additional events that could impact our performance include pandemics, terrorist threats and activities, worldwide military and domestic disturbances and conflicts, political instability and civil unrest. Declines in the level of consumer spending could adversely affect our growth and profitability.

Our business is seasonal, which impacts our results of operations.

Our annual earnings and cash flows depend to a great extent on the results of operations for the last quarter of our fiscal year, which includes the holiday season. Our fiscal fourth-quarter results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions. This seasonality causes our operating results to vary considerably from quarter to quarter.

Our profitability may be impacted by weather conditions.

Our merchandise assortments reflect assumptions regarding expected weather patterns and our profitability depends on our ability to timely deliver seasonally appropriate inventory. Unseasonable or unexpected weather conditions such as warm temperatures during the winter season or prolonged or extreme periods of warm or cold temperatures could render a portion of our inventory incompatible with consumer needs. Extreme weather or natural disasters could also severely hinder our ability to timely deliver seasonally appropriate merchandise, delay capital improvements or cause us to close stores. A reduction in the demand for or supply of our seasonal merchandise could have an adverse effect on our inventory levels, gross margins and results of operations.

Changes in federal, state or local laws and regulations could increase our expenses and adversely affect our results of operations.

Our business is subject to a wide array of laws and regulations. The current political environment, financial reform legislation, the current high level of government intervention and activism, regulatory reform and stockholder activism may result in substantial new regulations and disclosure obligations, which may lead to additional compliance costs as well as the diversion of our management's time and attention from strategic initiatives. If we fail to comply with applicable laws and regulations we could be subject to legal risk, including government enforcement action and class action civil litigation that could increase our cost of doing business. Changes in the regulatory environment regarding topics such as privacy and information security, product safety or environmental protection, including regulations in response to concerns regarding climate change, collective bargaining agreements and health care mandates, among others, could also cause our compliance costs to increase and adversely affect our results of operations.

Legal and regulatory proceedings could have an adverse impact on our results of operations.

Our Company is subject to various legal and regulatory proceedings relating to our business, certain of which may involve jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants. We are impacted by trends in litigation, including class action litigation brought under various consumer protection, employment, and privacy and information security laws. In addition, litigation risks related to claims that technologies we use infringe intellectual property rights of third parties have been amplified by the increase in third parties whose primary business is to assert such claims. Reserves are established based on our best estimates of our potential liability. However, we cannot accurately predict the ultimate outcome of any such proceedings due to the inherent uncertainties of litigation. Regardless of the outcome or whether the claims are meritorious, legal and regulatory proceedings may require that we devote substantial time and expense to defend our Company. Unfavorable rulings could result in a material adverse impact on our business, financial condition or results of operations.

On February 4, 2013, we received a purported notice of default from a law firm (Bondholders' Counsel) claiming to represent certain holders of our 7.4% Debentures due 2037 (the Debentures) issued under an Indenture dated April 1, 1994 (the Indenture). The notice of default asserted that the Company violated the equal and ratable lien covenant in the Indenture by entering into our revolving credit agreement and granting a lien on our inventory. We do not believe that the notice of default was valid and are seeking injunctive relief and a declaratory judgment that the Company is not in breach of the Indenture. As of March 5, 2013, approximately $326 million in principal amount of the Debentures was outstanding. On March 18, 2013, Bondholders' Counsel withdrew its notice of default.

As of March 5, 2013, approximately $2.868 billion of long-term debt was outstanding under the Company's indentures. If the Company were to be found to be in breach of an indenture and such breach is not timely cured, then holders of a certain percentage of such debt instruments may declare such obligations immediately due and payable. If outstanding debt instruments are, or are permitted to be, declared due and payable prior to their scheduled maturity, such event could constitute an event of default under our credit facility. If any debt outstanding under our indentures is declared due and payable or an event of default occurs under our credit facility, there is no assurance that we would have the cash resources available to repay such accelerated obligations, which would have a material adverse effect on our business, financial condition and liquidity.

Significant changes in discount rates, actual investment return on pension assets, and other factors could affect our earnings, equity, and pension contributions in future periods.

Our earnings may be positively or negatively impacted by the amount of income or expense recorded for our qualified pension plan. Generally accepted accounting principles in the United States of America (GAAP) require that income or expense for the plan be calculated at the annual measurement date using actuarial assumptions and calculations. The most significant assumptions relate to the capital markets, interest rates and other economic conditions. Changes in key economic indicators can change the assumptions. Two critical assumptions used to estimate pension income or expense for the year are the expected long-term rate of return on plan assets and the discount rate. In addition, at the measurement date, we must also reflect the funded status of the plan (assets and liabilities) on the balance sheet, which may result in a significant change to equity through a reduction or increase to other comprehensive income. Although GAAP expense and pension contributions are not directly related, the key economic factors that affect GAAP expense would also likely affect the amount of cash we could be required to contribute to the pension plan. Potential pension contributions include both mandatory amounts required under federal law and discretionary contributions to improve a plan’s funded status.

As a result of their ownership stakes in the Company, our largest stockholders have the ability to materially influence actions to be taken or approved by our stockholders. These stockholders are represented on our Board of Directors and, therefore, also have the ability to materially influence actions to be taken or approved by our Board.

As of March 5, 2013, Pershing Square Capital Management L.P., PS Management GP, LLC and Pershing Square GP, LLC (together Pershing Square) beneficially owned approximately 17.8% of the outstanding shares of our common stock. Pershing Square has additional economic exposure to approximately 7.3% of the outstanding shares of our common stock under cash-settled total return swaps, bringing their total aggregate economic exposure to approximately 25.1% of the outstanding shares of our common stock. William A. Ackman, Chief Executive Officer of Pershing Square Capital Management, is one of our directors.

As of March 5, 2013, Vornado Realty Trust, Vornado Realty L.P., VNO Fashion LLC, VSPS I L.L.C., Two Penn Plaza REIT, Inc., Two Penn Plaza REIT JP Fashion LLC, CESC H Street LLC, H Street Building Corporation, H Street JP Fashion LLC, Vornado RTR, Inc. and PCJ I Inc. (together Vornado) beneficially owned approximately 6.1% of the outstanding shares of our common stock. Steven Roth, Chairman of the Board of Trustees of Vornado Realty Trust, is one of our directors.

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Together, Pershing Square and Vornado owned approximately 23.9% of our outstanding shares as of March 5, 2013 and had aggregate economic exposure to approximately 31.2% of our outstanding shares. Pershing Square and Vornado have each stated that they intend to consult with each other in connection with their respective investments in our common stock. Pershing Square and Vornado have the ability to materially influence actions to be taken or approved by our stockholders, including the election of directors and any transactions involving a change of control. Pershing Square and Vornado also have the ability to materially influence actions to be taken or approved by our Board.

We are party to a stockholder agreement with Pershing Square that, among other things, prohibits Pershing Square from purchasing shares of our common stock and derivative securities whose value is derived from the value of our common stock in excess of 26.1% of the shares of our common stock outstanding and permits Pershing Square to designate one member of our Board of Directors. Pursuant to the stockholder agreement, Pershing Square is able to direct the vote of 15% of the shares of our common stock outstanding and is required to vote the number of any excess shares of our common stock that they beneficially own to be present and voted at stockholder meetings either as recommended by our Board of Directors or in direct proportion to how all other stockholders vote.

In addition, we are party to a stockholder agreement with Vornado that, among other things, prohibits Vornado from purchasing shares of our common stock and derivative securities whose value is derived from the value of our common stock in excess of 15.4% of the shares of our common stock outstanding and permits Vornado to designate one member of our Board of Directors. Pursuant to the stockholder agreement, Vornado may vote the number of shares that it owns up to a maximum of 9.9% of the shares of our common stock outstanding and is required to vote the number of any excess shares of our common stock that they beneficially own to be present and voted at stockholder meetings either as recommended by our Board of Directors or in direct proportion to how all other stockholders vote.

Our stock price has been and may continue to be volatile.

The market price of our common stock has fluctuated substantially and may continue to fluctuate significantly. Future announcements or disclosures concerning us or any of our competitors, our strategic initiatives, our sales and profitability, any quarterly variations in actual or anticipated operating results or comparable sales, any failure to meet analysts' expectations and sales of large blocks of our common stock, among other factors, could cause the market price of our common stock to fluctuate substantially. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many retail and other stocks and that have often been unrelated or disproportionate to the operating performance of these companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. Such litigation, if instituted against us, could result in substantial costs, divert our management's attention and resources and have an adverse effect on our business, results of operations and financial condition. This volatility could affect the price at which you could sell shares of our common stock.

The Company’s ability to use net operating loss carryforwards to offset future taxable income for U.S. federal income tax purposes may be limited.

In fiscal 2012, the Company incurred a federal net operating loss (NOL) of approximately $1.5 billion of which approximately $284 million is available for carryback. The remaining NOL carryforward (expiring between 2013 and 2032) is available to offset future taxable income. Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”) imposes an annual limitation on the amount of taxable income that may be offset if a corporation experiences an ”ownership change” as defined in Section 382 of the Code. An ownership change occurs when the Company’s “five-percent shareholders” (as defined in Section 382 of the Code) collectively increase their ownership in the Company by more than 50 percentage points (by value) over a rolling three-year period. This is different from a change in beneficial ownership under applicable securities laws. While the Company expects to be able to realize the total NOL prior to its expiration, if an ownership change occurs the Company’s ability to use the NOL to offset future taxable income will be subject to an annual limitation and will depend on the amount of taxable income generated by the Company in future periods. There is no assurance that the Company will be able to fully utilize the NOL and the Company could be required to record a valuation allowance related to the amount of the NOL that may not be realized, which could impact the Company’s net results of operations.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At February 2, 2013, we operated 1,104 department stores throughout the continental United States, Alaska and Puerto Rico, of which 429 were owned, including 123 stores located on ground leases. The following table lists the number of stores operating by state as of February 2, 2013:

Alabama	22	Maine	6	Oklahoma	19
Alaska	1	Maryland	19	Oregon	14
Arizona	22	Massachusetts	13	Pennsylvania	43
Arkansas	16	Michigan	43	Rhode Island	3
California	80	Minnesota	26	South Carolina	18
Colorado	22	Mississippi	18	South Dakota	8
Connecticut	10	Missouri	26	Tennessee	26
Delaware	3	Montana	9	Texas	94
Florida	59	Nebraska	11	Utah	9
Georgia	30	Nevada	7	Vermont	6
Idaho	9	New Hampshire	9	Virginia	28
Illinois	41	New Jersey	17	Washington	24
Indiana	30	New Mexico	10	West Virginia	9
Iowa	19	New York	43	Wisconsin	22
Kansas	19	North Carolina	36	Wyoming	5
Kentucky	22	North Dakota	8	Puerto Rico	7
Louisiana	16	Ohio	47		
Total square feet	111.6 million				

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At February 2, 2013, our supply chain network operated 24 facilities at 15 locations, of which nine were owned, with multiple types of distribution activities housed in certain owned locations. Our network includes 11 store merchandise distribution centers, five regional warehouses, four jcp.com fulfillment centers and four furniture distribution centers as indicated in the following table:

Facility / Location	Leased/Owned	Square Footage (in thousands)
Store Merchandise Distribution Centers		
Forest Park, Georgia	Owned	530
Buena Park, California	Owned	543
Cedar Hill, Texas	Leased	433
Columbus, Ohio	Owned	386
Lakeland, Florida	Leased	360
Lenexa, Kansas	Owned	322
Manchester, Connecticut	Owned	898
Wauwatosa, Wisconsin	Owned	507
Spanish Fork, Utah	Leased	400
Statesville, North Carolina	Owned	313
Sumner, Washington	Leased	350
Total store merchandise distribution centers		5,042
Regional Warehouses		
Haslet, Texas	Owned	1,063
Forest Park, Georgia	Owned	427
Buena Park, California	Owned	146
Lathrop, California	Leased	436
Statesville, North Carolina	Owned	131
Total regional warehouses		2,203
jcp.com Fulfillment Centers		
Columbus, Ohio	Owned	1,516
Lenexa, Kansas	Owned	1,622
Manchester, Connecticut(1)	Owned	888
Reno, Nevada	Owned	1,660
Total jcp.com fulfillment centers		5,686
Furniture Distribution Centers		
Forest Park, Georgia	Owned	343
Chino, California	Leased	325
Manchester, Connecticut	Owned	291
Wauwatosa, Wisconsin	Owned	592
Total furniture distribution centers		1,551
Total supply chain network		14,482

(1) As of February 2, 2013, this portion of the facility was not operating.

We also own our home office facility in Plano, Texas, and approximately 240 acres of property adjacent to the facility.

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Item 3. Legal Proceedings

Bond Litigation

On February 4, 2013, the Company received a letter (the Letter) from counsel (Bondholders' Counsel) for certain holders of the Company's 7.4% Debentures issued under an Indenture dated April 1, 1994 (the Indenture), purporting to be a Notice of Default under the Indenture. The Company believes that the Letter does not constitute a valid Notice of Default and filed suit on February 4, 2013, in Delaware Chancery Court against U.S. Bank National Association, as Indenture Trustee under the Indenture. The Company is seeking injunctive relief to prevent the Indenture Trustee from declaring an event of default and from taking any action based on such purported breach. The Company is also asking the Court to affirm that the Company is not in breach of the Indenture. The Company intends to vigorously seek the requested relief from the Court. On March 18, 2013, the Court ordered a hearing on the Company's motions for summary judgment and the Company's application for a preliminary injunction during the week of April 1. Immediately after the hearing, the Company received a withdrawal of the notice of default from Bondholders' Counsel.

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 seek primarily to prevent the Company from implementing our partnership agreement with MSLO as it relates 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 March 7, 2013, the judge adjourned the trial until April 8, 2013, and ordered the parties into mediation. While no assurance can be given as to the ultimate outcome of this matter, we currently 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 former executives. The Company is a nominal defendant in the suit. The lawsuit alleges 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 seeks 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 is not excused. The trial court heard arguments on the Special Exceptions on June 25, 2012, and denied them. The Company and named individuals have filed a mandamus proceeding in the Fifth District Court of Appeals challenging the trial court's decision. In the interim, the parties entered into a Memorandum of Understanding to settle the litigation. The plaintiff is currently engaging in confirmatory discovery. In light of these events, the appellate court has stayed issuance of its decision. While no assurance can be given as to the ultimate outcome of this matter, we currently 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.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for Registrant's Common Equity

Our common stock is traded principally on the New York Stock Exchange (NYSE) under the symbol "JCP." The number of stockholders of record at March 18, 2013, was 28,776. In addition to common stock, we have authorized 25 million shares of preferred stock, of which no shares were issued and outstanding at February 2, 2013.

The table below sets forth the quoted high and low market prices of our common stock on the NYSE for each quarterly period indicated, the quarter-end closing market price of our common stock, as well as the quarterly cash dividends declared per share of common stock:

Fiscal Year 2012	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Per share: Dividend	$	0.20	$	-	$	-	$	-
Market price:								
High	$	43.18	$	36.75	$	32.55	$	25.61
Low	$	32.51	$	19.06	$	20.40	$	15.69
Close	$	36.72	$	23.00	$	25.46	$	19.88

Fiscal Year 2011	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Per share: Dividend	$	0.20	$	0.20	$	0.20	$	0.20
Market price:								
High	$	39.24	$	41.00	$	34.50	$	41.86
Low	$	30.71	$	29.82	$	23.44	$	29.55
Close	$	38.45	$	30.76	$	33.08	$	41.42

Our Board of Directors (Board) periodically reviews the dividend policy and rate, taking into consideration the overall financial and strategic outlook for our earnings, liquidity and cash flow projections, as well as competitive factors. On May 15, 2012, we announced that we had discontinued the quarterly $0.20 per share dividend.

Additional information relating to the common stock and preferred stock is included in this Annual Report on Form 10-K in the Consolidated Statements of Stockholders' Equity and in Note 12 to the consolidated financial statements.

Issuer Purchases of Securities

No repurchases of common stock were made during the fourth quarter of 2012 and no amounts remained authorized for share repurchases as of February 2, 2013.

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Five-Year Total Stockholder Return Comparison

The following presentation compares our cumulative stockholder returns for the past five fiscal years with the returns of the S&P 500 Stock Index and the S&P 500 Retail Index for Department Stores over the same period. A list of these companies follows the graph below. The graph assumes $100 invested at the closing price of our common stock on the NYSE and each index as of the last trading day of our fiscal year 2007 and assumes that all dividends were reinvested on the date paid. The points on the graph represent fiscal year-end amounts based on the last trading day of each fiscal year. The following graph and related information shall not be deemed “soliciting material” or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

S&P Department Stores:

jcpenney, Dillard’s, Macy’s, Kohl’s, Nordstrom, Sears

	2007	2008	2009	2010	2011	2012
jcpenney	100	36	54	73	95	46
S&P 500	100	61	81	98	103	121
S&P Department Stores	100	47	79	91	102	105

The stockholder returns shown are neither determinative nor indicative of future performance.

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Item 6. Selected Financial Data

Five-Year Financial Summary

($ in millions, except per share data)	2012	2011	2010	2009	2008
Results for the year					
Total net sales	$ 12,985	$ 17,260	$ 17,759	$ 17,556	$ 18,486
Sales percent increase/(decrease):					
Total net sales	(24.8)% (1)	(2.8)%	1.2%	(5.0)%	(6.9)%
Comparable store sales(2)	(25.2)%	0.2%	2.5%	(6.3)%	(8.5)%
Operating income/(loss)	(1,310)	(2)	832	663	1,135
As a percent of sales	(10.1)%	(0.0)%	4.7%	3.8%	6.1%
Adjusted operating income/(loss) (non-GAAP)(3)	(939)	536	1,085	961	1,002
As a percent of sales (non-GAAP)(3)	(7.2)%	3.1%	6.1%	5.5%	5.4%
Income/(loss) from continuing operations	(985)	(152)	378	249	567
Adjusted income/(loss) from continuing operations (non-GAAP)(3)	(766)	207	533	433	484
Per common share					
Income/(loss) from continuing operations, diluted	$ (4.49)	$ (0.70)	$ 1.59	$ 1.07	$ 2.54
Adjusted income/(loss) from continuing operations, diluted (non-GAAP)(3)	(3.49)	0.94	2.24	1.86	2.17
Dividends declared(4)	0.20	0.80	0.80	0.80	0.80
Financial position and cash flow					
Total assets	$ 9,781	$ 11,424	$ 13,068	$ 12,609	$ 12,039
Cash and cash equivalents	930	1,507	2,622	3,011	2,352
Long-term debt, including capital leases, note payable and current maturities	2,982	3,102	3,099	3,392	3,505
Free cash flow (non-GAAP)(3)	(906)	23	158	677	22

(1) Includes the effect of the 53rd week in 2012. Excluding sales of $163 million for the 53rd week in 2012, total net sales decreased 25.7%.

(2) Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) See Non-GAAP Financial Measures beginning on the following page for additional information and reconciliation to the most directly comparable GAAP financial measure.

(4) On May 15, 2012, we announced that we had discontinued the quarterly $0.20 per share dividend.

Five-Year Operations Summary

	2012	2011	2010	2009	2008
Number of department stores:					
Beginning of year	1,102	1,106	1,108	1,093	1,067
Openings	9	3	2	17	35
Closings(1)	(7)	(7)	(4)	(2)	(9)
End of year	1,104	1,102	1,106	1,108	1,093
Gross selling space (square feet in millions)	111.6	111.2	111.6	111.7	109.9
Sales per gross square foot(2)	$ 116	$ 154	$ 153	$ 149	$ 160
Sales per net selling square foot(2)	$ 161	$ 212	$ 210	$ 206	$ 223
Number of the Foundry Big and Tall Supply Co. stores(3)	10	10	-	-	-

(1) Includes relocations of 3,-, -, 1, and 7 respectively.

(2) Calculation includes the sales and square footage of jcpenney department stores that were open for the full fiscal year and sales for jcp.com.

(3) All stores opened during 2011. Gross selling space was 51 thousand square feet as of February 2, 2013 and January 28, 2012.

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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. 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.

Non-GAAP Measures Excluding Markdowns Related to the Alignment of Inventory with Our New Strategy, Restructuring and Management Transition Charges, the Non-Cash Impact of Our Qualified Defined Benefit Pension Plan Expense and the Net Gain on the Sale or Redemption of Non-Operating Assets

The following non-GAAP financial measures are adjusted to exclude the impact of markdowns related to the alignment of inventory with our new strategy, restructuring and management transition charges, the non-cash impact of our qualified defined benefit pension plan (Primary Pension Plan) expense and the net gain on the sale or redemption of non-operating assets. Unlike other operating expenses, markdowns related to the alignment of inventory with our new strategy, restructuring and management transition charges and the net gain on the sale or redemption of non-operating assets are not directly related to our ongoing core business operations. Additionally, Primary Pension Plan expense 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. We believe it is useful for investors to understand the impact of markdowns related to the alignment of inventory with our new strategy, restructuring and management transition charges, the non-cash impact of our Primary Pension Plan expense and the net gain on the sale or redemption of non-operating assets on our financial results and therefore are presenting the following non-GAAP financial measures: (1) adjusted operating income/(loss); (2) adjusted net income/(loss); and (3) adjusted diluted earnings/(loss) per share (EPS).

Adjusted Operating Income/(Loss). The following table reconciles operating income/(loss), the most directly comparable GAAP financial measure, to adjusted operating income/(loss), a non-GAAP financial measure:

($ in millions)	2012	2011	2010	2009	2008
Operating income/(loss) (GAAP)	$ (1,310)	$ (2)	$ 832	$ 663	$ 1,135
As a percent of sales	(10.1)%	(0.0)%	4.7%	3.8%	6.1%
Add: markdowns - inventory strategy alignment	155	-	-	-	-
Add: restructuring and management transition charges	298	451	32	-	-
Add/(deduct): primary pension plan expense/(income)	315	87	221	298	(133)

Less: Net gain on sale or redemption of non-operating assets	(397)	-	-	-	-
Adjusted operating income/(loss) (non-GAAP)	$ (939)	$ 536	$ 1,085	$ 961	$ 1,002
As a percent of sales	(7.2)%	3.1%	6.1%	5.5%	5.4%

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

($ in millions, except per share data)	2012	2011		2010	2009	2008
Income/(loss) from continuing operations (GAAP)	$ (985)	$ (152)		$ 378	$ 249	$ 567
Diluted EPS from continuing operations (GAAP)	$ (4.49)	$ (0.70)		$ 1.59	$ 1.07	$ 2.54
Add: markdowns - inventory strategy alignment, net of tax of $60, $-, $-, $- and $-	95	-		-	-	-
Add: restructuring and management transition charges, net of tax of $116, $145, $12, $- and $-	182	306		20	-	-
Add/(deduct): primary pension plan expense/(income), net of tax of $122, $34, $86, $114, and $(50)	193	53		135	184	(83)
Less: Net gain on sale or redemption of non-operating assets, net of tax of $(146), $-, $-, $- and $-	(251)	-		-	-	-
Adjusted income/(loss) from continuing operations (non-GAAP)	$ (766)	$ 207		$ 533	$ 433	$ 484
Adjusted diluted EPS from continuing operations (non-GAAP)	$ (3.49)	$ 0.94	(1)	$ 2.24	$ 1.86	$ 2.17

(1) Weighted average shares–diluted of 220.7 million was used for this calculation as 2011 adjusted income from continuing operations was positive. 3.3 million shares were added to weighted average shares–basic of 217.4 million for assumed dilution for stock options, restricted stock awards and stock warrant.

Free Cash Flow

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 and dividends paid, 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 off-balance sheet 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.

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

($ in millions)	2012	2011	2010	2009	2008
Net cash provided by/(used in) operating activities (GAAP)	$ (10)	$ 820	$ 592	$ 1,573	$ 1,156
Less:					
Capital expenditures	(810)	(634)	(499)	(600)	(969)
Dividends paid, common stock	(86)	(178)	(189)	(183)	(178)
Tax benefit from pension contribution	-	-	(152)	(126) (1)	-
Plus:					
Discretionary cash pension contribution	-	-	392	-	-
Proceeds from sale of operating assets	-	15	14	13	13
Free cash flow (non-GAAP)	$ (906)	$ 23	$ 158	$ 677	$ 22

(1) Related to the discretionary contribution of $340 million of Company common stock in 2009.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion, which presents our results, should be read in conjunction with the accompanying consolidated financial statements and notes thereto, along with the Five-Year Financial and Operations Summaries, the risk factors and the cautionary statement regarding forward-looking information. Unless otherwise indicated, this Management's Discussion and Analysis (MD&A) relates only to results from continuing operations, 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.

Executive Overview

2012 was the first year of our multi-year transformation strategy to become America's favorite store. We underwent tremendous change as we began shifting our business model from a promotional department store to a specialty department store. 2012 was a difficult year and our sales and operating performance declined significantly. 2012 contained 53 weeks and 2011 and 2010 contained 52 weeks. Summarized financial performance for 2012 is as follows:

§ For 2012, sales were $12,985 million, a decrease of 24.8% as compared to 2011. Excluding sales of $163 million for the 53rd week in 2012, total net sales decreased 25.7%. Comparable store sales decreased 25.2% for 2012.

§ For 2012, gross margin as a percentage of sales was 31.3% compared to 36.0% last year. The decrease in gross margin as a percentage of sales is primarily due to a higher level of clearance merchandise sales and markdowns taken during the year to clear discontinued inventory in preparation for new product and brands being introduced as part of the transformation.

§ Selling, general and administrative (SG&A) expenses decreased $603 million, or 11.8%, for 2012 as compared to 2011 as we began to realize the benefits from our cost savings initiatives.

§ Our net loss from continuing operations for 2012 was $985 million, or $4.49 per share, compared to a net loss from continuing operations of $152 million, or $0.70 per share, for 2011 and net income from continuing operations of $378 million, or $1.59 per share, for 2010. Results for 2012 included $155 million ($95 million after taxes), or $0.43 per share, of markdowns related to the alignment of our inventory with our new strategy; $298 million ($182 million after taxes), or $0.83 per share, of restructuring and management transition charges; $315 million ($193 million after taxes), or $0.88 per share, for the non-cash impact of our qualified defined benefit pension plan (Primary Pension Plan) expense and $397 million ($251 million after taxes), or $1.15 per share, for the net gain on the sale or redemption of non-operating assets.

§ During the third quarter of 2012, we opened shops under the Levi's®, The Original Arizona Jean Co., Izod®, Liz Claiborne and jcp brands. During 2012, we also opened 78 Sephora inside jcpenney stores, bringing the total to 386.

Current Developments

§ On February 8, 2013, we entered into an amended and restated credit facility in an amount up to $1,850 million. We may request that the facility be increased by an additional amount up to $400 million.

§ On March 15, 2013, we opened women's Joe Fresh® shops in nearly 700 of our department stores.

§ In March 2013, we began the process of transforming our home department in 505 of our department stores with completion anticipated in May 2013. We anticipate opening close to 20 shops with brand partners such as Michael Graves, Jonathan Adler and Sir Terence Conran, among others.

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Results of Operations

Three-Year Comparison of Operating Performance

(in millions, except per share data)	2012		2011		2010
Total net sales	$ 12,985		$ 17,260		$ 17,759
Percent increase/(decrease) from prior year	(24.8)%	(1)	(2.8)%		1.2%
Comparable store sales increase/(decrease)(2)	(25.2)%		0.2%		2.5%
Gross margin	4,066		6,218		6,960
Operating expenses/(income):					
Selling, general and administrative	4,506		5,109		5,358
Pension	353		121		255
Depreciation and amortization	543		518		511
Real estate and other, net	(324)		21		(28)
Restructuring and management transition	298		451		32
Total operating expenses	5,376		6,220		6,128
Operating income/(loss)	(1,310)		(2)		832
As a percent of sales	(10.1)%		(0.0)%		4.7%
Adjusted operating income/(loss) (non-GAAP)(3)	(939)		536		1,085
As a percent of sales	(7.2)%		3.1%		6.1%
Net interest expense	226		227		231
Bond premiums and unamortized costs	-		-		20
Income/(loss) from continuing operations before income taxes	(1,536)		(229)		581
Income tax (benefit)/expense	(551)		(77)		203
Income/(loss) from continuing operations	$ (985)		$ (152)		$ 378
Adjusted income/(loss) from continuing operations (non-GAAP)(3)	$ (766)		$ 207		$ 533
Diluted EPS from continuing operations	$ (4.49)		$ (0.70)		$ 1.59
Adjusted diluted EPS from continuing operations (non-GAAP)(3)	$ (3.49)		$ 0.94	(4)	$ 2.24
Weighted average shares used for diluted EPS	219.2		217.4		238.0

(1) Includes the effect of the 53rd week in 2012. Excluding sales of $163 million for the 53rd week in 2012, total net sales decreased 25.7%.

(2) Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) See Item 6, Selected Financial Data, for a discussion of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure.

(4) Weighted average shares–diluted of 220.7 million was used for this calculation as adjusted income from continuing operations was positive. 3.3 million shares were added to weighted average shares–basic of 217.4 million for assumed dilution for stock options, restricted stock awards and stock warrant.

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2012 Compared to 2011

Total Net Sales

Our year-to-year change in total net sales is comprised of (a) sales from new stores net of closings and relocations including catalog print media and outlet store sales, referred to as non-comparable store sales and (b) sales of stores opened in both years as well as Internet sales, referred to as comparable store sales. We consider comparable store sales to be a key indicator of our current performance measuring the growth in sales and sales productivity of existing stores. Positive comparable store sales contribute to greater leveraging of operating costs, particularly payroll and occupancy costs, while negative comparable store sales contribute to de-leveraging of costs. Comparable store sales also have a direct impact on our total net sales and the level of cash flow.

	2012		2011
Total net sales (in millions)	$ 12,985		$ 17,260
Sales percent increase/(decrease)			
Total net sales	(24.8)%	(1)	(2.8)%
Comparable store sales(2)	(25.2)%		0.2%
Sales per gross square foot(3)	$ 116		$ 154

(1) Includes the effect of the 53rd week in 2012. Excluding sales of $163 million for the 53rd week in 2012, total net sales decreased 25.7%.

(2) Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) Calculation includes the sales and square footage of department stores that were open for the full fiscal year, as well as Internet sales.

Total net sales decreased $4,275 million in 2012 compared to 2011. The following table provides the components of the net sales decrease:

($ in millions)	2012
Comparable store sales, including Internet	$ (4,303)
Sales for the 53rd week	163
Sales of new (non-comparable) stores, net	11
Sales decline through catalog outlet stores	(146)

2012 total net sales decrease	$ (4,275)

In 2012, we completed the first year of our multi-year transformation strategy to become America's favorite store. We underwent tremendous change as we began shifting our business model from a promotional department store to a specialty department store. Our first year of our transformation was a difficult year, as our comparable store sales decreased 25.2% in 2012. Internet sales, which are included in comparable store sales, decreased 33.0%, to $1,023 million. Total net sales decreased 24.8% to $12,985 million compared with $17,260 million in 2011. The decrease in total net sales includes the impact of our exit from our catalog outlet businesses in October 2011.

Based on a sample of our mall and off-mall stores, our store traffic and conversion rate decreased in 2012 compared to 2011. Both the number of store transactions and the number of units sold decreased in 2012 as compared to the prior year. Although we sold more items at our everyday prices at a higher average unit retail during 2012, the increase in clearance merchandise sold at a lower average unit retail and the increase in clearance merchandise sold as a percentage of total sales more than offset that benefit.

All merchandise divisions experienced comparable store sales declines in 2012 compared to 2011. Men's and women's apparel experienced the smallest declines while the home division experienced the largest decline. All geographic regions also experienced comparable store sales declines. Private brands, including exclusive brands found only at jcpenney, comprised approximately 53% of total merchandise sales for 2012, compared to 55% in 2011.

As we transform substantially more of our selling space and introduce new merchandise and brands to our stores, we expect our sales performance to begin to improve in the future.

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Gross Margin

Gross margin is a measure of profitability of a retail company at the most fundamental level of buying and selling merchandise and measures a company's ability to effectively manage the total costs of sourcing and allocating merchandise against the corresponding retail pricing. Gross margins not only cover marketing, selling and other operating expenses, but also must include a profit element to reinvest back into the business. Gross margin is the difference between total net sales and cost of the merchandise sold and is typically expressed as a percentage of total net sales. The cost of merchandise sold includes all direct costs of bringing merchandise to its final selling destination. These costs include:

- cost of the merchandise (net of discounts or allowances earned)
- freight
- warehousing
- sourcing and procurement
- buying and brand development costs including buyers' salaries and related expenses
- royalties and brand design fees
- merchandise examination
- inspection and testing
- merchandise distribution center expenses
- shipping and handling costs incurred related to sales to customers

($ in millions)	2012	2011
Gross margin	$ 4,066	$ 6,218
As a percent of sales	31.3%	36.0%

Gross margin for 2012 was $4,066 million, a decrease of $2,152 million compared to $6,218 million in 2011. Gross margin as a percentage of sales in 2012 was 31.3% compared to 36.0% in 2011. The net 470 basis point decrease resulted from the following:

- higher margins realized on "everyday value" priced merchandise sales, despite a lower percentage of sales sold as "everyday value" (+240 basis points);
- lower margins achieved on clearance merchandise sales combined with a greater penetration of clearance sales (-460 basis points);
- lower margins on services and other activities, which includes the impact of free haircuts and promotionally priced photography services during 2012 (-130 basis points);
- higher levels of markdowns and inventory reserves related to our new strategy (-70 basis points); and
- reduced vendor cost concessions in connection with our simplified pricing strategy (-50 basis points).

SG&A Expenses

The following costs are included in SG&A expenses, except if related to merchandise buying, sourcing, warehousing or distribution activities:

- salaries
- marketing
- occupancy and rent
- utilities and maintenance
- information technology
- administrative costs related to our home office, district and regional operations
- credit/debit card fees
- real property, personal property and other taxes (excluding income taxes)

($ in millions)	2012	2011
SG&A	$ 4,506	$ 5,109
As a percent of sales	34.7%	29.6%

For 2012, SG&A expenses declined $603 million to $4,506 million compared to $5,109 million in 2011 primarily as a result of our cost savings initiatives. As a percent of sales, SG&A expenses increased to 34.7% compared to 29.6% in 2011, as we were not able to leverage our expense reductions against lower sales. The net decrease resulted from the following:

· reduced salaries and related benefits, including lower incentive compensation (-$386 million);

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- increased income from the jcpenney private label credit card activities which is recorded as a reduction of our SG&A expenses (-$95 million);
- reduced advertising expenses (-$106 million);
- reduced costs from the exit from our catalog outlet stores and our specialty websites CLAD™ and Gifting Grace™ (-$71 million);
- increased spending primarily related to enhancing information technology in our stores (+$25 million); and
- net increase in other miscellaneous items (+$30 million).

Pension Expense

($ in millions)	2012	2011
Primary pension plan expense	$ 167	$ 87
Primary pension plan settlement expense	148	-
Total primary pension plan expense	315	87
Supplemental pension plans expense	38	34
Total pension expense	$ 353	$ 121

Total pension expense consists of our non-cash Primary Pension Plan expense and our supplemental pension plans expense. During the third quarter of 2012, as a result of previous actions taken to reduce our workforce, we remeasured our pension plans as of September 30th. For the Primary Pension Plan, the remeasurement resulted in a reduction of $27 million to our full year 2012 non-cash Primary Pension Plan expense, bringing Primary Pension Plan expense to $167 million, excluding the settlement charge of $148 million incurred during the fourth quarter of 2012. The decline relates primarily to the decrease in the number of employees accruing benefits under the plan following the reductions in our workforce. The remeasurement did not materially impact the pension expense for our supplemental pension plans.

For the first eight months of fiscal 2012, our total pension expense was based on our 2011 year-end measurement of pension plan assets and benefit obligations. The 2011 year-end measurement resulted in an increase in 2012 pension plan expense as compared to 2011 primarily as a result of an approximately 80 basis point decrease in our discount rate, an increase in the pension liability resulting from our voluntary early retirement program offered during the third quarter of 2011 and a decrease in the value of plan assets due to unfavorable capital market returns in 2011.

In September 2012, as a result of a plan amendment, we offered approximately 35,000 participants in the Primary Pension Plan who separated from service and had a deferred vested benefit as of August 31, 2012 the option to receive a lump-sum settlement payment. These participants had until November 30, 2012 to elect to receive the lump-sum settlement payment with the payments made by the Company beginning on December 4, 2012 using assets from the Primary Pension Plan. As a result of the approximately 25,000 participants who elected the lump-sum settlements, we made payments totaling $439 million from the Primary Pension Plan's assets and recognized settlement expense of $148 million for unrecognized actuarial losses. We also amended the Primary Pension Plan to allow participants that separate from the Company on or after September 1, 2012 the option of a lump-sum settlement payment from the plan. The amendment also provided for automatic lump-sum settlement payments for participants with vested balances less than $5,000.

Based on our 2012 year-end measurement of Primary Pension Plan assets and benefit obligations, we expect our 2013 non-cash Primary Pension Plan expense to decrease to $100 million compared to $167 million in 2012, which excludes settlement expense of $148 million. The decrease in expected Primary Pension Plan expense for 2013 is a result of lower amortization of our actuarial loss due to the lump-sum settlements in 2012, lower service cost due to a decrease in the number of participants accruing benefits and strong asset performance. These decreases were partially offset by an approximately 60 basis point decrease in our discount rate and a 50 basis point decrease in our assumed expected return on assets.

Depreciation and Amortization Expense

Depreciation and amortization expense in 2012 increased $25 million to $543 million from $518 million in 2011 as a result of our investment in our shops inside our jcpenney department stores in addition to the opening of 9 department stores in 2012. Depreciation and amortization expense for 2012 excludes $25 million of increased depreciation as a result of shortening the useful lives of store fixtures in our department stores that are expected to be replaced throughout 2013 with the build out of additional shops. This amount is included in the line restructuring and management transition on the Consolidated Statements of Operations. We anticipate depreciation expense will continue to increase as we invest and replace store fixtures in connection with the implementation of our shop strategy.

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Real Estate and Other, Net

Real estate and other consists of ongoing operating income from our real estate subsidiaries whose investments are in real estate investment trusts (REITs), as well as investments in nine joint ventures that own regional mall properties. 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. The composition of real estate and other, net was as follows:

($ in millions)	2012	2011
Gain on sale or redemption of non-operating assets, net		
Redemption of Simon Property Group, L.P. (SPG) REIT units	$ (200)	$ -
Sale of CBL & Associates Properties, Inc. (CBL) REIT shares	(15)	-
Sale of leveraged lease assets	(28)	-
Sale of investment in joint ventures	(151)	-
Sale of building	(3)	-
Net gain on sale or redemption of non-operating assets	(397)	-
Dividend income from REITs	(6)	(10)
Investment income from joint ventures	(11)	(13)
Net gain from sale of operating assets	-	(6)
Store impairments	26	58
Operating asset impairments	60	-
Other	4	(8)
Total expense/(income)	$ (324)	$ 21

Monetization of Non-operating Assets

As part of our strategy to monetize assets that are not core to our operations, we generated $526 million of cash and recognized a net gain of $397 million from the sale or redemption of several non-operating assets during 2012. The monetization of non-operating assets primarily included the following:

REIT Assets

On July 20, 2012, SPG redeemed two million of our REIT units at a price of $124.00 per unit for a total redemption price of $246 million, net of fees. As of the market close on July 19, 2012, the SPG REIT units had a fair market value of $158.13 per unit. In connection with the redemption, we realized a net gain of $200 million determined using the first-in-first-out method for determining the cost of REIT units sold. Following the transaction, we continue to hold approximately 205,000 REIT units in SPG.

On October 23, 2012, we sold all of our CBL REIT shares at a price of $21.35 per share for a total price of $40 million, net of fees. In connection with the sale, we realized a net gain of $15 million.

Leveraged Leases

During the third quarter of 2012, we sold all of our leveraged lease assets for $146 million, net of fees. The investments in the leveraged lease assets as of the dates of the sales were $118 million and we recorded a net gain of $28 million.

Joint Ventures

During the third quarter of 2012, we sold our investments in four joint ventures that own regional mall properties for $90 million, resulting in net gains totaling $151 million. The gain exceeded the cash proceeds as a result of distributions of cash related to refinancing transactions in prior periods that were recorded as net reductions in the carrying amount of the investments. The cumulative net book value of the joint venture investments was a negative $61 million.

Building

During the third quarter of 2012, we sold a building used in our former drugstore operations with a net book value of zero for $3 million resulting in a net gain of $3 million.

Impairments

In 2012, store impairments totaled $26 million and related to 13 underperforming department stores that continued to operate. In addition, during the fourth quarter of 2012, we wrote off $60 million of store-related operating assets that are no longer being used in our operations. In 2011, store impairments totaled $58 million and related to eight underperforming department stores of which seven continued to operate.

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Restructuring and Management Transition

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

($ in millions)	2012	2011
Supply chain	$ 19	$ 41
Catalog and catalog outlet stores	-	34
Home office and stores	109	41
Software and systems	36	-
Store fixtures	78	-
Management transition	41	130
VERP	-	179
Other	15	26
Total	$ 298	$ 451

Supply chain

As a result of consolidating and streamlining our supply chain organization as part of a restructuring program that began in 2011, during 2012 and 2011, we recorded charges of $19 million and $41 million, respectively, related to increased depreciation, termination benefits and unit closing costs. Increased depreciation resulted from shortening the useful lives of assets related to the closing and consolidating of selected facilities. This restructuring activity was completed during the third quarter of 2012.

Catalog and catalog outlet stores

On October 16, 2011, we sold the assets related to the operations of our catalog outlet stores.
We sold fixed assets and inventory with combined net book values of approximately $31 million, for a total purchase price of
During 2011, we also
recorded $10 million of severance costs related to the sale of our outlet stores. This restructuring activity was completed in 201

Home office and stores

During 2012 and 2011, we recorded $109 million and $41
million, respectively, of net charges associated with employee termination benefits for actions to reduce our store and home of
During the third quarter of 2012, when substantially all employee exits related to 2012
were completed, we recorded a net curtailment gain of $7 million. The net curtailment gain was more than offset by 2012 charges associated with employee termination benefits of $116 million.

Software and systems

During 2012, we recorded a charge of $36 million related to the disposal of software and systems that based on our evaluation
Included in this amount is $3 million of consulting fees related to that evaluation.

Store fixtures

During 2012, we recorded $53 million of charges related to the removal of store fixtures in our department stores. In addition, we recorded $25 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that are expected to be replaced throughout 2013 with the build out of additional shops. As we continue to design and implement new shops in conjunction with our efforts to re-organize our department stores, we anticipate additional store fixture write-offs and increased depreciation.

Management transition

During 2012 and 2011, we implemented several changes within our management leadership team that resulted in management transition costs of $41 million and $130 million, respectively, for both incoming and outgoing members of management. Ronald B. Johnson became Chief Executive Officer on November 1, 2011, succeeding Myron E. Ullman, III. Mr. Ullman was Executive Chairman of the Board of Directors until January 27, 2012, at which time he retired from the Company. During 2011, we incurred transition charges of $53 million and $29 million related to Mr. Johnson and Mr. Ullman, respectively. In October 2011, Michael R. Francis was appointed President and as part of his employment package, he was awarded a one-time sign-on bonus of $12 million. In November 2011, Michael W. Kramer and Daniel E. Walker were appointed Chief Operating Officer and Chief Talent Officer, respectively, and as part of their respective employment packages, they were awarded one-time sign-on bonuses of $4 million and $8 million, respectively. In 2012 and 2011, we recorded $41 million and $24 million, respectively, of management transition charges related to other members of management.

VERP

As a part of several restructuring and cost-savings initiatives designed to reduce salary and related costs across the Company, in August of 2011 we announced a VERP which was offered to approximately 8,000 eligible associates. In the third quarter of 2011, we incurred a total charge of $179 million related to the VERP. Charges included $176 million related to enhanced retirement benefits

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for the approximately 4,000 employees who accepted the VERP, $1 million related to curtailment charges for our non qualified supplemental pension plans as a result of the reduction in the expected years of future service related to these plans, and $2 million of costs associated with administering the VERP. This restructuring activity was completed in 2011.

Other

During 2012 and 2011, we recorded miscellaneous restructuring charges of $15 million and $26 million, respectively. These charges were primarily related to the closing and consolidating of facilities related to our custom decorating operations, the exit of our specialty websites CLAD and Gifting Grace and the closure of our Pittsburgh, Pennsylvania customer call center. These restructuring activities were completed in 2012 and 2011.

Operating Income/(Loss)

For 2012, we reported an operating loss of $1,310 million compared to an operating loss of $2 million in 2011. Excluding markdowns related to the alignment of inventory with our new strategy, restructuring and management transition charges, the non-cash impact of our Primary Pension Plan expense and the net gain on the sale or redemption of non-operating assets, adjusted operating income/(loss) (non-GAAP) for 2012 was an operating loss of $939 million, a decrease of $1,475 million from operating income of $536 million in 2011.

Net Interest Expense

Net interest expense consists principally of interest expense on long-term debt, net of interest income earned on cash and cash equivalents. Net interest expense for 2012 was $226 million, a decrease of $1 million from $227 million in 2011. The decrease relates primarily to lower overall debt outstanding as a result of our $230 million debt repayment in August 2012 at maturity.

Income Taxes

The effective income tax rate was (35.9)% and (33.6)% for 2012 and 2011, respectively. Our income tax benefit for 2012 was positively impacted by federal wage tax credits, state law changes, state audit settlements and the sale and redemption of non-operating assets and negatively impacted by the discontinuation of our quarterly dividend and a valuation allowance for certain state net operating losses.

2011 Compared to 2010

Total Net Sales

	2011	2010
Total net sales (in millions)	$ 17,260	$ 17,759
Sales percent (decrease)/increase		
Total net sales	(2.8)%	1.2%
Comparable store sales	0.2%	2.5%
Sales per gross square foot[(1)]	$ 154	$ 153

(1) Calculation includes the sales and square footage of department stores that were open for the full fiscal year, as well as Internet sales.

Total net sales decreased $499 million in 2011 compared to 2010. The following table provides the components of the net sales decrease:

($ in millions)	2011
Comparable store sales, including Internet	$ 33
Sales of new (non-comparable) stores, net	11
Sales decline through catalog print media and outlet stores	(543)
2011 total net sales decrease	$ (499)

In 2011, comparable store sales were essentially flat at 0.2%, or $33 million higher, as we experienced a softer than expected selling environment. Sales of non-comparable stores opened in 2011 and 2010, net of closings, added $11 million. In 2011, we opened three new department stores and closed seven, while in 2010 we opened two new department stores and closed four. As expected, catalog print media and outlet store sales declined during 2011 due to the exit from the catalog and outlet store businesses. Internet sales, which are included in comparable store sales, remained essentially flat at $1.5 billion for 2011 and 2010. All components combined, total net sales decreased $499 million or 2.8% from 2010 to 2011.

During 2011, off-mall traffic increased compared to 2010, while mall traffic declined. In addition, our conversion rates for both mall and off-mall stores were above 2010 levels. Our average unit retail in jcpenney department stores increased slightly compared to the prior year. The number of store transactions increased during the year, while the number of units sold and units per transaction declined. Sales in all geographic regions remained relatively flat in 2011. Based on comparable store sales, our best sales performance was in the southwest region, with the weakest performance coming from the northwest and central regions. Also based on comparable store sales, our best performing categories were women's apparel and women's accessories, including Sephora. Home and family footwear experienced the weakest performance in 2011. Private and exclusive brands found only at jcpenney were 55% of total merchandise sales in 2011 and 2010.

Gross Margin

($ in millions)	2011	2010
Gross margin	$ 6,218	$ 6,960
As a percent of sales	36.0%	39.2%

Gross margin decreased to 36.0% of sales, or 320 basis points compared to 2010. On a dollar basis, gross margin decreased $742 million, or 10.7%, to $6,218 million in 2011 compared to $6,960 million in the prior year. The net 320 basis point decrease resulted from the following:

- costs associated with implementing our new pricing strategy in the fourth quarter of 2011, including $55 million of labor costs, $12 million of ticket and other miscellaneous costs and $140 million of markdowns of merchandise (-120 basis points);
- higher markdowns as a result of increased promotional activity (-100 basis points);
- lower vendor support, higher royalty payments and increased year-over-year shrinkage (-80 basis points); and
- non-comparable free shipping offers for jcp.com combined with higher delivery costs (-20 basis points).

SG&A Expenses

($ in millions)	2011	2010
SG&A	$ 5,109	$ 5,358
As a percent of sales	29.6%	30.2%

SG&A expenses declined $249 million to $5,109 million in 2011 compared to $5,358 million in 2010. As a percent of sales, SG&A expenses were leveraged and decreased 60 basis points to 29.6% compared to 30.2% in 2010. The net decrease resulted from the following:

- lower marketing expenses due to the elimination of catalog print media (-$133 million);
- increased income from the jcpenney private label credit card activities which is recorded as a reduction of our SG&A expenses (-$67 million);
- reduced salaries and related benefits, including lower incentive compensation (-$45 million);
- reduced costs from the exit from our catalog outlet stores (-$29 million);
- net reduction in other miscellaneous items (-$7 million); and
- increased spending for our continuing roll-out of Sephora inside jcpenney and investment in our Growth Brand Division, including The Foundry Big & Tall Supply Co. (Foundry stores) (+$32 million).

Pension Expense

($ in millions)	2011	2010
Primary pension plan expense	$ 87	$ 221
Supplemental pension plans expense	34	34
Total pension expense	$ 121	$ 255

Total pension expense was $121 million in 2011 compared to $255 million in 2010 and consisted mainly of the Primary Pension Plan expense of $87 million in 2011 versus $221 million for 2010. The 2011 Primary Pension Plan expense declined mainly as a result of the increase in the value of pension plan assets as of the 2010 year-end measurement date due to positive market returns in 2010 and our discretionary cash contribution of $392 million in May 2010, partially offset by a 90 basis point decline in our expected return on plan assets. The decline of the expected rate of return is due to our new target allocation strategy to mitigate volatility risk by decreasing the plan's asset allocation to equities and shifting to less volatile fixed income investments.

Depreciation and Amortization Expenses

Depreciation and amortization expenses in 2011 increased $7 million to $518 million, or approximately 1.4%, compared to $511 million in 2010 primarily as a result of our store renewals and updates over the past two years. This includes our investment in our in-store shops MNG by Mango, Call it Spring and Sephora inside jcpenney. During 2011, we also opened three new department stores and ten Foundry stores.

Real Estate and Other, Net

($ in millions)	2011	2010
Dividend income from REITs	$ (10)	$ (8)
Investment income from joint ventures	(13)	(15)
Net gain from sale of operating assets	(6)	(8)
Impairments	58	3
Other	(8)	-
Total expense/(income)	$ 21	$ (28)

Real estate and other expenses totaled $21 million in 2011 compared to income of $28 million in 2010. In 2011, store impairments totaled $58 million and related to eight underperforming department stores of which seven continued to operate. In 2010, impairments totaled $3 million and related primarily to one underperforming department store that continued to operate.

Restructuring and Management Transition Charges

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

($ in millions)	2011	2010
Supply chain	$ 41	$ -
Catalog and catalog outlet stores	34	21
Home office and stores	41	4
Management transition	130	-
VERP	179	-
Other	26	7
Total	$ 451	$ 32

Supply chain

As a result of consolidating and streamlining our supply chain organization as part of a restructuring program during 2011, we recorded $28 million of increased depreciation, $8 million of costs to close and consolidate facilities and $5 million of employee severance. Increased depreciation resulted from shortening the useful lives of assets related to the closing and consolidating of selected facilities.

Catalog and catalog outlet stores

In the fourth quarter of 2010, we announced our plan to exit the catalog outlet stores and wind down our catalog business. As a result, in 2010 we recorded $17 million of increased depreciation and $4 million of employee severance. Increased depreciation resulted from shortening the useful lives of assets associated with our catalog and catalog outlet stores. In October 2011, we completed an asset purchase agreement to sell the assets related to the operations of our catalog outlet stores. We sold fixed assets and inventory with combined net book values of approximately $31 million, for a total purchase price of $7 million, which resulted in a loss of $24 million. In 2011, we also recorded an additional $10 million of severance and other costs related to the sale of our catalog outlet stores. In total for 2011 and 2010, we recorded $55 million related to the exit of our catalog and catalog outlet stores.

Home office and stores

In 2011 and 2010, we recorded $41 million and $4 million, respectively, of employee termination benefits for actions to reduce our store and home office expenses.

Management transition

During 2011, we announced and implemented several changes within our management leadership team which resulted in management transition costs of $130 million during the year. Ronald B. Johnson became Chief Executive Officer on November 1, 2011, succeeding Myron E. Ullman, III. Mr. Ullman was Executive Chairman of the Board of Directors until January 27, 2012, at which time he retired from the Company. During 2011, we incurred transition charges of $53 million and $29 million related to Mr. Johnson and Mr. Ullman, respectively. In October 2011, Michael R. Francis was appointed President and as part of his employment package, he was awarded a one-time sign-on bonus of $12 million. In November 2011, Michael W. Kramer and Daniel E. Walker were appointed Chief Operating Officer and Chief Talent Officer, respectively, and as part of their respective employment packages, they were awarded one-time sign-on bonuses of $4 million and $8 million, respectively. We also recorded $24 million of management transition charges primarily related to other members of management in 2011.

VERP

As a part of several restructuring and cost-savings initiatives designed to reduce salary and related costs across the Company, in August of 2011 we announced a VERP which was offered to approximately 8,000 eligible associates. In the third quarter of 2011, we recorded a total charge of $179 million related to the VERP. Charges included $176 million related to enhanced retirement benefits for the approximately 4,000 associates who accepted the VERP, $1 million related to curtailment charges for our Supplemental Retirement Program and Benefit Restoration Plan as a result of the reduction in the expected years of future service related to these plans, and an additional $2 million of costs associated with administering the VERP.

Other

In 2011, we recorded $26 million of charges primarily related to the restructuring activities associated with streamlining our custom decorating operations and the exit of our specialty websites CLAD and Gifting Grace. In 2010, we recorded $7 million of charges primarily related to the restructuring activities associated with streamlining our custom decorating operations. In 2011 and 2010, we recorded $4 million and $3 million, respectively, of charges primarily related to increased depreciation as a result of closing and consolidating facilities related to our custom decorating operations. In the fourth quarter of 2011, we recorded $8 million related to the exit of our specialty websites primarily related to employment termination benefits and contract termination costs. In 2011 and 2010, we incurred $14 million and $4 million, respectively, of additional miscellaneous restructuring costs.

Operating Income/(Loss)

Operating income decreased 470 basis points to (0.0)% of sales in 2011 compared to 4.7% in 2010. Excluding restructuring and management transition charges and the non-cash impact of the Primary Pension Plan expense, adjusted operating income (non-GAAP) decreased 300 basis points to 3.1% of sales compared to 6.1% in 2010.

Net Interest Expense

Net interest expense was $227 million, a decrease of $4 million, or 1.7%, from $231 million in 2010. The decrease was primarily due to lower overall debt outstanding during 2011 as compared to 2010 combined with lower interest rate levels resulting from long-term debt transactions completed during 2010.

Bond Premiums and Unamortized Costs

In 2010, we incurred $20 million of additional financing costs, consisting primarily of bond premiums paid in connection with the debt tender offer completed in May 2010. There were no comparable costs in 2011.

Income Taxes

The effective income tax rate for continuing operations for 2011 was (33.6)% compared with 34.9% for 2010. The rate was positively impacted by federal wage tax credits and negatively impacted by non-deductible management transition costs.

Income/(Loss) from Continuing Operations

In 2011, we reported a loss from continuing operations of $152 million, or $0.70 per share, compared with income from continuing operations of $378 million, or $1.59 per share, last year. Excluding restructuring and management transition charges and the non-cash impact of the Primary Pension Plan expense, adjusted income from continuing operations (non-GAAP) decreased $326 million to $207 million, or $0.94 per share, compared to $533 million, or $2.24 per share, for 2010.

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Financial Condition and Liquidity

Overview

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our revolving credit facility. While our contractual obligations and commitment requirements over the next several years are significant, we continue to believe we will have available resources to meet our liquidity requirements. As of the end of fiscal year 2012, we had $930 million of cash and cash equivalents and $1,241 million available for borrowing under our revolving credit facility. On February 8, 2013, we entered into an amended and restated credit facility in an amount up to $1,850 million. We may request that the facility be increased by an additional amount up to $400 million. The future success of our business depends on our ability to generate positive free cash flow (non-GAAP).

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

($ in millions)	2012	2011	2010
Cash and cash equivalents	$ 930	$ 1,507	$ 2,622
Merchandise inventory	2,341	2,916	3,213
Property and equipment, net	5,353	5,176	5,231
Long-term debt, including capital leases, note payable and current maturities	2,982	3,102	3,099
Stockholders' equity	3,171	4,010	5,460
Total capital	6,153	7,112	8,559
Maximum capacity under our credit agreement	1,750 (1)	1,250	750
Cash flow from operating activities	(10)	820	592 (2)
Free cash flow (non-GAAP)(3)	(906)	23	158
Capital expenditures	810	634	499
Dividends paid	86	178	189
Ratios:			
Debt-to-total capital(4)	48.5%	43.6%	36.2%
Cash-to-debt(5)	31.2%	48.6%	84.6%

(1) On February 8, 2013, we entered into an amended and restated credit agreement which increased the size of our revolving credit facility to $1,850 million.

(2) Includes a $392 million discretionary cash contribution to the Primary Pension Plan and a related $152 million tax benefit.

(3) See Item 6, Selected Financial Data, for a discussion of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure.

(4) Long-term debt, including capital leases, note payable and current maturities, divided by total capitalization.

(5) Cash and cash equivalents divided by long-term debt, including capital leases, note payable and current maturities.

Cash and Cash Equivalents

At the end of 2012, we had $930 million of cash and cash equivalents, which represented approximately 31.2% of our $3.0 billion of outstanding long-term debt, including capital leases, note payable and current maturities. Cash and cash equivalents decreased $577 million after uses of cash that included an outflow of $10 million from operations, investment of $810 million in our business, which includes our investment in our shops inside jcpenney department stores, repayment of $230 million of long-term debt, and $86 million in dividends paid. Also in 2012, we realized $526 million in cash from the sale of non-operating assets.

Free Cash Flow (Non-GAAP)

During 2012, free cash flow decreased $929 million to an outflow of $906 million compared to an inflow of $23 million in 2011. The decrease was due to significantly reduced cash flow from operations and increased capital expenditures.

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 the impact of our transformation strategy.

In 2012, cash flow from operating activities was an outflow of $10 million, a decrease of $830 million from the prior year. The decrease in operating cash flow is reflective of significantly reduced operating performance. Our total year 2012 net loss of $985 million includes significant non-cash expenses and charges including depreciation and amortization, pension expense, and restructuring and management transition. We realized positive operating cash flow impacts from reduced operating expenses, reduced inventory levels, and specific steps taken to improve overall working capital.

Merchandise inventory decreased $575 million, or 19.7%, to $2,341 million as of the end of 2012 compared to $2,916 million as of the end of last year, reflecting planned inventory reduction efforts in 2012 to help better position our inventory levels during our transformation. Inventory turns for 2012, 2011 and 2010 were 3.03, 3.09 and 3.05, respectively. Merchandise accounts payable increased $140 million at year end 2012 compared to 2011.

In 2012, we realigned our merchandise and non-merchandise vendor payment schedule. The positive effect of this vendor payment schedule change on 2012 operating cash flow was $129 million. We also deferred $85 million of payments to selected merchandise vendors from the fourth quarter of 2012 to the first quarter of 2013. In the fourth quarter of 2012, we extended our private label credit card agreement and received a signing bonus and an advancement of our 2013 gain share totaling $75 million in cash.

In 2011, cash flow from operating activities was $820 million, an increase of $228 million from the prior year. In 2010, our cash flow from operating activities was impacted by a $392 million discretionary pension contribution which resulted in a tax benefit of $152 million, for a net use of cash of $240 million. Although operating performance was lower in 2011 as compared to 2010, this was offset as we managed inventories at lower levels during 2011.

Investing Activities

In 2012, cash flow from investing activities was an outflow of $293 million compared to an outflow of $870 million for the same period in 2011. The decrease in the cash outflow from investing activities was primarily a result of increased capital expenditures offset by proceeds from the sale or redemption of non-operating assets.

In 2012, capital expenditures were $810 million. Capital expenditures in 2012 included furniture and fixtures relating to men’s and women’s The Original Arizona Jean Co. shops, Levi’s shops and jcp shops; women’s Liz Claiborne shops and men’s Izod shops that launched in the third quarter of 2012. During the year, we also opened 78 Sephora inside jcpenney stores and nine new department stores.

In 2012, we received net proceeds of $526 million from the sale or redemption of non-operating assets including REIT shares or units, leveraged lease assets, investments in real estate joint ventures and a building used in our former drugstore operations.

In 2011, we invested $634 million in capital expenditures for renewals and modernizations, three new jcpenney department stores, 77 Sephora inside jcpenney locations, 423 MNG by Mango shops, 502 Call it Spring shops and the opening of 10 The Foundry Big and Tall Supply Co. stores.

In 2011, we purchased the worldwide rights for the Liz Claiborne family of trademarks and related intellectual property and the U.S. and Puerto Rico rights for the monet family of trademarks and related intellectual property for a total purchase price of $268 million and invested $39 million through the purchase of 11 million newly issued shares of Class A common stock of Martha Stewart Living Omnimedia, Inc. (MSLO) and one share of MSLO preferred stock which gave us the right to designate two members of MSLO's Board of Directors. These uses of cash were partially offset by the receipt of a $53 million cash distribution from one of our real estate joint ventures as a result of a refinancing transaction and a $3 million cash distribution from MSLO that was recorded as a return of investment.

In 2010, we invested $499 million in capital expenditures for two new stores, 26 major renovations, 76 new Sephora inside jcpenney locations, 15 store refurbishments, and fixture and store environment improvements in over 500 stores.

The following provides a breakdown of capital expenditures:

($ in millions)	2012	2011	2010
Store renewals and updates	$ 617	$ 410	$ 257
Capitalized software	65	120	100
New and relocated stores	63	33	25
Technology and other	65	71	117
Total	$ 810	$ 634	$ 499

In 2013, we plan to continue to invest in capital expenditures at levels comparable with 2012. Our plan is to fund these expenditures with cash flow from operations, existing cash and cash equivalents, and, if required, the access to our revolving credit facility. In accordance with our long-term financing strategy, we may access the capital markets opportunistically. Capital expenditures for 2013 will relate primarily to the investment in our shops inside jcpenney department stores and technology improvements.

Financing Activities

In 2012, cash flows from financing activities were an outflow of $274 million compared to an outflow of $1,065 million for the same period last year. On August 1, 2012, we repaid at maturity $230 million principal amount of 9% Notes Due 2012. Additionally, we made capital lease and financing payments totaling $20 million. As authorized by the Board, we paid quarterly dividends of $0.20 per share during the first half of 2012 for dividends declared during the fourth quarter of 2011 and the first quarter of 2012. On May 15, 2012, we announced that we had discontinued the quarterly $0.20 per share dividend, resulting in approximately $175 million in annual cash savings.

During the first half of 2011, we completed our share buyback program authorized by the Board of Directors in February 2011. Through open market transactions we repurchased approximately 24.4 million shares at a cost of $900 million and an average price of $36.98. In June 2011, we received proceeds of approximately $50 million from the sale of a warrant on 7.3 million shares of J. C. Penney Company, Inc. common stock to Ronald B. Johnson prior to the commencement of his employment. In April 2011, we paid $15 million in fees to renew our revolving credit facility and in January 2012, we paid $5 million in fees for an amendment and restatement of our credit facility, for a total of $20 million. In 2011, we maintained our quarterly dividend on common stock at $0.20 per share and returned $178 million to stockholders through dividend payments.

In 2010, we completed several financing transactions. On March 1, 2010, we repaid at maturity $393 million principal amount of 8.0% Notes due 2010. In May, we paid aggregate consideration of $314 million, including accrued but unpaid interest, to purchase $300 million principal amount of JCP's outstanding 6.375% Senior Notes due 2036, which were validly tendered pursuant to a cash tender offer. Also in May, we closed on our offering of $400 million aggregate principal amount of 5.65% Senior Notes due 2020 and used proceeds of the offering, net of discounts, of $392 million to make a voluntary cash contribution to the J. C. Penney Corporation, Inc. Pension Plan. During 2010, we returned $189 million to stockholders through dividend payments.

Cash Flow and Financing Outlook

We expect our investment in capital expenditures for 2013 to be at levels comparable to 2012 and will relate primarily to the investment in our shops inside jcpenney department stores and technology improvements. We believe that our expected cash flow generated from operations, combined with our existing cash and cash equivalents and the access to our credit facility will be adequate to fund our capital expenditures and working capital needs. In accordance with our long-term financing strategy, we may access the capital markets opportunistically. We may borrow under our credit facility for general corporate purposes including, but not limited to, seasonal working capital needs and to support ongoing letters of credit.

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 transformation strategy.

Credit Facility

On January 27, 2012, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation entered into a revolving credit facility in the amount up to $1,250 million (2012 Credit Facility), which amended and restated the Company's prior credit agreement entered into in April 2011, with the same syndicate of lenders under the previous agreement, with JPMorgan Chase Bank, N.A., as administrative agent. The 2012 Credit Facility matures on April 29, 2016. On February 10, 2012, we increased the size of our 2012 Credit Facility to $1,500 million and on January 31, 2013, we increased our 2012 Credit Facility by an additional $250 million to $1,750 million.

The 2012 Credit Facility is an asset-based revolving credit facility and is secured by a perfected first-priority security interest in substantially all of our eligible credit card receivables, accounts receivable and inventory. The 2012 Credit Facility is available for general corporate purposes, including the issuance of letters of credit. Pricing under the 2012 Credit Facility is tiered based on JCP's senior unsecured long-term credit ratings issued by Moody's Investors Service, Inc. and Standard & Poor's Ratings Services. JCP's obligations under the 2012 Credit Facility are guaranteed by J. C. Penney Company, Inc.

As of the end of fiscal year 2012, we had $281 million in standby and import letters of credit outstanding under the 2012 Credit Facility, none which have been drawn on, and we had $1,241 million available for borrowing under the 2012 Credit Facility.

On February 8, 2013, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation amended and restated the 2012 Credit Facility in the amount up to $1,850 million (2013 Credit Facility) with JPMorgan Chase Bank, N.A., as administrative agent. The 2013 Credit Facility continues to be an asset-based facility, in which borrowing availability varies according to the levels of inventory and accounts receivable, and matures on April 29, 2016. The 2013 Credit Facility increases the letter of credit sublimit to $750 million from $500 million and provides that the Company may at any time prior to the maturity date request that the aggregate size of the facility be increased by an additional amount not to exceed $400 million.

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Credit Ratings

Our credit ratings and outlook as of March 18, 2013 were as follows:

	Corporate	Long-Term Debt	Outlook
Fitch Ratings	B-	B-	Negative
Moody's Investors Service, Inc.	B3	Caa1	Negative
Standard & Poor's Ratings Services	CCC+	CCC+	Negative

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.

Contractual Obligations and Commitments

Aggregated information about our obligations and commitments to make future contractual payments, such as debt and lease agreements, and contingent commitments as of February 2, 2013 is presented in the following table.

($ in millions)	Total	Less Than 1 Years	1 - 3 Years	3 - 5 Years	More Than 5 Years
Recorded contractual obligations:					
Long-term debt(1)	$ 2,868	$ -	$ 200	$ 485	$ 2,183
Capital leases and note payable	124	30	68	24	2
Merchandise accounts payable	1,162	1,162	-	-	-
Unrecognized tax benefits(2)	76	2	-	-	74
Contributions to non-qualified supplemental retirement and postretirement medical plans(3)	297	53	97	60	87
	$ 4,527	$ 1,247	$ 365	$ 569	$ 2,346
Unrecorded contractual obligations:					
Interest payments on long-term debt	$ 5,096	$ 198 (4)	$ 396	$ 341	$ 4,161
Operating leases(5)	2,876	252	405	282	1,937
Standby and import letters of credit(6)	281	281	-	-	-
Surety bonds(7)	79	79	-	-	-

Contractual obligations(8)	1,796	465	834	338	159
Purchase orders(9)	2,510	2,510	-	-	-
Guarantees(10)	40	5	9	4	22
	$ 12,678	$ 3,790	$ 1,644	$ 965	$ 6,279
Total	$ 17,205	$ 5,037	$ 2,009	$ 1,534	$ 8,625

(1) The weighted-average maturity of long-term debt is 24 years.

(2) Represents management’s best estimate of the payments related to tax reserves for uncertain income tax positions. Based on the nature of these liabilities, the actual payments in any given year could vary significantly from these amounts. See Note 18 to the consolidated financial statements.

(3) Represents expected cash payments through 2022.

(4) Includes $65 million of accrued interest that is included in our Consolidated Balance Sheet at February 2, 2013.

(5) Represents future minimum lease payments for non-cancelable operating leases, including renewals determined to be reasonably assured. Future minimum lease payments have not been reduced for sublease income.

(6) Standby letters of credit, which totaled $276 million, are issued as collateral to a third-party administrator for self-insured workers’ compensation and general liability claims. The remaining $5 million are outstanding import letters of credit.

(7) Surety bonds are primarily for previously incurred and expensed obligations related to workers’ compensation and general liability claims.

(8) Consists primarily of (a) minimum purchase requirements for exclusive merchandise and fixtures; (b) royalty obligations; and (c) minimum obligations for professional services, energy services, software maintenance and network services.

(9) Amounts committed under open purchase orders for merchandise inventory of which a significant portion are cancelable without penalty prior to a date that precedes the vendor’s scheduled shipment date.

(10) Relates to third-party guarantees. See Note 20 to the consolidated financial statements.

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Off-Balance Sheet Arrangements

Management considers all on- and off-balance sheet debt in evaluating our overall liquidity position and capital structure. Other than operating leases, which are included in the Contractual Obligations and Commitments table, we do not have any material off-balance sheet financing. See detailed disclosure regarding operating leases and their off-balance sheet present value in Note 14 to the consolidated financial statements.

We do not have any additional arrangements or relationships with entities that are not consolidated into the financial statements.

Inflation

Over the past three years the retail industry has experienced inflationary cost increases. Inflation impacted our results of operations primarily during the first quarter of 2012 in the sales of our clearance items. This increase was driven primarily by rising costs for cotton and petroleum based textiles for 2011 holiday and early 2012 spring goods. Beginning in the second quarter of 2012 and continuing through the end of the fiscal year, these pressures eased.

Critical Accounting Policies

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires that we make estimates and use assumptions that in some instances may materially affect amounts reported in the accompanying consolidated financial statements. In preparing these financial statements, we have made our best estimates and judgments based on history and current trends, as well as other factors that we believe are relevant at the time of the preparation of our consolidated financial statements. Historically, actual results have not differed materially from estimates; however, future events and their effects cannot be determined with certainty and as a result, actual results could differ from our assumptions and estimates.

We have discussed the development and selection of the critical accounting policies with the Audit Committee of our Board of Directors. The Audit Committee has reviewed our disclosures relating to these policies in this MD&A. See Note 2 to the consolidated financial statements for a description of our significant accounting policies.

Inventory Valuation under the Retail Method

Inventories are valued primarily at the lower of cost (using the first-in, first-out or “FIFO” method) or market, determined under the Retail Inventory Method (RIM) for department stores, store distribution centers and regional warehouses and standard cost, representing average vendor cost, for merchandise we sell through the Internet at jcp.com. Under RIM, retail values are converted to a cost basis by applying specific average cost factors to groupings of merchandise. RIM inherently requires management judgment and certain estimates that may significantly impact the ending inventory valuation at cost, as well as gross margin. Two of the most significant estimates are permanent reductions to retail prices (markdowns) used primarily to clear seasonal merchandise or otherwise slow-moving inventory and inventory shortage (shrinkage).

Permanent markdowns designated for clearance activity are recorded at the point of decision, when the utility of inventory has diminished, versus the point of sale. Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise and style trends. Under RIM, permanent markdowns result in the devaluation of inventory and the corresponding reduction to gross margin is recognized in the period the decision to markdown is made. Shrinkage is estimated as a percent of sales for the period from the last physical inventory date to the end of the fiscal period. Physical inventories are taken at least annually and inventory records are adjusted accordingly. The shrinkage rate from the most recent physical inventory, in combination with current events and historical experience, is used as the standard for the shrinkage accrual rate for the next inventory cycle. Historically, our actual physical inventory count results have shown our estimates to be reliable. Based on prior experience, we do not believe that the actual results will differ significantly from the assumptions used in these estimates. A 10% increase or decrease in the permanent markdowns reflected in our inventory as of the end of the year would have impacted net income by approximately $17 million. A 10% increase or decrease in the estimated inventory shrinkage accrued as of the end of the year would have impacted net income by approximately $4 million.

Valuation of Long-Lived and Indefinite-Lived Assets

Long-Lived Assets

We evaluate recoverability of long-lived assets, such as property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable, such as historical operating losses or plans to close stores and dispose of or sell long-lived assets before the end of their previously estimated useful lives. Additionally, for store assets, in the fourth quarter of each fiscal year, we separately test the performance of individual stores, and underperforming stores are selected for further evaluation of the recoverability of the carrying amounts. If the evaluation, performed on an undiscounted cash flow basis, indicates that the carrying amount of the asset may not be recoverable, the potential impairment is measured as the excess of carrying value over the fair value of the impaired asset. The impairment calculation requires us to apply estimates for future cash flows and use judgments for qualitative factors such as local market conditions, operating environment, mall performance and other trends. We estimate fair value based on either a projected discounted cash flow method using a discount rate that is considered commensurate with the risk inherent in our current business model or appraised value, as appropriate.

We recognize impairment losses in the earliest period that it is determined a loss has occurred. The carrying value is adjusted to the new carrying value and any subsequent increases in fair value are not recorded. If it is determined that the estimated remaining useful life of the asset should be decreased, the periodic depreciation expense is adjusted based on the new carrying value of the asset. Impairment losses totaling $26 million, $58 million and $3 million in 2012, 2011 and 2010, respectively, were recorded in the Consolidated Statement of Operations in the real estate and other, net line item.

2012 was the first year of our transformation strategy to become America's favorite store. We underwent tremendous change as we began shifting our business model from a promotional department store to a specialty department store. Our 2012 sales, operating profit and cash flows have declined significantly. As we transform substantially more of our selling space and introduce new merchandise and brands to our stores, we expect our sales, operating profit and cash flows to improve in the future. Future cash flows used in our impairment analysis reflects these assumptions.

In 2012, we wrote the carrying value of assets of 13 underperforming department stores that continued to operate down to their fair value and recorded an impairment charge of $26 million. If operating performance begins to reflect an other than temporary decline and actual results are not consistent with our current estimates and assumptions, we may be exposed to additional impairment charges in the near future, which could be material to our results of operations.

Indefinite-Lived Assets

We assess the recoverability of indefinite-lived intangible assets at least annually during the fourth quarter of our fiscal year or whenever events or changes in circumstances indicate that the carrying amount of the indefinite-lived intangible asset may not be fully recoverable. Examples of a change in events or circumstances include, but are not limited to, a decrease in the market price of the asset, a history of cash flow losses related to the use of the asset or a significant adverse change in the extent or manner in which an asset is being used. During the fourth quarter of 2012, we early adopted the Financial Accounting Standards Board's (FASB) new guidance on impairment testing of indefinite-lived intangible assets. Under the new guidance, we have the option to first perform a qualitative assessment in our evaluation of our indefinite-lived intangible assets in order to determine whether the fair value of the indefinite-lived intangible asset is more likely than not impaired. Due to the significant decline in our sales during 2012, we decided not to perform a qualitative analysis for our 2012 annual impairment test. As such, for our 2012 annual impairment test, we tested our indefinite-lived intangible assets utilizing the relief from royalty method to determine the estimated fair value for each indefinite-lived intangible asset. The relief from royalty method estimates our theoretical royalty savings from ownership of the intangible asset. Key assumptions used in this model include discount rates, royalty rates, growth rates, sales projections and terminal value rates. Discount rates, royalty rates, growth rates and sales projections are the assumptions most sensitive and susceptible to change as they require significant management judgment. Discount rates used are similar to the rates estimated by the weighted average cost of capital considering any differences in company-specific risk factors. Royalty rates are established by management based on comparable trademark licensing agreements in the market. Operational management, considering industry and company-specific historical and projected data, develops growth rates and sales projections associated with each indefinite-lived intangible asset. Terminal value rate determination follows common methodology of capturing the present value of perpetual sales estimates beyond the last projected period assuming a constant weighted average cost of capital and long-term growth rates.

For all indefinite-lived intangible assets, the estimated fair value of the asset exceeded the carrying value of the asset by a substantial margin at the date of the most recent impairment test. Our monet and Liz Claiborne trade names, which are our only indefinite-lived intangible assets, have continued to perform at expectations. On September 1, 2012, we launched women’s Liz Claiborne shops inside jcpenney department stores that have provided positive sales results. In addition, we plan to launch additional product categories using our monet and Liz Claiborne trade names beginning in 2013 that have positively impacted our expected future sales growth assumptions for these trade names.

While we do not believe there is a reasonable likelihood that there will be a material change in our estimates or assumptions used to calculate indefinite-lived asset impairments, if actual results are not consistent with our current estimates and assumptions, we may be exposed to additional impairment charges, which could be material to our results of operations.

Reserves and Valuation Allowances

We are primarily self-insured for costs related to workers’ compensation and general liability claims. The liabilities represent our best estimate, using generally accepted actuarial reserving methods through which we record a provision for workers’ compensation and general liability risk based on historical experience, current claims data and independent actuarial best estimates, including incurred but not reported claims and projected loss development factors. These estimates are subject to the frequency, lag and severity of claims. We target this provision above the midpoint of the actuarial range, and total estimated claim liability amounts are discounted using a risk-free rate. We do not anticipate any significant change in loss trends, settlements or other costs that would cause a significant fluctuation in net income. However, a 10% variance in the workers' compensation and general liability reserves at year-end 2012 would have affected net income by approximately $14 million.

Income taxes are estimated for each jurisdiction in which we operate and require significant judgment, the use of estimates and the interpretation and application of complex tax laws. This involves assessing the current tax exposure together with temporary differences, which result from differing treatment of items for tax and book purposes. Deferred tax assets and liabilities are provided for based on these assessments. Deferred tax assets are evaluated for recoverability based on estimated future taxable income. To the extent that recovery is deemed unlikely, a valuation allowance is recorded. We record a liability for unrecognized tax benefits resulting from tax positions taken, or expected to be taken, in an income tax return. We recognize any interest and penalties related to unrecognized tax benefits in income tax expense. Significant judgment is required in assessing, among other things, the timing and amounts of deductible and taxable items. In assessing the likelihood of realization of deferred tax assets, we use estimates of the amount and character of future taxable income. Tax contingency accruals are evaluated and adjusted as appropriate, while taking into account the progress of audits of various taxing jurisdictions. We do not expect the outcome of tax audits to have a material adverse effect on our financial condition, results of operations or cash flow. Many years of data have been incorporated into the determination of tax reserves, and our estimates have historically been reasonable.

In establishing our reserves for liabilities associated with underground storage tanks, we maintain and periodically update an inventory listing of potentially impacted sites. The estimated cost of remediation efforts is based on our historical experience, as well as industry and other published data. With respect to our former drugstore operations, we accessed extensive databases of environmental matters, including data from the Environmental Protection Agency, to estimate the cost of remediation. Our experience, as well as relevant data, was used to develop a range of potential liabilities, and a reserve was established at the time of the sale of our drugstore business. The reserve is adjusted as payments are made or new information becomes known. In 2010, we lowered the reserve due to the affirmation of another responsible party to one of the known sites involving a warehouse facility and review of our actual experience over the past several years. Reserves for asbestos removal are based on our known liabilities in connection with approved plans for store modernization, renovations or dispositions of store locations.

We believe the established reserves, as adjusted, are adequate to cover estimated potential liabilities.

Pension

Pension Accounting

We maintain a qualified funded defined benefit pension plan (Primary Pension Plan) and smaller non-qualified unfunded supplemental defined benefit plans. The determination of pension expense is the result of actuarial calculations that are based on important assumptions about pension assets and liabilities. The most important of these are the rate of return on assets and the discount rate assumptions. These assumptions require significant judgment and a change in any one of them could have a material impact on pension expense reported in our Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income/(Loss), as well as in the assets, liability and equity sections of the Consolidated Balance Sheets.

The following table reflects our rate of return and discount rate assumptions:

	2012	2011	2010
Expected return on plan assets	7.5%	7.5%	8.4%
Discount rate for pension expense	4.82% (1)	5.65% (2)	5.90%
Discount rate for pension obligation	4.19%	4.82%	5.65%

(1) The discount rate used was revised to 4.25% on the remeasurement date of September 30, 2012 as a result of the curtailments.

(2) The discount rate used for the Supplemental Retirement Program and Benefit Restoration Plan was revised to 5.06% on the remeasurement date of October 15, 2011 as a result of the VERP.

Return on Plan Assets and Impact on Earnings

For the Primary Pension Plan, we apply our expected return on plan assets using fair market value as of the annual measurement date. The fair market value method results in greater volatility to our pension expense than the more commonly used calculated value method (referred to as smoothing of assets). Our Primary Pension Plan asset base is well diversified with an asset allocation mix of equities (U.S., non-U.S. and private), fixed income (investment-grade and high-yield) and real estate (private and public).

As of January 1, 2007, the Primary Pension Plan was closed to new entrants. As a result of this action, the future growth of the plan liability is expected to moderate and ultimately begin to decline. In recognition of the changing liability characteristics and to provide a more desirable balance of investment return and volatility risk, in 2010, we shifted 15% of the plan’s allocation from equities to fixed income. The shift to a higher mix of fixed income investments provides a better match to the plan’s changing liability characteristics. As a result of the asset allocation shift, our expected return on plan assets was reduced to 7.5% in 2011 and remained

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at that rate for 2012. For 2013, our expected return on plan assets was reduced to 7.0% in alignment with 2013 asset allocation targets and updated expected capital markets return assumptions.

Discount Rate

The discount rate assumption used to determine our postretirement obligations was based on a yield curve determined by the plan's actuary. The discount rate used was based on a hypothetical AA yield curve represented by a series of bonds maturing over the next 30 years, designed to match the corresponding pension benefit cash payments to retirees.

For 2012, the discount rate to measure pension expense was 4.82% compared to 5.65% in 2011. The discount rate to measure pension obligation declined to 4.19% as of February 2, 2013 from 4.82% as of January 28, 2012.

Sensitivity

The sensitivity of the pension expense to a plus or minus one-half of one percent of expected return on assets is a decrease or increase in expense of approximately $0.07 per share. An increase or decrease in the discount rate of one-half of one percent would decrease or increase the expense by approximately $0.05 per share.

Pension Funding

Funding requirements for our Primary Pension Plan are determined under Employee Retirement Income Security Act of 1974 (ERISA) rules, as amended by the Pension Protection Act of 2006. As a result of the funded status of the Primary Pension Plan, we are not required to make cash contributions in 2013.

Our funding policy is to maintain a well-funded pension plan throughout all business and economic cycles. Consistent with our funding policy, on May 24, 2010, we used net proceeds of approximately $392 million from the issuance of $400 million of 5.65% Senior Notes due 2020 to make a voluntary cash contribution to the Primary Pension Plan.

Recent Accounting Pronouncements

Refer to Note 3 to the consolidated financial statements.

Cautionary Statement Regarding Forward-Looking Information

This Annual Report on Form 10-K 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. The words expect, plan, anticipate, believe, intend, should, will and similar expressions identify forward-looking statements. Any such forward-looking statements are subject to known and unknown risks and uncertainties that may cause our actual results to be materially different from planned or expected results. Those risks and uncertainties include, but are not limited to, the success of our transformation, the impact of changes designed to transform our business, competition and promotional activities, changes in merchandise styles and trends, changes in store traffic trends, maintaining an appropriate mix and level of inventory, the implementation of our new store layout, the availability of internal and external sources of liquidity, our failure to retain, attract and motivate our employees, the reduction and restructuring of our workforce, the impact of cost reduction initiatives, a systems failure and/or security breach that results in the theft, transfer or unauthorized disclosure of customer, employee or Company information, disruptions in our information technology systems or website, changes in our credit ratings, our failure to source and deliver merchandise in a timely and cost-effective manner, changes in our arrangements with our suppliers and vendors, restrictions under our revolving credit facility, potential asset impairment charges, risks associated with importing merchandise from foreign countries, economic and political conditions that impact consumer confidence and spending, the impact of holiday spending patterns and weather conditions, changes in federal, state or local laws and regulations, legal and regulatory proceedings, significant changes in discount rates, actual investment return on pension assets and other factors related to our qualified pension plan, the influence of our largest stockholders, the volatility of our stock price and our ability to use net operating loss carryforwards to offset future taxable income for U.S. federal income tax purposes. 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 Item 1A, Risk Factors. We intend the forward-looking statements in this Annual Report on Form 10-K 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 7A. Quantitative and Qualitative Disclosures about Market Risk

We maintain a majority of our cash and cash equivalents in financial instruments with original maturities of three months or less. Such investments are subject to interest rate risk and may have a small decline in value if interest rates increase. Since the financial instruments are of short duration, a change of 100 basis points in interest rates would not have a material effect on our financial condition.

All of our outstanding long-term debt as of February 2, 2013 is at fixed interest rates and would not be affected by interest rate changes. Future borrowings under our multi-year revolving credit facility, to the extent that fluctuating rate loans were used, would be affected by interest rate changes. As of February 2, 2013, no borrowings were outstanding under the facility other than the issuance of standby and import letters of credit, which totaled $281 million. We do not believe that a change of 100 basis points in interest rates would have a material effect on our financial condition.

The fair value of long-term debt is estimated by obtaining quotes from brokers or is based on current rates offered for similar debt. At February 2, 2013, long-term debt had a carrying value of $2.9 billion and a fair value of $2.5 billion. January 28, 2012, long-term debt, including current maturities, had a carrying value of $3.1 billion and a fair value of $3.0 billion.

The effects of changes in the U.S. equity and bond markets serve to increase or decrease the value of assets in our Primary Pension Plan. We seek to manage exposure to adverse equity and bond returns by maintaining diversified investment portfolios and utilizing professional investment managers.

Item 8. Financial Statements and Supplementary Data

See the Index to consolidated financial statements on Page 49.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The management of our company, under the supervision and with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our principal executive officer and principal financial officer concluded that 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, (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and (ii) is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.