

J C PENNEY CO INC  
Form 10-Q  
June 04, 2015  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended May 2, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 1-15274

J. C. PENNEY COMPANY, INC.  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or  
organization)

26-0037077  
(I.R.S. Employer Identification No.)

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

75024 - 3698  
(Zip Code)

(972) 431-1000  
(Registrant's telephone number, including area code)

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

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

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

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

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

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

J. C. PENNEY COMPANY, INC.  
 FORM 10-Q  
 For the Quarterly Period Ended May 2, 2015  
 INDEX

	Page
<u>Part I. Financial Information</u>	
<u>Item 1. Unaudited Interim Consolidated Financial Statements</u>	
<u>Consolidated Statements of Operations</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income/(Loss)</u>	<u>3</u>
<u>Consolidated Balance Sheets</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows</u>	<u>5</u>
<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	
<u>1. Basis of Presentation and Consolidation</u>	<u>6</u>
<u>2. Earnings/(Loss) per Share</u>	<u>7</u>
<u>3. Credit Facility</u>	<u>7</u>
<u>4. Fair Value Disclosures</u>	<u>7</u>
<u>5. Stockholders' Equity</u>	<u>8</u>
<u>6. Stock-Based Compensation</u>	<u>9</u>
<u>7. Retirement Benefit Plans</u>	<u>10</u>
<u>8. Restructuring and Management Transition</u>	<u>11</u>
<u>9. Real Estate and Other, Net</u>	<u>12</u>
<u>10. Income Taxes</u>	<u>12</u>
<u>11. Litigation, Other Contingencies and Guarantees</u>	<u>13</u>
<u>12. Effect of New Accounting Standards</u>	<u>13</u>
<u>13. Subsequent Event</u>	<u>13</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>14</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>27</u>
<u>Item 4. Controls and Procedures</u>	<u>27</u>
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	<u>28</u>
<u>Item 1A. Risk Factors</u>	<u>30</u>
<u>Item 6. Exhibits</u>	<u>41</u>
<u>SIGNATURES</u>	<u>43</u>

Table of Contents

## Part I. Financial Information

## Item 1. Unaudited Interim Consolidated Financial Statements

## J. C. PENNEY COMPANY, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

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

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

Table of Contents

J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(Unaudited)

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

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

3

Table of ContentsJ. C. PENNEY COMPANY, INC.  
CONSOLIDATED BALANCE SHEETS

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

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

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

Table of Contents

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

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

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



Table of Contents

J. C. PENNEY COMPANY, INC.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Consolidation

Basis of Presentation

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

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

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

Fiscal Year

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

Basis of Consolidation

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

Use of Estimates and Assumptions

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



Table of Contents

## 2. Earnings/(Loss) per Share

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

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

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

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

## 3. Credit Facility

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

## 4. Fair Value Disclosures

## Other Financial Instruments

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

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

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



Table of Contents

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

## Concentrations of Credit Risk

We have no significant concentrations of credit risk.

## 5. Stockholders' Equity

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

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

## Comprehensive Income

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

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

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

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

Table of Contents

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

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

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

#### 6. Stock-Based Compensation

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

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

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

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

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

Table of Contents

## 7. Retirement Benefit Plans

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

(\$ in millions)	Three Months Ended	
	May 2, 2015	May 3, 2014
<b>Primary Pension Plan</b>		
Service cost	\$17	\$15
Interest cost	49	53
Expected return on plan assets	(89	) (87
Amortization of actuarial loss/(gain)	26	13
Amortization of prior service cost/(credit)	2	1
Net periodic benefit expense/(income)	\$5	\$(5
<b>Supplemental Pension Plans</b>		
Service cost	\$—	\$—
Interest cost	2	2
Amortization of actuarial loss/(gain)	3	4
Amortization of prior service cost/(credit)	—	—
Net periodic benefit expense/(income)	\$5	\$6
<b>Primary and Supplemental Pension Plans Total</b>		
Service cost	\$17	\$15
Interest cost	51	55
Expected return on plan assets	(89	) (87
Amortization of actuarial loss/(gain)	29	17
Amortization of prior service cost/(credit)	2	1
Net periodic benefit expense/(income)	\$10	\$1
<b>Postretirement Health and Welfare Plan</b>		
Service cost	\$—	\$—
Interest cost	—	—
Amortization of actuarial loss/(gain)	—	—
Amortization of prior service cost/(credit)	(2	) (2
Net periodic benefit expense/(income)	\$(2	) \$(2
<b>Retirement Benefit Plans Total</b>		
Service cost	\$17	\$15
Interest cost	51	55
Expected return on plan assets	(89	) (87
Amortization of actuarial loss/(gain)	29	17
Amortization of prior service cost/(credit)	—	(1
Net periodic benefit expense/(income)	\$8	\$(1

Net periodic benefit expense/(income) for our noncontributory postretirement health and welfare plan was predominantly included in SG&A expense in the unaudited Interim Consolidated Statements of Operations.



Table of Contents

## Defined Contribution Plans

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

## 8. Restructuring and Management Transition

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

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

## Home Office and Stores

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

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

## Management Transition

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

## Other

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

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

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

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



## Table of Contents

### 9. Real Estate and Other, Net

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

#### Non-Operating Assets

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

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

#### Operating Assets

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

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

#### Other

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

### 10. Income Taxes

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

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

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

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

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

Table of Contents

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

11. Litigation, Other Contingencies and Guarantees

Litigation

Macy's Litigation

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

Other Legal Proceedings

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

Contingencies

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

Guarantees

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

12. Effect of New Accounting Standards

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

### 13. Subsequent Event

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

Table of Contents

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

General

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

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

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

Table of Contents

First Quarter Summary and Key Developments

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

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

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

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

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

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

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

Table of Contents

## Results of Operations

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

Comparable store sales include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales (1) through jcp.com. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation.

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

## Non-GAAP Financial Measures

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





Table of Contents

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

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

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

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

Table of Contents

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

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

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

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

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

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

## Total Net Sales

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

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

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

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

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

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



Table of Contents

Most Internet purchases are easily returned in our stores.

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

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

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

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

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

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

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

#### Store Count

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

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

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

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

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

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

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

#### Gross Margin

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

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

Table of Contents

## SG&amp;A Expenses

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

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

## Pension Expense

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

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

## Depreciation and Amortization Expense

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

## Restructuring and Management Transition

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

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

## Home Office and Stores

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

## Table of Contents

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

### Management Transition

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

### Other

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

### Real Estate and Other, Net

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

### Non-Operating Assets

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

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

### Operating Assets

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

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

### Other

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

### Operating Income/(Loss)

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

### Net Interest Expense

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

### Income Taxes



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

Table of Contents

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

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

**EBITDA and Adjusted EBITDA (non-GAAP)**

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

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

Table of Contents

## Liquidity and Capital Resources

## Overview

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

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

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

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

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

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

(4) Total debt divided by total capitalization.

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

## Free Cash Flow (Non-GAAP)

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

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

Table of Contents

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

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

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

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

**Operating Activities**

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

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

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

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

**Investing Activities**

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

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

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

24

---

Table of Contents

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

Financing Activities

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

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

Cash Flow Outlook

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

2014 Credit Facility

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

Credit Ratings

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

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

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

Contractual Obligations and Commitments

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

Inflation

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

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

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

25

---



Table of Contents

Critical Accounting Policies

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

Recently Issued Accounting Pronouncements

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

Seasonality

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

Cautionary Statement Regarding Forward-Looking Statements

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

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

26

---

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

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

## Table of Contents

### Part II. Other Information

#### Item 1. Legal Proceedings

##### Macy's Litigation

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

##### Ozenne Derivative Lawsuit

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

##### Class Action Securities Litigation

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

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

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

## Table of Contents

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

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

### Shareholder Derivative Litigation

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

### ERISA Class Action Litigation

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

### Employment Class Action Litigation

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

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

## Table of Contents

### Pricing Class Action Litigation

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

### Other Legal Proceedings

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

### Item 1A. Risk Factors

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

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

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

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



our ability to achieve positive cash flow;

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

general economic conditions.

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, which could adversely impact our sales and profitability.

30

---

Table of Contents

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 those on 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, selling their products, updating their store environment and updating their technology. Competition is characterized by many factors, including merchandise assortment, advertising, price, quality, service, location, reputation, credit availability and customer loyalty. We have experienced, and anticipate that we will continue to experience for at least the foreseeable future, significant competition from our competitors. The performance of competitors as well as changes in their pricing and promotional policies, marketing activities, customer loyalty programs, new store openings, store renovations, launches of Internet websites or mobile platforms, 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.

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. There is no assurance that these efforts will be successful or that we will be able to satisfy constantly changing customer demands. To the extent our decisions regarding our merchandise 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 results may be negatively impacted if customers do not maintain their favorable perception of our Company and our private brand merchandise.

Maintaining and continually enhancing the value of our Company and our private brand merchandise is important to the success of our business. The value of our private brands is based in large part on the degree to which customers perceive and react to them. The value of our private brands could diminish significantly due to a number of factors, including customer perception that we have acted in an irresponsible manner in sourcing our private brand merchandise, adverse publicity about our private brand merchandise, our failure to maintain the quality of our private brand products, or the failure of our private brand merchandise to deliver consistently good value to the customer. The growing use of social and digital media by customers, us, and third parties increases the speed and extent that information or misinformation and opinions can be shared. Negative posts or comments about us, our private brands, or any of our merchandise on social or digital media could seriously damage our reputation. If we do not maintain the favorable perception of our Company and our private brand merchandise, our business results could be negatively impacted.

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

Customer traffic depends upon our ability to successfully market compelling merchandise assortments as well as present an appealing shopping environment and experience to customers. Our strategies focus on increasing customer traffic and improving conversion in our stores and online; however, there can be no assurance that our efforts will be successful or will result in increased sales. In addition, external events outside of our control, including pandemics, terrorist threats, domestic conflicts and civil unrest, may influence customers' decisions to visit malls or might otherwise cause customers to avoid public places. There is no assurance that we will be able to reverse any decline in traffic or that increases in Internet sales will offset any decline in store traffic. We may need to respond to any declines in customer traffic or conversion rates by increasing markdowns or promotions to attract customers, which could adversely impact our gross margins, operating results and cash flows from operating activities.

Table of Contents

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 and online, timely and efficiently distributing inventory to stores, maintaining an appropriate mix and level of inventory in stores and online, adjusting our merchandise mix between our private and exclusive brands and national brands, 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 sell the excess inventory 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.

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

As part of our normal operations, we and third-party service providers with whom we contract receive and maintain information about our customers (including credit/debit card information), our employees and other third parties. Confidential data must at all times be protected against security breaches or other unauthorized disclosure. We have, and require our third-party service providers to have, administrative, physical and technical safeguards and procedures in place to protect the security, confidentiality and integrity of such information and to protect such information against unauthorized access, disclosure or acquisition. Despite our safeguards and security processes and procedures, there is no assurance that all of our systems and processes, or those of our third-party service providers, are free from vulnerability to security breaches or inadvertent data disclosure or acquisition by third parties or us. Further, because the methods used to obtain unauthorized access change frequently and may not be immediately detected, we may be unable to anticipate these methods or promptly implement safeguards. Any failure to protect confidential data about our business or our customers, employees or other third parties could materially damage our brand and reputation as well as result in significant expenses and disruptions to our operations, and loss of customer confidence, any of which could have a material adverse impact on our business and results of operations. We could also be subject to government enforcement actions and private litigation as a result of any such failure.

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, which have historically had high rates of turnover. We currently operate with significantly fewer individuals than we have in the past who have assumed additional duties and responsibilities, which could have an adverse impact on our operating performance and efficiency. Because of our lower than expected operating results in prior years, salary increases, bonuses and incentive compensation opportunities have been limited. Any prolonged inability to provide meaningful salary increases or incentive compensation opportunities, or media reports regarding our financial condition, 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, we may not achieve our objectives and our results of operations could be adversely impacted. 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. An inability to provide wages and/or benefits that are competitive within the markets in which we operate could adversely affect our ability to retain and attract employees. 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.

Disruptions in our Internet website or mobile application, or our inability to successfully execute our online strategy, could have an adverse impact on our sales and results of operations.

We sell merchandise over the Internet through our website, [www.jcpenney.com](http://www.jcpenney.com), and through a mobile application for phones and tablets. Our Internet operations are subject to numerous risks, including rapid technological change and the implementation of new systems and platforms; liability for online and mobile content; violations of state or federal laws, including those relating to online and mobile privacy and intellectual property rights; credit card fraud; problems associated with the operation and security 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 or mobile application to perform as expected could result in disruptions and costs to our operations and make it more difficult for customers to purchase merchandise online. In addition, our inability to successfully develop and maintain the necessary

Table of Contents

technological interfaces for our customers to purchase merchandise through our website, including user friendly software applications for smart phones and tablets, could result in the loss of Internet sales and have an adverse impact on our 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, generate performance and financial reports and administer payroll and benefit plans.

We have implemented several products from third party vendors to simplify our processes and reduce our use of customized existing legacy systems and expect to place additional applications into operation in the future. 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, the potential inability to meet reporting requirements and unintentional security vulnerabilities. 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.

Our vendors are also highly dependent on the use of information technology systems. Major disruptions in their information technology systems could result in their inability to communicate with us or otherwise to process our transactions or information, their inability to perform required functions, or in the loss or corruption of our information, any and all of which could result in disruptions to our operations. Our vendors are responsible for having safeguards and procedures in place to protect the confidentiality, integrity and security of our information, and to protect our information and systems against unauthorized access, disclosure or acquisition. Any failure in their systems to operate or in their ability to protect our information or systems could have a material adverse impact on our business 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. There is no assurance that we will 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 economic conditions on our suppliers cannot be predicted and our suppliers may be unable to access financing or become insolvent and thus become unable to supply us with products.

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 key 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 or more costly 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 on a timely basis or at all. Our arrangements with our suppliers and

Table of Contents

vendors may also be impacted by media reports regarding our financial position. Our need for additional liquidity could significantly increase and our supply of merchandise could be materially disrupted if a significant portion of our key suppliers and vendors took one or more of the actions described above, which could have a material adverse effect on our sales, customer satisfaction, cash flows, liquidity and financial position.

Our senior secured real estate term loan credit facility is secured by certain of our real property and substantially all of our personal property, and such property may be subject to foreclosure or other remedies in the event of our default. In addition, the real estate term loan credit facility contains provisions that could restrict our operations and our ability to obtain additional financing.

We are party to a \$2.25 billion senior secured term loan credit facility that is secured by mortgages on certain real property of the Company, in addition to liens on substantially all personal property of the Company, subject to certain exclusions set forth in the credit and security agreement governing the term loan credit facility and related security documents.

The real property subject to mortgages under the term loan credit facility includes our headquarters, distribution centers and certain of our stores.

The credit and guaranty agreement governing the term loan credit facility contains operating restrictions which may impact our future alternatives by limiting, without lender consent, our ability to borrow additional funds, execute certain equity financings or enter into dispositions or other liquidity enhancing or strategic transactions regarding certain of our assets, including our real property. Our ability to obtain additional or other financing or to dispose of certain assets could also be negatively impacted because a substantial portion of our owned assets have been pledged as collateral for repayment of our indebtedness under the term loan credit facility.

If an event of default occurs and is continuing, our outstanding obligations under the term loan credit facility could be declared immediately due and payable or the lenders could foreclose on or exercise other remedies with respect to the assets securing the term loan credit facility, including our headquarters, distribution centers and certain of our stores. If an event of default occurs, there is no assurance that we would have the cash resources available to repay such accelerated obligations or refinance such indebtedness on commercially reasonable terms, or at all. The occurrence of any one of these events could have a material adverse effect on our business, financial condition, results of operations and liquidity.

Our senior secured asset-based revolving credit and term loan facility limits our borrowing capacity to the value of certain of our assets. In addition, our senior secured asset-based revolving credit and term loan facility is secured by certain of our personal property, and lenders may exercise remedies against the collateral in the event of our default.

In June 2014, we entered into a new \$2.35 billion senior secured asset-based revolving credit and term loan facility. 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.



Our obligations under the revolving credit facility are secured by liens with respect to inventory, accounts receivable, deposit accounts and certain related collateral. 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, refinance such indebtedness on commercially reasonable terms, or at all, or cash collateralize our letters of credit, which would have a material adverse effect on our business, financial condition, results of operations and liquidity.

Table of Contents

Our level of indebtedness may adversely affect our business and results of operations and may require the use of our available cash resources to meet repayment obligations, which could reduce the cash available for other purposes.

As of May 2, 2015, we have \$5.405 billion in total indebtedness and we are highly leveraged. Our level of indebtedness may limit our ability to obtain additional financing, if needed, to fund additional projects, working capital requirements, capital expenditures, debt service, and other general corporate or other obligations, as well as increase the risks to our business associated with general adverse economic and industry conditions. Our level of indebtedness may also place us at a competitive disadvantage to our competitors that are not as highly leveraged.

We are required to make quarterly repayments in a principal amount equal to \$5.625 million during the five-year term of the real estate term loan credit facility, subject to certain reductions for mandatory and optional prepayments, and quarterly repayments in a principal amount equal to \$1.25 million during the five-year term of the senior secured asset-based revolving credit and term loan facility.

In addition, we are required to make prepayments of the real estate term loan credit facility with the proceeds of certain asset sales, insurance proceeds and excess cash flow, and prepayments of the asset-based revolving credit and term loan facility with excess cash flow, which will reduce the cash available for other purposes, including capital expenditures for store improvements, and could impact our ability to reinvest in other areas of our business.

There is no assurance 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, equity financings and sales of non-operating assets. We expect our ability to generate cash through the sale of non-operating assets to diminish as our portfolio of non-operating assets decreases. In addition, our recent operating losses 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. Accordingly, there is no assurance that cash flows from operations 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 to reduce costs. There can be no assurance that any of these actions would be successful, sufficient 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 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 there is no assurance would be obtainable. Any additional financing or refinancing could also be extended only 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.

Our use of interest rate hedging transactions could expose us to risks and financial losses that may adversely affect our financial condition, liquidity and results of operations.

To reduce our exposure to interest rate fluctuations, we have entered into, and in the future may enter into, interest rate swaps with various financial counterparties. The interest rate swap agreements effectively convert a portion of our variable rate interest payments to a fixed price. There can be no assurances, however, that our hedging activity will be effective in insulating us from the risks associated with changes in interest rates. In addition, our hedging transactions may expose us to certain risks and financial losses, including, among other things:

- counterparty credit risk;

- the risk that the duration or amount of the hedge may not match the duration or amount of the related liability;

Table of Contents

the hedging transactions may be adjusted from time to time in accordance with accounting rules to reflect changes in fair values, downward adjustments or “mark-to-market losses,” which would affect our stockholders’ equity; and

the risk that we may not be able to meet the terms and conditions of the hedging instruments, in which case we may be required to settle the instruments prior to maturity with cash payments that could significantly affect our liquidity.

Further, we have designated the swaps as cash flow hedges in accordance with Accounting Standards Codification Topic 815, Derivatives and Hedging. However, in the future, we may fail to qualify for hedge accounting treatment under these standards for a number of reasons, including if we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or if the swaps are not highly effective. If we fail to qualify for hedge accounting treatment, losses on the swaps caused by the change in their fair value will be recognized as part of net income, rather than being recognized as part of other comprehensive income.

Operating results and cash flows 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. We also assess the recoverability of indefinite-lived intangible assets at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. Our impairment review requires us to make estimates and projections regarding, but not limited to, sales, operating profit and future cash flows. If our operating performance reflects a sustained decline, we may be exposed to significant asset impairment charges in future periods, which could be material to our results of operations.

Reductions in income and cash flow from our marketing and servicing arrangement related to our private label and co-branded credit cards could adversely affect our operating results and cash flows.

Synchrony Financial (“Synchrony”) owns and services our private label credit card and co-branded MasterCard® programs. Our agreement with Synchrony provides for certain payments to be made by Synchrony to the Company, including a share of revenues from the performance of the credit card portfolios. The income and cash flow that the Company receives from Synchrony is dependent upon a number of factors including the level of sales on private label and co-branded accounts, the percentage of sales on private label and co-branded accounts relative to the Company’s total sales, the level of balances carried on the accounts, payment rates on the accounts, finance charge rates and other fees on the accounts, the level of credit losses for the accounts, Synchrony’s ability to extend credit to our customers as well as the cost of customer rewards programs. All of these factors can vary based on changes in federal and state credit card, banking and consumer protection laws, which could also materially limit the availability of credit to consumers or increase the cost of credit to our cardholders. The factors affecting the income and cash flow that the Company receives from Synchrony can also vary based on a variety of economic, legal, social and other factors that we cannot control. If the income or cash flow that the Company receives from our consumer credit card program agreement with Synchrony decreases, our operating results and cash flows could be adversely affected.

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.

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;

36

---

Table of Contents

• 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;

• local business practice and political issues that may result in adverse publicity or threatened or actual adverse consumer actions, including boycotts;

• 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, congestion and labor issues at major ports, 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. 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.

Disruptions and congestion at ports through which we import merchandise may increase our costs and/or delay the receipt of goods in our stores, which could adversely impact our profitability, financial position and cash flows.

We ship the majority of our private brand merchandise by ocean to ports in the United States. Our national brand suppliers also ship merchandise by ocean. Disruptions in the operations of ports through which we import our merchandise, including but not limited to labor disputes involving work slowdowns, lockouts or strikes, could require us and/or our vendors to ship merchandise by air freight or to alternative ports in the United States. Shipping by air is significantly more expensive than shipping by ocean which could adversely affect our profitability. Similarly, shipping to alternative ports in the United States could result in increased lead times and transportation costs. Disruptions at ports through which we import our goods could also result in unanticipated inventory shortages, which could adversely impact our reputation and 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. In particular, the moderate income consumer, which is our core customer, has been under economic pressure for the past several years, and may have less disposable income for items such as apparel and home goods. 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,

Table of Contents

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, preclude customers from traveling to our stores, 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 and/or changes in the interpretation of existing laws and regulations, 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 disrupt our operations and increase our costs 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 activities, minimum wage, wage and hour, and health care mandates, among others, could also cause our compliance costs to increase and adversely affect our business and 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.

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.

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, our

## Table of Contents

financial condition, 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 that have often been unrelated or disproportionate to the operating performance of these companies. This volatility could affect the price at which you could sell shares of our common stock.

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. The Company and certain of our current and former members of the Board of Directors and executives are defendants in a consolidated class action lawsuit and two related shareholder derivative actions that were filed following our announcement of an issuance of common stock on September 26, 2013. An additional class action complaint regarding the same announcement was also recently filed. Such litigation 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.

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.

The Company has a federal net operating loss (NOL) of \$2.6 billion as of January 31, 2015. These NOL carryforwards (expiring in 2032 through 2034) are available to offset future taxable income. The Company may recognize additional NOLs in the future.

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 by a corporation's NOLs if the 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. Additionally, various states have similar limitations on the use of state NOLs following an ownership change.

If an ownership change occurs, the amount of the taxable income for any post-change year that may be offset by a pre-change loss is subject to an annual limitation that is cumulative to the extent it is not all utilized in a year. This limitation is derived by multiplying the fair market value of the Company stock as of the ownership change by the applicable federal long-term tax-exempt rate, which was 2.8% at January 31, 2015. To the extent that a company has a net unrealized built-in gain at the time of an ownership change, which is realized or deemed recognized during the five-year period following the ownership change, there is an increase in the annual limitation for each of the first five-years that is cumulative to the extent it is not all utilized in a year.

The Company has an ongoing study of the rolling three-year testing periods. Based upon the elections the Company has made and the information that has been filed with the Securities and Exchange Commission through May 2, 2015, the Company has not had a Section 382 ownership change through May 2, 2015.

If an ownership change should occur in the future, 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 an additional valuation allowance related to the amount of the NOL that may not be realized, which could impact the Company's result of operations.

We believe that these NOL carryforwards are a valuable asset for us. Consequently, we have a stockholder rights plan in place, which was approved by the Company's stockholders, to protect our NOLs during the effective period of the

rights plan. Although the rights plan is intended to reduce the likelihood of an “ownership change” that could adversely affect us, there is no assurance that the restrictions on transferability in the rights plan will prevent all transfers that could result in such an “ownership change”.

The rights plan could make it more difficult for a third party to acquire, or could discourage a third party from acquiring, our Company or a large block of our common stock. A third party that acquires 4.9% or more of our common stock could suffer substantial dilution of its ownership interest under the terms of the rights plan through the issuance of common stock or common stock equivalents to all stockholders other than the acquiring person.

The foregoing provisions may adversely affect the marketability of our common stock by discouraging potential investors from acquiring our stock. In addition, these provisions could delay or frustrate the removal of incumbent directors and could make

Table of Contents

more difficult a merger, tender offer or proxy contest involving us, or impede an attempt to acquire a significant or controlling interest in us, even if such events might be beneficial to us and our stockholders.

40

---

Table of ContentsItem 6. Exhibits  
Exhibit Index

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
3.1	Restated Certificate of Incorporation of J. C. Penney Company, Inc., as amended to May 20, 2011	10-Q	001-15274	3.1	6/8/2011	
3.2	J. C. Penney Company, Inc. Bylaws, as amended to July 23, 2013	8-K	001-15274	3.1	7/26/2013	
3.3	Certificate of Designation, Preferences and Rights of Series C Junior Participating Preferred Stock Fifth Amendment dated as of April 6, 2015 to Consumer Credit Card Program Agreement by and between J. C. Penney Corporation, Inc. and Synchrony Bank, as amended and restated as of November 5, 2009, as amended by the First Amendment thereto dated as of October 29, 2010, the Second Amendment thereto dated as of January 30, 2013, the Third Amendment thereto dated October 11, 2013 and the Fourth Amendment thereto dated February 25, 2014	8-K	001-15274	3.1	8/22/2013	
10.1	Form of Notice of 2015 CEO Performance Unit Grant under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan					†
10.2	Form of Notice of 2015 CEO Stock Option Grant under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan					†
10.3	Form of Notice of Restricted Stock Unit Grant under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan					†
10.4	Form of Notice of Stock Option Grant under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan					†
10.5	Form of Notice of Performance Unit Grant under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan					†
10.6	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
31.1						†
31.2						†

	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	†
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	†
101.INS	XBRL Instance Document	†
101.SCH	XBRL Taxonomy Extension Schema Document	†

41

---

Table of Contents

101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	†
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	†
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	†
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	†

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

J. C. PENNEY COMPANY, INC.  
By /s/ Dennis P. Miller  
Dennis P. Miller  
Senior Vice President and Controller  
(Principal Accounting Officer)

Date: June 4, 2015