J C PENNEY CO INC
Form 10-Q
December 04, 2012

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 October 27, 2012

or

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

For the transition period from ______________ to ________________

Commission File Number: 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)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 o

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

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

(Do not check if a smaller reporting company)

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

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

219,244,826 shares of Common Stock of 50 cents par value, as of November 30, 2012

J. C. PENNEY COMPANY, INC.

FORM 10-Q

For the Quarterly Period Ended October 27, 2012

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Part I. Financial Information

Item 1. Unaudited Interim Consolidated Financial Statements

J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions, except per share data)	Three Months Ended October 27, 2012	Three Months Ended October 29, 2011	Nine Months Ended October 27, 2012	Nine Months Ended October 29, 2011
Total net sales	$ 2,927	$ 3,986	$ 9,101	$ 11,835
Cost of goods sold	1,975	2,497	5,959	7,254
Gross margin	952	1,489	3,142	4,581
Operating expenses/(income):				
Selling, general and administrative (SG&A)	1,087	1,242	3,297	3,766
Pension	51	31	167	88
Depreciation and amortization	133	127	386	383
Real estate and other, net	(197)	(5)	(412)	(24)
Restructuring and management transition	34	265	269	297
Total operating expenses	1,108	1,660	3,707	4,510
Operating income/(loss)	(156)	(171)	(565)	71
Net interest expense	55	55	169	170
Income/(loss) before income taxes	(211)	(226)	(734)	(99)
Income tax expense/(benefit)	(88)	(83)	(301)	(34)
Net income/(loss)	$ (123)	$ (143)	$ (433)	$ (65)
Earnings/(loss) per share:				
Basic	$ (0.56)	$ (0.67)	$ (1.98)	$ (0.30)
Diluted	$ (0.56)	$ (0.67)	$ (1.98)	$ (0.30)
Weighted average shares – basic	219.4	213.3	219.1	218.6
Weighted average shares – diluted	219.4	213.3	219.1	218.6

The accompanying notes are an integral part of these unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(Unaudited)

($ in millions)	Three Months Ended October 27, 2012	Three Months Ended October 29, 2011	Nine Months Ended October 27, 2012	Nine Months Ended October 29, 2011
Net income/(loss)	$ (123)	$ (143)	$ (433)	$ (65)
Other comprehensive income/(loss), net of tax				
Real estate investment trusts (REITs)				
Unrealized gain/(loss) on REITs	1	10	34	40
Reclassification adjustment for (gain)/loss on REITs included in net income/(loss)	(10)	-	(184)	-
Retirement benefit plans				
Net actuarial gain/(loss) arising during the period	(75)	(37)	(75)	(37)
Prior service credit/(cost) arising during the period	-	(2)	-	(2)
Reclassification of net prior service (credit)/cost recognized in net income/(loss) from a curtailment	(3)	1	(3)	1
Reclassification for amortization of net actuarial (gain)/loss included in net periodic benefit expense/(income)	37	24	114	70
Reclassification for amortization of prior service (credit)/cost included in net periodic benefit expense/(income)	(2)	(4)	(6)	(12)
Total other comprehensive income/(loss), net of tax	(52)	(8)	(120)	60
Total comprehensive income/(loss), net of tax	$ (175)	$ (151)	$ (553)	$ (5)

The accompanying notes are an integral part of these unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	October 27, 2012 (Unaudited)	October 29, 2011 (Unaudited)	January 28, 2012
Assets			
Current assets:			
Cash in banks and in transit	$ 141	$ 205	$ 175
Cash short-term investments	384	880	1,332
Cash and cash equivalents	525	1,085	1,507
Merchandise inventory	3,362	4,376	2,916
Income tax receivable	69	175	168
Deferred taxes	409	189	245
Prepaid expenses and other	265	285	245
Total current assets	4,630	6,110	5,081
Property and equipment (net of accumulated depreciation of $3,070, $3,035 and $2,965)	5,493	5,242	5,176
Prepaid pension	-	668	-
Other assets	767	807	1,167
Total Assets	$ 10,890	$ 12,827	$ 11,424
Liabilities and Stockholders’ Equity			
Current liabilities:			
Merchandise accounts payable	$ 1,408	$ 1,831	$ 1,022
Other accounts payable and accrued expenses	1,344	1,404	1,503
Current portion of capital leases and note payable	22	1	1
Current maturities of long-term debt	-	230	230
Total current liabilities	2,774	3,466	2,756
Long-term capital leases and note payable	75	3	3
Long-term debt	2,868	2,868	2,868
Deferred taxes	786	1,152	888
Other liabilities	885	816	899
Total Liabilities	7,388	8,305	7,414
Stockholders' Equity			
Common stock[1]	110	107	108
Additional paid-in capital	3,789	3,619	3,699
Reinvested earnings	932	1,541	1,412
Accumulated other comprehensive income/(loss)	(1,329)	(745)	(1,209)

Total Stockholders' Equity	3,502	4,522	4,010
Total Liabilities and Stockholders' Equity	$ 10,890	$ 12,827	$ 11,424

(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 219.2 million, 213.4 million and 215.9 million as of October 27, 2012, October 29, 2011 and January 28, 2012, respectively.

The accompanying notes are an integral part of these unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

($ in millions)	Three Months Ended October 27, 2012	Three Months Ended October 29, 2011	Nine Months Ended October 27, 2012	Nine Months Ended October 29, 2011
Cash flows from operating activities				
Net income/(loss)	$ (123)	$ (143)	$ (433)	$ (65)
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:				
Restructuring and management transition	12	216	102	230
Asset impairments and other charges	6	6	10	8
Net gain on sale or redemption of non-operating assets	(197)	-	(397)	-
Depreciation and amortization	133	127	386	383
Benefit plans	31	18	110	46
Stock-based compensation	12	7	38	33
Excess tax benefits from stock-based compensation	6	(1)	(17)	(5)
Deferred taxes	(27)	9	(224)	(96)
Change in cash from:				
Inventory	(369)	(804)	(446)	(1,163)
Prepaid expenses and other assets	(26)	(89)	(41)	(86)
Merchandise accounts payable	393	445	386	698
Current income taxes	74	(108)	108	(34)
Accrued expenses and other	27	12	(237)	(82)
Net cash provided by/(used in) operating activities	(48)	(305)	(655)	(133)
Cash flows from investing activities				
Capital expenditures	(341)	(174)	(580)	(469)
Proceeds from sale or redemption of non-operating assets	279	-	525	-
Acquisition	-	-	(9)	-
Proceeds from sale of operating assets	-	1	-	1
Proceeds from joint venture cash distribution	-	53	-	53
Net cash provided by/(used in) investing activities	(62)	(120)	(64)	(415)
Cash flows from financing activities				
Payments of capital leases and note payable	(13)	-	(13)	-
Payment of long-term debt	(230)	-	(230)	-
Financing costs	-	-	(4)	(15)
Dividends paid, common	-	(43)	(86)	(135)
Stock repurchase program	-	-	-	(900)
Proceeds from issuance of stock warrant	-	-	-	50
Proceeds from stock options exercised	1	1	70	12
Excess tax benefits from stock-based compensation	(6)	1	17	5

Tax withholding payments for vested restricted stock	(5)	-	(17)	(6)
Net cash provided by/(used in) financing activities	(253)	(41)	(263)	(989)
Net increase/(decrease) in cash and cash equivalents	(363)	(466)	(982)	(1,537)
Cash and cash equivalents at beginning of period	888	1,551	1,507	2,622
Cash and cash equivalents at end of period	$ 525	$ 1,085	$ 525	$ 1,085
Supplemental cash flow information				
Income taxes received/(paid), net	134	(15)	185	(96)
Interest received/(paid), net	(92)	(90)	(205)	(202)
Supplemental non-cash investing and financing activity				
Increase (decrease) in other accounts payable related to purchases of property and equipment	(24)	(7)	139	5
Purchase of property and equipment and software through capital leases and a note payable	57	3	106	4

The accompanying notes are an integral part of these unaudited Interim Consolidated Financial Statements.

J. C. PENNEY COMPANY, INC.

NOTES TO 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, 2012 (2011 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 2011 Form 10-K. The January 28, 2012 financial information was derived from the audited Consolidated Financial Statements, with related footnotes, included in the 2011 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 October 27, 2012” and “three months ended October 29, 2011” refer to the 13-week periods ended October 27, 2012 and October 29, 2011, respectively. “Nine months ended October 27, 2012,” and “nine months ended October 29, 2011,” refer to the 39-week periods ended October 27, 2012 and October 29, 2011, respectively. Fiscal year 2012 contains 53 weeks.

Basis of Consolidation

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

Use of Estimates and Assumptions

The preparation of unaudited Interim Consolidated Financial Statements, in conformity with GAAP, requires us to make assumptions and use estimates that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to: inventory valuation under the retail method; 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.

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2. Effect of New Accounting Standards

In July 2012, the Financial Accounting Standards Board issued Accounting Standards Update 2012-02, “Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment” (ASU 2012-02). ASU 2012-02 provides companies with the option to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If the company concludes that it is more likely than not that the asset is impaired, it is required to determine the fair value of the intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying value in accordance with Topic 350. If the company concludes otherwise, no further quantitative assessment is required. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. We intend to early adopt ASU 2012-02 beginning with our annual indefinite-lived intangible asset impairment test during the fourth quarter of our fiscal year 2012. We do not expect the adoption to have a material impact on our consolidated results of operations, cash flows or financial position.

3. Earnings/(Loss) per Share

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

	Three Months Ended		Nine Months Ended	
(in millions, except per share data)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Earnings/(loss)				
Net income/(loss)	$ (123)	$ (143)	$ (433)	$ (65)
Shares				
Weighted average common shares outstanding (basic shares)	219.4	213.3	219.1	218.6
Adjustment for assumed dilution:				
Stock options, restricted stock awards and warrant	-	-	-	-
Weighted average shares assuming dilution (diluted shares)	219.4	213.3	219.1	218.6
EPS				
Basic	$ (0.56)	$ (0.67)	$ (1.98)	$ (0.30)

Diluted	$ (0.56)	$ (0.67)	$ (1.98)	$ (0.30)

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

	Three Months Ended		Nine Months Ended	
(Shares in millions)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Stock options, restricted stock awards and warrant	26	19	25	18

4. Credit Facility

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

The 2012 Credit Facility is an asset-based revolving credit facility and is secured by a perfected first-priority security interest in substantially all of our eligible credit card receivables, accounts receivable and inventory. The 2012 Credit Facility is available for general corporate purposes, including the issuance of letters of credit. Pricing under the 2012 Credit Facility is tiered based on JCP's

senior unsecured long-term credit ratings issued by Moody's Investors Service, Inc. and Standard & Poor's Ratings Services. JCP's obligations under the 2012 Credit Facility are guaranteed by J. C. Penney Company, Inc.

Availability under the 2012 Credit Facility is limited to a borrowing base which allows us to borrow up to 85% of eligible accounts receivable, plus 90% of eligible credit card receivables, plus 85% of the liquidation value of our inventory, net of certain reserves. Letters of credit reduce the amount available to borrow by their face value. In the event that availability under the 2012 Credit Facility is at any time less than the greater of (1) $125 million or (2) 10% of the lesser of the total facility or the borrowing base then in effect, for a period of at least 30 days, the Company will be subject to a fixed charge coverage ratio covenant of 1.0 to 1.0 which is calculated as of the last day of the quarter and measured on a trailing four-quarter basis.

The 2012 Credit Facility contains covenants including, but not limited to, restrictions on the Company's and its subsidiaries' ability to incur indebtedness; grant liens on assets; guarantee obligations; merge, consolidate or sell assets; pay dividends or make other restricted payments; make investments; prepay or modify certain indebtedness; engage in transactions with affiliates; or enter into sale-leaseback transactions under certain conditions.

No borrowings, other than the issuance of standby and import letters of credit totaling $214 million as of October 27, 2012, have been made under the 2012 Credit Facility. As of October 27, 2012, the applicable rate for standby and import letters of credit was 3.00% and 1.50%, respectively, while the required commitment fee was 0.50% for the unused portion of the 2012 Credit Facility. As of October 27, 2012, we had $1,286 million available for borrowing under the 2012 Credit Facility.

5. Long-Term Debt, Capital Leases and Note Payable

In August 2012, we repaid $230 million of 9.0% Notes at maturity. During the nine months ended October 27, 2012, we made capital expenditures totaling $106 million that were financed through either capital lease commitments or a note payable.

During the nine months ended October 29, 2011, there were no issuances of debt and no scheduled debt maturities.

6. 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.

REIT Assets Measured on a Recurring Basis

The market value of our investment in public REIT assets are accounted for as available-for-sale securities and are carried at fair value on an ongoing basis in Other assets in the unaudited Interim Consolidated Balance Sheets. We determined the fair value of our investments in REITs using quoted market prices. There were no transfers in or out of any levels during any period presented. Our REIT assets measured at fair value on a recurring basis are as follows:

		REIT Assets at Fair Value		
($ in millions)	Cost Basis	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
October 27, 2012	$ 9	$ 32	$ -	$ -
October 29, 2011	80	316	-	-
January 28, 2012	80	336	-	-

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Other Financial Instruments

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

	October 27, 2012		October 29, 2011		January 28, 2012	
($ in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	$ 2,868	$ 2,706	$ 3,098	$ 2,988	$ 3,098	$ 3,046
Cost investment	36	-	-	-	36	-

The fair value of long-term debt is estimated by obtaining quotes from brokers or is based on current rates offered for similar debt. The cost investment is for equity securities that are not registered and freely tradable shares and their fair values are not readily determinable; however, we believe the carrying value approximates or is less than the fair value.

As of October 27, 2012, October 29, 2011 and January 28, 2012, the fair values of cash and cash equivalents and accounts payable approximate their carrying values due to the short-term nature of these instruments. In addition, the fair values of the capital lease commitments and the note payable approximate their carrying values. These items have been excluded from the table above.

Concentrations of Credit Risk

We have no significant concentrations of credit risk.

7. Stockholders' Equity

The following table shows the change in the components of stockholders' equity for the nine months ended October 27, 2012:

(in millions)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Reinvested Earnings/ (Loss)	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
January 28, 2012	215.9	$ 108	$ 3,699	$ 1,412	$ (1,209)	$ 4,010
Net income/(loss)	-	-	-	(433)	-	(433)
Other comprehensive income/(loss)	-	-	-	-	(120)	(120)
Dividends declared, common	-	-	-	(47)	-	(47)
Stock-based compensation	3.3	2	90	-	-	92
October 27, 2012	219.2	$ 110	$ 3,789	$ 932	$ (1,329)	$ 3,502

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

	Three Months Ended					
	October 27, 2012			October 29, 2011		
($ in millions)	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount
REITs						
Unrealized gain/(loss) on REITs	$ 1	$ -	$ 1	$ 15	$ (5)	$ 10
Reclassification adjustment for (gain)/loss on REITs included in net income/(loss)	(15)	5	(10)	-	-	-
Retirement benefit plans						
Net actuarial gain/(loss) arising during the period	(125)	50	(75)	(58)	21	(37)
Prior service credit/(cost) arising during the period	-	-	-	(4)	2	(2)
Reclassification of net prior service (credit)/cost recognized in net income/(loss) from a curtailment	(5)	2	(3)	1	-	1
Reclassification for amortization of net actuarial (gain)/loss included in net periodic benefit expense/(income)	61	(24)	37	40	(16)	24
Reclassification for amortization of prior service (credit)/cost included in net periodic benefit expense/(income)	(4)	2	(2)	(6)	2	(4)
Total	$ (87)	$ 35	$ (52)	$ (12)	$ 4	$ (8)

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($ in millions)	Nine Months Ended October 27, 2012 Gross Amount	Income Tax (Expense)/ Benefit	Net Amount	October 29, 2011 Gross Amount	Income Tax (Expense)/ Benefit	Net Amount
REITs						
Unrealized gain/(loss) on REITs	$ 52	$ (18)	$ 34	$ 62	$ (22)	$ 40
Reclassification adjustment for (gain)/loss on REITs included in net income/(loss)	(285) (1)	101	(184)	-	-	-
Retirement benefit plans						
Net actuarial gain/(loss) arising during the period	(125)	50	(75)	(58)	21	(37)
Prior service credit/(cost) arising during the period	-	-	-	(4)	2	(2)
Reclassification of net prior service (credit)/cost recognized in net income/(loss) from a curtailment	(5)	2	(3)	1	-	1
Reclassification for amortization of net actuarial (gain)/loss included in net periodic benefit expense/(income)	188	(74)	114	115	(45)	70
Reclassification for amortization of prior service (credit)/cost included in net periodic benefit expense/(income)	(11)	5	(6)	(19)	7	(12)
Total	$ (186)	$ 66	$ (120)	$ 97	$ (37)	$ 60

(1) During the second quarter of 2012, the reclassification adjustment for the Simon Property Group, L.P. (SPG) units of $270 million was calculated by using the closing fair market value per SPG unit of $158.13 on July 19, 2012 for the two million REIT units that were redeemed on July 20, 2012. The REIT units were redeemed at a price of $124.00 per unit (see Note 11).

The following table shows the changes in accumulated other comprehensive income/(loss) balances for the nine months ended October 27, 2012:

($ in millions)	Unrealized Gain/(Loss) on REITs	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Accumulated Other Comprehensive Income/(Loss)

January 28, 2012	$	165	$	(1,397)	$	23	$	(1,209)
Current period change		(150)		39		(9)		(120)
October 27, 2012	$	15	$	(1,358)	$	14	$	(1,329)

8. Stock-Based Compensation

We grant stock-based compensation awards to employees and non-employee directors under our equity compensation plan. On May 18, 2012, our stockholders approved the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan (2012 Plan), reserving 7 million shares for future grants (1.5 million newly authorized shares plus up to 5.5 million reserved but unissued shares from our prior 2009 Long-Term Incentive Plan (2009 Plan)). In addition, shares underlying any outstanding stock award or stock option grant cancelled prior to vesting or exercise become available for use under the 2012 Plan. The 2009 Plan terminated on May 18, 2012, except for outstanding awards, and all subsequent awards have been granted under the 2012 Plan. As of October 27, 2012, there were approximately 6 million shares of stock available for future grant under the 2012 Plan.

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The components of total stock-based compensation costs are as follows:

($ in millions)	Three Months Ended October 27, 2012	Three Months Ended October 29, 2011	Nine Months Ended October 27, 2012	Nine Months Ended October 29, 2011
Stock awards (shares and units)	$ 8	$ 2	$ 26	$ 14
Stock options	4	5	12	19
Total stock-based compensation	$ 12	$ 7 (1)	$ 38 (2)	$ 33 (1)

(1) Excludes $6 million of stock-based compensation costs reported in restructuring and management transition charges (see Note 10).

(2) Excludes $9 million of stock-based compensation costs reported in restructuring and management transition charges (see Note 10).

On March 13, 2012, we made an annual grant of approximately 1.9 million stock options to employees at an option price of $37.63, with a fair value of $11.68 per option and approximately 646,000 time-based restricted stock units (RSUs) to employees with a fair value of $37.63 per RSU award.

During the second quarter of 2012, we granted approximately 704,000 stock options to employees at an option price of $26.29 and a fair value of $11.36 per option. Additionally, we granted approximately 690,000 time-based RSUs which includes 640,000 RSUs to employees with a fair value of $26.29 per RSU award as well as 50,000 RSUs to directors with a fair value of $27.26 per RSU award.

During the third quarter of 2012, we granted employees approximately 80,000 stock options at an option price of $22.98 and a fair value of $10.11 per option and approximately 390,000 time-based RSUs with a fair value of $22.98.

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9. Retirement Benefit Plans

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

	Three Months Ended		Nine Months Ended	
Primary Pension Plan	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Service cost	$ 21	$ 22	$ 67	$ 66
Interest cost	61	62	185	186
Expected return on plan assets	(95)	(97)	(284)	(290)
Net amortization	55	35	171	103
Net periodic benefit expense/(income)	$ 42	$ 22	$ 139	$ 65
Supplemental Pension Plans				
Service cost	$ -	$ 1	$ 1	$ 2
Interest cost	3	3	10	9
Expected return on plan assets	-	-	-	-
Net amortization	6	5	17	12
Net periodic benefit expense/(income)	$ 9	$ 9	$ 28	$ 23
Primary and Supplemental Pension Plans Total				
Service cost	$ 21	$ 23	$ 68	$ 68
Interest cost	64	65	195	195
Expected return on plan assets	(95)	(97)	(284)	(290)
Net amortization	61	40	188	115
Net periodic benefit expense/(income)	$ 51	$ 31	$ 167	$ 88
Postretirement Health and Welfare Plan				
Service cost	$ -	$ -	$ -	$ -
Interest cost	-	-	1	-
Expected return on plan assets	-	-	-	-
Net amortization	(4)	(6)	(11)	(19)
Net periodic benefit expense/(income)	$ (4)	$ (6)	$ (10)	$ (19)
Retirement Benefit Plans Total				
Service cost	$ 21	$ 23	$ 68	$ 68
Interest cost	64	65	196	195
Expected return on plan assets	(95)	(97)	(284)	(290)
Net amortization	57	34	177	96
Net periodic benefit expense/(income)	$ 47	$ 25	$ 157	$ 69

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

Curtailments

During the first half of 2012, we took actions to reduce our work force. During the third quarter of 2012, when substantially all employee exits were completed, we recorded a net curtailment gain of $7 million due to the reduction in the expected years of future service related to our retirement benefit plans. The net curtailment gain is included in the line item Restructuring and management transition in the unaudited Interim Consolidated Statements of Operations (see Note 10). The curtailments resulted in reductions in the projected benefit obligations (PBOs) of our Primary Pension Plan, non-qualified supplemental plans and the postretirement health and welfare plan of $80 million, $13 million and $2 million, respectively. As a result of these curtailments, the liabilities for our retirement benefit plans were remeasured as of September 30, 2012 using a discount rate of 4.25% compared to the year-end 2011 discount rate of 4.82%. As a result of the remeasurements, the PBOs of our Primary Pension Plan and the non-qualified supplemental plans were increased by $166 million and $55 million, respectively, which was offset by a decrease in our PBO for our post-retirement health and welfare plan by $5 million. As of September 30, 2012, the PBO's of our Primary Pension Plan, non-qualified supplemental plans and postretirement health and welfare plan were $5,550 million, $300 million and $18 million, respectively.

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Primary Pension Plan Lump-Sum Payment Offer

In September 2012, we offered approximately 35,000 participants in the Primary Pension Plan who have separated from service and had a deferred vested benefit as of August 31, 2012 the option to receive a lump-sum settlement payment. These participants had until November 30, 2012 to elect to receive the lump-sum settlement payment with the payments to be made by the Company beginning on December 4, 2012 using assets from the Primary Pension Plan.

Defined Contribution Plans

Our defined contribution plans include a qualified Savings, Profit-Sharing and Stock Ownership Plan (401(k) plan), which includes a non-contributory retirement account, and a non-qualified contributory unfunded mirror savings plan offered to certain members of management. Total expense for our defined contribution plans for the third quarters of 2012 and 2011 was $13 million and $16 million, respectively, and was predominantly included in SG&A expenses on the Consolidated Statements of Operations. Total expense for the nine months ended October 27, 2012 and October 29, 2011 was $43 million and $48 million, respectively.

10. Restructuring and Management Transition

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

	Three Months Ended		Nine Months Ended		Cumulative Amount
($ in millions)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011	Through October 27, 2012
Supply chain	$ 3	$ 16	$ 19	$ 31	$ 60
Catalog and catalog outlet stores	-	30	-	34	55
Home office and stores	4	12	105	17	150
Software and systems	-	-	36	-	36
Store fixtures	18	-	60	-	60
Management transition	6	27	36	29	166
	-	179	-	179	179

Voluntary early retirement program (VERP)					
Other	3	1	13	7	46
Total	$ 34	$ 265	$ 269	$ 297	$ 752

Supply chain

As a result of consolidating and streamlining our supply chain organization as part of a restructuring program that began in 2011, during the three months ended October 27, 2012 and October 29, 2011, we recorded charges of $3 million and $16 million, respectively, related to increased depreciation, termination benefits and unit closing costs. During the nine months ended October 27, 2012 and October 29, 2011, we recorded charges of $19 million and $31 million, respectively. This program was completed during the third quarter of 2012.

Catalog and catalog outlet stores

On October 16, 2011, we sold the assets related to the operations of our catalog outlet stores. We sold fixed assets and inventory with combined net book values of approximately $31 million, for a total purchase price of $7 million, which resulted in a loss of $24 million. During the three and nine months ended October 29, 2011, we recorded $6 million and $10 million, respectively, of severance costs related to the sale of our outlet stores. This restructuring activity was completed in 2011.

Home office and stores

During the three months ended October 27, 2012 and October 29, 2011, we recorded $4 million and $12 million, respectively, of net charges associated with employee termination benefits for actions to reduce our store and home office expenses. During the third quarter of 2012, when substantially all employee exits were completed, we recorded a net curtailment gain of $7 million (see Note 9). The net curtailment gain was more than offset by charges associated with employee termination benefits of $11 million. During the nine months ended October 27, 2012 and October 29, 2011, we recorded net charges of $105 million and $17 million, respectively. For the remainder of 2012 we do not anticipate incurring significant charges related to this restructuring activity.

Software and systems

During the nine months ended October 27, 2012, we recorded a charge of $36 million related to the disposal of software and systems that based on our evaluation no longer support our new strategy. Included in this amount is $3 million of consulting fees related to that evaluation.

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Store fixtures

During the three months ended October 27, 2012, we recorded $11 million of charges related to the removal of store fixtures in our department stores. In addition, we recorded $7 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that are expected to be replaced throughout 2013 with the build out of additional shops. During the nine months ended October 27, 2012, we recorded charges of $60 million related to the write-off and increased depreciation for store fixtures that were replaced or are expected to be replaced with the new store shop fixtures. As we continue to design and implement new shops in conjunction with our efforts to re-organize our department stores, we anticipate additional store fixture write-offs and increased depreciation.

Management transition

We implemented several changes within our management leadership team that resulted in management transition costs of $36 million and $29 million for the nine months ended October 27, 2012 and October 29, 2011, respectively, for both incoming and outgoing members of management.

VERP

As a part of several restructuring and cost-savings initiatives designed to reduce salary and related costs across the Company, in the third quarter of 2011 we incurred a total charge of $179 million related to the VERP. Charges included $176 million related to enhanced retirement benefits for the approximately 4,000 employees who accepted the VERP, $1 million related to curtailment charges for our non-qualified supplemental pension plans as a result of the reduction in the expected years of future service related to these plans, and $2 million of costs associated with administering the VERP. This restructuring activity was completed in 2011.

Other

During the three months ended October 27, 2012 and October 29, 2011, we recorded miscellaneous restructuring charges of $3 million and $1 million, respectively. During the nine months ended October 27, 2012 and October 29, 2011, we recorded miscellaneous restructuring charges of $13 million and $7 million, respectively. These charges were primarily related to the exit of our specialty websites CLAD™ and Gifting Grace™ and the closure of our Pittsburgh, Pennsylvania customer call center.

Activity for the restructuring and management transition liability for the nine months ended October 27, 2012 was as follows:

($ in millions)	Supply Chain	Home Office and Stores	Software and Systems	Store Fixtures	Management Transition	Other	Total
January 28, 2012	$ 3	$ 28	$ -	$ -	$		