J C PENNEY CO INC
Form 10-Q
August 30, 2017
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 29, 2017
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-15274

J. C. PENNEY COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware	26-0037077
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6501 Legacy Drive, Plano, Texas	75024 - 3698
(Address of principal executive offices)	(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 x 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 x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date. 310,741,236 shares of Common Stock of 50 cents par value, as of August 25, 2017.

J. C. PENNEY COMPANY, INC.
FORM 10-Q
For the Quarterly Period Ended July 29, 2017
INDEX

	Page
Part I. Financial Information	
Item 1. Unaudited Interim Consolidated Financial Statements	
Consolidated Statements of Operations	2
Consolidated Statements of Comprehensive Income/(Loss)	3
Consolidated Balance Sheets	4
Consolidated Statements of Cash Flows	5
Notes to Unaudited Interim Consolidated Financial Statements	
1. Basis of Presentation and Consolidation	6
2. Effect of New Accounting Standards	6
3. Earnings/(Loss) per Share	8
4. Long-Term Debt	8
5. Derivative Financial Instruments	9
6. Restructuring and Management Transition	10
7. Fair Value Disclosures	11
8. Stockholders’ Equity	12
9. Retirement Benefit Plans	13
10. Real Estate and Other, Net	13
11. Income Taxes	14
12. Litigation and Other Contingencies	14
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3. Quantitative and Qualitative Disclosures About Market Risk	30
Item 4. Controls and Procedures	30
Part II. Other Information	
Item 1. Legal Proceedings	30
Item 1A. Risk Factors	30
Item 6. Exhibits	41
SIGNATURES	43

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		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Costs and expenses/(income):				
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	1,923	1,834	3,646	3,627
Selling, general and administrative (SG&A)	842	853	1,685	1,725
Pension	(4)	2	(6)	4
Depreciation and amortization	144	153	289	307
Real estate and other, net	(19)	(9)	(137)	(47)
Restructuring and management transition	23	9	243	15
Total costs and expenses	2,909	2,842	5,720	5,631
Operating income/(loss)	53	76	(52)	98
(Gain)/loss on extinguishment of debt	35	34	35	30
Net interest expense	79	93	166	188
Income/(loss) before income taxes	(61)	(51)	(253)	(120)
Income tax expense/(benefit)	1	5	(11)	4
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Earnings/(loss) per share:				
Basic	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Diluted	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Weighted average shares – basic	310.8	308.0	310.2	307.6
Weighted average shares – diluted	310.8	308.0	310.2	307.6

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		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$(62)	$ (56)	$(242)	$(124)
Other comprehensive income/(loss), net of tax:				
Retirement benefit plans				
Net actuarial gain/(loss) arising during the period [1]	—	—	5	—
Prior service credit/(cost) arising during the period [2]	—	—	—	5
Reclassification for net actuarial (gain)/loss [3]	—	(1)	—	(2)
Reclassification for amortization of prior service (credit)/cost [4]	1	—	2	—
Net curtailment gain [5]	—	—	20	—
Cash flow hedges				
Gain/(loss) on interest rate swaps [6]	(3)	(6)	(6)	(9)
Reclassification for periodic settlements [7]	2	2	4	4
Foreign currency translation				
Unrealized (gain)/loss	2	—	2	—
Deferred tax valuation allowance	—	(1)	—	(1)
Total other comprehensive income/(loss), net of tax	2	(6)	27	(3)
Total comprehensive income/(loss), net of tax	$(60)	$ (62)	$(215)	$(127)

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

(1) Net of $(4) million in tax in the six months ended July 29, 2017.

(2) Net of $(3) million in tax in the six months ended July 30, 2016.

(3) Net of $1 million and $2 million in tax in the three and six months ended July 30, 2016, respectively. Pre-tax amounts of $(2) million and $(4) million in the three and six months ended July 30, 2016, respectively, were recognized in SG&A in the Consolidated Statements of Operations.

(4) Net of $(1) million and $(2) million in tax in the three and six months ended July 29, 2017, respectively. Pre-tax amounts of $2 million and $4 million in the three and six months ended both July 29, 2017 and July 30, 2016, respectively, were recognized in Pension in the Consolidated Statements of Operations. Pre-tax amounts of $(2) million and $(4) million in the three and six months ended July 30, 2016, respectively, were recognized in SG&A in the Consolidated Statements of Operations.

(5) Net of $(11) million in tax in the six months ended July 29, 2017. Pre-tax prior service cost of $5 million related to the curtailment is included in Restructuring and management transition in the Consolidated Statements of Operations in the six months ended July 29, 2017.

(6) Net of $2 million and $3 million of tax in the three and six months ended July 29, 2017, respectively. Net of $3 million and $4 million of tax in the three and six months ended July 30, 2016, respectively.

(7) Net of $(1) million and $(2) million of tax in each of the three and six months ended July 29, 2017 and July 30, 2016, respectively, and $3 million and $6 million in pre-tax amounts for each of the three and six months ended July 29, 2017 and July 30, 2016, respectively, were recognized in Net interest expense in the Consolidated Statements of Operations.

Table of Contents

J. C. PENNEY COMPANY, INC.
CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	July 29, 2017 (Unaudited)	July 30, 2016 (Unaudited)	January 28, 2017
Assets			
Current assets:			
Cash in banks and in transit	$ 186	$ 171	$ 125
Cash short-term investments	128	258	762
Cash and cash equivalents	314	429	887
Merchandise inventory	2,777	2,981	2,854
Prepaid expenses and other	223	235	160
Total current assets	3,314	3,645	3,901
Property and equipment (net of accumulated depreciation of $3,610, $3,742 and $3,842)	4,390	4,686	4,599
Other assets	622	604	618
Total Assets	$ 8,326	$ 8,935	$ 9,118
Liabilities and Stockholders' Equity			
Current liabilities:			
Merchandise accounts payable	$ 950	$ 1,094	$ 977
Other accounts payable and accrued expenses	1,091	1,121	1,164
Current portion of capital leases, financing obligation and note payable	9	18	15
Current maturities of long-term debt	232	341	263
Total current liabilities	2,282	2,574	2,419
Long-term capital leases, financing obligation and note payable	216	10	219
Long-term debt	3,836	4,356	4,339
Deferred taxes	202	194	204
Other liabilities	635	604	583
Total Liabilities	7,171	7,738	7,764
Stockholders' Equity			
Common stock[(1)]	155	154	154
Additional paid-in capital	4,694	4,668	4,679
Reinvested earnings/(accumulated deficit)	(3,248)	(3,131)	(3,006)
Accumulated other comprehensive income/(loss)	(446)	(494)	(473)
Total Stockholders' Equity	1,155	1,197	1,354
Total Liabilities and Stockholders' Equity	$ 8,326	$ 8,935	$ 9,118

(1) 1,250 million shares of common stock are authorized with a par value of $0.50 per share. The total shares issued and outstanding were 310.3 million, 307.6 million and 308.3 million as of July 29, 2017, July 30, 2016 and January 28, 2017, respectively.

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

4

Table of Contents

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Cash flows from operating activities				
Net income/(loss)	$ (62)	$ (56)	$ (242)	$ (124)
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:				
Restructuring and management transition	(4)	—	73	(1)
Asset impairments and other charges	2	1	3	2
Net gain on sale of non-operating assets	—	—	—	(5)
Net gain on sale of operating assets	(1)	(2)	(118)	(10)
(Gain)/loss on extinguishment of debt	35	34	35	30
Depreciation and amortization	144	153	289	307
Benefit plans	(15)	(15)	96	(27)
Stock-based compensation	9	10	16	20
Deferred taxes	(1)	3	(19)	—
Change in cash from:				
Inventory	172	(56)	77	(260)
Prepaid expenses and other	7	(9)	(64)	(68)
Merchandise accounts payable	57	99	(27)	169
Current income taxes	(2)	(3)	3	(4)
Accrued expenses and other	61	27	(66)	(237)
Net cash provided by/(used in) operating activities	402	186	56	(208)
Cash flows from investing activities				
Capital expenditures	(109)	(121)	(192)	(160)
Net proceeds from sale of non-operating assets	—	—	—	2
Net proceeds from sale of operating assets	10	4	146	16
Joint venture return of investment	1	1	9	15
Net cash provided by/(used in) investing activities	(98)	(116)	(37)	(127)
Cash flows from financing activities				
Proceeds from issuance of long-term debt	—	2,188	—	2,188
Proceeds from borrowings under the credit facility	272	—	272	—
Payments of borrowings under the credit facility	(272)	—	(272)	—
Premium on early retirement of debt	(30)	—	(30)	—
Payments of capital leases, financing obligation and note payable	(6)	(5)	(12)	(19)
Payments of long-term debt	(311)	(2,188)	(541)	(2,250)
Financing costs	(9)	(49)	(9)	(49)
Proceeds from stock issued under stock plans	3	—	3	1
Tax withholding payments for vested restricted stock	—	(2)	(3)	(7)
Net cash provided by/(used in) financing activities	(353)	(56)	(592)	(136)
Net increase/(decrease) in cash and cash equivalents	(49)	14	(573)	(471)
Cash and cash equivalents at beginning of period	363	415	887	900
Cash and cash equivalents at end of period	$ 314	$ 429	$ 314	$ 429

Supplemental cash flow information

Income taxes received/(paid), net	$ (4)	$ (5)	$ (5)	$ (8)
Interest received/(paid), net	(59)	(62)	(163)	(184)
Supplemental non-cash investing and financing activity				
Increase/(decrease) in other accounts payable related to purchases of property and equipment and software	1	(9)	6	32

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 28, 2017 (2016 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 2016 Form 10-K. The January 28, 2017 financial information was derived from the audited Consolidated Financial Statements, with related footnotes, included in the 2016 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 July 29, 2017" and "three months ended July 30, 2016" refer to the 13-week periods ended July 29, 2017 and July 30, 2016, respectively. "Six months ended July 29, 2017" and "six months ended July 30, 2016" refer to the 26-week periods ended July 29, 2017 and July 30, 2016, respectively. Fiscal year 2017 contains 53 weeks, and fiscal year 2016 contains 52 weeks.

Basis of Consolidation

All significant inter-company 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.

2. Effect of New Accounting Standards

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes, which requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The new standard no longer requires allocating valuation allowances between current and noncurrent deferred tax assets because those allowances are classified as noncurrent. The Company adopted ASU 2015-17 retrospectively in its first quarter ended April 29, 2017. As a result of the retrospective adoption, the Company reclassified deferred tax assets of $231 million and $196 million as of July 30, 2016, and January 28, 2017, respectively, from Deferred taxes (a component of current assets) to a reduction in Deferred taxes (a component of long-term liabilities) on the unaudited Interim Consolidated Balance Sheets.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330), Simplifying the Measurement of Inventory, which simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. Under previous guidance, net realizable value is one of several calculations an entity needs to make to measure inventory at the lower of cost or market. However, companies will continue to apply their existing

impairment models to inventories that are accounted for using last-in first-out (LIFO) and the retail inventory method (RIM). The Company adopted ASU 2015-11 in its first quarter ended April 29, 2017. The adoption of this standard did not have a material impact on our financial condition, results of operations or cash flows as substantially all of our inventory is measured by the RIM impairment model which is considered a continued acceptable method under the new standard.

Table of Contents

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 changes how companies account for certain aspects of share-based payments to employees. Entities are required to recognize the income tax effects of awards (windfalls or shortfalls) in the income statement when the awards vest or are settled (i.e., additional paid-in capital or APIC pools will be eliminated). The guidance on employers' accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and for forfeitures also changed. The ASU also provides a practical expedient for public companies that allows the use of a simplified method to estimate the expected term for certain awards. The Company adopted ASU 2016-09 in its first quarter ended April 29, 2017.

As a result of ASU 2016-09 requiring all windfalls and shortfalls to be recognized when they arise, excess tax benefits that were not previously recognized because the related tax deduction had not reduced current taxes payable have been recorded on a modified retrospective basis through a cumulative effect adjustment to retained earnings as of January 29, 2017. Additionally, the deferred tax assets recognized as a result of this transition guidance have been assessed for realizability and any valuation allowance has been recognized as part of the cumulative effect adjustment to retained earnings also as a result of this transition guidance. Considering these aspects of transitioning to the new guidance, there was no impact to retained earnings as a result of a valuation allowance being recorded against the related deferred tax asset recorded as the cumulative adjustment.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the FASB Emerging Issues Task Force) (ASU 2016-05). Under the ASU, the novation of a derivative contract (i.e., a change in the counterparty) in a hedge accounting relationship does not, in and of itself, require dedesignation of that hedge accounting relationship. The hedge accounting relationship could continue uninterrupted if all of the other hedge accounting criteria are met, including the expectation that the hedge will be highly effective when the creditworthiness of the new counterparty to the derivative contract is considered. The Company adopted ASU 2016-05 in the first quarter ended April 29, 2017 and the new guidance had no impact as the Company had no transactions involving the novation of a derivative.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. Companies will present all other components of net benefit cost outside of operating income, if this subtotal is presented. This guidance is effective for fiscal years beginning after December 15, 2017, and interim periods therein. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Entities should apply this guidance retrospectively for the presentation of the service cost component and the other components of net periodic pension cost in the income statement and prospectively, on and after the effective date, for any capitalization of the service cost component of net periodic pension cost in assets. We are currently evaluating the effect that adopting this new accounting guidance will have on our financial condition, results of operations, or cash flows.

In May 2014, the FASB issued ASC Topic 606, Revenue from Contracts with Customers, a replacement of Revenue Recognition (Topic 605). The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle of the guidance is that a Company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard is effective for us beginning in fiscal 2018 and we plan to adopt the new standard using the full retrospective approach. We are analyzing the impact of the new standard on our current accounting policies and internal controls and the software changes required to implement the new standard. Although we have not completed all of the required due diligence, we have identified the certain impacts to our revenue recognition policies related to gift card breakage and our customer loyalty programs. Whereas we currently recognize gift card breakage, net of required escheatment, 60

months after the gift card is issued, the new standard will require us to recognize gift card breakage, net of required escheatment, over the redemption pattern of gift cards. Additionally, whereas under current standards we utilize the incremental cost method to account for our customer loyalty programs, the new standard will require us to account for our customer loyalty program as revenue which will require us to defer a portion of our incremental sales to loyalty rewards to be earned by reward members.

We are also evaluating the classification of profit sharing income earned in connection with our private label credit card and co-branded MasterCard® programs 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. Currently the income we earn under our agreement with Synchrony is included as an offset to SG&A expenses and along with the adoption of the new standard, we plan to change our presentation to include such income in Real estate and other, net.

Table of Contents

3. 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		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Earnings/(loss)				
Net income/(loss)	$ (62)	$ (56)	$ (242)	$ (124)
Shares				
Weighted average common shares outstanding (basic shares)	310.8	308.0	310.2	307.6
Adjustment for assumed dilution:				
Stock options, restricted stock awards and warrant	—	—	—	—
Weighted average shares assuming dilution (diluted shares)	310.8	308.0	310.2	307.6
EPS				
Basic	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)
Diluted	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)

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		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Stock options, restricted stock awards and warrant	33.5	34.8	33.3	35.0

4. Long-Term Debt

($ in millions)	July 29, 2017	July 30, 2016	January 28, 2017
Issue:			
7.65% Debentures Due 2016	$—	$78	$ —
7.95% Debentures Due 2017	—	220	220
5.75% Senior Notes Due 2018 (1)	190	265	265
8.125% Senior Notes Due 2019 (1)	175	400	400
5.65% Senior Notes Due 2020 (1)	400	400	400
2016 Term Loan Facility (Matures in 2023)	1,646	1,688	1,667
5.875% Senior Secured Notes Due 2023 (1)	500	500	500
7.125% Debentures Due 2023	10	10	10
6.9% Notes Due 2026	2	2	2
6.375% Senior Notes Due 2036 (1)	388	388	388
7.4% Debentures Due 2037	313	313	313
7.625% Notes Due 2097	500	500	500
Total debt, excluding unamortized debt issuance costs, capital leases, financing obligation and note payable	4,124	4,764	4,665
Unamortized debt issuance costs	(56)	(67)	(63)
Total debt, excluding capital leases, financing obligation and note payable	4,068	4,697	4,602
Less: current maturities	232	341	263
Total long-term debt, excluding capital leases, financing obligation and note payable	$3,836	$4,356	$ 4,339

Table of Contents

(1) These debt issuances contain a change of control provision that would obligate us, at the holders' option, to repurchase the debt at a price of 101%.

On May 22, 2017, we paid approximately $334 million aggregate consideration to settle cash tender offers with respect to portions of our outstanding 5.75% Senior Notes due 2018 and 8.125% Senior Notes due 2019 (collectively, the Securities). In doing so, we recognized a loss on extinguishment of debt of $34 million which includes the premium paid over the face value of the accepted Securities of $30 million, reacquisition costs of $1 million and the write off of unamortized debt issuance costs of $3 million.

During the second quarter of 2017, we amended our $2.35 billion senior secured asset-based revolving credit facility (2017 Credit Facility) to, among other things, extend the maturity date to June 20, 2022 and to lower the interest rate spread by 75 basis points. All borrowings under the 2017 Credit Facility accrue interest at a rate equal to, at the Company's option, a base rate or an adjusted LIBOR rate plus a spread. As of July 29, 2017, there were no outstanding borrowings under the 2017 Credit Facility.

5. Derivative Financial Instruments

We use derivative financial instruments for hedging and non-trading purposes to manage our exposure to changes in interest rates. Use of derivative financial instruments in hedging programs subjects us to certain risks, such as market and credit risks. Market risk represents the possibility that the value of the derivative instrument will change. In an effective hedging relationship, the change in the value of the derivative is offset to a great extent by the change in the value of the underlying hedged item. Credit risk related to derivatives represents the possibility that the counterparty will not fulfill the terms of the contract. The notional, or contractual, amount of our derivative financial instruments is used to measure interest to be paid or received and does not represent our exposure due to credit risk. Credit risk is monitored through established approval procedures, including setting concentration limits by counterparty, reviewing credit ratings and requiring collateral (generally cash) from the counterparty when appropriate.

When we use derivative financial instruments for the purpose of hedging our exposure to interest rates, the contract terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria are recorded using hedge accounting. If a derivative instrument qualifies for hedge accounting, depending on the nature of the hedge, changes in the fair value of the instrument will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or be recognized in accumulated other comprehensive income/(loss) until the hedged item is recognized in earnings. The ineffective portion of an instrument's change in fair value will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which we have not elected to apply hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of change.

We have 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 have a weighted-average fixed rate of 2.04%, mature on May 7, 2020 and have been designated as cash flow hedges.

The fair value of our interest rate swaps are recorded on the unaudited Interim Consolidated Balance Sheets as an asset or a liability (see Note 7). The effective portion of the interest rate swaps' changes in fair values is reported in Accumulated other comprehensive income/(loss) (see Note 8), and the ineffective portion is reported in Net income/(loss). Amounts in Accumulated other comprehensive income/(loss) are reclassified into net income/(loss) when the related interest payments affect earnings. For the periods presented, all of the interest rate swaps were 100% effective.

Table of Contents

Information regarding the gross amounts of our derivative instruments in the unaudited Interim Consolidated Balance Sheets is as follows:

	Asset Derivatives at Fair Value				Liability Derivatives at Fair Value			
($ in millions)	Balance Sheet Location	July 29, 2017	July 30, 2016	January 28, 2017	Balance Sheet Location	July 29, 2017	July 30, 2016	January 28, 2017
Derivatives designated as hedging instruments:								
Interest rate swaps	N/A	$ —	$ —	$ —	Other accounts payable and accrued expenses	$ 2	$ 2	$ 2
Interest rate swaps	N/A	—	—	—	Other liabilities	13	35	10
Total derivatives designated as hedging instruments		$ —	$ —	$ —		$ 15	$ 37	$ 12

6. Restructuring and Management Transition

On March 17, 2017, the Company finalized its plans to close 138 stores to help align the Company's brick-and-mortar presence with its omnichannel network, thereby redirecting capital resources to invest in locations and initiatives that offer the greatest revenue potential. The expected store closures resulted in a $77 million asset impairment charge for store assets with limited future use and a $14 million severance charge for the expected displacement of store associates. Other store related closing costs such as certain lease obligations will be recorded as incurred when each respective store ceases operations.

The Company also initiated a Voluntary Early Retirement Program (VERP) for approximately 6,000 eligible associates. Eligibility for the VERP included home office, stores and supply chain personnel who met certain criteria related to age and years of service as of January 31, 2017. The consideration period for eligible associates to accept the VERP ended on March 31, 2017. Based on the approximately 2,800 associates who elected to accept the VERP, we incurred a total charge of $112 million for enhanced retirement benefits. The enhanced retirement benefits increased the projected benefit obligation (PBO) of the Primary Pension Plan and the Supplemental Pension Plans by $88 million and $24 million, respectively. In addition, we incurred curtailment charges of $6 million related to our Primary Pension Plan and $2 million related to Supplemental Pension Plans as a result of the reduction in the expected years of future service related to these plans. As a result of these curtailments, the assets and the liabilities for our Primary Pension Plan and the liabilities of certain Supplemental Pension Plans were remeasured as of March 31, 2017. The discount rate used for the March 31 remeasurements was 4.34% compared to the year-end 2016 discount rate of 4.40%. These events resulted in the PBO of our Primary Pension Plan decreasing by $3 million and the related assets increasing by $34 million and the PBO of our Supplemental Pension Plans increasing by $3 million. The funded status of the Primary Pension Plan was 98% as of the remeasurement date.

The components of restructuring and management transition include:

- VERP — charges for enhanced retirement benefits, curtailment and other expenses related to the VERP;
- Home office and stores — charges for actions to reduce our store and home office expenses including employee termination benefits, store lease termination and impairment charges;
- Management transition — charges related to implementing changes within our management leadership team for both incoming and outgoing members of management; and
- Other — charges related primarily to contract termination costs and other costs associated with our previous shops strategy and costs related to the closure of certain supply chain locations.

Table of Contents

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

($ in millions)	Three Months Ended		Six Months Ended		Cumulative Amount From Program Inception Through July 29, 2017
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016	
VERP	$ —	$ —	$ 122	$ —	$ 122
Home office and stores	23	—	121	4	418
Management transition	—	1	—	3	255
Other	—	8	—	8	178
Total	$ 23	$ 9	$ 243	$ 15	$ 973

Activity for the restructuring and management transition liability for the six months ended July 29, 2017 was as follows:

($ in millions)	Home Office and Stores	Other	Total
January 28, 2017	$ 4	$ 27	$ 31
Charges	48	—	48
Cash payments	(25)	(21)	(46)
July 29, 2017	$ 27	$ 6	$ 33

7. Fair Value Disclosures

In determining fair value, the accounting standards establish a three level hierarchy for inputs used in measuring fair value, as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Significant observable inputs other than quoted prices in active markets for similar assets and liabilities, such as quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Significant unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants.

Cash Flow Hedges Measured on a Recurring Basis

As of July 29, 2017, July 30, 2016 and January 28, 2017, the $15 million, $37 million and $12 million fair value of our cash flow hedges, respectively, are valued in the market using discounted cash flow techniques which use quoted market interest rates in discounted cash flow calculations which consider the instrument's term, notional amount, discount rate and credit risk. Significant inputs to the derivative valuation for interest rate swaps are observable in the active markets and are classified as Level 2 in the fair value measurement hierarchy.

Other Non-Financial Assets Measured on a Non-Recurring Basis

In connection with the Company announcing its plan to close underperforming department stores, long-lived assets held and used with a carrying value of $86 million were written down to their fair value of $9 million, resulting in asset impairment charges of $77 million in the six months ended July 29, 2017. The fair value was determined based on comparable market values of similar properties or on a rental income approach and the significant inputs related to valuing the store related assets are classified as Level 2 in the fair value measurement hierarchy.

Table of Contents

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)	July 29, 2017		July 30, 2016		January 28, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Total debt, excluding unamortized debt issuance costs, capital leases, financing obligation and note payable	$4,124	$3,817	$4,764	$4,530	$4,665	$4,495

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 July 29, 2017, July 30, 2016 and January 28, 2017, the fair values of cash and cash equivalents and accounts payable approximated their carrying values due to the short-term nature of these instruments.

Concentrations of Credit Risk

We have no significant concentrations of credit risk.

8. Stockholders' Equity

The following table shows the change in the components of stockholders' equity for the six months ended July 29, 2017:

(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 28, 2017	308.3	$ 154	$ 4,679	$ (3,006)	$ (473)	$ 1,354
Net income/(loss)	—	—	—	(242)	—	(242)
Other comprehensive income/(loss)	—	—	—	—	27	27
Stock-based compensation and other	2.0	1	15	—	—	16
July 29, 2017	310.3	$ 155	$ 4,694	$ (3,248)	$ (446)	$ 1,155

Accumulated Other Comprehensive Income/(Loss)

The following table shows the changes in accumulated other comprehensive income/(loss) balances for the six months ended July 29, 2017:

($ in millions)	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Foreign Currency Translation	Gain/(Loss) on Cash Flow Hedges	Accumulated Other Comprehensive Income/(Loss)
January 28, 2017	$ (421)	$ (33)	$ (2)	$ (17)	$ (473)
Other comprehensive income/(loss) before reclassifications	22	—	2	(6)	18
Amounts reclassified from accumulated other comprehensive income	—	5	—	4	9
July 29, 2017	$ (399)	$ (28)	$ —	$ (19)	$ (446)

Table of Contents

9. Retirement Benefit Plans

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

	Three Months Ended		Six Months Ended	
($ in millions)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Primary Pension Plan				
Service cost	$ 10	$ 14	$ 21	$ 28
Interest cost	36	38	73	76
Expected return on plan assets	(53)	(54)	(107)	(108)
Amortization of prior service cost/(credit)	2	2	4	4
Net periodic benefit expense/(income)	$ (5)	$ —	$ (9)	$ —
Supplemental Pension Plans				
Service cost	$ —	$ —	$ —	$ —
Interest cost	1	2	3	4
Net periodic benefit expense/(income)	$ 1	$ 2	$ 3	$ 4
Primary and Supplemental Pension Plans Total				
Service cost	$ 10	$ 14	$ 21	$ 28
Interest cost	37	40	76	80
Expected return on plan assets	(53)	(54)	(107)	(108)
Amortization of prior service cost/(credit)	2	2	4	4
Net periodic benefit expense/(income)	$ (4)	$ 2	$ (6)	$ 4

Additionally, the Company had net periodic postretirement income of $4 million and $8 million, respectively, in the three and six months ended July 30, 2016 related to the Company's noncontributory postretirement medical and dental plan which was included in SG&A expense in the unaudited Interim Consolidated Statements of Operations. The postretirement medical and dental plan was terminated effective December 31, 2016.

10. 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, accruals for certain litigation 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 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.

The composition of Real estate and other, net was as follows:

	Three Months Ended		Six Months Ended	
($ in millions)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net gain from sale of non-operating assets	$ —	$ —	$ —	$ (5)
Investment income from Home Office Land Joint Venture	(19)	(5)	(20)	(29)
Net gain from sale of operating assets	(1)	(2)	(118)	(10)
Other	1	(2)	1	(3)
Total expense/(income)	$ (19)	$ (9)	$ (137)	$ (47)

Investment Income from Joint Ventures

During the second quarter and first six months of 2017, the Company had income of $19 million and $20 million, respectively, related to its proportional share of the net income in the Home Office Land Joint Venture and received aggregate cash distributions of $20 million and $28 million, respectively. During the second quarter and first six months of 2016, the

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Table of Contents

Company had income of $5 million and $29 million, respectively, related to its proportional share of the net income in the Home Office Land Joint Venture and received aggregate cash distributions of $6 million and $44 million, respectively.

Net Gain from Sale of Operating Assets

During the first quarter of 2017, we completed the sale of our Buena Park, California distribution facility for a net sale price of
$131 million and recorded a net gain of $111 million.

11. Income Taxes

The net tax expense of $1 million for the three months ended July 29, 2017 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 net tax benefit of $4 million to adjust the valuation allowance and $1 million resulting from state audit settlements.

The net tax benefit of $11 million for the six months ended July 29, 2017 consisted of state and foreign tax expenses of $7 million and $4 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a $16 million benefit relating to other comprehensive income and a net tax benefit of $4 million to adjust the valuation allowance and $2 million resulting from state audit settlements.

As of July 29, 2017, we have approximately $2.2 billion of net operating losses (NOLs) available for U.S. federal income tax purposes, which expire in 2032 through 2034 and $62 million of tax credit carryforwards that expire at various dates through 2035. A valuation allowance of $826 million fully offsets the federal deferred tax assets resulting from the NOL and tax credit carryforwards that expire at various dates through 2034. A valuation allowance of $247 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034. 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 periodic assessment, our estimate of the realization of deferred tax assets is solely based 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 NOL and tax credit carryforwards. Accordingly, in the second quarter and first six months of 2017, the valuation allowance was increased by $16 million and $80 million, respectively, to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards.

12. Litigation and Other Contingencies

Litigation

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 filed a motion to dismiss the consolidated complaint which was denied by the court on September 29, 2015. Defendants filed an answer to the consolidated complaint on November 12, 2015. Plaintiff filed a motion for class certification on January 25, 2016, and on August 29, 2016, a magistrate judge issued a report and recommendation that the motion for class certification be granted. The district court adopted this report and recommendation granting class certification on March 8, 2017.

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, generally mirrors the allegations contained in the Marcus lawsuit discussed above, and seeks similar relief. On June 8, 2015, plaintiff in the Marcus lawsuit amended the consolidated complaint to include the members of the purported class in the Johnson lawsuit, and on June 10, 2015, the Johnson lawsuit was consolidated into the Marcus lawsuit.

The parties have reached an agreement in principle, subject to final court approval, to settle the consolidated securities class action for $97.5 million, which will be funded by insurance. The court granted preliminary approval of the settlement on June 24, 2017. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of

Table of Contents

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.

Also, in March 2016, plaintiff Frank Lipsius filed a purported shareholder derivative action against certain present and former members of the Company's Board of Directors and executives in the District Court of Collin County in the State of Texas. The Company is named as a nominal defendant in the suit. The suit generally mirrors the allegations contained in the Weitzman and Zauderer suits discussed above, and seeks similar relief. On May 18, 2017, plaintiff in the Lipsius suit voluntarily dismissed the Collin County action, and on May 19, 2017, refiled the action in the District Court of Dallas County, Texas.

On June 8, 2017, the Company’s Board of Directors received a demand from a purported shareholder of the Company, Douglas Carlson, to conduct an investigation regarding potential claims that certain present and former members of the Board of Directors and executives violated federal securities law and/or breached their fiduciary duties to the Company based upon allegations similar to those in the Marcus class action securities litigation and the related shareholder derivative litigation. An initial response to the demand has been sent.

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.

ERISA Class Action Litigation

JCP and certain present and former members of JCP'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 which was granted in part and denied in part by the court on September 29, 2015. The parties reached a settlement agreement, subject to final court approval, pursuant to which JCP would make available $4.5 million to settle class members’ claims, and the court granted preliminary approval of the settlement on January 3, 2017. 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
JCP 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' motion for class certification. Pursuant to a motion by the Company, the California court decertified the

Table of Contents

class on December 9, 2015. On March 30, 2016, the California court granted JCP's motion for summary judgment. On April 26, 2016, the California plaintiffs filed a notice of appeal. On May 4, 2016, the California court entered judgment for JCP on all plaintiffs' claims. The Illinois court denied without prejudice plaintiffs' motion for class certification pending the filing of an amended complaint. Plaintiffs filed their amended complaint in the Illinois lawsuit on April 14, 2015 and the Company answered. On July 2, 2015, the Illinois plaintiffs renewed their motion for class certification, which the Illinois court granted on March 8, 2016. The parties have reached a settlement agreement, subject to final court approval, to resolve the California action for $1.75 million. The California court granted preliminary approval of the settlement on June 7, 2017. The parties have also reached a settlement agreement to resolve the Illinois action for $5 million. The Illinois court granted final approval of the settlement on August 9, 2017. 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.

Other Legal Proceedings

We are subject to various other legal and governmental proceedings involving routine litigation incidental to our business. Accruals have been established based on our best estimates of our potential liability in certain of these matters, including certain matters discussed above, all of which we believe aggregate to an amount that is not material to the Consolidated Financial Statements. 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, we currently believe 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 July 29, 2017, we estimated our total potential environmental liabilities to range from $20 million to $25 million and recorded our best estimate of $24 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.

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 28, 2017, 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 28, 2017 (2016 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

Growth Initiatives

Our growth strategy for 2017 focuses on the following five initiatives:

- Beauty;
- Home refresh;
- Omnichannel;
- Pricing strategy; and
- Women's apparel business.

First, we will continue to focus on our beauty categories of Sephora and The Salon by InStyle. In 2016, we opened 60 additional Sephora locations, bringing our total number of locations to 577, and we launched several new brands in our Sephora shops. We plan to add approximately 70 new Sephora locations and expand 32 existing locations in 2017. During the second quarter, 32 new Sephora locations and 31 expansions were completed. We also plan to continue to roll out and launch new beauty merchandise brands in 2017. With these plans every Sephora location we operate will be enhanced in 2017 either through an expansion or an updated assortment of brands. We are rebranding our salons to The Salon by InStyle and also recently added new functionality to jcpenney.com and our mobile app, allowing customers to book salon services appointments easily and more conveniently. Magnifying the importance of physical stores, we see Sephora and Salon as differentiators to help drive traffic and increase the frequency of visits to our stores.

Second, we plan to increase our revenue per customer with our home refresh initiative. We have established appliance showrooms in over 600 stores and plan to add new brand partners to our showrooms throughout the year. Additionally, we plan to expand our mattress showrooms to 500 stores and to add new toy shops to the merchandise assortment of all stores. Lastly, we are conducting several tests within our Home Store focusing on home installed services including an HVAC install program through our partnership with Trane, bathroom remodeling with Re-Bath, and quick ship and installed window blinds.

Third, we remain committed to becoming a world-class omnichannel retailer. Our online business remains strong, having delivered double-digit growth in 2016. We plan to continue to drive increased online revenue in 2017 by increasing our online SKU assortment, continuing to improve site functionality and our mobile app. During the second quarter of 2017, we expanded our ship-from-store capabilities from approximately 250 stores to 100% of our store network.

Pricing strategy is our fourth initiative. In 2017, we have restructured the internal pricing process so that all of our pricing and promotional decisions will be made using a more data-driven approach. Once fully implemented, we expect our pricing initiatives to enhance our merchandise margin performance in 2017 and beyond.

Last, we are focused on improving our women's apparel merchandise assortment. We are enhancing our partnership with Nike to create inspiring brand shops and offering an improved assortment of apparel, accessories and footwear across all divisions. In the women's area we will have Nike in all stores, an increase of over 400 stores from 2016. We are also converting all women's shoe areas to open sale fixtures this year and are introducing new styles and comfort features to attempt to seize available market share in footwear. In addition, we are taking steps in women's apparel to simplify the floor, better balance our career and casual offerings and creating a stronger value statement with pricing. We also plan to expand our use of customer and trend data more effectively to ensure we better understand the desires of the customer in advance of the season. Finally, we see an opportunity with the plus size community that remains underserved, and we want to become the destination for providing style, value and an appealing shopping environment. Our women's plus boutique shop Boutique+™ continues to resonate with our plus size customers and we plan to enhance this strategy for 2017 by launching swimwear and other accessories.

We believe these growth initiatives will not only serve the needs of our value-oriented customer, they will differentiate us from our traditional competitors.

Second Quarter Overview

- Sales were $2,962 million with a total sales increase of 1.5% compared to the second quarter of 2016 and a comparable store sales decrease of 1.3%.

Cost of goods sold as a percentage of sales increased to 64.9% compared to 62.9% in the same period last year primarily driven by the liquidation of inventory in closing stores, higher penetration of Internet and appliance sales and increased shrinkage.

Table of Contents

Selling, general and administrative (SG&A) expenses decreased $11 million, or 1.3%, for the second quarter of 2017 as compared to the same period last year. These savings were primarily driven by reductions in store controllable costs and corporate overhead and an increase in private label credit card income. SG&A as a percentage of sales decreased to 28.4% compared to 29.2% in the same period last year.

Our net loss was $62 million, or ($0.20) per share, compared to a net loss of $56 million, or ($0.18) 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:

$23 million, or ($0.07) per share, of restructuring and management transition charges;
$5 million, or $0.02 per share, of Primary Pension income;
$35 million, or ($0.11) per share, for loss on extinguishment of debt; and
$19 million, or $0.06 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).

Adjusted net loss was $28 million, or $(0.09) per share, compared to an adjusted net loss of $16 million, or $(0.05) per share, in last year's first quarter. See the reconciliation of net income/(loss) and diluted EPS, the most directly comparable GAAP financial measures, to adjusted net income/(loss) and adjusted diluted EPS on pages 24 and 25.

Adjusted earnings before interest expense, income tax (benefit)/expense and depreciation and amortization (Adjusted EBITDA) (non-GAAP) was $196 million, a $37 million decline from the same period last year.

On May 22, 2017, we paid approximately $334 million aggregate consideration to settle cash tender offers with respect to portions of our outstanding 5.75% Senior Notes due 2018 (2018 Notes) and 8.125% Senior Notes due 2019 (2019 Notes).

On June 20, 2017, we amended our $2.35 billion senior secured asset-based revolving credit facility (Revolving Credit Facility). Among other things, the amended and restated facility provides improved pricing terms and extends the maturity from 2019 to 2022.

Effective July 24, 2017, the Board of Directors elected Jeffrey Davis as Executive Vice President and Chief Financial Officer of the Company.

Table of Contents

Results of Operations

($ in millions, except EPS)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Percent increase/(decrease) from prior year	1.5 %	1.5 %	(1.1)%	(0.1)%
Comparable store sales increase/(decrease)[1]	(1.3)%	2.2 %	(2.4)%	0.9 %
Costs and expenses/(income):				
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	1,923	1,834	3,646	3,627
Selling, general and administrative	842	853	1,685	1,725
Primary pension plan	(5)	—	(9)	—
Supplemental pension plans	1	2	3	4
Total pension	(4)	2	(6)	4
Depreciation and amortization	144	153	289	307
Real estate and other, net	(19)	(9)	(137)	(47)
Restructuring and management transition	23	9	243	15
Total costs and expenses	2,909	2,842	5,720	5,631
Operating income/(loss)	53	76	(52)	98
(Gain)/loss on extinguishment of debt	35	34	35	30
Net interest expense	79	93	166	188
Income/(loss) before income taxes	(61)	(51)	(253)	(120)
Income tax expense/(benefit)	1	5	(11)	4
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Adjusted EBITDA (non-GAAP) [2]	$196	$233	$451	$386
Adjusted net income/(loss) (non-GAAP) [2]	$(28)	$(16)	$(9)	$(113)
Diluted EPS	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Adjusted diluted EPS (non-GAAP) [2]	$(0.09)	$(0.05)	$(0.03)	$(0.37)
Ratios as a percent of sales:				
Cost of goods sold	64.9 %	62.9 %	64.3 %	63.3 %
SG&A	28.4 %	29.2 %	29.7 %	30.1 %
Operating income/(loss)	1.8 %	2.6 %	(0.9)%	1.7 %

(1) 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. 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. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(2) See "Non-GAAP Financial Measures" 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.

Table of Contents

Total Net Sales

($ in millions)	Three Months Ended July 29, 2017	Three Months Ended July 30, 2016	Six Months Ended July 29, 2017	Six Months Ended July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Sales percent increase/(decrease):				
Total net sales	1.5 %	1.5 %	(1.1)%	(0.1)%
Comparable store sales	(1.3)%	2.2 %	(2.4)%	0.9 %

Total net sales increased $44 million in the second quarter of 2017 compared to the second quarter of 2016. For the first six months of 2017, total net sales decreased $61 million from the same period last year.

The following table provides the components of the net sales increase/(decrease):

($ in millions)	Three Months Ended July 29, 2017	Six Months Ended July 29, 2017
Comparable store sales increase/(decrease)	$ (35)	$ (133)
Closed stores, net	79	69
Other revenues and sales adjustments	—	3
Total net sales increase/(decrease)	$ 44	$ (61)

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.
- Most Internet purchases are easily returned in our stores.
- JCPenney Rewards can be earned and redeemed online or in stores.
- In-store customers can order from our website with the assistance of associates in our stores or they can shop our website from the JCPenney app while inside the store.
- Customers who utilize our mobile application can receive mobile coupons to use when they check out both online or in our stores.
- Internet orders can be shipped from a dedicated jcpenney.com fulfillment center, a store, a store merchandise distribution center, a regional warehouse, directly from vendors or any combination of the above.
- Certain categories of store inventory can be accessed and purchased by jcpenney.com customers and shipped directly to the customer's home from the store.
- Internet orders can be shipped to stores for customer pick up.
- "Buy online and pick up in store same day" is available in all of our stores.

For the second quarter and first six months of 2017, average unit retail and units per transaction increased, while transaction counts decreased as compared to the prior year.

For the second quarter of 2017, Home, Fine Jewelry, Footwear and Handbags and Sephora were our top-performing merchandise divisions. For the first half of 2017, our top-performing merchandise divisions were Home, Sephora and Fine Jewelry, with all experiencing sales gains on a comparable store basis. Geographically, the Southwest and Southeast were the best performing regions of the country during the second quarter and first half of 2017.

During the second quarters of both 2017 and 2016, private brand merchandise comprised 46% of total merchandise sales. During the second quarters of 2017 and 2016, exclusive brand merchandise comprised 7% and 8% of total merchandise sales,

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respectively. For the first halves of both 2017 and 2016, private brand merchandise comprised 45% of total merchandise sales. For the first halves of 2017 and 2016, exclusive brand merchandise comprised 8% and 9%, respectively, of total merchandise sales.

Store Count

The following table compares the number of stores for the three and six months ended July 29, 2017 and July 30, 2016:

	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
JCPenney department stores				
Beginning of period	1,013	1,014	1,013	1,021
Closed stores	(2)	—	(2)	(7)
End of period [1]	1,011 [2]	1,014	1,011 [2]	1,014

(1) Gross selling space, including selling space allocated to services and licensed departments, was 103 million square feet as of July 29, 2017 and 104 million square feet as of July 30, 2016.

(2) During August 2017, 125 stores ceased operations and were closed.

Cost of Good Sold

Cost of goods sold, exclusive of depreciation and amortization, for the three months ended July 29, 2017 was $1,923 million, an increase of $89 million compared to $1,834 million for the three months ended July 30, 2016. Cost of goods sold as a percentage of sales was 64.9% for the three months ended July 29, 2017 compared to 62.9% for the three months ended July 30, 2016, an increase of 200 basis points. Cost of goods sold, exclusive of depreciation and amortization, for the six months ended July 29, 2017 was $3,646 million, an increase of $19 million compared to $3,627 million for the six months ended July 30, 2016. Cost of goods sold as a percentage of sales was 64.3% for the six months ended July 29, 2017 compared to 63.3% for the six months ended July 30, 2016, an increase of 100 basis points. The increase for the second quarter and the first six months was primarily driven by the liquidation of inventory in closing stores, higher penetration of Internet and appliance sales and increased shrinkage.

SG&A Expenses

For the three months ended July 29, 2017, SG&A expenses were $11 million lower than the corresponding period of 2016. As a percent of sales, SG&A expenses decreased to 28.4% compared to 29.2% in the second quarter of 2016. Through the first six months of 2017, SG&A expenses were $40 million lower than the corresponding period of 2016. Through the first six months of 2017, as a percent of sales, SG&A expenses decreased to 29.7% compared to 30.1% in the corresponding period of 2016. The net decrease in SG&A expenses for the three month period was primarily driven by reductions in store controllable costs and corporate overhead and an increase in private label credit card income. The net decrease in SG&A expenses for the six month period was primarily driven by lower marketing, store controllable costs, and incentive compensation and an increase in private label 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 SG&A expenses. For the second quarters of 2017 and 2016, we recognized income of $83 million and $75 million, respectively, pursuant to our private label credit card programs. Through the first halves of 2017 and 2016, we recognized income of $166 million and $154 million, respectively.

21

Table of Contents

Pension Expense/(Income)

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Primary Pension Plan	$ (5)	$ —	$ (9)	$ —
Supplemental pension plans	1	2	3	4
Total pension expense/(income)	$ (4)	$ 2	$ (6)	$ 4

Depreciation and Amortization Expense

Depreciation and amortization expense was $144 million and $153 million for the three months ended July 29, 2017 and July 30, 2016, respectively, and $289 million and $307 million for the six months ended July 29, 2017 and July 30, 2016, respectively. The decrease is primarily a result of closing store locations since the beginning of 2015.

Restructuring and Management Transition

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Voluntary early retirement program (VERP)	$ —	$ —	$ 122	$ —
Home office and stores	23	—	121	4
Management transition	—	1	—	3
Other	—	8	—	8
Total	$ 23	$ 9	$ 243	$ 15

In February 2017, we announced a VERP, which was offered to approximately 6,000 eligible associates. In the first quarter of 2017, we recorded a total charge of $122 million related to the VERP. Charges included $112 million related to enhanced retirement benefits for the approximately 2,800 associates who accepted the VERP, $8 million related to curtailment charges for our Primary Pension Plan and Supplemental Pension Plans as a result of the reduction in the expected years of future service related to these plans and $2 million in other related costs.

During the six months ended July 29, 2017 and July 30, 2016, we recorded $121 million and $4 million, respectively, of costs to reduce our store and home office expenses. Costs during the first half of 2017 include store closing asset impairments of $77 million, employee termination benefits of $20 million and store closing costs of $24 million. Costs during the first half of 2016 primarily include employee termination benefits in connection with the elimination of positions in our home office.

We also implemented changes within our management leadership team during the six months ended July 30, 2016 that resulted in management transition costs of $3 million for both incoming and outgoing members of management.

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, accruals for certain litigation 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 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.

Table of Contents

The composition of Real estate and other, net was as follows:

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net gain from sale of non-operating assets	$—	$ —	$—	$ (5)
Investment income from Home Office Land Joint Venture	(19)	(5)	(20)	(29)
Net gain from sale of operating assets	(1)	(2)	(118)	(10)
Other	1	(2)	1	(3)
Total expense/(income)	$(19)	$ (9)	$(137)	$ (47)

During the first half of 2016, we sold non-operating assets for a net gain of $5 million. Investment income from the Home Office Land Joint Venture represents our proportional share of net income from the joint venture.

During the first half of 2017, the net gain from the sale of operating assets includes a $111 million net gain on the sale of our Buena Park, California distribution facility and $7 million in net gains on the sale of excess land. During the first half of 2016, the net gain from the sale of operating assets related primarily to the sale of land adjacent to our home office not contributed to the Home Office Land Joint Venture.

Operating Income/(Loss)
For the second quarter of 2017, we reported operating income of $53 million compared to operating income of $76 million in the second quarter of 2016. For the first six months of 2017, we reported an operating loss of $52 million compared to operating income of $98 million in the prior year corresponding period.

(Gain)/Loss on Extinguishment of Debt
During the second quarter of 2017, we settled cash tender offers with respect to portions of our outstanding 2018 Notes and 2019 Notes, resulting in a loss on extinguishment of debt of $34 million, and amended our Revolving Credit Facility, which resulted in a loss on extinguishment of debt of $1 million.

During the first quarter of 2016, we repurchased and retired $60 million aggregate principal amount of our outstanding debt resulting in a gain on extinguishment of debt of $4 million.

During the second quarter of 2016, we completed the refinancing of our $2.25 billion five-year senior secured term loan facility entered into in 2013 with an amended and restated $1.688 billion seven-year senior secured term loan facility and the issuance of $500 million of 5.875% Senior Secured Notes due 2023, resulting in a loss on extinguishment of debt of $34 million.

Net Interest Expense
Net interest expense for the second quarters of 2017 and 2016 was $79 million and $93 million, respectively, a year-over-year decrease of $14 million, or 15.1%. For the first six months of 2017, net interest expense was $166 million, a decrease of $22 million, or 11.7%, from $188 million in 2016. The reduction in net interest expense is due to lower debt levels in 2017 compared to 2016.
Income Taxes
The net tax expense of $1 million for the three months ended July 29, 2017 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 net tax benefit of $4 million to adjust the valuation allowance and $1 million resulting from state audit settlements.

The net tax benefit of $11 million for the six months ended July 29, 2017 consisted of state and foreign tax expenses of $7 million and $4 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a $16 million benefit relating to other comprehensive income and a net tax benefit of $4 million to adjust the valuation allowance and $2 million resulting from state audit settlements.
As of July 29, 2017, we have approximately $2.2 billion of net operating losses (NOLs) available for U.S. federal income tax purposes, which expire in 2032 through 2034 and $62 million of tax credit carryforwards that expire at various dates through 2035. A valuation allowance of $826 million fully offsets the federal deferred tax assets resulting from the NOL and tax credit carryforwards that expire at various dates through 2034. A valuation allowance of $247 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034. In assessing the need for the

Table of Contents

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 periodic assessment, our estimate of the realization of deferred tax assets is solely based 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 NOL and tax credit carryforwards. Accordingly, in the second quarter and first six months of 2017, the valuation allowance was increased by $16 million and $80 million, respectively, to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards.

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 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 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 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 prepared in accordance with GAAP. We have provided reconciliations of the most directly comparable GAAP measures to our non-GAAP financial measures presented.

The following non-GAAP financial measures are adjusted to exclude restructuring and management transition charges, the impact of our Primary Pension Plan, the (gain)/loss on extinguishment of debt, 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 income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps. Unlike other operating expenses, restructuring and management transition charges, the (gain)/loss on extinguishment of debt, 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 income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps 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 (gain)/loss on extinguishment of debt, 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 income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps 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.

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Add: Net interest expense	79	93	166	188
Add: (Gain)/loss on extinguishment of debt	35	34	35	30
Add: Income tax expense/(benefit)	1	5	(11)	4
Add: Depreciation and amortization	144	153	289	307
Add: Restructuring and management transition charges	23	9	243	15

Add: Primary Pension Plan expense/(income)	(5)	—	(9)	—
Less: Net gain on the sale of non-operating assets	—	—	—	(5)
Less: Proportional share of net income from joint venture	(19)	(5)	(20)	(29)
Adjusted EBITDA (non-GAAP)	$ 196	$ 233	$ 451	$ 386

For the three months ended July 29, 2017, adjusted EBITDA was $196 million, a reduction of $37 million compared to $233 million in the prior year corresponding period. For the six months ended July 29, 2017, adjusted EBITDA was $451 million, an improvement of $65 million compared to $386 million in the prior year corresponding period.

24

Table of Contents

Adjusted EBITDA for the second quarter of 2017 declined as compared to the corresponding prior year period due to the liquidation of inventory in the closing stores, partially offset by reductions in our controllable expenses.

Adjusted EBITDA for the first half of 2017 improved as compared to the corresponding prior year period as we recorded a significant net gain on the sale of operating assets and effectively managed our controllable expenses, partially offset by the liquidation of inventory in the closing stores.

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:

	Three Months Ended		Six Months Ended	
($ in millions, except per share data)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$ (62)	$ (56)	$ (242)	$ (124)
Diluted EPS	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)
Add: Restructuring and management transition charges [1]	23	9	243	15
Add: Primary Pension Plan expense/(income) [1]	(5)	—	(9)	—
Add: (Gain)/loss on extinguishment of debt [1]	35	34	35	30
Less: Net gain on sale of non-operating assets [1]	—	—	—	(5)
Less: Proportional share of net income from joint venture [1]	(19)	(5)	(20)	(29)
Less: Tax impact resulting from other comprehensive income allocation [2]	—	2	(16)	—
Adjusted net income/(loss) (non-GAAP)	$ (28)	$ (16)	$ (9)	$ (113)
Adjusted diluted EPS (non-GAAP)	$ (0.09)	$ (0.05)	$ (0.03)	$ (0.37)

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

(2) Represents the net tax benefit that resulted from our other comprehensive income allocation between our Operating loss and Accumulated other comprehensive income.

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 second quarter of 2017 with $314 million of cash and cash equivalents. As of the end of the second quarter of 2017, based on our borrowing base and amounts reserved for outstanding letters of credit, we had $1,968 million available for future borrowings under our revolving credit facility, providing total available liquidity of $2,282 million.

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

($ in millions)	Six Months Ended July 29, 2017	July 30, 2016
Cash and cash equivalents	$314	$429
Merchandise inventory	2,777	2,981
Property and equipment, net	4,390	4,686
Total debt [1]	4,293	4,725
Stockholders' equity	1,155	1,197
Total capital	5,448	5,922
Maximum capacity under our credit agreement	2,350	2,350
Cash flow from operating activities	56	(208)
Free cash flow (non-GAAP) [2]	10	(352)
Capital expenditures [3]	192	160
Ratios:		
Total debt-to-total capital [4]	79%	80%
Cash-to-total debt [5]	7%	9%

(1) Total debt includes long-term debt, net of unamortized debt issuance costs, including current maturities, capital leases, financing obligation, note payable and any 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 second quarters of 2017 and 2016, we had accrued capital expenditures of $39 million and $45 million, respectively.

(4) Total debt divided by total capital.

(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, payments made for business acquisitions or required pension contributions, if any. 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 sets forth a reconciliation of net cash provided by/(used in) operating activities, the most directly comparable GAAP financial measure, to free cash flow, a non-GAAP financial measure, as well as information regarding net cash provided by/(used in) investing activities and net cash provided by/(used in) financing activities:

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net cash provided by/(used in) operating activities (GAAP)	$ 402	$ 186	$ 56	$ (208)
Add:				
Proceeds from sale of operating assets	10	4	146	16
Less:				
Capital expenditures [1]	(109)	(121)	(192)	(160)
Free cash flow (non-GAAP)	$ 303	$ 69	$ 10	$ (352)
Net cash provided by/(used in) investing activities [2]	$ (98)	$ (116)	$ (37)	$ (127)
Net cash provided by/(used in) financing activities	$ (353)	$ (56)	$ (592)	$ (136)

(1) As of the end of the second quarters of 2017 and 2016, we had accrued capital expenditures of $39 million and $45 million, respectively.

(2) Net cash provided by investing activities includes capital expenditures and proceeds from sale of operating assets, which are also included in our computation of free cash flow.

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 July 29, 2017 improved $216 million to an inflow of $402 million compared to an inflow of $186 million for the same period in 2016. Cash flow from operating activities for the six months ended July 29, 2017 improved $264 million to an inflow of $56 million compared to an outflow of $208 million for the same period in 2016. Our net loss of $242 million for the six months ended July 29, 2017 includes significant income and expense items that do not impact operating cash flow including depreciation and amortization, the gain on the sale of assets, restructuring and management transition, benefit plans and stock-based compensation. The improvement in cash flow from operations for the three month period was primarily due to the liquidation of inventory in closing stores. The overall year-over-year decrease in cash used for operations for the six month period was primarily due to less merchandise purchases, lower incentive compensation payments and the result of liquidating inventory in closing stores.

Cash flows from operating activities for the first six months of 2017 also included construction allowances from landlords of $14 million, which funded a portion of our capital expenditures in investing activities.

Merchandise inventory decreased $204 million to $2,777 million, or 6.8%, as of the end of the second quarter of 2017 compared to $2,981 million as of the end of the second quarter last year and decreased $77 million from year-end 2016. Merchandise accounts payable decreased $144 million as of the end of the second quarter of 2017 compared to the corresponding prior year period and decreased $27 million from year end.

Investing Activities

Investing activities for the three months ended July 29, 2017 resulted in cash outflows of $98 million compared to outflows of $116 million for the same three month period of 2016. Investing activities through the first six months of 2017 resulted in cash outflows of $37 million compared to outflows of $127 million for the same six month period of 2016.

Cash capital expenditures were $192 million for the six months ended July 29, 2017 and were $160 million for the six months ended July 30, 2016. In addition, as of the end of the second quarters of 2017 and 2016, we had $39 million

and $45 million, respectively, of accrued capital expenditures. Through the first six months of 2017, capital expenditures related primarily to investments in our store environment and store facility improvements, including investments in 32 new and 31 expanded Sephora inside JCPenney stores, the roll out of 100 new appliance showrooms and investments in information technology in both our home office and stores. We received construction allowances from landlords of $14 million in the first six months of

Table of Contents

2017 to fund a portion of the capital expenditures related to store leasehold improvements. These funds are classified as operating activities and have been recorded as deferred rent credits in the Consolidated Balance Sheets and are amortized as an offset to rent expense.

For the six months ended July 30, 2016 capital expenditures related primarily to the roll out of our center core concept in 350 locations, the opening of 56 Sephora inside JCPenney stores, other investments in our store environment and store facility improvements and investments in information technology in both our home office and stores. We also received construction allowances from landlords of $6 million in the first six months of 2016.

Full year 2017 capital expenditures are expected to be approximately $400 million net of construction allowances from landlords. Capital expenditures for the remainder of 2017 include accrued expenditures of $39 million at the end of the second quarter.

Financing Activities

Financing activities for the six months ended July 29, 2017 resulted in an outflow of $592 million compared to an outflow of $136 million for the same period last year.

During the first six months of 2017, we paid $330 million to settle cash tender offers with respect to portions of our outstanding 2018 Notes and 2019 Notes. Additionally, we paid $220 million to retire outstanding debt at maturity and we paid $21 million in required principal payments on outstanding debt and $12 million in required payments on our capital leases, financing obligation and note payable.

Free Cash Flow

Free cash flow for the three months ended July 29, 2017 improved $234 million to an inflow of $303 million compared to an inflow of $69 million in the same period last year. Free cash flow for the six months ended July 29, 2017 improved $362 million to an inflow of $10 million compared to an outflow of $352 million in the same period last year. The improvement for the three month period was primarily due to the liquidation of inventory in closing stores. The year-over-year increase was primarily due to the net gain on the Buena Park, California distribution facility sale, lower incentive compensation payments, and the liquidation of inventory in closing stores.

Cash Flow Outlook

For the remainder of 2017, 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.

Credit Ratings

Our credit ratings and outlook as of August 25, 2017 from various credit rating agencies were as follows:

	Corporate	Outlook
Fitch Ratings	B+	Stable
Moody’s Investors Service, Inc.	B1	Stable
Standard & Poor’s Ratings Services	B+	Positive

Standard and Poor's Rating Services upgraded our corporate credit rating in March 2017 to B+ from B.

Credit rating agencies periodically review our capital structure and the quality and stability of our earnings. Rating agencies consider, among other things, changes in operating performance, comparable store sales, the economic environment, conditions in the retail industry, financial leverage and changes in our business strategy in their rating decisions. Downgrades to our long-term credit ratings could result in reduced access to the credit and capital markets and higher interest costs on future financings.

Contractual Obligations and Commitments

Aggregate information about our obligations and commitments to make future payments under contractual or contingent arrangements was disclosed in the 2016 Form 10-K.

Table of Contents

Impact of Inflation, Deflation and Changing Prices

We have experienced inflation and deflation related to our purchase of certain commodity products. We do not believe that changing prices for commodities have had a material effect on our Net Sales or results of operations. Although we cannot precisely determine the overall effect of inflation and deflation on operations, we do not believe inflation and deflation have had a material effect on our financial condition or results of operations.

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 six months ended July 29, 2017. 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 2016 Form 10-K.

Recently Issued Accounting Pronouncements

Recently issued accounting pronouncements are discussed in Note 2 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 six months ended July 29, 2017 are not necessarily indicative of the results for future quarters or the entire year.

Cautionary Statement Regarding Forward-Looking Statements

This report may contain forward-looking statements 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, cost of goods sold, selling, general and administrative expenses, earnings, 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 including our omnichannel initiatives, 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

Table of Contents

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. 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 projections as more information becomes available.

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 July 29, 2017 are similar to those disclosed in the 2016 Form 10-K.

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 second quarter ended July 29, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

The matters under the caption "Litigation" in Note 12 of the Notes to Unaudited Interim Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

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 28, 2017.

Our ability to sustain 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 an adequate and uninterrupted supply of merchandise from suppliers at expected levels and on acceptable terms;

Table of Contents

- changes to the regulatory environment in which our business operates; and
- general economic conditions.

There is no assurance that our marketing, merchandising and omnichannel 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.
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, large appliance retailers, 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, shipping times and cost, credit availability, customer loyalty and availability of in-store services, such as styling salon, optical, portrait photography and custom decorating. 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, availability of in-store services, 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 merchandise 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.
We may also seek to expand into new lines of business from time to time, such as offering large appliances for sale and offering home improvement products and installation services through third-parties. There is no assurance that these efforts will be successful. Further, if we devote time and resources to new lines of business and those businesses are not as successful as we planned, then we risk damaging our overall business results. In addition, we may also seek to expand our merchandise offerings into new product categories, which may carry new or additional risks beyond those typically associated with our traditional apparel and home furnishings businesses. We may not be able to develop new lines of business in a manner that improves our operating results or address or mitigate the risks associated with new product categories, and may therefore be forced to close the new lines of business or reduce our expanded merchandise offerings, which may damage our reputation and negatively impact our operating results.

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

Table of Contents

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, present an appealing shopping environment and experience to customers, and attract customers to our stores through omnichannel initiatives such as pickup-in-store programs. 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. Further, costs to drive online traffic may be higher than anticipated and actions to drive online traffic may not deliver anticipated results. In addition, external events outside of our control, including store closings by our competitors, 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 operating results and cash flows from operating activities. In addition, the challenge of declining store traffic along with the growth of digital shopping channels and its diversion of sales from brick-and-mortar stores could lead to store closures and/or asset impairment charges, which could adversely impact our operating results, financial position and cash flows.

If we are unable to manage our inventory effectively, our merchandise 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 merchandise 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, integrity and availability 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, inadvertent data disclosure or acquisition by third parties. 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. Negative media

Table of Contents

reports regarding the Company or the retail industry in general, as well as uncertainty due to announced store closings, could also 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, potential union organizing efforts and government regulation. 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.

If we are unable to successfully develop and maintain a relevant and reliable omnichannel experience for our customers, our sales, results of operations and reputation could be adversely affected.

One of the pillars of our strategic framework is to deliver a superior omnichannel shopping experience for our customers through the integration of our store and digital shopping channels. Omnichannel retailing is rapidly evolving and we must anticipate and meet changing customer expectations. Our omnichannel initiatives include our ship-from-store and pickup-in-store programs and expansion of our SKU count online. In addition, we continue to explore ways to enhance our customers' omnichannel shopping experience. These initiatives involve significant investments in IT systems and significant operational changes. In addition, our competitors are also investing in omnichannel initiatives, some of which may be more successful than our initiatives. For example, online and other competitors have placed an emphasis on delivery services, with customers increasingly seeking faster, guaranteed delivery times and low-price or free shipping. There is no assurance that we will be able to maintain an ability to be competitive on delivery times and delivery costs, which is dependent on many factors. If the implementation of our omnichannel initiatives is not successful or does not meet customer expectations, or we do not realize a return on our omnichannel investments, our reputation and operating results may be adversely affected.

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

We sell merchandise over the Internet through our website, www.jcpenney.com, and through mobile applications for smart 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, security and availability of our website, mobile applications and related support systems; computer malware; telecommunications failures; electronic break-ins and similar disruptions; and the allocation of inventory between our online operations and department stores. The failure of our website or mobile applications 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 technological interfaces for our customers to purchase merchandise through our website and mobile applications, 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 and mobile applications, 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 applications and systems from third party vendors, providers and licensors to simplify our processes and reduce our use of customized existing legacy systems and expect to place additional applications and systems into operation in the future. Any continued reliance on existing legacy systems may result in extended

system outages due to the difficulty in recovering those systems as well as inefficiencies in our business workflow due to the complexity and high levels of customization inherent in such systems. Implementing new applications and 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 applications and systems as planned, that the new applications and systems will perform as expected or that the new applications and 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.

Table of Contents

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.

We are in the process of insourcing certain business functions from third party vendors and may seek to relocate certain business functions to international locations in an attempt to achieve additional efficiencies, both of which subject us to risks, including disruptions in our business.
We are in the process of insourcing certain business functions and may also need to continue to insource other aspects of our business in the future in order to effectively manage our costs and stay competitive. We may also seek from time to time to relocate certain business functions to countries other than the United States to access highly skilled labor markets and further control costs. There is no assurance that these efforts will be successful. In addition, future regulatory developments could hinder our ability to realize the anticipated benefits of these actions. These actions may also cause disruptions that negatively impact our business. If we are ultimately unable to perform insourced functions better than, or at least as well as, our current third party providers, or otherwise realize the anticipated benefits of these actions, our operating results could be adversely impacted.

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. Any 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. Developments in tax policy, such as the disallowance of tax deductions for imported merchandise, or the imposition of tariffs on imported merchandise, could further have a material adverse effect on our results of operations and liquidity.

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 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.

Table of Contents

Our senior secured real estate term loan credit facility and senior secured notes are 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 and the indenture governing the senior secured notes contain provisions that could restrict our operations and our ability to obtain additional financing.

We are (i) party to a $1.688 billion senior secured term loan credit facility and (ii) the issuer of $500 million aggregate principal amount of senior secured notes that are 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 security documents relating to the term loan credit facility and the senior secured notes. The real property subject to mortgages under the term loan credit facility and the indenture governing the senior secured notes includes our distribution centers and certain of our stores.

The credit and guaranty agreement governing the term loan credit facility and the indenture governing the senior secured notes contain 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 and the senior secured notes.

If an event of default occurs and is continuing, our outstanding obligations under the term loan credit facility and the senior secured notes 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 and the senior secured notes, including our 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 facility limits our borrowing capacity to the value of certain of our assets. In addition, our senior secured asset-based revolving credit facility is secured by certain of our personal property, and lenders may exercise remedies against the collateral in the event of our default.

We are party to a $2.35 billion senior secured asset-based revolving credit 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.

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 July 29, 2017, we have $4.293 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. In addition, developments in tax policy, such as the

Table of Contents

disallowance of tax deductions for interest paid on outstanding indebtedness, could have a material adverse effect on our results of operations and liquidity.
We are required to make quarterly repayments in a principal amount equal to $10.55 million during the seven-year term of the real estate term loan credit facility, subject to certain reductions for mandatory and optional prepayments. 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, which could 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;

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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

Table of Contents

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 vendors 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;

- 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;

Table of Contents

- 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. In addition, developments in tax policy, such as the disallowance of tax deductions for imported merchandise, or the imposition of tariffs on imported merchandise, could have a material adverse effect on our results of operations and liquidity.

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. Additional events that could impact our performance include pandemics, terrorist threats and activities, worldwide military and domestic disturbances and conflicts, political instability and civil unrest. Declines in the level of consumer spending could adversely affect our growth and profitability.

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

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

Our profitability may be impacted by weather conditions.

Our merchandise assortments reflect assumptions regarding expected weather patterns and our profitability depends on our ability to timely deliver seasonally appropriate inventory. Unseasonable or unexpected weather conditions such as warm temperatures during the winter season or prolonged or extreme periods of warm or cold temperatures could render a portion of our inventory incompatible with consumer needs. Extreme weather or natural disasters could also severely hinder our ability to timely deliver seasonally appropriate merchandise, preclude customers from traveling to our stores, delay capital improvements

Table of Contents

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 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. Government intervention and activism and/or regulatory reform 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, tax policy, product safety, 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, as well as changes to applicable accounting rules and regulations, such as changes to lease accounting standards, could also cause our compliance costs to increase and adversely affect our business, financial condition 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. We may also experience volatility in the amount of the annual actuarial gains or losses recognized as income or expense because we have elected to recognize pension expense using mark-to-market accounting. 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 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 former members of the Board of Directors

Table of Contents

and executives are defendants in a consolidated class action lawsuit and two related stockholder derivative actions that were filed following our announcement of an issuance of common stock on September 26, 2013. 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 $2.2 billion as of July 29, 2017. 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 2.04% at January 28, 2017. 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 July 29, 2017, the Company has not had a Section 382 ownership change through July 29, 2017.

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 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.

Table of Contents

Item 6. Exhibits
Exhibit Index

Exhibit No.	Exhibit Description	Incorporated by Reference				Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit	Filing Date	
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 20, 2016	8-K	001-15274	3.1	7/21/2016	
3.3	Certificate of Designation, Preferences and Rights of Series C Junior Participating Preferred Stock	8-K	001-15274	3.1	8/22/2013	
10.1	Amendment No. 2 to Credit Agreement, dated as of June 20, 2017, among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., J. C. Penney Purchasing Corporation, the subsidiary guarantors party thereto, the lenders party thereto, and Wells Fargo Bank, National Association, as administrative agent	8-K	001-15274	10.1	6/21/2017	
10.2	Ninth Amendment dated as of July 10, 2017 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, the Fourth Amendment thereto dated February 25, 2014, the Fifth Amendment thereto dated April 6, 2015, the Sixth Amendment thereto dated June 26, 2015, the Seventh Amendment thereto dated August 17, 2016, and the Eighth Amendment thereto dated January 18, 2017					†
10.3	Letter Agreement dated July 24, 2017 between J. C. Penney Company, Inc. and Jeffrey Davis	8-K	001-15274	10.1	7/24/2017	
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
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					†
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					†

41

Table of Contents

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/Andrew S. Drexler
Andrew S. Drexler
Senior Vice President,
Chief Accounting
Officer and Controller
(Principal Accounting
Officer)
Date: August 30, 2017