

J.C. Penney Corporation, Inc.: Reinventing Retail

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The authors constructed this case solely to provide the basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation. All people, places and financial data are fictionalized with the exception of direct quotations from publically available documents.

Abstract

This case study requires students to apply the capital budgeting framework to evaluate the extensive store remodeling decision made by J.C. Penney's CEO, Ron Johnson. The case also offers students a chance to assess the strategic choices of top managers, as they implement new retail strategies to jump start sales growth. The case focuses on various aspects of estimating the cost of capital and cash flows for the NPV calculation. In addition, the case provides students an opportunity to explore the challenges financial analysts face when valuing businesses under very volatile capital market conditions.

Key Words: Corporate Finance, Capital Budgeting, Retail Industry, Strategy, J.C. Penney

SITUATION

On Thursday, May 17, 2012, Russell Williamson, a junior equity analyst for Brooks Associates, Inc., a private equity company, was asked to review the performance of retail companies by Rachel Adams, the equity research team leader. Adams was especially interested in J.C. Penney Corporation, Inc. (JCP), which announced 2012 Q1 results the day before, after which JCP's stock price plummeted by 20% during late afternoon trading.

Brooks Associates had recently raised \$500 million for a new private equity fund, the Deep Value Fund. The fund's strategy was to invest in undervalued assets. Up to 20% of its assets could be in publicly traded stock. Adams was in charge of the asset allocation plan for the Deep Value Fund and was intrigued by JCP's stock price movement. She knew that JCP was trying to reinvent itself as America's favorite department store and that the company's new CEO, Ron Johnson, had enjoyed a successful career leading the transformation of Apple's stores. Hence, she thought that investors might be overreacting to JCP's negative short-term results and underestimating Johnson's long-term efforts to transform the aging retailer to become more hip and relevant.

Adams understood how important it was for JCP to reposition and refocus its business strategy. She believed the valuation of JCP was closely tied to the success of the company's remodeling process that was announced in February 2012. The remodeling Johnson planned would redesign JCP stores into a "stores-within-a-store" format. Before finalizing her equity allocation plan, Adams wanted Williamson to perform an independent capital budgeting analysis on JCP's remodeling plans to determine if the project added value to the company. She also wanted Williamson to analyze JCP's historical financial statements and the competitive environment of the department store industry. These three elements would be used to help Adams make her final decision on whether or not to buy JCP stock.

COMPANY BACKGROUND AND INDUSTRY INFORMATION

J. C. Penney Corporation Inc. (JCP) was founded in 1902 by James Cash Penney. The company grew its network of department stores throughout all 50 states and Puerto Rico with the total number of stores reaching 1,102 by the end of 2011 (Exhibit 1). JCP is recognized as one of the nation's largest apparel and home furnishing retailers.

In the years just prior to 2012, JCP's primary strategy was to draw customer traffic through coupons and discounts. In 2011, for example, there were 590 separate sales, an average of nearly two sales per day (Mattioli (2012)). This strategy was largely unsuccessful at increasing the volume of in-store shoppers, and furthermore, it put significant downward pressure on existing prices. Three-quarters of all JCP products were sold at discounts of at least 50%, even before the application of coupons, and less than 1% of such products were being sold at full price (Berfield & Maheshwari (2012)).

Furthermore, the design of most J.C. Penney stores was quite unspectacular, largely unchanged from 20 years earlier, and mostly indistinguishable from its middle-market competitors. Hence, JCP struggled to increase overall sales. In 2011, JCP sales were \$17.3 billion, down from \$17.8 billion in 2010; however, this amount was far below the \$19.9 billion in sales the company reported in 2006 (Exhibit 2). Consequently, JCP reported overall net losses of \$152 million in 2011, compared to net profits of \$389 million in 2010. JCP's total assets were also down to \$11.4 billion in 2011 from \$13.0 billion in 2010 and its cash balance decreased to \$1.5 billion in 2011 from \$2.6 billion in 2010 (Exhibit 3). The five largest sales categories for JCP were women's apparel (25% of sales), men's apparel and accessories (20%), home products (15%), women's accessories (12%), and children's apparel (12%); other remaining categories included footwear, jewelry, and services (Figure 1).

Retail Industry Background

Companies in the retail department store industry operate physical establishments, selling items including clothing, cosmetics, footwear, and home furnishings, typically from registers within individual departments. Besides specialty department stores (SPD) and full-line department stores (FLDS), there are now also discounters and wholesale clubs. SPDs depend more on apparel, accessories, and cosmetics. Upscale SPDs, that sell high-end American and European fashion designer merchandise, charge a premium for their goods.

On the other hand, FLDS offer reasonably priced products across several merchandise categories. The major products sold at FLDS include apparel (about 55 percent of sales), cosmetics (8 percent), footwear (7 percent) and appliances (7 percent). Apparel includes women's, men's, and children's clothing. Cosmetics include makeup, skin care, hair care, and fragrances. Appliances include refrigerators, stoves, washers, dryers, and dishwashers. These stores may also sell kitchenware, bedding, towels, and sheets. FLDS also provide services such as gift wrapping, delivery, appliance installation, and personal shopping. According to the Valueline data, major U.S.-based full line department stores include JCP, Dillard's, Kohl's, Macy's, Nordstrom's, and Sears.

Discounters sell a vast array of everyday items, such as stationary, sporting goods, toys, hardware, and over-the-counter pharmaceuticals. A number of discounters began offering groceries to gain business as growth opportunities diminished. Wholesale clubs provide an assortment of goods similar to that of discounters, but they sell products from warehouse-like centers in bulk packages, under no-frills, self-service terms. They also charge membership fees, which are a significant portion of their operating profits.

Historically, to increase sales in this industry, a company has to open new stores, a process that entails significant capital expenditures. The firm has to be careful to open stores in such a way that this does not cannibalize its already existing stores. The ability to build or lease new stores depends on a company's cash balance, debt, and available credit. This effort will initially put a drag on profitability, but new sales will result in higher earnings over time. On the other hand, cash-strapped companies may cut back and decide to close

underperforming locations. The option to lease property requires less capital than does construction, and permits quicker expansion. However, a long-term lease may make it difficult to close underperforming stores when cash needs to be conserved.

Whereas new stores increase company sales, the ideal way to establish and interpret sales growth is by using comparable store sales (referred to as comps), which limits any comparisons to be made amongst stores one-year old or older. Rising comps impact profits positively as they occur with marginal changes in fixed costs, but declining comps may require the firm to re-examine its operations to increase margins. A retailer could mitigate the declining sales problem by forecasting the types of merchandise needed by its target demographic. However, it is quite difficult to project the tastes of customers, especially if they change relatively frequently. This problem is exasperated in this age where online merchandizing is drastically changing the retail landscape.

Recent Industry Landscape

Department stores are no longer the 'go-to' destination for mass shopping needs. They have lost market share to specialty retailers, big-box stores, and more recently, web-based merchants such as Amazon.com. Furthermore, department stores still suffer from hit-or-miss fashions, spotty customer service, and sprawling designs, which make it difficult for customers to locate desired goods in an efficient manner.

Until recently, the differentiation between chains was small, as most retailers sold similar apparel produced by the same vendors. As consumers began to shop elsewhere, there was some consolidation within the industry, and when the economic recession of 2008-2009 arrived, many stores had to cut costs, close underperforming stores, and deal with ballooning inventories (Timberlake & Townsend (2011)).

As the U.S. economy continues its recovery, full-line department stores such as J.C. Penney, Macy's, Dillard's and Kohl's have been experiencing a revival of sorts. They have been uncharacteristically luring shoppers with exclusive, trendy items that appeal largely to the younger demographic. The cohort of 18-to-30 year olds spends 50% more on average than other age groups (Timberlake & Townsend (2011)).

J.C. PENNEY'S NEW CEO, AND HIS RADICAL VISION

On June 14, 2011, J.C. Penney announced that Ron Johnson, 52, would replace Myron Ullman, 64, as CEO, effective November 1, 2011. Ullman would stay on, though, as executive Chairman of the Board. Johnson was poached from Apple, where he helped create the extremely successful, 'ultracool' culture observed in Apple's retail stores. Prior to Johnson's arrival, JCP's stock performance was trailing behind Dillard's, Macy's, Kohl's, and Nordstrom (Figure 2). However, when the hiring announcement was made, JCP's stock rose from \$30.11 per share to \$35.37 per share, an increase of \$5.26, or 17.5%. William Ackerman of Pershing Square Capital Management (18%) and Steven Roth of Vornado Realty Trust (8%) together

bought 26% of JCP stock, and both gained seats on JCP's Board of Directors (Holmes & Lublin (2011)).

Before working at Apple, Johnson was employed by Target, where he brokered a deal with renowned architect Michael Graves to design household items, establishing a reputation for style that set Target apart from its discount-retailer rivals. These types of collaborations enabled Target to have more control over its goods, especially with respect to pricing. When Johnson was leading the launch of Apple stores, analysts applauded his strategies, and compared Apple stores favorably to Best Buy's in the following manner: "It sells a single brand, has far fewer products, and has only a few hundred stores compared to Best Buy's more than 4,000 (Kane & Sherr (2011))."

With respect to in-store design which was the Johnson's niche area of expertise, he created Apple's 'Genius Bar' tech support area while also developing a top-notch detailed approach to in-store customer service. Apple's hottest products were placed in the front of each store, adjacent to the Genius Bar, with a dedicated section for kids featuring children's software programs. Apple stores featured an open, clutter-free design, using hip-looking natural materials like wood, glass, stone, and stainless steel (Kane & Sherr (2011)).

JCP hired Ron Johnson for his expertise on the creative aspects of retailing, including marketing and merchandising. JCP's Board, led by financiers Ackerman and Roth, hoped that Johnson would change both how people shopped at JCP, and the type of people that would shop at JCP, just as he had done at Target and Apple. More specifically, JCP needed to connect better with both newer, younger customers, and its older, existing customer base.

Johnson's New Strategic Initiative

On January 25, 2012, nearly 3 months after Johnson's CEO tenure commenced, he officially laid out the core elements of his strategic plan for JCP. First, he planned to redesign the sprawling floor plans of JCP stores into a plethora of boutique specialty shops. Second, he wanted to add areas - near existing high-traffic areas - for customers to hang out and be entertained in style. Third, he intended to wean existing customers from discounts and coupons in favor of everyday low, but trustworthy, prices (Berfield & Maheshwari (2012)).

The ultimate goal would be to make shopping at JCP more inviting, while highlighting brand names, and gaining more control over pricing structures. The planned overhaul was quite dramatic and costly, especially considering that JCP had been around for over 100 years and had never before attempted to change so quickly and drastically.

On February 1, 2012, JCP introduced a transformational strategy based on 6 P's of retail – price, promotion, personality, product, presentation and place (Galante (2012)):

- **Price:** The new pricing strategy was called *Fair and Square* and included three types of prices: (1) everyday, (2) month-long, and (3) best or lowest prices.

- **Promotion:** The new brand marketing campaign was focused on showcasing products, highlighting the new pricing strategy, and staging 12 promotional events each year, one particularly themed to each calendar month.
- **Personality:** JCP introduced a new logo to revitalize the brand.
- **Product:** JCP made substantial changes in their merchandise while planning to add more global brands.
- **Presentation:** The manner in which goods are displayed would be enhanced and more varied.
- **Place:** JCP planned to re-organize its department stores into separately curated stores, shops, and boutiques.

Starting in February 2012, JCP lowered the initial (pre-discounted) price for items by about 40%, relative to where they were. In return, the number of sales promotions was reduced sharply. Going forward, JCP planned to limit these promotions to two clearance sales on the 1st and 3rd Fridays of each month, along with a small number of monthly in-season sales (Mattioli (2012)). JCP planned to spend about \$80 million per month on this new program of promotions.

As mentioned earlier, JCP also decided to simplify product pricing into 3 tiers: everyday pricing, monthly specials, and clearance sales. However, the key to this plan was to educate customers about which tier applied to desired goods (Weise (2012)). In other words, bargain hunters must be able to tell whether or not they are actually getting a bargain; they must be able to trust JCP about the real price of goods.

Remodeling Project: Stores-within-a-store

Consistent with the overall strategy of reaching out to younger and hipper customers, JCP made forays to other suppliers to form exclusive in-store, mini-boutique arrangements. Johnson planned to redesign the high-traffic middle areas of stores, previously called the “center core” into what he called a “Town Square.” Traditionally, these were the locations where cosmetics, accessories, and other high-margin impulse buys were most likely to take place. The Town Square would feature displays that rotate each month; for example, there might be free hot dogs and ice cream in July, free back-to-school haircuts for kids in August, or free family portraits in December (Mattioli (2012)).

In an interview with Bloomberg’s *Businessweek* in August 2012, Ron Johnson elaborated more on his vision for the physical design of JCP stores. “When you walk into a store today, you’re overwhelmed by merchandise. There is a narrow aisle. Typically, it’s filled with product on tables and you’re overwhelmed with the noise of signs and promotions. Especially in the age of the Internet, the idea of going to a very large store and having so much abundance is actually not very appealing...We can create a place where people feel they belong (Brady, 2012).” In short, he wanted JCP to become not only America’s favorite department store, but America’s favorite store in general.

Thus, Johnson suggested widening the aisles to 14 feet, which was even more spacious than the aisle width at competitor Nordstrom. He would also remove the traditional bulky cashier stations and replace those with checkout devices that employees could operate anywhere within the store using iPads. Also, these employees would be able to wear whatever they wanted (within reason), much like the way employees dressed in Apple stores, rather than drab corporate uniforms. He would increase the use of very methodically placed mannequins. Finally, each store would have an entertainment area catering to a specific demographic group (e.g. kids, women, men, etc.) (Townsend, 2013).

While these ideas were potentially expensive, Johnson said that cost cutting and the elimination of many existing sales promotions had been “engineered to pay for it.” For example, JCP would cut the number of coupon packs it sends to stores from 3 per week to 1 per month. On an annual basis, the number of promotions would decline from 590 to fewer than 100 (Mattioli (2012)). Furthermore, the ever-present availability of discounts would eat into profit margins, especially for merchants with high fixed labor and material costs.

One of Johnson’s first moves as new CEO of JCP was to broker a deal with Martha Stewart Living Omnimedia (MSLO). On December 7, 2011, JCP paid \$38.5 million to acquire a 17% stake in MSLO (Timberlake & Townsend (2012)). This was done to enable JCP to set up mini-stores dedicated to MSLO at its department stores, while improving its overall brand awareness. The ‘stores-within-a-store’ would open in February 2013, and would sell specialized home and lifestyle goods, all featuring the Martha Stewart brand (Weise (2011)). These mini-stores would be new, distinct retail spaces within the overall JCP floor plans. The partnership was expected to generate more than \$200 million in revenue over 10 years for MSLO (Mattioli & Adams (2011)).

Johnson’s ultimate goal was to develop about 100 such branded stores (Berfield & Maheshwari (2012)). These brands were expected to produce higher sales than in-house labels that lacked distinctiveness and pricing power. Ideally, if JCP could lock up rights to sell desirable product lines exclusively, customers would then consider JCP a destination for their shopping experience. Some of the most prominent brands which had agreed to participate in the store within a store concept included:

- Sephora makeup and cosmetics
- MNG by Mango
- Call it Spring by Aldo Group
- The Foundry Big & Tall Supply Co.
- Joe Fresh
- Stardoll’s Pretty n’ Love line
- Liz Claiborne and Monet lines
- Shops promoting Nanette Lepore, Izod, Arizona Jean, or Levi’s
- Specially designed items from Jonathan Adler, Vivienne Tam, and Tourneau

- Cafés that would offer coffees and pastries for customers wanting a shopping break

JCP planned to remodel 700 of its 1,100 stores, with each department store ultimately featuring 100 stores-within-a-store upon completion of the remodeling process (Galante (2012)). The remaining 400 JCP stores, primarily located in small towns, were not included in the current remodeling plan. The new stores-within-a-store would feature three main categories; a *store* (approximately 1,400 square feet), a *shop* (750 square feet), and a *boutique* (under 750 square feet). These new stores-within-a-store were designed to be open toward the widened aisle without doors. They would be separated by 5-by-5 feet walls designed to fit most stores. Initial estimates suggested that the cost of remodeling would be approximately \$46,000, on average, for each store-within-a-store.

The results from a 30,000-square-foot remodeled prototype store in Dallas, near JCP's headquarters, were very positive. The converted stores' average sales were more than double the sales in the rest of the store. For instance, the Sephora stores within JCP averaged \$600 of sales per square foot, which was about 3 times higher than the corresponding figure for the entire JCP stores that contained Sephora in-stores (Berfield (2013), Galante (2012)).

Encouraged by the initial results, JCP planned to roll out the nationwide remodeling project in August 2012. Each of the 700 JCP stores would add two to three stores-within-a-store per month, while the entire project was expected to be completed by the end of 2015. To help take on such an extensive remodeling process, Johnson hired his former colleague, Benjamin Fay, as Executive Vice President of real estate, store design and development on April 26, 2012. Fay had been previously working for Apple as Senior Director of retail real estate, design and development.

THE DECISION

At first glance, Williamson of Brooks Associates agreed that JCP might be in trouble. For the entire fiscal year in 2011, JCP sales were down 2.8% to \$17.26 billion (relative to 2010), even though JCP's stock price was up 6.7%, reflecting investors' cautious optimism for the new stores-within-a-store strategy. On the other hand, one of JCP's main competitors, Macy's, had outperformed JCP by a wide margin; Macy's sales increased by 5.4% in 2011, while their stock price rose by nearly 47% (Mattioli (2012)). (See Exhibit 4 for JCP's competitors' data.)

Moreover, JCP's sales per gross square foot, one of the most important retail industry statistics, were lower than all of its main competitors except for Dillard's. In 2011, JCP's sales per gross square foot were \$154, while the corresponding figure for Nordstrom was \$431 (Exhibit 5). To make matters worse, during the first quarter of 2012, JCP reported sales of \$3.15 billion, a 20% overall decline compared with the first quarter of 2011, with \$55 million in losses, excluding restructuring costs and charges for reducing inventory (Weise (2012)). Comparable store sales for the first quarter of 2012 fell by 18.9%, and online sales were down

27.9% (Berfield & Maheshwari (2012)). The company's gross margin was 37.6%, lower than the 40.5% gross margin recorded in the first quarter of 2011.

Subsequently, JCP announced it would discontinue its \$0.20/share dividend to free up approximately \$175 million per year in cash (Weise (2012)). Furthermore, the number of people coming into JCP stores dropped by 10%, and the number who bought something fell by 5% (Berfield & Maheshwari (2012)). Johnson, however, was optimistic that the remodeling strategy was going to turn the company around and pledged to continue the transformation of JCP into becoming America's favorite store. Investors, on the other hand, were not as forgiving; JCP stock dropped by 20% to \$26.75 when the 1Q2012 results were announced on Wednesday, May 16.

Although Williamson understood Adams' reasoning that the stock market might be overreacting to JCP's short-term results, he wondered if there might be other factors at play. Williamson's task from Adams was twofold: He needed to evaluate the decision of JCP to remodel their stores, using a capital budgeting framework, and he needed to examine both JCP's past financial statements and the current competitive environment within the full line department store industry. This information would help Adams make a decision regarding the purchase of JCP stock.

CASE QUESTIONS

The following list of questions covers the majority of issues that Russell Williamson would seek to address in his capital budgeting analysis of J.C. Penney's stores-within-a-store project, especially in relation to the financial performance of its industry peers. These questions will lead to discussions regarding whether or not to invest in J.C. Penney stock.

- 1) How competitive is J.C. Penney? Answer by analyzing J.C. Penney's historical financial statements in comparison to data from other retail companies.

Conduct a retrospective financial statement analysis that incorporates both the given balance sheet and income statement information in the supporting tables.

- 2) Evaluate J.C. Penney's remodeling strategy. Does the stores-within-a-store project add value to the company?

As a starting point, perform a prospective NPV-based capital budgeting analysis, while justifying your choice for the 'cost of capital' assumption.

- 3) What are other issues alluded to in the case that may have a substantial impact on the future viability of J.C. Penney? How will consumers respond to the changes in J.C. Penney's strategy?
 - a) Assess the potential for success for the company's new pricing strategy.
 - b) Discuss how J.C. Penney might improve the chance that its remodeling process will be successful.
 - c) Assess the impact of key competitors on the potential success or failure of J.C. Penney.

- 4) Should Brooks Associates invest in J.C. Penney stock?

The final recommendation should consider not only the impact from the new remodeling project, but also other qualitative factors such as changes in pricing strategy, responses from competitors, and the changing tastes of consumers.

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Exhibit 1. J.C. Penney – Income Statement (\$ millions)

FY	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Sales	19,903.0	19,860.0	18,486.0	17,556.0	17,759.0	17,260.0
Cost of Sales	12,078.0	12,189.0	11,571.0	10,646.0	10,799.0	11,042.0
Gross Profit	7,825.0	7,671.0	6,915.0	6,910.0	6,960.0	6,218.0
SG&A	5,548.0	5,403.0	5,336.0	5,747.0	5,613.0	5,230.0
EBITDA	2,277.0	2,268.0	1,579.0	1,163.0	1,347.0	988.0
Depreciation	389.0	426.0	469.0	495.0	511.0	518.0
EBIT	1,888.0	1,842.0	1,110.0	668.0	836.0	470.0
Interest Expense	270.0	278.0	268.0	263.0	253.0	228.0
Nonoperating Income	174.0	171.0	68.0	(2.0)	30.0	(20.0)
Special Items	0.0	(12.0)	0.0	0.0	(32.0)	(451.0)
Pretax Income	1,792.0	1,723.0	910.0	403.0	581.0	(229.0)
Total Taxes	658.0	618.0	343.0	154.0	203.0	(77.0)
Income Bef Extra Items	1,134.0	1,105.0	567.0	249.0	378.0	(152.0)
Cash Preferred Div	0.0	0.0	0.0	0.0	0.0	0.0
Disc Operations	19.0	6.0	5.0	2.0	11.0	0.0
Extra Items	0.0	0.0	0.0	0.0	0.0	0.0
Net Income	1,153.0	1,111.0	572.0	251.0	389.0	(152.0)

Source: Company Reports

Exhibit 2. J.C. Penney – Balance Sheet (\$ millions except for share values)

FY	2006	2007	2008	2009	2010	2011
Cash & Marketable Sec.	2,747.0	2,471.0	2,352.0	3,011.0	2,622.0	1,507.0
Receivables	205.0	286.0	243.0	258.0	208.0	233.0
Bad Debt Reserve	0.0	0.0	0.0	0.0	0.0	0.0
Inventory	3,400.0	3,641.0	3,259.0	3,024.0	3,213.0	2,916.0
Total Current Assets	6,648.0	6,751.0	6,220.0	6,652.0	6,370.0	5,081.0
PP&E	4,162.0	4,959.0	5,367.0	5,357.0	5,231.0	5,176.0
Intangibles	95.0	107.0	140.0	178.0	233.0	565.0
Deferred Charges	1,256.0	2,064.0	30.0	26.0	788.0	22.0
Equity Investments	16.0	9.0	-	-	-	-
Other Investments	474.0	395.0	229.0	310.0	375.0	500.0
Total Assets	12,673.0	14,309.0	12,011.0	12,581.0	13,042.0	11,424.0
Debt - Current Portion	434.0	203.0	0.0	393.0	0.0	231.0
Notes Payable	0.0	0.0	0.0	0.0	0.0	0.0
Accounts Payable	1,366.0	1,472.0	1,194.0	1,226.0	1,133.0	1,022.0
Taxes Payable	0.0	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	3,492.0	3,338.0	2,794.0	3,249.0	2,647.0	2,756.0
Total Long Term Debt	3,010.0	3,505.0	3,505.0	2,999.0	3,099.0	2,871.0
Deferred LT Taxes	1,206.0	1,463.0	599.0	817.0	1,192.0	888.0
Total Liabilities	8,385.0	8,997.0	7,856.0	7,803.0	7,582.0	7,414.0
Preferred Stock - Total	0.0	0.0	0.0	0.0	0.0	0.0
Common Equity	4,288.0	5,312.0	4,155.0	4,778.0	5,460.0	4,010.0
Total Stockholders' Equity	4,288.0	5,312.0	4,155.0	4,778.0	5,460.0	4,010.0
Shares Outstanding	226.0	222.0	222.0	236.0	236.7	215.9
Stock Price - FY Close	81.2	47.3	16.8	24.8	32.1	41.5
Cash Dividends	165.0	178.0	179.0	187.0	190.0	174.0

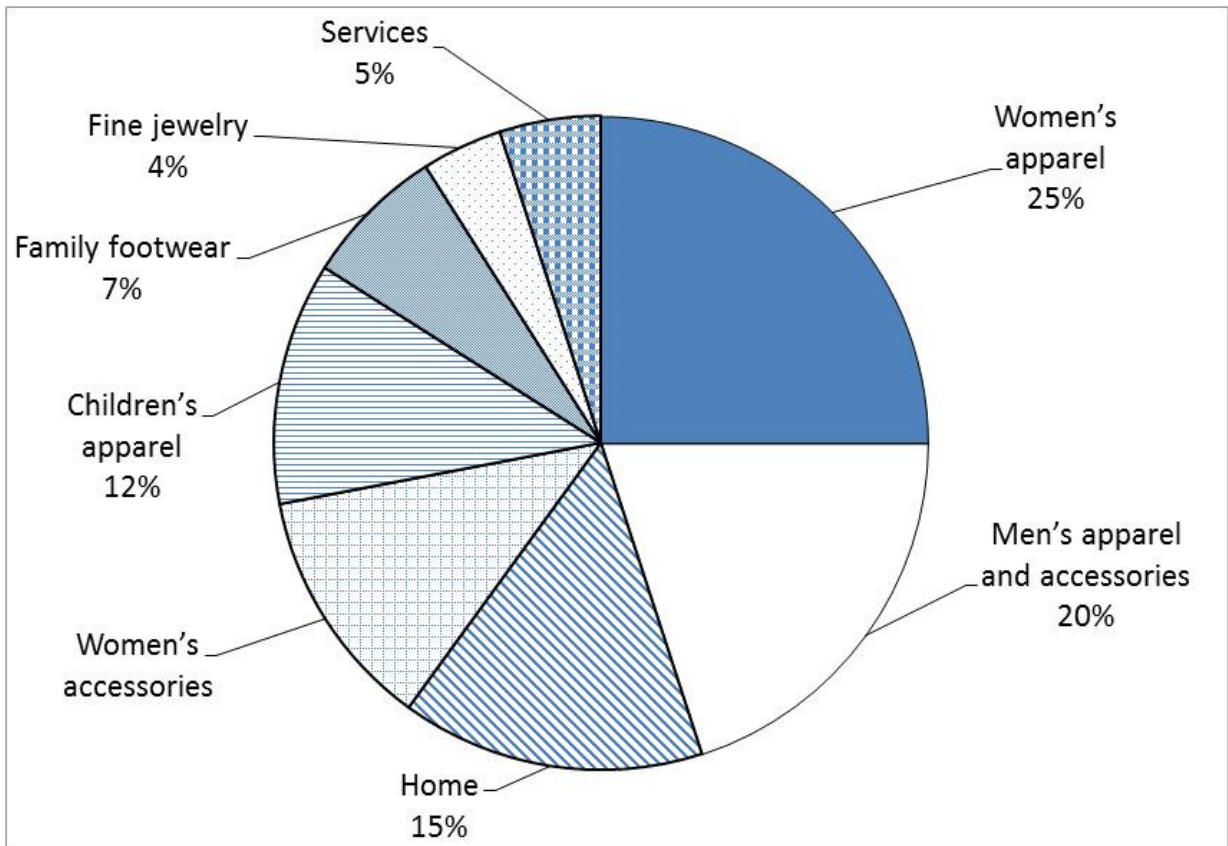
Source: Company Reports

Exhibit 3. J.C. Penney Stores by Location (As of January 28, 2012)

<u>Location</u>	<u>No. of Stores</u>	<u>Location</u>	<u>No. of Stores</u>	<u>Location</u>	<u>No. of Stores</u>
Alabama	22	Maine	6	Oklahoma	19
Alaska	1	Maryland	18	Oregon	14
Arizona	22	Massachusetts	13	Pennsylvania	41
Arkansas	16	Michigan	43	Rhode Island	3
California	81	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	60	Nebraska	12	Utah	9
Georgia	30	Nevada	7	Vermont	6
Idaho	9	New Hampshire	9	Virginia	27
Illinois	41	New Jersey	17	Washington	23
Indiana	30	New Mexico	10	West Virginia	9
Iowa	19	New York	43	Wisconsin	23
Kansas	19	North Carolina	35	Wyoming	5
Kentucky	22	North Dakota	8	Puerto Rico	7
Louisiana	16	Ohio	47		
				Total	<u><u>1,102</u></u>

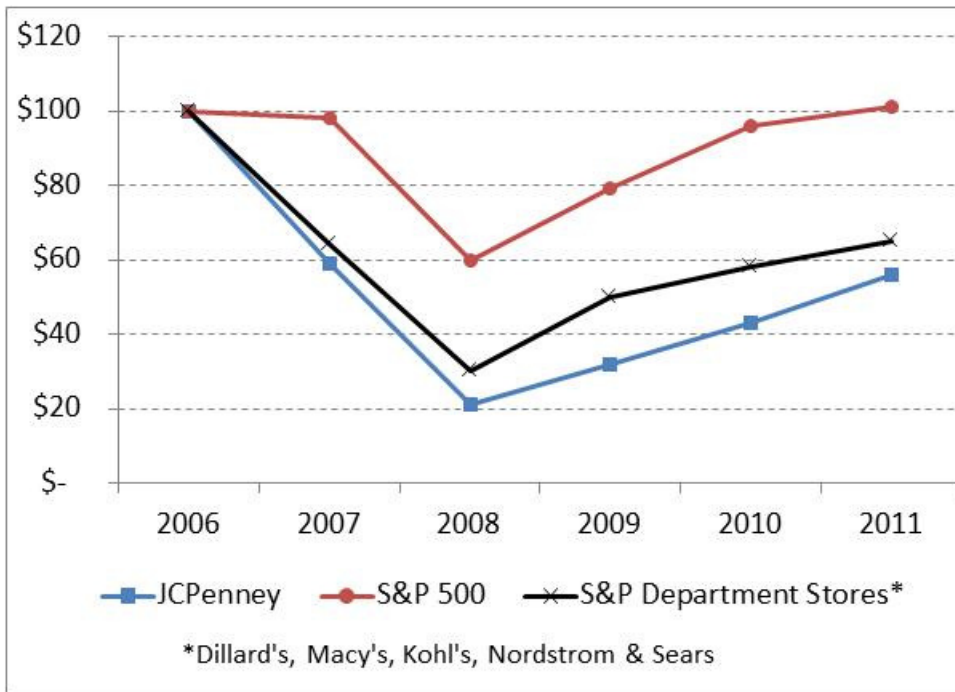
Source: Company Reports

Exhibit 4. J.C. Penney Sales Breakdown by Category (As of January 28, 2012)



Source: Company Reports

Exhibit 5. J.C. Penney Stock Performance – Hypothetical Value of \$100 Investment in 2006



Source: Company Reports

Exhibit 6. Competitors' Data (\$ millions except for share values)

	Dillard's Inc.			Kohl's Corp.		
Income Statement	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Sales	6,194.4	6,215.7	6,369.5	17,178.0	18,391.0	18,804.0
Cost of Sales	4,102.9	3,976.1	4,041.6	10,680.0	11,359.0	11,625.0
Gross Profit	2,091.5	2,239.6	2,327.9	6,498.0	7,032.0	7,179.0
SG&A	1,702.5	1,676.8	1,679.0	4,196.0	4,190.0	4,243.0
EBITDA	389.1	562.8	648.9	2,302.0	2,842.0	2,936.0
Depreciation	262.9	261.5	257.7	590.0	750.0	778.0
EBIT	126.2	301.2	391.2	1,712.0	2,092.0	2,158.0
Interest Expense	79.7	76.2	73.9	139.0	319.0	309.0
Nonoperating Income	27.4	31.1	39.4	15.0	15.0	10.0
Special Items	7.4	7.9	44.6	0.0	0.0	0.0
Pretax Income	81.2	264.1	401.4	1,588.0	1,788.0	1,859.0
Total Taxes	12.7	84.4	(62.5)	597.0	668.0	692.0
Net Income	68.5	179.6	463.9	991.0	1,120.0	1,167.0
Balance Sheet	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Cash & Marketable Sec.	341.7	343.3	224.3	2,267.0	2,277.0	1,205.0
Receivables	63.4	26.0	28.7	0.0	0.0	0.0
Inventory	1,300.7	1,290.1	1,304.1	2,923.0	3,036.0	3,199.0
Total Current Assets	1,749.5	1,701.9	1,591.7	5,485.0	5,642.0	4,775.0
PP&E	2,780.8	2,595.5	2,440.3	7,018.0	8,692.0	8,905.0
Intangibles	0.0	0.0	0.0	204.0	-	-
Total Assets	4,606.3	4,374.2	4,306.1	13,160.0	14,779.0	14,094.0
Debt - Current Portion	3.5	51.3	79.1	16.0	486.0	94.0
Notes Payable	0.0	0.0	0.0	0.0	0.0	0.0
Accounts Payable	494.4	491.5	452.4	1,188.0	1,138.0	1,233.0
Taxes Payable	62.3	34.8	74.1	184.0	127.0	133.0
Total Current Liabilities	769.0	831.2	870.4	2,390.0	2,781.0	2,590.0
Total Long Term Debt	970.0	908.6	823.9	2,052.0	3,512.0	4,150.0
Deferred LT Taxes	349.7	341.7	314.6	377.0	256.0	386.0
Total Liabilities	2,302.2	2,287.4	2,254.1	5,307.0	6,929.0	7,586.0
Preferred Stock - Total	0.0	0.0	0.0	0.0	0.0	0.0
Common Equity	2,304.1	2,086.7	2,052.0	7,853.0	7,850.0	6,508.0
Total Stockholders' Equity	2,304.1	2,086.7	2,052.0	7,853.0	7,850.0	6,508.0
Shares Outstanding	73.8	60.0	49.4	307.0	291.0	247.0
Stock Price - FY Close	16.6	39.7	44.3	50.4	50.8	46.0
Cash Dividends	11.8	10.6	10.0	0.0	0.0	271.0

	<u>Macy's Inc.</u>			<u>Nordstrom Inc.</u>		
Income Statement	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Sales	23,489.0	25,003.0	26,405.0	8,627.0	9,700.0	10,877.0
Cost of Sales	13,973.0	14,824.0	15,738.0	5,015.0	5,570.0	6,221.0
Gross Profit	9,516.0	10,179.0	10,667.0	3,612.0	4,130.0	4,656.0
SG&A	6,868.0	7,117.0	7,203.0	2,465.0	2,685.0	3,023.0
EBITDA	2,648.0	3,062.0	3,464.0	1,147.0	1,445.0	1,633.0
Depreciation	1,210.0	1,150.0	1,085.0	313.0	327.0	371.0
EBIT	1,438.0	1,912.0	2,379.0	834.0	1,118.0	1,262.0
Interest Expense	567.0	518.0	455.0	148.0	133.0	139.0
Nonoperating Income	(94.0)	(8.0)	(10.0)	10.0	6.0	9.0
Special Items	(270.0)	(66.0)	54.0	0.0	0.0	(13.0)
Pretax Income	507.0	1,320.0	1,968.0	696.0	991.0	1,119.0
Total Taxes	157.0	473.0	712.0	255.0	378.0	436.0
Net Income	350.0	847.0	1,256.0	441.0	613.0	683.0
Balance Sheet	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Cash & Marketable Sec.	1,686.0	1,516.0	2,961.0	795.0	1,506.0	2,077.0
Receivables	358.0	392.0	368.0	2,035.0	2,026.0	2,033.0
Inventory	4,615.0	4,758.0	5,117.0	898.0	977.0	1,148.0
Total Current Assets	6,882.0	6,899.0	8,777.0	4,054.0	4,824.0	5,560.0
PP&E	9,507.0	8,813.0	8,420.0	2,242.0	2,318.0	2,469.0
Intangibles	4,421.0	4,380.0	4,341.0	53.0	53.0	175.0
Total Assets	21,300.0	20,631.0	22,095.0	6,579.0	7,462.0	8,491.0
Debt - Current Portion	242.0	454.0	1,103.0	356.0	6.0	506.0
Notes Payable	0.0	0.0	0.0	0.0	0.0	0.0
Accounts Payable	1,796.0	1,980.0	2,262.0	726.0	846.0	917.0
Taxes Payable	68.0	182.0	371.0	0.0	0.0	0.0
Total Current Liabilities	4,454.0	5,065.0	6,263.0	2,014.0	1,879.0	2,575.0
Total Long Term Debt	8,456.0	6,971.0	6,655.0	2,257.0	2,775.0	3,141.0
Deferred LT Taxes	1,068.0	1,245.0	1,141.0	-	-	-
Total Liabilities	16,599.0	15,101.0	16,162.0	5,007.0	5,441.0	6,535.0
Preferred Stock - Total	0.0	0.0	0.0	0.0	0.0	0.0
Common Equity	4,701.0	5,530.0	5,933.0	1,572.0	2,021.0	1,956.0
Total Stockholders' Equity	4,701.0	5,530.0	5,933.0	1,572.0	2,021.0	1,956.0
Shares Outstanding	420.8	423.3	414.2	217.7	218.0	207.6
Stock Price - FY Close	15.9	23.1	33.7	34.5	41.2	49.4
Cash Dividends	84.0	84.0	231.0	139.0	167.0	197.0

Data Source: Company Reports

Exhibit 7. J.C. Penney and Competitors' Store Sales Comparison (Note: Gross selling space - square feet in millions)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
<u>J.C. Penney</u>					
Number of stores-Year end	1,067	1,093	1,108	1,106	1,102
Gross selling space	106.6	109.9	111.7	111.6	111.2
Sales per gross square foot	\$ 177	\$ 160	\$ 149	\$ 153	\$ 154
<u>Dillard's</u>					
Number of stores-Year end	326	315	309	308	304
Gross selling space	56.3	54.4	53.5	53.3	52.5
Sales per gross square foot	\$ 128	\$ 124	\$ 110	\$ 113	\$ 118
<u>Kohl's</u>					
Number of stores-Year end	929	1,004	1,058	1,089	1,127
Gross selling space	69.9	75.0	78.4	80.1	82.2
Sales per gross square foot	\$ 249	\$ 222	\$ 217	\$ 222	\$ 220
<u>Macy's</u>					
Number of stores-Year end	853	847	850	850	842
Gross selling space	155.2	154.3	154.5	154.2	151.9
Sales per gross square foot	\$ 170	\$ 161	\$ 152	\$ 162	\$ 174
<u>Nordstrom</u>					
Number of stores-Year end	156	169	184	204	225
Gross selling space	20.5	21.9	22.8	23.8	24.7
Sales per gross square foot	\$ 435	\$ 388	\$ 368	\$ 397	\$ 431

Data Source: Company Reports

Exhibit 8. J.C. Penney's New Stores-Within-Stores Example



Liz Claiborne



Joe Fresh

Source: J.C. Penney