

J C PENNEY CO INC  
Form 10-K  
March 23, 2015  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K  
(Mark  
One)

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

For the fiscal year ended January 31, 2015  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-15274

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

6501 Legacy Drive, Plano, Texas 75024-3698  
(Address of principal executive offices)  
(Zip Code)  
(972) 431-1000  
(Registrant's telephone number, including  
area code)

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

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

Securities registered pursuant to Section 12(g) of  
the Act:  
None  
(Title of class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any,  
every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of

Edgar Filing: J C PENNEY CO INC - Form 10-K

this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter (August 2, 2014). \$2,930,303,291

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

305,120,922 shares of Common Stock of 50 cents par value, as of March 16, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Documents from which portions are incorporated by reference

J. C. Penney Company, Inc. 2015 Proxy Statement

Parts of the Form 10-K into which  
incorporated  
Part III

Table of Contents

INDEX

	Page
<u>Part I</u>	
<u>Item 1. Business</u>	<u>3</u>
<u>Item 1A. Risk Factors</u>	<u>6</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>15</u>
<u>Item 2. Properties</u>	<u>16</u>
<u>Item 3. Legal Proceedings</u>	<u>18</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>20</u>
<u>Part II</u>	
<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>21</u>
<u>Item 6. Selected Financial Data</u>	<u>23</u>
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>27</u>
<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>51</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>51</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>51</u>
<u>Item 9A. Controls and Procedures</u>	<u>52</u>
<u>Item 9B. Other Information</u>	<u>54</u>
<u>Part III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>54</u>
<u>Item 11. Executive Compensation</u>	<u>54</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>54</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>55</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>55</u>
<u>Part IV</u>	
<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>56</u>
<u>Signatures</u>	<u>57</u>
<u>Index to Consolidated Financial Statements</u>	<u>59</u>
<u>Exhibit Index</u>	<u>105</u>

Table of Contents

## PART I

## Item 1. Business

## Business Overview

J. C. Penney Company, Inc. is a holding company whose principal operating subsidiary is J. C. Penney Corporation, Inc. (JCP). JCP was incorporated in Delaware in 1924, and J. C. Penney Company, Inc. was incorporated in Delaware in 2002, when the holding company structure was implemented. The new holding company assumed the name J. C. Penney Company, Inc. (Company). The holding company has no independent assets or operations, and no direct subsidiaries other than JCP. Common stock of the Company is publicly traded under the symbol “JCP” on the New York Stock Exchange. The Company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP’s outstanding debt securities. The guarantee by the Company of certain of JCP’s outstanding debt securities is full and unconditional. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this Annual Report on Form 10-K as “we,” “us,” “our,” “ourselves,” “Company” or “JCPenney.”

Since our founding by James Cash Penney in 1902, we have grown to be a major retailer, operating 1,062 department stores in 49 states and Puerto Rico as of January 31, 2015. Our fiscal year ends on the Saturday closest to January 31. Unless otherwise stated, references to years in this report relate to fiscal years, rather than to calendar years. Fiscal year 2014 ended on January 31, 2015; fiscal year 2013 ended on February 1, 2014; and fiscal year 2012 ended on February 2, 2013. Fiscal years 2014 and 2013 consisted of 52 weeks and fiscal year 2012 consisted of 53 weeks.

Our business consists of selling merchandise and services to consumers through our department stores and our website at jcpenny.com, which utilizes fully optimized applications for desktop, mobile and tablet devices. Our department stores and website generally serve the same type of customers and provide virtually the same mix of merchandise, and our department stores accept returns from sales made in stores and via our website. We fulfill online customer purchases by direct shipment to the customer from our distribution facilities and stores or from our suppliers' warehouses and by in store customer pick up. We sell family apparel and footwear, accessories, fine and fashion jewelry, beauty products through Sephora inside JCPenney and home furnishings. In addition, our department stores provide our customers with services such as styling salon, optical, portrait photography and custom decorating.

Based on how we categorized our divisions in 2014, our merchandise mix of total net sales over the last three years was as follows:

	2014	2013	2012	
Women’s apparel	24	% 24	% 24	%
Men’s apparel and accessories	22	% 22	% 21	%
Home	12	% 11	% 12	%
Women’s accessories, including Sephora	12	% 11	% 10	%
Children’s apparel	10	% 11	% 12	%
Family footwear	8	% 9	% 9	%
Fine jewelry	7	% 7	% 7	%
Services and other	5	% 5	% 5	%
	100	% 100	% 100	%

## Competition and Seasonality

The business of selling merchandise and services is highly competitive. We are one of the largest department store and e-commerce retailers in the United States, and we have numerous competitors, as further described in Item 1A, Risk Factors. Many factors enter into the competition for the consumer’s patronage, including price, quality, style, service, product mix, convenience, loyalty programs and credit availability. Our annual earnings depend to a great extent on

the results of operations for the last quarter of the fiscal year, which includes the holiday season, when a significant portion of our sales and profits are recorded.

## Table of Contents

### Trademarks

The JCPenney®, JCP®, Liz Claiborne®, Claiborne®, Okie Dokie®, Worthington®, a.n.a®, St. John's Bay®, The Original Arizona Jean Company®, Ambrielle®, Decree®, Stafford®, J. Ferrar®, Xersion™, Total Girl™, minkC Penney Home™, Studio JCP Home™, Home Collection by JCPenney™, Made for Life™, Stylus™, Sleep Chic™, Home Expressions™, Cooks JCPenney Home™ trademarks, as well as certain other trademarks, have been registered, or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law. We consider our marks and the accompanying name recognition to be valuable to our business.

### Website Availability

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

### Suppliers

We have a diversified supplier base, both domestic and foreign, and are not dependent to any significant degree on any single supplier. We purchase our merchandise from approximately 2,400 domestic and foreign suppliers, many of which have done business with us for many years. In addition to our Plano, Texas home office, we, through our purchasing subsidiary, maintained buying and quality assurance offices in 11 foreign countries as of January 31, 2015.

### Employment

The Company and its consolidated subsidiaries employed approximately 114,000 full-time and part-time employees as of January 31, 2015.

### Environmental Matters

Environmental protection requirements did not have a material effect upon our operations during 2014. It is possible that compliance with such requirements (including any new requirements) would lengthen lead time in expansion or renovation plans and increase construction costs, and therefore operating costs, due in part to the expense and time required to conduct environmental and ecological studies and any required remediation.

As of January 31, 2015, we estimated our total potential environmental liabilities to range from \$20 million to \$25 million and recorded our best estimate of \$22 million in Other accounts payable and accrued expenses and Other liabilities in the Consolidated Balance Sheet as of that date. This estimate covered potential liabilities primarily related to underground storage tanks, remediation of environmental conditions involving our former drugstore locations and asbestos removal in connection with approved plans to renovate or dispose of our facilities. We continue to assess required remediation and the adequacy of environmental reserves as new information becomes available and known conditions are further delineated. If we were to incur losses at the upper end of the estimated range, we do not believe that such losses would have a material effect on our financial condition, results of operations or liquidity.



Table of Contents

## Executive Officers of the Registrant

The following is a list, as of March 16, 2015, of the names and ages of the executive officers of J. C. Penney Company, Inc. and of the offices and other positions held by each such person with the Company. These officers hold identical positions with JCP. There is no family relationship between any of the named persons.

Name	Offices and Other Positions Held With the Company	Age
Myron E. Ullman, III	Chief Executive Officer	68
Marvin R. Ellison	President and CEO-Designee	50
Edward J. Record	Executive Vice President and Chief Financial Officer	46
Janet Dhillon*	Executive Vice President, General Counsel and Secretary	52
Brynn L. Evanson	Executive Vice President, Human Resources	45
D. Scott Laverty	Executive Vice President, Chief Information Officer	55
Dennis P. Miller	Senior Vice President and Controller	62

\* Ms. Dhillon left the Company effective March 20, 2015.

Mr. Ullman has served as Chief Executive Officer of the Company since April 2013. He previously served as Chairman of the Board of Directors from 2004 to January 2012 and Chief Executive Officer of the Company from 2004 to November 2011. He was Directeur General, Group Managing Director, LVMH Moët Hennessy Louis Vuitton (luxury goods manufacturer/retailer) from 1999 to 2002. He was President of LVMH Selective Retail Group from 1998 to 1999. From 1995 to 1998, he was Chairman of the Board and Chief Executive Officer of DFS Group Ltd. From 1992 to 1995, he was Chairman of the Board and Chief Executive Officer of R. H. Macy & Company, Inc. He has served as a director of the Company and as a director of JCP since 2013.

Mr. Ellison has served as President and CEO-Designee of the Company since November 2014. Prior to joining the Company, he served as Executive Vice President - U.S. Stores of The Home Depot, Inc. from 2008 to 2014. His prior roles with The Home Depot, Inc. included President - Northern Division from 2006 to 2008, Senior Vice President - Logistics from 2005 to 2006, Vice President - Logistics from 2004 to 2005, and Vice President - Loss Prevention from 2002 to 2004. Mr. Ellison began his career with Target Corporation where he served in a variety of operational roles. He has served as a director of the Company and as a director of JCP since 2014.

Mr. Record has served as Executive Vice President and Chief Financial Officer since 2014. Prior to joining the Company, he served as Executive Vice President and Chief Operating Officer of Stage Stores, Inc. (apparel retailer) from 2010 to 2014. His prior roles with Stage Stores, Inc. included Chief Financial Officer from September 2007 to 2010 and Executive Vice President and Chief Administrative Officer from May 2007 to September 2007. Mr. Record was Senior Vice President of Finance of Kohl's Corporation from 2005 to 2007. Prior to that, he served as Senior Vice President of Finance and Controller of Belk, Inc. from April 2005 to October 2005 and Senior Vice President and Controller of Belk from 2002 to April 2005. He has served as a director of JCP since 2014.

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

Ms. Evanson has served as Executive Vice President, Human Resources since 2013. She joined the Company in 2009 as Director of Compensation and became Vice President, Compensation, Benefits and Talent Operations in 2010. Prior to joining the Company, she worked at the Dayton Hudson Corporation from 1991 to 2009 (renamed Target



Corporation in 2000). Ms. Evanson began her career with Marshall Field's where she advanced through positions in stores, finance, human resources and merchandising. She moved to the Target stores division in 2000, ultimately serving as Director of Executive Compensation and Retirement Plans.

Mr. Lavery has served as Executive Vice President, Chief Information Officer since September 2013 after serving as interim Chief Information Officer from June 2013 to September 2013. He joined the Company as Senior Vice President, Business Solutions in 2012. Prior to joining the Company, Mr. Lavery served as the Americas retail practice leader for HCL Axon

## Table of Contents

(technology consultancy) from 2011 to 2012. He served as Senior Vice President, Chief Information Officer of Borders Group from May 2009 to January 2011. In February 2011, Borders Group and its subsidiaries filed voluntary petitions for relief under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. Previously, Mr. Laverty held senior consulting roles with IBM, Deloitte, PricewaterhouseCoopers and Ernst & Young. Early in his career he led inventory management and planning at several retail companies, including Michael's Stores and Payless Shoesource.

Mr. Miller has served as Senior Vice President and Controller of the Company since September 2013. He previously served as Senior Vice President and Controller from 2008 to September 2012 and was Senior Vice President, Finance with responsibility for the Company's shared services center in Salt Lake City from September 2012 to September 2013. Mr. Miller served as Vice President, Director of Procurement and Strategic Sourcing of JCP from 2004 to 2008. From 2001 to 2004, he served as Senior Vice President and Chief Financial Officer of Eckerd Corporation, a former subsidiary of the Company.

### Item 1A. Risk Factors

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

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

During fiscal 2014, we entered the "go-forward" phase of our turnaround as we position the Company for long-term growth. However, it may take longer than expected to achieve our objectives, and actual results may be materially less than planned. Our ability to improve our operating results depends upon a significant number of factors, some of which are beyond our control, including:

- customer response to our marketing and merchandise strategies;
- our ability to achieve profitable sales and to make adjustments in response to changing conditions;
- our ability to respond to competitive pressures in our industry;
- our ability to effectively manage inventory;
- the success of our omnichannel strategy;
- our ability to benefit from capital improvements made to our store environment;
- our ability to respond to any unanticipated changes in expected cash flows, liquidity and cash needs, including our ability to obtain any additional financing or other liquidity enhancing transactions, if and when needed;
- our ability to achieve positive cash flow;
- our ability to access adequate and uninterrupted supply of merchandise from suppliers at expected levels and on acceptable terms; and
- general economic conditions.

There is no assurance that our pricing, branding, store layout, marketing and merchandising strategies, or any future adjustments to our strategies, will improve our operating results.

We operate in a highly competitive industry, which could adversely impact our sales and profitability.

The retail industry is highly competitive, with few barriers to entry. We compete with many other local, regional and national retailers for customers, employees, locations, merchandise, services and other important aspects of our business. Those competitors include other department stores, discounters, home furnishing stores, specialty retailers, wholesale clubs, direct-to-consumer businesses, including those on the Internet, and other forms of retail commerce. Some competitors are larger than

## Table of Contents

JCPenney, and/or have greater financial resources available to them, and, as a result, may be able to devote greater resources to sourcing, promoting, selling their products, updating their store environment and updating their technology. Competition is characterized by many factors, including merchandise assortment, advertising, price, quality, service, location, reputation, credit availability and customer loyalty. We have experienced, and anticipate that we will continue to experience for at least the foreseeable future, significant competition from our competitors. The performance of competitors as well as changes in their pricing and promotional policies, marketing activities, customer loyalty programs, new store openings, store renovations, launches of Internet websites or mobile platforms, brand launches and other merchandise and operational strategies could cause us to have lower sales, lower gross margin and/or higher operating expenses such as marketing costs and other selling, general and administrative expenses, which in turn could have an adverse impact on our profitability.

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

Our sales and operating results depend in part on our ability to predict and respond to changes in fashion trends and customer preferences in a timely manner by consistently offering stylish, quality merchandise assortments at competitive prices. We continuously assess emerging styles and trends and focus on developing a merchandise assortment to meet customer preferences. There is no assurance that these efforts will be successful or that we will be able to satisfy constantly changing customer demands. To the extent our decisions regarding our merchandise differ from our customers' preferences, we may be faced with reduced sales and excess inventories for some products and/or missed opportunities for others. Any sustained failure to identify and respond to emerging trends in lifestyle and customer preferences and buying trends could have an adverse impact on our business. In addition, merchandise misjudgments may adversely impact the perception or reputation of our Company, which could result in declines in customer loyalty and vendor relationship issues, and ultimately have a material adverse effect on our business, financial condition and results of operations.

Our results may be negatively impacted if customers do not maintain their favorable perception of our Company and our private brand merchandise.

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

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

Customer traffic depends upon our ability to successfully market compelling merchandise assortments as well as present an appealing shopping environment and experience to customers. Our strategies focus on increasing customer traffic and improving conversion in our stores and online; however, there can be no assurance that our efforts will be successful or will result in increased sales. In addition, external events outside of our control, including pandemics, terrorist threats, domestic conflicts and civil unrest, may influence customers' decisions to visit malls or might

otherwise cause customers to avoid public places. There is no assurance that we will be able to reverse any decline in traffic or that increases in Internet sales will offset any decline in store traffic. We may need to respond to any declines in customer traffic or conversion rates by increasing markdowns or promotions to attract customers, which could adversely impact our gross margins, operating results and cash flows from operating activities.

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

Our profitability depends upon our ability to manage appropriate inventory levels and respond quickly to shifts in consumer demand patterns. We must properly execute our inventory management strategies by appropriately allocating merchandise among our stores and online, timely and efficiently distributing inventory to stores, maintaining an appropriate mix and level of inventory in stores and online, adjusting our merchandise mix between our private and exclusive brands and national brands, appropriately changing the allocation of floor space of stores among product categories to respond to customer demand and

## Table of Contents

effectively managing pricing and markdowns. If we overestimate customer demand for our merchandise, we will likely need to record inventory markdowns and sell the excess inventory at clearance prices which would negatively impact our gross margins and operating results. If we underestimate customer demand for our merchandise, we may experience inventory shortages which may result in missed sales opportunities and have a negative impact on customer loyalty.

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

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

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

Our results depend on the contributions of our employees, including our senior management team and other key employees. This depends to a great extent on our ability to retain, attract and motivate talented employees throughout the organization, many of whom, particularly in the stores, are in entry level or part-time positions, which have historically had high rates of turnover. We currently operate with significantly fewer individuals than we have in the past who have assumed additional duties and responsibilities, which could have an adverse impact on our operating performance and efficiency. Because of our lower than expected operating results in prior years, salary increases, bonuses and incentive compensation opportunities have been limited. Any prolonged inability to provide meaningful salary increases or incentive compensation opportunities, or media reports regarding our financial condition, could have an adverse impact on our ability to attract, retain and motivate our employees. If we are unable to retain, attract and motivate talented employees with the appropriate skill sets, we may not achieve our objectives and our results of operations could be adversely impacted. Our ability to meet our changing labor needs while controlling our costs is also subject to external factors such as unemployment levels, competing wages and potential union organizing efforts. An inability to provide wages and/or benefits that are competitive within the markets in which we operate could adversely affect our ability to retain and attract employees. In addition, the loss of one or more of our key personnel or the inability to effectively identify a suitable successor to a key role in our senior management could have a material adverse effect on our business.

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

We sell merchandise over the Internet through our website, [www.jcpenney.com](http://www.jcpenney.com), and through a mobile application for phones and tablets. Our Internet operations are subject to numerous risks, including rapid technological change and

the implementation of new systems and platforms; liability for online and mobile content; violations of state or federal laws, including those relating to online and mobile privacy and intellectual property rights; credit card fraud; problems associated with the operation and security of our website and related support systems; computer viruses; telecommunications failures; electronic break-ins and similar disruptions; and the allocation of inventory between our website and department stores. The failure of our website or mobile application to perform as expected could result in disruptions and costs to our operations and make it more difficult for customers to purchase merchandise online. In addition, our inability to successfully develop and maintain the necessary technological interfaces for our customers to purchase merchandise through our website, including user friendly software applications for smart phones and tablets, could result in the loss of Internet sales and have an adverse impact on our results of operations.

## Table of Contents

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

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

We have implemented several products from third party vendors to simplify our processes and reduce our use of customized existing legacy systems and expect to place additional applications into operation in the future. Implementing new systems carries substantial risk, including implementation delays, cost overruns, disruption of operations, potential loss of data or information, lower customer satisfaction resulting in lost customers or sales, inability to deliver merchandise to our stores or our customers, the potential inability to meet reporting requirements and unintentional security vulnerabilities. There can be no assurances that we will successfully launch the new systems as planned, that the new systems will perform as expected or that the new systems will be implemented without disruptions to our operations, any of which may cause critical information upon which we rely to be delayed, unreliable, corrupted, insufficient or inaccessible.

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

Our vendors are also highly dependent on the use of information technology systems. Major disruptions in their information technology systems could result in their inability to communicate with us or otherwise to process our transactions or information, their inability to perform required functions, or in the loss or corruption of our information, any and all of which could result in disruptions to our operations. Our vendors are responsible for having safeguards and procedures in place to protect the confidentiality, integrity and security of our information, and to protect our information and systems against unauthorized access, disclosure or acquisition. Any failure in their systems to operate or in their ability to protect our information or systems could have a material adverse impact on our business and results of operations.

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

The credit rating agencies periodically review our capital structure and the quality and stability of our earnings, as a result of which we have experienced multiple corporate credit ratings downgrades. These downgrades, and any future downgrades, to our long-term credit ratings could result in reduced access to the credit and capital markets and higher interest costs on future financings. The future availability of financing will depend on a variety of factors, such as economic and market conditions, the availability of credit and our credit ratings, as well as the possibility that lenders could develop a negative perception of us. There is no assurance that we will be able to obtain additional financing, on favorable terms or at all.

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

Our merchandise is sourced from a wide variety of suppliers, and our business depends on being able to find qualified suppliers and access products in a timely and efficient manner. Inflationary pressures on commodity prices and other input costs could increase our cost of goods, and an inability to pass such cost increases on to our customers or a change in our merchandise mix as a result of such cost increases could have an adverse impact on our profitability.



Additionally, the impact of economic conditions on our suppliers cannot be predicted and our suppliers may be unable to access financing or become insolvent and thus become unable to supply us with products.

Table of Contents

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.

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

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

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

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

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

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

In June 2014, we entered into a new \$2.35 billion senior secured asset-based revolving credit and term loan facility. Our borrowing capacity under our revolving credit facility varies according to the Company's inventory levels, accounts receivable and credit card receivables, net of certain reserves. In the event of any material decrease in the amount of or appraised value of these assets, our borrowing capacity would similarly decrease, which could adversely

impact our business and liquidity.

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

Our obligations under the revolving credit facility are secured by liens with respect to inventory, accounts receivable, deposit accounts and certain related collateral. In the event of a default that is not cured or waived within any applicable cure periods, the lenders' commitment to extend further credit under our revolving credit facility could be terminated, our outstanding obligations could become immediately due and payable, outstanding letters of credit may be required to be cash collateralized and remedies may be exercised against the collateral, which generally consists of the Company's inventory, accounts receivable and deposit accounts and cash credited thereto. If we are unable to borrow under our revolving credit facility, we may not have

## Table of Contents

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 January 31, 2015, we have \$5.416 billion in total indebtedness and we are highly leveraged. Our level of indebtedness may limit our ability to obtain additional financing, if needed, to fund additional projects, working capital requirements, capital expenditures, debt service, and other general corporate or other obligations, as well as increase the risks to our business associated with general adverse economic and industry conditions. Our level of indebtedness may also place us at a competitive disadvantage to our competitors that are not as highly leveraged.

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

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

There is no assurance that our internal and external sources of liquidity will at all times be sufficient for our cash requirements.

We must have sufficient sources of liquidity to fund our working capital requirements, capital improvement plans, service our outstanding indebtedness and finance investment opportunities. The principal sources of our liquidity are funds generated from operating activities, available cash and cash equivalents, borrowings under our credit facilities, other debt financings, equity financings and sales of non-operating assets. We expect our ability to generate cash through the sale of non-operating assets to diminish as our portfolio of non-operating assets decreases. In addition, our recent operating losses have limited our capital resources. Our ability to achieve our business and cash flow plans is based on a number of assumptions which involve significant judgments and estimates of future performance, borrowing capacity and credit availability, which cannot at all times be assured. Accordingly, there is no assurance that cash flows from operations and other internal and external sources of liquidity will at all times be sufficient for our cash requirements. If necessary, we may need to consider actions and steps to improve our cash position and mitigate any potential liquidity shortfall, such as modifying our business plan, pursuing additional financing to the extent available, reducing capital expenditures, pursuing and evaluating other alternatives and opportunities to obtain additional sources of liquidity and other potential actions to reduce costs. There can be no assurance that any of these actions would be successful, sufficient or available on favorable terms. Any inability to generate or obtain sufficient levels of liquidity to meet our cash requirements at the level and times needed could have a material adverse impact on our business and financial position.

Our ability to obtain any additional financing or any refinancing of our debt, if needed at any time, depends upon many factors, including our existing level of indebtedness and restrictions in our debt facilities, historical business performance, financial projections, prospects and creditworthiness and external economic conditions and general liquidity in the credit and capital markets. Any additional debt, equity or equity-linked financing may require modification of our existing debt agreements, which there is no assurance would be obtainable. Any additional

financing or refinancing could also be extended only at higher costs and require us to satisfy more restrictive covenants, which could further limit or restrict our business and results of operations, or be dilutive to our stockholders.

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

## Table of Contents

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.

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

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

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

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

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

Political or financial instability, trade restrictions, tariffs, currency exchange rates, labor conditions, congestion and labor issues at major ports, transport capacity and costs, systems issues, problems in third party distribution and warehousing and other interruptions of the supply chain, compliance with U.S. and foreign laws and regulations and

other factors relating to international trade and imported merchandise beyond our control could affect the availability and the price of our inventory. These risks and other factors relating to foreign trade could subject us to liability or hinder our ability to access suitable merchandise on acceptable terms, which could adversely impact our results of operations.

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

We ship the majority of our private brand merchandise by ocean to ports in the United States. Our national brand suppliers also ship merchandise by ocean. Disruptions in the operations of ports through which we import our merchandise, including but not

## Table of Contents

limited to labor disputes involving work slowdowns, lockouts or strikes, could require us and/or our vendors to ship merchandise by air freight or to alternative ports in the United States. Shipping by air is significantly more expensive than shipping by ocean which could adversely affect our profitability. Similarly, shipping to alternative ports in the United States could result in increased lead times and transportation costs. Disruptions at ports through which we import our goods could also result in unanticipated inventory shortages, which could adversely impact our reputation and our results of operations.

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

Our results of operations are sensitive to changes in overall economic and political conditions that impact consumer spending, including discretionary spending. Many economic factors outside of our control, including the housing market, interest rates, recession, inflation and deflation, energy costs and availability, consumer credit availability and terms, consumer debt levels, tax rates and policy, and unemployment trends influence consumer confidence and spending. The domestic and international political situation and actions also affect consumer confidence and spending. In particular, the moderate income consumer, which is our core customer, has been under economic pressure for the past several years, and may have less disposable income for items such as apparel and home goods. Additional events that could impact our performance include pandemics, terrorist threats and activities, worldwide military and domestic disturbances and conflicts, political instability and civil unrest. Declines in the level of consumer spending could adversely affect our growth and profitability.

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

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

Our profitability may be impacted by weather conditions.

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

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

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



health care mandates, among others, could also cause our compliance costs to increase and adversely affect our business and results of operations.

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

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

## Table of Contents

whether the claims are meritorious, legal and regulatory proceedings may require that we devote substantial time and expense to defend our Company. Unfavorable rulings could result in a material adverse impact on our business, financial condition or results of operations.

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

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

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

The market price of our common stock has fluctuated substantially and may continue to fluctuate significantly. Future announcements or disclosures concerning us or any of our competitors, our strategic initiatives, our sales and profitability, our financial condition, any quarterly variations in actual or anticipated operating results or comparable sales, any failure to meet analysts' expectations and sales of large blocks of our common stock, among other factors, could cause the market price of our common stock to fluctuate substantially. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many retail and other stocks that have often been unrelated or disproportionate to the operating performance of these companies. This volatility could affect the price at which you could sell shares of our common stock.

Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. The Company and certain of our current and former members of the Board of Directors and executives are defendants in a consolidated class action lawsuit and two related shareholder derivative actions that were filed following our announcement of an issuance of common stock on September 26, 2013. An additional class action complaint regarding the same announcement was also recently filed. Such litigation could result in substantial costs, divert our management's attention and resources and have an adverse effect on our business, results of operations and financial condition.

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

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

Section 382 of the Internal Revenue Code of 1986, as amended (the Code) imposes an annual limitation on the amount of taxable income that may be offset by a corporation's NOLs if the corporation experiences an "ownership change" as defined in Section 382 of the Code. An ownership change occurs when the Company's "five-percent

shareholders” (as defined in Section 382 of the Code) collectively increase their ownership in the Company by more than 50 percentage points (by value) over a rolling three-year period. Additionally, various states have similar limitations on the use of state NOLs following an ownership change.

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

Table of Contents

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 March 9, 2015, the Company has not had a Section 382 ownership change through March 9, 2015.

If an ownership change should occur in the future, the Company's ability to use the NOL to offset future taxable income will be subject to an annual limitation and will depend on the amount of taxable income generated by the Company in future periods. There is no assurance that the Company will be able to fully utilize the NOL and the Company could be required to record an additional valuation allowance related to the amount of the NOL that may not be realized, which could impact the Company's result of operations.

We believe that these NOL carryforwards are a valuable asset for us. Consequently, we have a stockholder rights plan in place, which was approved by the Company's stockholders, to protect our NOLs during the effective period of the rights plan. Although the rights plan is intended to reduce the likelihood of an "ownership change" that could adversely affect us, there is no assurance that the restrictions on transferability in the rights plan will prevent all transfers that could result in such an "ownership change".

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

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

Item 1B. Unresolved Staff Comments

None.

Table of Contents

## Item 2. Properties

At January 31, 2015, we operated 1,062 department stores throughout the continental United States, Alaska and Puerto Rico, of which 425 were owned, including 122 stores located on ground leases. The following table lists the number of stores operating by state as of January 31, 2015:

Alabama	21	Maine	6	Oklahoma	19
Alaska	1	Maryland	18	Oregon	14
Arizona	22	Massachusetts	13	Pennsylvania	40
Arkansas	16	Michigan	42	Rhode Island	3
California	80	Minnesota	25	South Carolina	18
Colorado	21	Mississippi	15	South Dakota	8
Connecticut	8	Missouri	26	Tennessee	25
Delaware	3	Montana	7	Texas	92
Florida	55	Nebraska	11	Utah	9
Georgia	30	Nevada	7	Vermont	6
Idaho	9	New Hampshire	9	Virginia	26
Illinois	39	New Jersey	15	Washington	22
Indiana	28	New Mexico	10	West Virginia	9
Iowa	18	New York	43	Wisconsin	17
Kansas	19	North Carolina	33	Wyoming	5
Kentucky	22	North Dakota	8	Puerto Rico	7
Louisiana	16	Ohio	46		
Total square feet	107.9 million				

In May 2013, we entered into a \$2.25 billion five-year senior secured term loan that is secured by mortgages on certain real property of the Company, in addition to liens on substantially all personal property of the Company, subject to certain exclusions set forth in the credit and security agreement governing the term loan credit facility and related security documents. The real property subject to mortgages under the term loan credit facility includes our headquarters, distribution centers and certain of our stores.

In January 2015, we announced the closing of 40 underperforming department stores in fiscal 2015. All store closures are expected to be completed throughout 2015 and are included in the list above.

Table of Contents

At January 31, 2015, our supply chain network operated 14 facilities with multiple types of distribution activities, including store merchandise distribution centers (stores), regional warehouses (regional), jcpennney.com fulfillment centers (direct to customers) and furniture distribution centers (furniture) as indicated in the following table:

Location	Leased/Owned	Primary Function(s)	Square Footage (in thousands)
Manchester, Connecticut	Owned	stores, furniture	2,120
Lenexa, Kansas	Owned	stores, direct to customers	1,944
Columbus, Ohio	Owned	stores, direct to customers	1,902
Milwaukee, Wisconsin	Owned	stores, furniture	1,869
Atlanta, Georgia	Owned	stores, regional, furniture	1,764
Reno, Nevada	Owned	stores, regional, direct to customers	1,660
Buena Park, California	Owned	stores, regional, furniture	1,082
Alliance, Texas	Owned	regional	1,071
Statesville, North Carolina	Owned	stores, regional	595
Lathrop, California	Leased	regional	436
Cedar Hill, Texas	Leased	stores	420
Spanish Fork, Utah	Leased	stores	400
Lakeland, Florida	Leased	stores	360
Sumner, Washington <sup>(1)</sup>	Leased	stores	350
Total supply chain network			15,973

(1) Store merchandise distribution center discontinued shipping to stores in January 2015 and will be vacated by the Company in April 2015.

## Table of Contents

### Item 3. Legal Proceedings

#### Macy's Litigation

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

#### Ozenne Derivative Lawsuit

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

#### Class Action Securities Litigation

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

caused our common stock to trade at artificially inflated prices. The consolidated complaint seeks class certification, unspecified compensatory damages, including interest, reasonable costs and expenses, and other relief as the court may deem just and proper. Defendants have filed a motion to dismiss the consolidated complaint. Briefing on the motion to dismiss was completed in November, 2014.

Also, on August 26, 2014, plaintiff Nathan Johnson filed a purported class action lawsuit against the Company, Myron E. Ullman, III and Kenneth H. Hannah in the U.S. District Court, Eastern District of Texas, Tyler Division. The suit is purportedly brought on behalf of persons who acquired our securities other than common stock during the period from August 20, 2013 through September 26, 2013, and alleges claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiff's lawsuit generally mirrors the allegations contained in the Marcus lawsuit discussed above, and seeks similar relief. On November 11, 2014, defendants filed an unopposed motion to consolidate this lawsuit with the Marcus lawsuit. On November 18, 2014, plaintiff filed a motion for appointment of lead plaintiff. On



## Table of Contents

December 5, 2014, the lead plaintiff in the Marcus lawsuit filed an opposition to the plaintiff's motion for appointment of lead plaintiff.

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

### Shareholder Derivative Litigation

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

### ERISA Class Action Litigation

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

### Employment Class Action Litigation

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

of all employees in California and Illinois based on the specific claims at issue. On December 17, 2014, the California court granted plaintiffs' request for class certification. The Illinois court has not yet ruled on plaintiffs' motion for class certification. We believe these lawsuits are without merit and we intend to continue to vigorously defend these lawsuits. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Table of Contents

Other Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents

## PART II

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

## Market for Registrant's Common Equity

Our common stock is traded principally on the New York Stock Exchange (NYSE) under the symbol "JCP." The number of stockholders of record at March 16, 2015, was 26,540. In addition to common stock, we have authorized 25 million shares of preferred stock, of which no shares were issued and outstanding at January 31, 2015.

The table below sets forth the quoted high and low intraday sale prices of our common stock on the NYSE for each quarterly period indicated and the quarter-end closing market price of our common stock:

Fiscal Year 2014	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price:				
High	\$9.28	\$9.93	\$11.30	\$8.30
Low	\$4.90	\$8.03	\$6.73	\$5.90
Close	\$8.58	\$9.63	\$7.61	\$7.27
Fiscal Year 2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price:				
High	\$23.10	\$19.63	\$14.65	\$10.30
Low	\$13.55	\$13.97	\$6.24	\$5.68
Close	\$17.26	\$14.28	\$8.14	\$5.92

Since May 2012, the Company has not paid a dividend. Under our 2013 senior secured term loan and 2014 senior asset-based credit facility, we are subject to restrictive covenants regarding our ability to pay cash dividends.

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

## Issuer Purchases of Securities

No repurchases of common stock were made during the fourth quarter of 2014 and no amounts remained authorized for share repurchases as of January 31, 2015.

Table of Contents

## Five-Year Total Stockholder Return Comparison

The following presentation compares our cumulative stockholder returns for the past five fiscal years with the returns of the S&P 500 Stock Index and the S&P 500 Retail Index for Department Stores over the same period. A list of these companies follows the graph below. The graph assumes \$100 invested at the closing price of our common stock on the NYSE and each index as of the last trading day of our fiscal year 2009 and assumes that all dividends were reinvested on the date paid. The points on the graph represent fiscal year-end amounts based on the last trading day of each fiscal year. The following graph and related information shall not be deemed “soliciting material” or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

S&P Department Stores:

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

	2009	2010	2011	2012	2013	2014
JCPenney	\$100	\$134	\$176	\$85	\$25	\$31
S&P 500	100	121	128	150	181	206
S&P Department Stores	100	115	130	134	155	194

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

Table of Contents

## Item 6. Selected Financial Data

## Five-Year Financial Summary

(\$ in millions, except per share data)	2014	2013	2012	2011	2010
Results for the year					
Total net sales	\$12,257	\$11,859	\$12,985	\$17,260	\$17,759
Sales percent increase/(decrease):					
Total net sales	3.4 %	(8.7 )%	(24.8 )%	(2.8 )%	1.2 %
Comparable store sales <sup>(2)</sup>	4.4 %	(7.4 )%	(25.1 )%	0.3 %	2.6 %
Operating income/(loss)	(308 )	(1,420 )	(1,310 )	(2 )	832
As a percent of sales	(2.5 )%	(12.0 )%	(10.1 )%	0.0 %	4.7 %
Net income/(loss) from continuing operations	(771 )	(1,388 )	(985 )	(152 )	378
Net income/(loss) from continuing operations before net interest expense, income tax (benefit)/expense and depreciation and amortization (EBITDA) (non-GAAP) <sup>(3)</sup>	323	(819 )	(767 )	516	1,343
Adjusted EBITDA (non-GAAP) <sup>(3)</sup>	242	(636 )	(396 )	1,054	1,596
Adjusted net income/(loss) (non-GAAP) from continuing operations <sup>(3)</sup>	(816 )	(1,431 )	(766 )	207	533
Per common share					
Earnings/(loss) per share from continuing operations, diluted	\$(2.53 )	\$(5.57 )	\$(4.49 )	\$(0.70 )	\$1.59
Adjusted earnings/(loss) per share from continuing operations, diluted (non-GAAP) <sup>(3)</sup>	\$(2.67 )	\$(5.74 )	\$(3.49 )	\$0.94	<sup>(4)</sup> \$2.24
Dividends declared <sup>(5)</sup>	—	—	0.20	0.80	0.80
Financial position and cash flow					
Total assets	\$10,404	\$11,801	\$9,781	\$11,424	\$13,068
Cash and cash equivalents	1,318	1,515	930	1,507	2,622
Total debt, including capital leases and note payable	5,416	5,601	2,982	3,102	3,099
Free cash flow (non-GAAP) <sup>(3)</sup>	57	(2,746 )	(906 )	23	158

(1) Includes the effect of the 53rd week in 2012. Excluding sales of \$163 million for the 53rd week in 2012, total net sales decreased 7.5% and 25.7% in 2013 and 2012, respectively.

Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Beginning in 2014, the Company simplified its comparable store sales calculation to better reflect year-over-year comparability. Certain items, such as sales return estimates and store liquidation sales, are now excluded from the Company's calculation. Prior periods have been adjusted to reflect this new methodology. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

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

(3) Weighted average shares—diluted of 220.7 million was used for this calculation as adjusted income/(loss) from continuing operations was positive. 3.3 million shares were added to weighted average shares—basic of 217.4 million

for assumed dilution for stock options, restricted stock awards and stock warrant.

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

Table of Contents

## Five-Year Operations Summary

	2014	2013	2012	2011	2010
Number of department stores:					
Beginning of year	1,094	1,104	1,102	1,106	1,108
Openings	1	—	9	(1) 3	2
Closings	(33)	(10)	(7)	(1) (7)	(4)
End of year	1,062	1,094	1,104	1,102	1,106
Gross selling space (square feet in millions)	107.9	110.6	111.6	111.2	111.6
Sales per gross square foot <sup>(2)</sup>	\$113	\$107	\$116	\$154	\$153
Sales per net selling square foot <sup>(2)</sup>	\$155	\$147	\$161	\$212	\$210

Number of the Foundry Big and Tall Supply Co. stores<sup>(3)</sup> — 10 10 10 —

(1) Includes 3 relocations.

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

(3) All stores opened during 2011 and closed during 2014. Gross selling space was 51 thousand square feet as of the end of 2013, 2012 and 2011.

## Non-GAAP Financial Measures

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

The following non-GAAP financial measures are adjusted to exclude the impact of markdowns related to the alignment of inventory with our prior strategy, restructuring and management transition charges, the impact of our qualified defined benefit pension plan (Primary Pension Plan), the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from our joint venture formed to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture) and the tax impact related to the allocation of tax expense to other comprehensive income items. Unlike other operating expenses, the impact of markdowns related to the alignment of inventory with our prior strategy, restructuring and management transition charges, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from the Home Office Land Joint Venture and the tax impact related to the allocation of tax expense to other comprehensive income items 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 markdowns related to the alignment of inventory with our prior strategy, restructuring and management transition charges, Primary Pension Plan expense/(income), the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from the Home Office Land Joint



Venture and the tax impact related to the allocation of tax expense to other comprehensive income items on our financial results and therefore are presenting the following non-GAAP financial measures: (1) adjusted EBITDA; (2) adjusted net income/(loss); and (3) adjusted earnings/(loss) per share-diluted.

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

Table of Contents

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

(\$ in millions)	2014	2013	2012	2011	2010
Net income/(loss) from continuing operations	\$(771 )	\$(1,388 )	\$(985 )	\$(152 )	\$378
Add: Net interest expense	406	352	226	227	231
Add: Loss on extinguishment of debt	34	114	—	—	20
Total interest expense	440	466	226	227	251
Add: Income tax expense/(benefit)	23	(498 )	(551 )	(77 )	203
Add: Depreciation and amortization	631	601	543	518	511
EBITDA (non-GAAP)	323	(819 )	(767 )	516	1,343
Add: Markdowns - inventory strategy alignment	—	—	155	—	—
Add: Restructuring and management transition charges	87	215	298	451	32
Add: Primary pension plan expense/(income)	(2 )	100	315	87	221
Less: Net gain on the sale of non-operating assets	(25 )	(132 )	(397 )	—	—
Less: Proportional share of net income from home office land joint venture	(53 )	—	—	—	—
Less: Certain net gains	(88 )	(1)	—	—	—
Adjusted EBITDA (non-GAAP)	\$242	\$(636 )	\$(396 )	\$1,054	\$1,596

(1) Represents the net gain on the sale of one department store location and the net gain recognized on a payment received from a landlord to terminate an existing lease prior to its original expiration date.

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

(\$ in millions, except per share data)	2014	2013	2012	2011	2010	
Net income/(loss) (GAAP) from continuing operations	\$(771 )	\$(1,388 )	\$(985 )	\$(152 )	\$378	
Diluted EPS (GAAP) from continuing operations	\$(2.53 )	\$(5.57 )	\$(4.49 )	\$(0.70 )	\$1.59	
Add: markdowns - inventory strategy alignment, net of tax of \$-, \$-, \$60, \$- and \$-	—	—	95	(1) —	—	
Add: restructuring and management transition charges, net of tax of \$-, \$28, \$116, \$145 and \$12	87	(2) 187	(3) 182	(1) 306	(4) 20	(1)
Add/(deduct): primary pension plan expense/(income), net of tax of \$-, \$10, \$122, \$34, (2) and \$86	(2) 90	(5)(6) 193	(1) 53	(1) 135	(1)	(1)
Add: Loss on extinguishment of debt, net of tax of \$-, \$-, \$-, \$- and \$-	34	(2) 114	(2) —	—	—	—
Less: Net gain on sale or redemption of non-operating assets, net of tax of \$-, \$1, \$146, \$- and \$-	(25 )	(2) (131 )	(7) (251 )	(4) —	—	—
Less: Proportional share of net income from home office land joint venture, net of tax of \$-, \$-, \$-, \$- and \$-	(53 )	(2) —	—	—	—	—
Less: Certain net gains, net of tax of \$2, \$-, \$-, \$- and \$-	(86 )	(7) —	—	—	—	—
	—	(303 )	(8) —	—	—	—

Less: Tax benefit resulting from other  
comprehensive income allocation

Adjusted net income/(loss) (non-GAAP) from continuing operations	\$(816 )	\$(1,431 )	\$(766 )	\$207	\$533
Adjusted diluted EPS (non-GAAP) from continuing operations	\$(2.67 )	\$(5.74 )	\$(3.49 )	\$0.94	<sup>(9)</sup> \$2.24

(1) Tax effect was calculated using the Company's statutory rate of  
38.82%.

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

Table of Contents

(3) Tax effect for the three months ended May 4, 2013 was calculated using the Company's statutory rate of 38.82%.

The last nine months of 2013 reflects no tax effect due to the impact of the Company's tax valuation allowance.

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

(5) Tax benefit for the last nine months of 2013 is included in the line item Tax benefit resulting from other comprehensive income allocation. See footnote 8 below.

(6) Tax effect for the three months ended May 4, 2013 was calculated using the Company's statutory rate of 38.82%.

(7) Tax effect represents state taxes payable in separately filing states related to the sale of assets.

Represents the tax benefits related to the allocation of tax expense to other comprehensive income items, including the amortization of actuarial losses and prior service costs related to the Primary Pension Plan and the results of our annual remeasurement of our pension plans.

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

## Free Cash Flow

Free cash flow is a key financial measure of our ability to generate additional cash from operating our business. We define free cash flow as cash flow from operating activities, less capital expenditures and dividends paid, plus the proceeds from the sale of operating assets. Free cash flow is a relevant indicator of our ability to repay maturing debt, revise our dividend policy or fund other uses of capital that we believe will enhance stockholder value. Free cash flow is considered a non-GAAP financial measure under the rules of the SEC. Free cash flow is limited and does not represent remaining cash flow available for discretionary expenditures due to the fact that the measure does not deduct payments required for debt maturities, pay-down of pension debt, and other obligations or payments made for business acquisitions. Therefore, it is important to view free cash flow in addition to, rather than as a substitute for, our entire statement of cash flows and those measures prepared in accordance with GAAP.

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

(\$ in millions)	2014	2013	2012	2011	2010
Net cash provided by/(used in) operating activities (GAAP)	\$239	\$(1,814 )	\$(10 )	\$820	\$592
Less:					
Capital expenditures	(252 )	(951 )	(810 )	(634 )	(499 )
Dividends paid, common stock	—	—	(86 )	(178 )	(189 )
Tax benefit from pension contribution	—	—	—	—	(152 )
Plus:					
Discretionary cash pension contribution	—	—	—	—	392
Proceeds from sale of operating assets	70	19	—	15	14
Free cash flow (non-GAAP)	\$57	\$(2,746 )	\$(906 )	\$23	\$158

Table of Contents

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

The following discussion, which presents our results, should be read in conjunction with the accompanying Consolidated Financial Statements and notes thereto, along with the Five-Year Financial and Operations Summaries, the risk factors and the cautionary statement regarding forward-looking information. Unless otherwise indicated, all references in this Management's Discussion and Analysis (MD&A) related 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.

2014 Executive Overview

Sales were \$12,257 million, an increase of 3.4% as compared to 2013, and comparable store sales increased 4.4%.

Gross margin as a percentage of sales was 34.8% compared to 29.4% last year. The increase in gross margin as a percentage of sales is primarily due to the decrease in clearance sales as a percentage of total sales and an increase in margin on those clearance sales over the prior year.

Selling, general and administrative (SG&A) expenses decreased \$121 million, or 2.9%, as compared to 2013.

Our net loss was \$771 million, or \$2.53 per share, compared to a net loss of \$1,388 million, or \$5.57 per share, in 2013. Results for 2014 included the following amounts that are not directly related to our ongoing core business operations:

\$87 million, or \$0.29 per share, of restructuring and management transition charges;  
\$2 million of income, or \$0.01 per share, for the impact of our qualified defined benefit pension plan (Primary Pension Plan) expense;  
\$34 million, or \$0.11 per share, for the loss on extinguishment of debt;  
\$25 million, or \$0.08 per share, for the net gain on the sale or redemption of non-operating assets;  
\$53 million, or \$0.17 per share, for our proportional share of net income from our joint venture formed to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture); and  
\$88 million, or \$0.28 per share, for certain net gains.

Net income/(loss) from continuing operations before net interest expense, income tax (benefit)/expense and depreciation and amortization (EBITDA) was a positive \$323 million for 2014, an improvement of over \$1.1 billion compared to a negative EBITDA of \$819 million in 2013. Adjusted EBITDA, adjusted for the amounts disclosed above that are not directly related to our ongoing core business operations, was a positive \$242 million for 2014 compared to a negative adjusted EBITDA of \$636 million in 2013.

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million senior asset-based credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and a \$500 million term loan (2014 Term Loan).

During the third quarter of 2014, we completed an offering of \$400 million aggregate principal amount of 8.125% Senior Unsecured Notes due 2019 (2019 Notes). The majority of the net proceeds of the offering were used to pay the tender consideration and related transaction fees and expenses for our contemporaneous cash tender offers (2014 Tender Offers) for \$327 million aggregate principal amount of our outstanding 6.875% Medium-Term Notes due 2015 (2015 Notes), 7.65% Debentures due 2016 (2016 Notes) and 7.95% Debentures due 2017 (2017 Notes).

In October 2014, subsequent to the completion of the 2014 Tender Offers, we used \$64 million of available cash to effect a legal defeasance of the remaining outstanding principal amount of 2015 Notes by depositing funds with the

Trustee for the 2015 Notes sufficient to make all payments of interest and principal on the outstanding 2015 Notes to the stated maturity of October 15, 2015.

Effective November 1, 2014, the Board of Directors (Board) elected Marvin R. Ellison as President and CEO-Designee and a Director of the Company. He will succeed Myron E. Ullman, III as CEO of the Company on August 1, 2015. At that time, Mr. Ullman will become Executive Chairman of the Board for a period of one year.

Table of Contents

## Results of Operations

## Three-Year Comparison of Operating Performance

(in millions, except per share data)	2014		2013		2012	
Total net sales	\$12,257		\$11,859		\$12,985	
Percent increase/(decrease) from prior year	3.4	%	(8.7)	)% <sup>(1)</sup>	(24.8)	)% <sup>(1)</sup>
Comparable store sales increase/(decrease) <sup>(2)</sup>	4.4	%	(7.4)	)%	(25.1)	)%
Gross margin	4,261		3,492		4,066	
Operating expenses/(income):						
Selling, general and administrative	3,993		4,114		4,506	
Pension	6		137		353	
Depreciation and amortization	631		601		543	
Real estate and other, net	(148)	)	(155)	)	(324)	)
Restructuring and management transition	87		215		298	
Total operating expenses	4,569		4,912		5,376	
Operating income/(loss)	(308)	)	(1,420)	)	(1,310)	)
As a percent of sales	(2.5)	)%	(12.0)	)%	(10.1)	)%
Loss on extinguishment of debt	34		114		—	
Net interest expense	406		352		226	
Income/(loss) before income taxes	(748)	)	(1,886)	)	(1,536)	)
Income tax (benefit)/expense	23		(498)	)	(551)	)
Net income/(loss)	\$(771)	)	\$(1,388)	)	\$(985)	)
EBITDA <sup>(3)</sup>	\$323		\$(819)	)	\$(767)	)
Adjusted EBITDA <sup>(3)</sup>	\$242		\$(636)	)	\$(396)	)
Adjusted net income/(loss) (non-GAAP) <sup>(3)</sup>	\$(816)	)	\$(1,431)	)	\$(766)	)
Diluted EPS	\$(2.53)	)	\$(5.57)	)	\$(4.49)	)
Adjusted diluted EPS (non-GAAP) <sup>(3)</sup>	\$(2.67)	)	\$(5.74)	)	\$(3.49)	)
Weighted average shares used for diluted EPS	305.2		249.3		219.2	

(1) Includes the effect of the 53rd week in 2012. Excluding sales of \$163 million for the 53rd week in 2012, total net sales decreased 7.5% and 25.7% in 2013 and 2012, respectively.

Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Beginning in 2014, the Company simplified its comparable store sales calculation to better reflect year-over-year comparability. Certain items, such as sales return estimates and store liquidation sales, are now excluded from the Company's calculation. Prior periods have been adjusted to reflect this new methodology. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

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

## 2014 Compared to 2013

## Total Net Sales

Our year-to-year change in total net sales is comprised of (a) sales from new stores net of closings and relocations, referred to as non-comparable store sales (b) sales of stores opened in both years as well as Internet sales, referred to as comparable store sales and (c) other revenue adjustments such as sales return estimates and store liquidation sales. We consider comparable store sales to be a key indicator of our current performance measuring the growth in sales and sales productivity of existing stores. Positive comparable store sales contribute to greater leveraging of operating

costs, particularly payroll and occupancy costs, while negative comparable store sales contribute to de-leveraging of costs. Comparable store sales also have a direct impact on our total net sales and the level of cash flow.



Table of Contents

	2014	2013
Total net sales (in millions)	\$ 12,257	\$ 11,859
Sales percent increase/(decrease)		
Total net sales <sup>(1)</sup>	3.4	% (8.7 )% <sup>(1)</sup>
Comparable store sales <sup>(2)</sup>	4.4	% (7.4 )%
Sales per gross square foot <sup>(3)</sup>	\$ 113	\$ 107

(1) Includes the effect of the 53rd week in 2012. Excluding sales of \$163 million for the 53rd week in 2012, total net sales decreased 7.5% in 2013.

Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Beginning in 2014, the Company simplified its comparable store sales calculation to better reflect year-over-year comparability. Certain items, such as sales return estimates and store liquidation sales, are now excluded from the Company's calculation. Prior periods have been adjusted to reflect this new methodology. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

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

Total net sales increased \$398 million in 2014 compared to 2013. The following table provides the components of the net sales increase:

(\$ in millions)	2014
Comparable store sales, including Internet	\$508
Sales of closed (non-comparable) stores, net	(90 )
Other revenues and sales adjustments	(20 )
Total net sales increase/(decrease)	\$398

In 2014, comparable store sales increased 4.4%. Total net sales increased 3.4% to \$12,257 million compared with \$11,859 million in 2013 and Internet sales increased 13.4% to \$1,225 million.

Both total net sales and comparable store sales increased during 2014 as we gained market share in a highly competitive environment. Internet sales grew at a faster rate compared to our department stores and were positively impacted by our new mobile application that creates an enhanced digital experience. In addition, we continue to move closer to a true omni-channel state with our continuation of "ship to stores" and "ship from stores" and our planned roll out in 2015 of "pick up in store same day".

Based on a sample of our mall and off-mall stores, our store traffic, while negative for 2014, improved sequentially each quarter. Additionally, conversion improved for 2014 as compared to the prior year. For 2014, the average transaction value and average unit retail increased, while the units per transaction decreased as compared to the prior year. All geographic regions experienced sales increases for 2014 compared to the prior year. During 2014, most of our divisions experienced a sales increase, with our home and women's accessories divisions, including Sephora, which reflected the addition of 46 Sephora inside JCPenney locations, experiencing the highest sales increases. Our childrens and footwear divisions were the only divisions that experienced sales declines.

**Gross Margin**

Gross margin is a measure of profitability of a retail company at the most fundamental level of buying and selling merchandise and measures a company's ability to effectively manage the total costs of sourcing and allocating merchandise against the corresponding retail pricing. Gross margins not only cover marketing, selling and other

operating expenses, but also must include a profit element. Gross margin is the difference between total net sales and cost of the merchandise sold and is typically expressed as a percentage of total net sales. The cost of merchandise sold includes all direct costs of bringing merchandise to its final selling destination.

Table of Contents

These costs include:

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

Gross margin increased to 34.8% of sales in 2014, or 540 basis points, compared to 2013. On a dollar basis, gross margin increased \$769 million, or 22.0%, to \$4,261 million in 2014 compared to \$3,492 million in the prior year. The net 540 basis point increase resulted primarily from the change in merchandise mix largely related to better clearance sales performance as a result of fewer units of clearance merchandise sold at higher clearance margins and higher re-ticketing costs in the prior year as a result of moving back to a promotional strategy.

#### SG&A Expenses

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

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

SG&A expenses declined \$121 million to \$3,993 million in 2014 compared to \$4,114 million in 2013. As a percent of sales, SG&A expenses were 32.6% compared to 34.7% in the prior year. The net 210 basis point decrease primarily resulted from lower store expenses, advertising costs and corporate overhead throughout the period and higher income from the JCPenney private label credit card activities, which is recorded as a reduction of our SG&A expenses. These decreases were slightly offset by an increase in incentive compensation.

#### Pension Expense

(\$ in millions)	2014	2013
Primary pension plan expense/(income)	\$(2	) \$100
Supplemental pension plans expense	8	37
Total pension expense	\$6	\$137

Total pension expense, which consists of our Primary Pension Plan expense and our supplemental pension plans expense, is based on our prior year-end measurement of pension plan assets and benefit obligations. Primary Pension Plan expense for 2014 decreased \$102 million to income of \$2 million, compared with \$100 million of expense in 2013. The change to income for our Primary Pension Plan was primarily a result of improved asset performance in prior periods, higher fair value of plan assets and a 70 basis point increase in our discount rate. During 2014 and 2013, supplemental pension plans expense was \$8 million and \$37 million, respectively. During 2014, we transferred \$56 million of supplemental pension plan benefits, as allowed under the Employee Retirement Income Security Act of 1974, out of our supplemental pension plans and into our Primary Pension Plan. The transfer did not have a significant

impact on our Consolidated Financial Statements; however, the transfer of benefits resulted in a one-time expense of \$15 million to our Primary Pension Plan and an offsetting \$15 million benefit to our supplemental pension plans during 2014.

Table of Contents

Based on our 2014 year-end measurement of Primary Pension Plan assets and benefit obligations, our 2015 Primary Pension Plan expense will change to an expense of \$19 million compared to income of \$2 million in 2014. The increase in pension expense is primarily driven by a 102 basis point decline in our discount rate; the adoption of new mortality tables for the majority of the plan participants which reflect longer life expectations and anticipated rates of improvement in life expectancy compared to previous mortality assumptions; and lowering the expected return on plan assets from 7.0% to 6.75%. These negative impacts were partially offset by strong asset performance in 2014.

**Depreciation and Amortization Expenses**

Depreciation and amortization expense in 2014 increased \$30 million to \$631 million, or 5.0%, compared to \$601 million in 2013. This increase is a result of our investment and replacement of store fixtures in connection with the implementation of our prior strategy. Depreciation and amortization expense for 2013 excludes \$37 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced during 2013 with the build out of our home department and other attractions. These amounts are included in the line Restructuring and management transition in the Consolidated Statements of Operations.

**Real Estate and Other, Net**

Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments and other non-operating charges and credits. In addition, during the first quarter of 2014, we entered into the Home Office Land Joint Venture in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas. The new joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities will be recorded in Real estate and other, net.

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

(\$ in millions)	2014	2013
Gain on sale or redemption of non-operating assets, net:		
Sale of Simon Property Group, L.P. (SPG) real estate investment trusts units (REITs)	\$—	\$(24 )
Sale of investments in joint ventures	—	(85 )
Sale of other non-operating assets	(25 )	(23 )
Net gain on sale or redemption of non-operating assets	(25 )	(132 )
Dividend income from REITs	—	(1 )
Investment income from home office land joint venture	(53 )	—
Investment income from joint ventures	(1 )	(6 )
Net gain from sale of operating assets	(92 )	(17 )
Store impairments	30	18
Intangible asset impairment	—	9
Other	(7 )	(26 )
Total expense/(income)	\$(148 )	\$(155 )

**Monetization of Non-operating Assets**

As part of our strategy to monetize assets that are not core to our operations, during 2014 we generated \$35 million of cash and recognized a net gain of \$25 million from the sale of several non-operating assets. During 2013, we generated \$143 million of cash and recognized a net gain of \$132 million. The monetization of non-operating assets primarily included the following:

**Sale of REIT Asset**

In November 2013, we converted 205,000 REIT units of SPG into SPG shares, which were sold in December 2013 at an average price of \$151.97 per share for a total price of \$31 million, net of fees, and a realized net gain of \$24 million.

#### Sale of Investments in Joint Ventures

During the third quarter of 2013, we sold our investment in three joint ventures for \$32 million, resulting in a net gain of \$23 million. During the second quarter of 2013, we sold our investment in one joint venture for \$55 million, resulting in a net gain of \$62 million. The gain for this transaction exceeded the cash proceeds as a result of distributions of cash related to refinancing activities in prior periods that were recorded as net reductions in the carrying amount of the investment. The net book value of the joint venture investment was a negative \$7 million and was included in Other liabilities in the Consolidated Balance Sheets.

## Table of Contents

### Sale of Other Non-Operating Assets

During the fourth quarter of 2014, we sold two properties used in our former auto center operations and excess property adjacent to our home office facility not contributed to the Home Office Land Joint Venture for net proceeds of \$7 million, resulting in net gains totaling \$2 million.

During the third quarter of 2014, we sold one closed store and one additional property used in our former auto center operations for net proceeds and a gain of \$2 million.

During the second quarter of 2014, we sold four additional properties used in our former auto center operations for net proceeds of \$11 million, resulting in net gains totaling \$9 million.

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

During the fourth quarter of 2013, we sold 10 properties used in our former auto center operations for net proceeds of \$25 million, resulting in net gains totaling \$22 million. During the third quarter of 2013, we sold approximately 10 acres of excess land for net proceeds and a gain of \$1 million.

### Sale of Operating Assets

During the first quarter of 2014, we sold a former department store location with a net book value of \$1 million for net proceeds of \$2 million, realizing a gain of \$1 million. During the third quarter of 2014, we sold three department store locations and recognized a net gain on a payment received from a landlord to terminate an existing lease prior to its original expiration date for total net proceeds of \$66 million and a net gain of \$90 million. During the fourth quarter of 2014, we sold one department store location for net proceeds of \$2 million, resulting in a net gain of \$1 million.

During the first quarter of 2013, we sold our leasehold interest of a former department store location with a net book value of \$2 million for net proceeds of \$18 million, realizing a gain of \$16 million. During the second quarter of 2013, we sold two properties for total net proceeds and a gain of \$1 million.

### Impairments

In 2014, store impairments totaled \$30 million and related to 19 underperforming department stores that continued to operate.

In 2013, store impairments totaled \$18 million and related to 25 underperforming department stores that continued to operate. In addition, during the fourth quarter of 2013, we recorded a \$9 million impairment charge for our ownership of the U.S. and Puerto Rico rights of the monet trade name.

See restructuring and management transition charges below for additional impairments related to stores closed in 2014 and stores scheduled to be closed in 2015.

### Investment Income from Joint Ventures

During the second quarter of 2014, the Company recorded \$43 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$51 million. During the fourth quarter of 2014, the Company recorded \$10 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$7 million.





Table of Contents

## Restructuring and Management Transition Charges

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

(\$ in millions)	2014	2013
Home office and stores	\$45	\$48
Store fixtures	—	55
Management transition	16	37
Other	26	75
Total	\$87	\$215

## Home office and stores

In 2014 and 2013, we recorded \$45 million and \$48 million, respectively, of costs to reduce our store and home office expenses. During the nine months ended November 1, 2014, we recorded \$15 million of charges for actions taken to reduce our home office and store expenses. In January 2015, we announced the closing of 40 department stores, and as a result, during the fourth quarter of 2014, we incurred charges of \$20 million related to asset impairments and \$1 million of employee termination benefit costs. Additionally, we incurred \$9 million of other miscellaneous store restructuring costs during 2014.

During the first three quarters of 2013, we recorded \$26 million of employee termination benefits for both store and home office associates. In addition, in January 2014, we announced a strategic initiative to close 33 underperforming stores as part of our turnaround efforts. In conjunction with this initiative, during the fourth quarter of 2013, we incurred charges of \$21 million related to asset impairments and \$1 million of employee termination benefit costs.

## Store Fixtures

During 2013, we recorded a total charge of \$55 million related to store fixtures which consisted of \$37 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced throughout 2013, \$11 million of charges for the impairment of certain store fixtures related to our former shops strategy that had been used in our prototype department store and a \$7 million asset write down of store fixtures related to the renovations in our home department.

## Management transition

During 2014 and 2013, we implemented several changes within our management leadership team that resulted in management transition costs of \$16 million and \$37 million, respectively, for both incoming and outgoing members of management.

## Other

During 2014 and 2013, we recorded miscellaneous restructuring charges of \$26 million and \$75 million, respectively. The charges during 2014 and 2013 were primarily related to contract termination costs and other costs associated with our previous marketing and shops strategy, including a non-cash charge of \$36 million during the third quarter of 2013 related to the return of shares of Martha Stewart Living Omnimedia, Inc. (MSLO) previously acquired by the Company, which was accounted for as a cost investment.

## Operating Income/(Loss)

For 2014, we reported an operating loss of \$308 million compared to an operating loss of \$1,420 million in 2013, which is an improvement of \$1,112 million.

## Loss on Extinguishment of Debt

During the third quarter of 2014, we completed an offering of \$400 million aggregate principal amount of our 2019 Notes. The majority of the net proceeds of the offering were used to pay the tender consideration and related transaction fees and expenses for our contemporaneous cash 2014 Tender Offers for \$327 million aggregate principal

amount of our outstanding 2015 Notes, 2016 Notes and 2017 Notes (the Securities). In October 2014, subsequent to the completion of the 2014 Tender Offers, we used \$64 million of available cash to effect a legal defeasance of the remaining outstanding principal amount of 2015 Notes by depositing funds with the Trustee for the 2015 Notes sufficient to make all payments of interest and principal on the outstanding 2015 Notes to the stated maturity of October 15, 2015. These transactions resulted in a loss on extinguishment of debt of \$34 million which includes the premium paid over face value of the accepted Securities of \$29 million, \$4 million for the portion of the deposited funds for future interest payments on the 2015 Notes and reacquisition costs of \$1 million.

During the second quarter of 2013, we paid \$355 million to complete a cash tender offer and consent solicitation with respect to substantially all of our outstanding 7.125% Debentures due 2023. In doing so, we also recognized a loss on extinguishment of

## Table of Contents

debt of \$114 million, which included the premium paid over face value of the debentures of \$110 million, reacquisition costs of \$2 million and the write-off of unamortized debt issuance costs of \$2 million.

### Net Interest Expense

Net interest expense consists principally of interest expense on long-term debt, net of interest income earned on cash and cash equivalents. Net interest expense was \$406 million, an increase of \$54 million, or 15.3%, from \$352 million in 2013. The increase in net interest expense is primarily related to the increased interest expense associated with the previous borrowings under our former revolving credit facility (2013 Credit Facility), the \$2.25 billion five-year senior secured term loan that was entered into in May 2013 (2013 Term Loan), the 2014 Term Loan and the additional debt that was outstanding during the third quarter of 2014 as a result of the timing of our debt transactions. In addition, during the second quarter of 2014, the Company expensed \$9 million of capitalized debt issue costs associated with our previous credit facility that was replaced by our 2014 Credit Facility.

### Income Taxes

Our net deferred tax assets, which include the future tax benefits of our net operating loss carryforwards, are subject to a valuation allowance. At January 31, 2015, the federal and state valuation allowances were \$586 million and \$198 million, respectively. Future book pre-tax losses will require additional valuation allowances to offset the deferred tax assets created. Until such time that we achieve sufficient profitability to allow removal of most of our valuation allowance, utilization of our loss carryforwards will result in a corresponding decrease in the valuation allowance and offset our tax provision dollar for dollar.

Each period we are required to allocate our income tax expense or benefit to continuing operations and other items such as other comprehensive income and stockholder's equity. In accordance with these rules when we have a loss in continuing operations and a gain in other comprehensive income, as arose in our year ended February 1, 2014, we are required to recognize a tax benefit in continuing operations up to the amount of tax expense that we are required to report in other comprehensive income. In our year ended January 31, 2015 we experienced losses in both continuing operations and other comprehensive income. Under the allocation rules we are required to recognize the valuation allowance allocable to the tax benefit attributable to these losses in each component of comprehensive income. Accordingly, included in the total valuation allowance of \$784 million noted above is \$169 million of valuation allowance which offsets the deferred tax benefit attributable to the actuarial loss reported in other comprehensive income.

For the year ended January 31, 2015, we recorded a net tax expense of \$23 million resulting in an effective tax rate of 3.1%. The net tax expense included \$7 million related to the amortization of certain indefinite-lived intangible assets, \$10 million for state and foreign jurisdictions where loss carryforwards are limited or unavailable and \$6 million for federal and state audit settlements.

For the year ended February 1, 2014, we recorded a net tax benefit of \$498 million resulting in an effective tax rate of (26.4)%. The net tax benefit consisted of net federal, foreign and state tax benefits of \$197 million, a \$303 million tax benefit resulting from actuarial gains in other comprehensive income, offset by \$2 million of tax expense related to the amortization of certain indefinite-lived intangible assets. The \$303 million tax benefit recorded on the loss in continuing operations was offset by income tax expense in other comprehensive income of \$303 million.

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

In 2014, EBITDA was a positive \$323 million, an improvement of \$1,142 million compared to a negative EBITDA of \$819 million in the prior year corresponding period. Excluding restructuring and management transition charges, the impact of our Primary Pension Plan expense/(income), the net gain on the sale of non-operating assets, the proportional share of net income from the Home Office Land Joint Venture and certain net gains, adjusted EBITDA was positive, improving \$878 million to an adjusted EBITDA of \$242 million for 2014 compared to a negative

adjusted EBITDA of \$636 million for the prior year corresponding period.

Overall, EBITDA and adjusted EBITDA improved significantly in 2014 as compared to the corresponding prior year periods as we were able to improve sales, achieve higher margins and reduce our operating costs.

Net Income/(Loss) and Adjusted Net Income/(Loss)

In 2014, we reported a loss of \$771 million, or \$2.53 per share, compared with a loss of \$1,388 million, or \$5.57 per share, last year. Excluding the impact of restructuring and management transition charges, the impact of our Primary Pension Plan expense, the loss on extinguishment of debt, the net gain on sale of non-operating assets, the proportional share of net income from joint venture, certain net gains and the tax impact resulting from other comprehensive income allocation, adjusted net

Table of Contents

income/(loss) (non-GAAP) went from a loss of \$1,431 million, or \$5.74 per share, in 2013 to a loss of \$816 million, or \$2.67 per share, in 2014.

2013 Compared to 2012

## Total Net Sales

	2013	2012
Total net sales (in millions)	\$11,859	\$12,985
Sales percent increase/(decrease)		
Total net sales <sup>(1)</sup>	(8.7	)% (24.8
Comparable store sales <sup>(2)</sup>	(7.4	)% (25.1
Sales per gross square foot <sup>(3)</sup>	\$107	\$116

(1) Includes the effect of the 53rd week in 2012. Excluding sales of \$163 million for the 53rd week in 2012, total net sales decreased 7.5% and 25.7% in 2013 and 2012, respectively.

Comparable store sales are presented on a 52-week basis and include sales from new and relocated stores that have been opened for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closures remain in the calculations. Beginning in 2014, the Company simplified its comparable store sales calculation to better reflect year-over-year comparability. Certain items, such as sales return estimates and store liquidation sales, are now excluded from the Company's calculation. Prior periods have been adjusted to reflect this new methodology. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

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

Total net sales decreased \$1,126 million in 2013 compared to 2012. The following table provides the components of the net sales decrease:

(\$ in millions)	2013	
Comparable store sales, including Internet	\$(944	)
Sales of new and closed (non-comparable) stores, net	(183	)
Other revenues and sales adjustments	1	
Total net sales increase/(decrease)	\$(1,126	)

In 2013, comparable store sales decreased 7.4%. Total net sales decreased 8.7% to \$11,859 million compared with \$12,985 million in 2012 and Internet sales increased 5.5% to \$1,079 million. Excluding sales of \$163 million for the 53rd week in 2012, total net sales decreased 7.5%. Internet sales experienced an increase during the year primarily as a result of better in-stock merchandise positions, improvements in site performance and a favorable response to our promotional activity.

The decline in total net sales was primarily related to our prior strategy that did not resonate with our customers. The prior strategy focused on everyday low prices, substantially eliminated promotional activities, emphasized brands in a shops presentation and introduced new merchandise brands. Fiscal 2013 was a transitional year in which we worked to stabilize our business and to rebuild the Company, working to create strategies to reconnect with our core customer. During 2013, we began editing our merchandise assortments and undertaking several merchandise initiatives to make assortments more compelling to customers, reintroducing some of our private brands and returning the majority of our business to a promotional model. We saw a positive response to these efforts as our 2013 comparable store sales improved sequentially each quarter, with the fourth quarter delivering a comparable store sales gain of 1.4%, which was our first quarterly comparable store sales gain since the second quarter of 2011.

Based on a sample of our mall and off-mall stores, our store traffic and conversion rate decreased compared to 2012. The number of store transactions and the total number of units decreased while the average number of units per transaction increased slightly during 2013 as compared to 2012. All geographic regions experienced sales declines for 2013 compared to the prior year. During 2013, the women's accessories division, including Sephora, which reflected the addition of 60 Sephora inside JCPenney locations, experienced a slight sales increase. All other divisions experienced sales declines with men's and women's apparel, jewelry and footwear experiencing the smallest declines and home and children's experiencing the largest declines.

Table of Contents

Gross Margin (\$ in millions)	2013	2012		
Gross margin	\$3,492	\$4,066		
As a percent of sales	29.4	% 31.3		%

Gross margin decreased to 29.4% of sales in 2013, or 190 basis points, compared to 2012. On a dollar basis, gross margin decreased \$574 million, or 14.1%, to \$3,492 million in 2013 compared to \$4,066 million in the prior year. The net 190 basis point decrease resulted from a decrease primarily from the change in merchandise mix sold primarily related to sales of clearance merchandise at lower margins as compared to 2012, including additional markdowns taken to sell through inventory associated with our previous strategy, as well as our transition back to a promotional pricing strategy, including re-ticketing costs on selected merchandise, and reduced vendor cost concessions.

SG&A Expenses (\$ in millions)	2013	2012		
SG&A	\$4,114	\$4,506		
As a percent of sales	34.7	% 34.7		%

SG&A expenses declined \$392 million to \$4,114 million in 2013 compared to \$4,506 million in 2012. As a percent of sales, SG&A expenses were flat with last year at 34.7%. The net savings resulted primarily from lower salaries and related benefits; higher income from the JCPenney private label credit card activities, which is recorded as a reduction of our SG&A expenses; lower utilities; savings in advertising expenses; and lower general store expense, support costs and rent.

Pension Expense (\$ in millions)	2013	2012
Primary pension plan expense	\$100	\$167
Primary pension plan settlement expense	—	148
Total primary pension plan expense	100	315
Supplemental pension plans expense	37	38
Total pension expense	\$137	\$353

Primary Pension Plan expense for 2013 decreased \$67 million to \$100 million, compared with \$167 million in 2012, excluding the settlement charge of \$148 million incurred during the fourth quarter of 2012. The decrease in Primary Pension Plan expense for 2013 was a result of lower amortization of our actuarial loss due to certain lump-sum settlements in 2012, lower service cost due to a decrease in the number of participants accruing benefits and strong asset performance in 2012. These decreases were partially offset by an approximately 60 basis point decrease in our discount rate and a 50 basis point decrease in our assumed expected return on assets. During the fourth quarter of 2012, we recognized settlement expense of \$148 million for unrecognized actuarial losses related to participants who separated from service and had a deferred vested benefit as of August 31, 2012 who elected to receive a lump-sum settlement payment as a result of a plan amendment. During 2013 and 2012, supplemental pension plans expense was \$37 million and \$38 million, respectively.

#### Depreciation and Amortization Expense

Depreciation and amortization expense in 2013 increased \$58 million to \$601 million, or approximately 10.7%, compared to \$543 million in 2012. This increase is a result of our investment and replacement of store fixtures in connection with the implementation of our prior strategy. Depreciation and amortization expense for 2013 and 2012 excluded \$37 million and \$25 million, respectively, of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced during 2013 with the build out of our home department and other attractions. These amounts were included in the line Restructuring and management transition in the Consolidated

Statements of Operations.

36

---



Table of Contents

## Real Estate and Other, Net

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

(\$ in millions)	2013	2012
Gain on sale or redemption of non-operating assets, net		
Sale or redemption of Simon Property Group, L.P. (SPG) REIT units	\$(24	) \$(200
Sale of CBL & Associates Properties, Inc. (CBL) REIT shares	—	(15
Sale of leveraged leases	—	(28
Sale of investment in joint ventures	(85	) (151
Sale of other non-operating assets	(23	) (3
Net gain on sale or redemption of non-operating assets	(132	) (397
Dividend income from REITs	(1	) (6
Investment income from joint ventures	(6	) (11
Net gain from sale of operating assets	(17	) —
Store impairments	18	26
Intangible asset impairment	9	—
Operating asset impairments	—	60
Other	(26	) 4
Total expense/(income)	\$(155	) \$(324

## Monetization of Non-operating Assets

As part of our strategy to monetize assets that are not core to our operations, during 2013 we generated \$143 million of cash and recognized a net gain of \$132 million from the sale of several non-operating assets. During 2012, we generated \$526 million of cash and recognized a net gain of \$397 million. The monetization of non-operating assets primarily included the following:

## Sale or Redemption of REIT Assets

On July 20, 2012, SPG redeemed two million of our REIT units at a price of \$124.00 per unit for a total redemption price of \$246 million, net of fees. As of the market close on July 19, 2012, the SPG REIT units had a fair market value of \$158.13 per unit. In connection with the redemption, we realized a net gain of \$200 million determined using the first-in-first-out method for determining the cost of REIT units sold. Following the transaction, we continued to hold approximately 205,000 REIT units in SPG. In November 2013, we converted our remaining 205,000 REIT units into SPG shares, which were sold in December 2013 at an average price of \$151.97 per share for a total price of \$31 million, net of fees, and a realized net gain of \$24 million.

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

## Sale of Leveraged Leases

During the third quarter of 2012, we sold all of our leveraged leases for \$146 million, net of fees. The investments in the leveraged leases as of the dates of the sales were \$118 million and were recorded in Other assets in the Consolidated Balance Sheets. In connection with the sales, we recorded a net gain of \$28 million.

## Sale of Investments in Joint Ventures

During the third quarter of 2013, we sold our investment in three joint ventures for \$32 million, resulting in a net gain of \$23 million. During the second quarter of 2013, we sold our investment in one joint venture for \$55 million, resulting in a net gain of \$62 million. The gain for this transaction exceeded the cash proceeds as a result of distributions of cash related to refinancing activities in prior periods that were recorded as net reductions in the carrying amount of the investment. The net book value of the joint venture investment was a negative \$7 million and was included in Other liabilities in the Consolidated Balance Sheets.

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

Table of Contents**Sale of Other Non-Operating Assets**

During the fourth quarter of 2013, we sold 10 properties used in our former auto center operations for net proceeds of \$25 million, resulting in net gains totaling \$22 million. During the third quarter of 2013, we sold approximately 10 acres of excess land for net proceeds and a gain of \$1 million.

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

**Sale of Operating Assets**

During the first quarter of 2013, we sold our leasehold interest of a former department store location with a net book value of \$2 million for net proceeds of \$18 million, realizing a gain of \$16 million. During the second quarter of 2013, we sold two properties for total net proceeds and a gain of \$1 million.

**Impairments**

In 2013, store impairments totaled \$18 million and related to 25 underperforming department stores that continued to operate. In addition, during the fourth quarter of 2013, we recorded a \$9 million impairment charge for our ownership of the U.S. and Puerto Rico rights of the monet® trade name. See restructuring and management transition charges below for additional impairments related to stores that closed in 2014.

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

**Restructuring and Management Transition**

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

(\$ in millions)	2013	2012
Supply chain	\$—	\$19
Home office and stores	48	109
Software and systems	—	36
Store fixtures	55	78
Management transition	37	41
Other	75	15
Total	\$215	\$298

**Supply chain**

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

**Home office and stores**

In 2013 and 2012, we recorded \$48 million and \$109 million, respectively, of costs to reduce our store and home office expenses. During the first three quarters of 2013, we recorded \$26 million of employee termination benefits for both store and home office associates. In addition, in January 2014, we announced a strategic initiative to close 33 underperforming stores as part of our turnaround efforts. In conjunction with this initiative, during the fourth quarter of 2013 we incurred charges of \$21 million related to asset impairments and \$1 million of employee termination benefit costs.

In 2012, charges of \$116 million associated with employee termination benefits for both store and home office associates were offset by a net curtailment gain of \$7 million related to our retirement benefit plans, which was incurred during the third quarter of 2012 when substantially all employee exits related to 2012 were completed, for a net charge of \$109 million.

#### Software and systems

During 2012, we recorded a charge of \$36 million related to the disposal of software and systems that based on our evaluation no longer supported our operations. This amount included \$3 million of consulting fees related to that evaluation.

## Table of Contents

### Store Fixtures

During 2013, we recorded a total charge of \$55 million related to store fixtures which consisted of \$37 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced throughout 2013, \$11 million of charges for the impairment of certain store fixtures related to our former shops strategy that had been used in our prototype department store and a \$7 million asset write down of store fixtures related to the renovations in our home department.

During 2012, we recorded a total charge of \$78 million related to store fixtures which consisted of a \$53 million asset write-off related to the removal of store fixtures in our department stores and \$25 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced throughout 2013 with the build out of additional shops.

### Management transition

During 2013 and 2012, we implemented several changes within our management leadership team that resulted in management transition costs of \$37 million and \$41 million, respectively, for both incoming and outgoing members of management.

### Other

During 2013 and 2012, we recorded \$75 million and \$15 million, respectively, of miscellaneous restructuring charges. The charges during 2013 were primarily related to contract termination costs and other costs associated with our previous marketing and shops strategy, including a non-cash charge of \$36 million during the third quarter related to the return of shares of Martha Stewart Living Omnimedia, Inc. previously acquired by the Company, which was accounted for as a cost investment. The charges in 2012 were primarily related to the exit of our specialty websites CLAD™ and Gifting Grace™ in the first quarter of 2012, and costs associated with the closing of our Pittsburgh, Pennsylvania customer call center in the second quarter of 2012.

### Operating Income/(Loss)

For 2013, we reported an operating loss of \$1,420 million compared to an operating loss of \$1,310 million in 2012.

### Loss on Extinguishment of Debt

During the second quarter of 2013, we paid \$355 million to complete a cash tender offer and consent solicitation with respect to substantially all of our outstanding 7.125% Debentures due 2023. In doing so, we also recognized a loss on extinguishment of debt of \$114 million, which included the premium paid over face value of the debentures of \$110 million, reacquisition costs of \$2 million and the write-off of unamortized debt issuance costs of \$2 million.

### Net Interest Expense

Net interest expense was \$352 million, an increase of \$126 million, or 55.8%, from \$226 million in 2012. The increase in net interest expense is primarily related to the increased interest expense associated with the borrowings under our revolving credit facility which bore interest at a rate of LIBOR plus 3.0% and the \$2.25 billion five-year senior secured term loan that was entered into in May 2013 which bears interest at a rate of LIBOR plus 5.0%.

### Income Taxes

Beginning in the second quarter of 2013, as a result of our net deferred tax position changing from a net deferred tax liability to a net deferred tax asset (exclusive of any valuation allowance), we determined that an increase in the valuation allowance was needed. In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our assessment, we concluded that our estimate of the realization of deferred tax assets would be based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring net operating loss (NOL) and tax credit carryforwards. As of February 1, 2014, a valuation

allowance of \$304 million was recorded against our deferred tax assets.

For the year ended February 1, 2014, we recorded a net tax benefit of \$498 million resulting in an effective tax rate of (26.4)%. The net tax benefit consisted of net federal, foreign and state tax benefits of \$197 million, a \$303 million tax benefit resulting from actuarial gains in other comprehensive income, offset by \$2 million of tax expense related to the amortization of certain indefinite-lived intangible assets. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. As a result, the Company recorded a tax benefit on the loss for the year, which was offset by income tax expense in other comprehensive income of \$303 million.

Table of Contents

In 2012, we recorded an income tax benefit of \$551 million, resulting in an effective tax rate of (35.9)%. Our income tax benefit for 2012 was impacted by the establishment of a \$66 million valuation allowance relating to state NOL carryforwards in certain separate filing states.

Net Income/(Loss) and Adjusted Net Income/(Loss)

In 2013, we reported a loss of \$1,388 million, or \$5.57 per share, compared with a loss of \$985 million, or \$4.49 per share, in 2012. Excluding the impact of markdowns related to the alignment of inventory with our prior strategy, restructuring and management transition charges, the impact of our Primary Pension Plan expense, the loss on extinguishment of debt, the net gain on sale or redemption of non-operating assets and the tax benefit from income related to actuarial gains included in other comprehensive income, adjusted net income/(loss) (non-GAAP) went from a loss of \$766 million, or \$3.49 per share, in 2012 to a loss of \$1,431 million, or \$5.74 per share, in 2013.

Table of Contents

## Financial Condition and Liquidity

## Overview

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our revolving credit facility. During 2014, we completed the following transactions to enhance our liquidity:

In June 2014, J. C. Penney Company, Inc., JCP and Purchasing entered into the 2014 Credit Facility, comprised of a \$1,850 million Revolving Facility and the \$500 million 2014 Term Loan;

During the third quarter of 2014, we completed an offering of \$400 million aggregate principal amount of 2019 Notes. The majority of the net proceeds of the offering were used to pay the tender consideration and related transaction fees and expenses for our contemporaneous cash 2014 Tender Offers for \$327 million aggregate principal amount of our outstanding 2015 Notes, 2016 Notes and 2017 Notes;

In October 2014, subsequent to the completion of the 2014 Tender Offers, we used \$64 million of available cash to effect a legal defeasance of the remaining outstanding principal amount of 2015 Notes by depositing funds with the Trustee for the 2015 Notes sufficient to make all payments of interest and principal on the outstanding 2015 Notes to the stated maturity of October 15, 2015.

We generated \$105 million of cash from the sale of several operating and non-operating assets.

The 2014 Credit Facility extends the maturity of the previous credit facility several years and further enhances our liquidity position, particularly during periods of peak working capital needs. Through the 2019 Notes offering, 2014 Tender Offers and debt defeasance, we were able to address our near-term debt maturities, with our next debt maturity occurring in August 2016 for \$78 million.

We ended the year with \$1,318 million of cash and cash equivalents, a decrease of \$197 million from the prior year. As of the end of 2014, based on our borrowing base, we had \$923 million available for future borrowing, of which \$773 million was accessible due to the minimum excess availability threshold, providing a total available liquidity of \$2.1 billion.

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

(\$ in millions)	2014	2013	2012
Cash and cash equivalents	\$1,318	\$1,515	\$930
Merchandise inventory	2,652	2,935	2,341
Property and equipment, net	5,148	5,619	5,353
Total debt <sup>(1)</sup>	5,416	5,601	2,982
Stockholders' equity	1,914	3,087	3,171
Total capital	7,330	8,688	6,153
Maximum capacity under our credit agreement	1,850	1,850	1,750
Cash flow from operating activities	239	(1,814)	(10)
Free cash flow (non-GAAP) <sup>(2)</sup>	57	(2,746)	(906)
Capital expenditures	252	951	810
Dividends paid	—	—	86
Ratios:			
Debt-to-total capital <sup>(3)</sup>	73.9	% 64.5	% 48.5
Cash-to-debt <sup>(4)</sup>	24.3	% 27.0	% 31.2

(1) Total debt includes short-term debt and long-term debt, capital leases, note payable and related current maturities.

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

(3) Total debt divided by total capitalization.



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

## Table of Contents

### Free Cash Flow (Non-GAAP)

During 2014, free cash flow increased \$2,803 million to an inflow of \$57 million compared to an outflow of \$2,746 million in 2013. This significant improvement was driven primarily by the increase in sales and operating performance of the Company and better inventory management. In addition, free cash flow was positively impacted by a decrease in capital expenditures and an increase in proceeds from the sale of operating assets during 2014 when compared to 2013.

### Operating Activities

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

In 2014, cash flow from operating activities was an inflow of \$239 million, an increase of \$2,053 million compared to an outflow of \$1,814 million during the same period last year. Our net loss as of the end of 2014 of \$771 million included significant charges and credits that did not impact operating cash flow, including depreciation and amortization, certain restructuring and management transition charges, loss on extinguishment of debt, the sale of operating and non-operating assets and asset impairments. Overall, the generation of cash from operations was driven primarily by the increase in sales and operating performance of the Company, including higher margins and better expense control, and better inventory management. In addition, during 2014 we received an aggregate cash distribution of \$58 million from the Home Office Land Joint Venture of which \$53 million was included in operating activities and \$5 million was classified as investing activities as it was considered a return of investment as the aggregate cash distribution exceeded our proportional share of the cumulative earnings of the joint venture by this amount. Cash flows from operating activities also included construction allowances from landlords of \$8 million, which funded a portion of our capital expenditures in investing activities.

Merchandise inventory decreased \$283 million to \$2,652 million, or 9.6%, as of the end of 2014 compared to \$2,935 million as of the end of last year. Merchandise inventory decreased as we were able to better manage our inventory levels during the year based on customer demand and seasonal needs. Inventory turns for 2014, 2013 and 2012 were 2.74, 2.65 and 3.03 respectively. Merchandise accounts payable increased \$49 million at the end of 2014 compared to 2013.

In 2013, cash flow from operating activities was an outflow of \$1,814 million, a decrease of \$1,804 million compared to an outflow of \$10 million during the prior year. The overall increased cash outflow from operations for 2013 related to a larger net loss for the period, the increase in cash used to restore inventory levels in basics and private branded categories during the year and cash used for the corresponding merchandise accounts payable. Cash flows from operating activities also included construction allowances from landlords of \$6 million, which funded a portion of our capital expenditures in investing activities. Additionally, our net loss as of the end of fiscal 2013 of \$1,388 million included significant charges and credits that did not impact operating cash flow including depreciation and amortization, restructuring and management transition charges, pension expense, loss on extinguishment of debt, an income tax benefit from income resulting from actuarial gains in other comprehensive income and asset impairments and other charges.

In 2012, cash flow from operating activities was an outflow of \$10 million. Our total year 2012 net loss of \$985 million included significant charges that did not impact operating cash flow including depreciation and amortization, pension expense, and restructuring and management transition. We realized positive operating cash flow impacts from reduced operating expenses, reduced inventory levels, and specific steps taken to improve overall working capital. In addition, in the fourth quarter of 2012, we extended our private label credit card agreement and received a signing bonus and an advance of our 2013 gain share totaling \$75 million in cash. Additionally, cash flows from operating activities also included construction allowances from landlords of \$7 million, which funded a portion of our capital

expenditures in investing activities.

#### Investing Activities

In 2014, investing activities was a cash outflow of \$142 million compared to an outflow of \$789 million for 2013. The decrease in the cash outflow from investing activities was primarily a result of decreased capital expenditures and an increase in proceeds from the sale of operating assets.

For 2014, capital expenditures were \$252 million. At the end of the year, we also had an additional \$12 million of accrued capital expenditures, which will be paid in subsequent periods. The capital expenditures for 2014 related primarily to the opening of 46 Sephora inside JCPenney stores, the opening of a new department store in the third quarter of 2014, investments in information technology in both our home office and stores and investments in our store environment. We received construction allowances from landlords of \$8 million in 2014, which are classified as operating activities, to fund a portion of the capital expenditures related to store leasehold improvements. These funds have been recorded as deferred rent credits in the Consolidated Balance Sheets and are amortized as an offset to rent expense.

Table of Contents

During 2014, we sold several operating and non-operating assets for total net proceeds of \$105 million consisting primarily of 11 properties used in our former auto center operations, six department store locations (current and former) and two parcels of undeveloped land.

In 2013, investing activities was a cash outflow of \$789 million compared to an outflow of \$293 million for 2012. The increase in the cash outflow from investing activities was primarily a result of increased capital expenditures and a decrease in proceeds from the sale or redemption of non-operating and operating assets.

For 2013, capital expenditures were \$951 million. At the end of the year, we also had an additional \$25 million of accrued capital expenditures, which were paid in 2014. The capital expenditures for 2013 related primarily to the opening of the women's and children's Joe Fresh® attractions in nearly 700 of our department stores, the opening of Disney® and giggleBaby™ in approximately 560 stores, extensive renovations in our home department in approximately 500 of our department stores and the opening of 60 Sephora inside JCPenney stores. Additionally, we received construction allowances from landlords of \$6 million in 2013.

During 2013, we sold several non-operating assets for total net proceeds of \$143 million consisting primarily of our investments in four real estate joint ventures, our remaining Simon REIT units, ten properties used in our former auto center operations and a leasehold interest in a former department store location.

In 2012, capital expenditures were \$810 million. Capital expenditures in 2012 included furniture and fixtures relating to shop concepts for The Original Arizona Jean Co., Levi's, jcp, Liz Claiborne and Izod. During the year, we also opened 78 Sephora inside JCPenney stores and nine new department stores. Additionally, we received construction allowances from landlords of \$7 million in 2012.

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

The following provides a breakdown of capital expenditures:

(\$ in millions)	2014	2013	2012
Store renewals and updates	\$152	\$875	\$617
Capitalized software	39	29	65
New and relocated stores	30	10	63
Technology and other	31	37	65
Total	\$252	\$951	\$810

We expect our investment in capital expenditures for 2015 to be approximately \$250 million, net of construction allowances from landlords, which will relate primarily to our store environment, investments in information technology and the continued roll-out of 25 new Sephora inside JCPenney locations. Our plan is to fund these expenditures with cash flow from operations and existing cash and cash equivalents.

#### Financing Activities

In 2014, cash flows from financing activities were an outflow of \$294 million compared to an inflow of \$3,188 million for the same period last year.

During the third quarter of 2014, we closed on our offering of \$400 million aggregate principal amount of 2019 Notes and used the majority of the \$393 million of proceeds from the offering, net of underwriting discounts, to pay \$362 million for the tender consideration and related transaction fees and expenses for our contemporaneous cash 2014 Tender Offers to purchase approximately \$327 million aggregate principal amount of our outstanding 2015 Notes, 2016 Notes and 2017 Notes. Subsequent to the completion of the 2014 Tender Offers, we used approximately \$64 million of available cash to effect a legal defeasance of the remaining outstanding principal amount of \$60 million on

our 2015 Notes by depositing funds with the Trustee for the 2015 Notes sufficient to make all payments of interest and principal on the outstanding Notes to October 15, 2015, the stated maturity of the 2015 Notes. These transactions resulted in a loss on extinguishment of debt of \$34 million which includes the premium paid over face value of the Securities of \$29 million, \$4 million for the portion of the deposited funds for future interest payments on the 2015 Notes and reacquisition costs of \$1 million.

## Table of Contents

During the second quarter of 2014, in conjunction with entering into our 2014 Credit Facility, we used the \$500 million of proceeds from the 2014 Term Loan, in addition to \$150 million of cash on hand, to pay down the \$650 million cash borrowings that were outstanding under the previous revolving credit facility. In addition, we incurred \$60 million of financing costs relating to the 2014 Credit Facility. Through 2014, we repaid \$26 million on our capital leases and note payable, \$23 million on our 2013 Term Loan and \$2 million on our 2014 Term Loan.

In 2013, cash flows from financing activities were an inflow of \$3,188 million compared to an outflow of \$274 million for the same period last year. During the third quarter of 2013, we issued 84 million shares of common stock with a par value of \$0.50 per share for net proceeds of \$786 million. During the second quarter of 2013, we received net proceeds of \$2.18 billion from our senior secured term loan facility and completed the cash tender offer and consent solicitation with respect to our outstanding 7.125% Debentures due 2023 for \$355 million. During the first quarter of 2013, we borrowed \$850 million under our revolving credit facility of which \$200 million was repaid during the third quarter of 2013.

In 2012, cash flows from financing activities were an outflow of \$274 million. On August 1, 2012, we repaid at maturity \$230 million principal amount of 9% Notes Due 2012. Additionally, we made capital lease, note payable and financing payments totaling \$24 million. As authorized by the Board, we paid quarterly dividends of \$0.20 per share during the first half of 2012 for dividends declared during the fourth quarter of 2011 and the first quarter of 2012. On May 15, 2012, we announced that we had discontinued the quarterly \$0.20 per share dividend.

### Cash Flow and Financing Outlook

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. During 2014, we completed several transactions to further enhance our liquidity. During the second quarter of 2014, we closed on our 2014 Credit Facility which extends the maturity of the previous credit facility several years and further enhances our liquidity position, particularly during periods of peak working capital needs, by adding up to \$500 million of additional liquidity. During the third quarter of 2014, through the 2019 Notes offering, the 2014 Tender Offers and the defeasance of our 2015 Notes, we were able to address our near-term debt maturities, with our next debt maturity occurring in August 2016 for \$78 million. For 2015, we believe that our existing liquidity will be adequate to fund our capital expenditures and working capital needs; however, in accordance with our long-term financing strategy, we may access the capital markets opportunistically.

### 2014 Credit Facility

On June 20, 2014, J. C. Penney Company, Inc., JCP and Purchasing entered into the 2014 Credit Facility, comprised of the Revolving Facility and the 2014 Term Loan. The 2014 Credit Facility, which matures on June 20, 2019, replaced the Company's prior credit agreement entered into in February 2013 and contains a letter of credit sublimit of \$750 million. Proceeds from the 2014 Term Loan, in addition to \$150 million of cash on hand, were used to pay down the \$650 million cash borrowings that were outstanding under the previous facility.

The 2014 Credit Facility is a senior asset-based 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 Revolving Facility is available for general corporate purposes, including the issuance of letters of credit. Pricing under the Revolving Facility is tiered based on our utilization under the line of credit. JCP's obligations under the 2014 Credit Facility are guaranteed by J. C. Penney Company, Inc.

The borrowing base under the Revolving Facility, which is limited to a maximum of \$1,850 million, is calculated as 85% of eligible accounts receivable, plus 90% of eligible credit card receivables, plus 90% 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

addition, the maximum availability is limited by a minimum excess availability threshold which is the greater of 10% of the borrowing base or \$150 million.

As of the end of 2014, we had \$498 million outstanding on the 2014 Term Loan and no borrowings outstanding under the Revolving Facility. The 2014 Term Loan bears interest at a rate of LIBOR plus 4.0% and requires quarterly repayments in a principal amount equal to \$1.25 million during the five-year term beginning October 1, 2014. As of the end of 2014, we had \$397 million in standby and import letters of credit outstanding under the Revolving Facility, the majority of which were standby letters of credit that support our merchandise initiatives and workers' compensation. None of the standby or import letters of credit have been drawn on. The applicable rates for standby and import letters of credit were 2.75% and 1.375%, respectively, while the commitment fee was 0.375% for the unused portion of the Revolving Facility. As of the end of 2014,

Table of Contents

based on our borrowing base, we had \$923 million available for future borrowing, of which \$773 million was accessible due to the minimum excess availability threshold.

## Credit Ratings

Our credit ratings and outlook as of March 16, 2015 were as follows:

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

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

## Contractual Obligations and Commitments

Aggregated information about our obligations and commitments to make future contractual payments, such as debt and lease agreements, and contingent commitments as of January 31, 2015 is presented in the following table.

(\$ in millions)	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Recorded contractual obligations:					
Long-term debt	\$5,350	\$28	\$354	\$3,332	\$1,636
Capital leases and note payable	70	33	37	—	—
Unrecognized tax benefits <sup>(1)</sup>	62	5	—	—	57
Contributions to non-qualified supplemental retirement and postretirement medical plans <sup>(2)</sup>	188	17	68	31	72
	\$5,670	\$83	\$459	\$3,363	\$1,765
Unrecorded contractual obligations:					
Interest payments on long-term and short-term debt <sup>(3)</sup>	\$5,233	\$345	<sup>(4)</sup> \$669	\$394	\$3,825
Operating leases <sup>(5)</sup>	2,819	237	401	285	1,896
Standby and import letters of credit <sup>(6)</sup>	397	397	—	—	—
Surety bonds <sup>(7)</sup>	79	79	—	—	—
Contractual obligations <sup>(8)</sup>	645	313	324	8	—
Purchase orders <sup>(9)</sup>	2,211	2,211	—	—	—
Guarantees <sup>(10)</sup>	4	1	1	1	1
	\$11,388	\$3,583	\$1,395	\$688	\$5,722
Total	\$17,058	\$3,666	\$1,854	\$4,051	\$7,487

Represents management's best estimate of the payments related to tax reserves for uncertain income tax positions.

(1) Based on the nature of these liabilities, the actual payments in any given year could vary significantly from these amounts. See Note 17 to the Consolidated Financial Statements.

(2) Represents expected cash payments through 2024.

Includes interest expense related to our 2013 Term Loan and 2014 Term loan of \$462 million and \$110 million, respectively, that was calculated using their respective interest rates as of January 31, 2015 for the anticipated amounts outstanding each period, which assumes the required principal payments for each loan remains the same each quarter.

(4) Includes \$88 million of accrued interest that is included in our Consolidated Balance Sheet at January 31, 2015.



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

Standby letters of credit, which totaled \$396 million, are issued as collateral to a third-party administrator for (6) self-insured workers' compensation and general liability claims and to support our merchandise initiatives. The remaining \$1 million are outstanding import letters of credit.

## Table of Contents

- (7) Surety bonds are primarily for previously incurred and expensed obligations related to workers' compensation and general liability claims.  
Consists primarily of (a) minimum purchase requirements for exclusive merchandise and fixtures; (b) royalty obligations; and (c) minimum obligations for professional services, energy services, software maintenance and network services.
- (9) Amounts committed under open purchase orders for merchandise inventory of which a significant portion are cancelable without penalty prior to a date that precedes the vendor's scheduled shipment date.
- (10) Relates to third-party guarantees. See Note 19 to the Consolidated Financial Statements.

### Off-Balance Sheet Arrangements

Management considers all on- and off-balance sheet debt in evaluating our overall liquidity position and capital structure. Other than operating leases, which are included in the Contractual Obligations and Commitments table, we do not have any material off-balance sheet financing. See detailed disclosure regarding operating leases in Note 13 to the Consolidated Financial Statements.

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

### Inflation

Our business is affected by general economic conditions, including changes in prices for labor and commodities such as petroleum, energy and cotton. In the fall of 2014, the overall cost of goods benefited modestly from the reduction to the price of cotton, improved freight rates due to increased vessel capacity and lower fuel cost offset slightly by minimum wage increases in Asian countries. For spring 2015 goods, we anticipate that we will continue to benefit from these lower costs offset by freight premiums to ship goods to East and Gulf Coast ports and increased air shipments due to disruptions in the operations of West Coast ports.

### Critical Accounting Policies

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

See Note 2 to the Consolidated Financial Statements for a description of our significant accounting policies.

### Inventory Valuation under the Retail Method

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

Permanent markdowns and markdown accruals are designated for clearance activity and are recorded at the point of decision, when the utility of inventory has diminished, versus the point of sale. Factors considered in the

determination of permanent markdowns and markdown accruals include current and anticipated demand, customer preferences, age of the merchandise and style trends. Under RIM, permanent markdowns and markdown accruals result in the devaluation of inventory and the corresponding reduction to gross margin is recognized in the period the decision to markdown is made. Shrinkage is estimated as a percent of sales for the period from the last physical inventory date to the end of the fiscal period. Physical inventories are taken at least annually and inventory records are adjusted accordingly. The shrinkage rate from the most recent physical inventory, in combination with current events and historical experience, is used as the standard for the shrinkage accrual rate for the next inventory cycle. Historically, our actual physical inventory count results have shown our estimates to be reliable. Based on prior experience, we do not believe that the actual results will differ significantly from the assumptions used in these estimates. A 10% increase or decrease in markdowns and markdown accruals reflected in our inventory as of the end of the year would have impacted gross margin by approximately \$20 million. A 10% increase or decrease in the estimated inventory shrinkage accrued as of the end of the year would have impacted gross margin by approximately \$7 million.

## Table of Contents

### Valuation of Long-Lived and Indefinite-Lived Assets

#### Long-Lived Assets

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

We recognize impairment losses in the earliest period that it is determined a loss has occurred. The carrying value is adjusted to the new carrying value and any subsequent increases in fair value are not recorded. If it is determined that the estimated remaining useful life of the asset should be decreased, the periodic depreciation expense is adjusted based on the new carrying value of the asset. Impairment losses totaling \$30 million, \$18 million and \$26 million in 2014, 2013 and 2012, respectively, were recorded in the Consolidated Statement of Operations in the line item Real estate and other, net.

In 2014, we wrote the carrying value of assets of 19 underperforming department stores that continued to operate down to their fair value and recorded an impairment charge of \$30 million. If operating performance begins to reflect an other than temporary decline and actual results are not consistent with our current estimates and assumptions, we may be exposed to additional impairment charges in the future, which could be material to our results of operations.

#### Indefinite-Lived Assets

We assess the recoverability of indefinite-lived intangible assets at least annually during the fourth quarter of our fiscal year or whenever events or changes in circumstances indicate that the carrying amount of the indefinite-lived intangible asset may not be fully recoverable. Examples of a change in events or circumstances include, but are not limited to, a decrease in the market price of the asset, a history of cash flow losses related to the use of the asset or a significant adverse change in the extent or manner in which an asset is being used. GAAP gives us the option to first perform a qualitative assessment in our evaluation of our indefinite-lived intangible assets in order to determine whether the fair value of the indefinite-lived intangible asset is more likely than not impaired. For our 2014 annual impairment test, we tested our indefinite-lived intangible assets utilizing the relief from royalty method to determine the estimated fair value for each indefinite-lived intangible asset. The relief from royalty method estimates our theoretical royalty savings from ownership of the intangible asset. Key assumptions used in this model include discount rates, royalty rates, growth rates, sales projections and terminal value rates. Discount rates, royalty rates, growth rates and sales projections are the assumptions most sensitive and susceptible to change as they require significant management judgment. Discount rates used are similar to the rates estimated by the weighted average cost of capital considering any differences in company-specific risk factors. Royalty rates are established by management based on comparable trademark licensing agreements in the market. Operational management, considering industry and company-specific historical and projected data, develops growth rates and sales projections associated with each indefinite-lived intangible asset. Terminal value rate determination follows common methodology of capturing the present value of perpetual sales estimates beyond the last projected period assuming a constant weighted average cost of capital and long-term growth rates.

Our worldwide rights for the Liz Claiborne family of trademarks and related intellectual property and our ownership of the U.S. and Puerto Rico rights of the monet trademarks and related intellectual property are our only

indefinite-lived intangibles assets and the estimated fair values of the assets exceeded their carrying values by margins of approximately 28% and 10%, respectively, at the date of the most recent impairment tests. During the fourth quarter of 2013, we recorded an impairment charge of \$9 million for our monet trade name due to the reduction of future product offerings under the monet trade name as a result of sales performance below our expectations.

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

## Table of Contents

### Reserves and Valuation Allowances

#### Insurance Reserves

We are primarily self-insured for costs related to workers' compensation and general liability claims. The liabilities represent our best estimate, using generally accepted actuarial reserving methods through which we record a provision for workers' compensation and general liability risk based on historical experience, current claims data and independent actuarial best estimates, including incurred but not reported claims and projected loss development factors. These estimates are subject to the frequency, lag and severity of claims. We target this provision above the midpoint of the actuarial range, and total estimated claim liability amounts are discounted using a risk-free rate. We do not anticipate any significant change in loss trends, settlements or other costs that would cause a significant fluctuation in net income. However, a 10% variance in the workers' compensation and general liability reserves at year-end 2014 would have affected our SG&A expenses by approximately \$22 million.

#### Valuation of Deferred Tax Assets

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of the realization of the deferred tax assets based on future events. Our accounting for deferred tax consequences represents our best estimate of those future events. If based on the weight of available evidence, it is more likely than not (defined as a likelihood of more than 50%) the deferred tax assets will not be realized, we record a valuation allowance. The weight given to both positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, to outweigh objective negative evidence of recent losses. Cumulative losses in recent years is a significant piece of negative evidence that is difficult to overcome in determining that a valuation allowance is not needed against deferred tax assets.

This assessment is completed on a taxing jurisdiction basis and takes into account several types of evidence, including the following:

Nature, frequency, and severity of current and cumulative financial reporting losses. A pattern of recent losses is heavily weighted as a source of negative evidence. In certain circumstances, historical information may not be as relevant due to a change in circumstances.

Sources of future taxable income. Future reversals of existing temporary differences are heavily weighted sources of objectively verifiable positive evidence. Projections of future taxable income, exclusive of reversing temporary differences, are a source of positive evidence only when the projections are combined with a history of recent profits and can be reasonably estimated. Otherwise, these projections are considered inherently subjective and generally will not be sufficient to overcome negative evidence that includes cumulative losses in recent years, particularly if the projected future taxable income is dependent on an anticipated turnaround to profitability that has not yet been achieved. In such cases, we generally give these projections of future taxable income no weight for the purposes of our valuation allowance assessment.

•

Tax planning strategies. If necessary and available, tax-planning strategies would be implemented to accelerate taxable amounts to utilize expiring net operating loss carryforwards. These strategies would be a source of additional positive evidence and, depending on their nature, could be heavily weighted.

In the second quarter of 2013, our net deferred tax position, exclusive of any valuation allowance, changed from a net deferred tax liability to a net deferred tax asset. In our assessment of the need for a valuation allowance, we heavily weighted the negative evidence of cumulative losses in recent periods and the positive evidence of future reversals of existing temporary differences. Although a sizable portion of our losses in recent years were the result of charges incurred for restructuring and other special items, even without these charges we still would have incurred significant losses. Accordingly, we considered our pattern of recent losses to be relevant to our analysis. Considering this pattern of recent losses and the uncertainties associated with projected future taxable income exclusive of reversing temporary differences, we gave no weight to projections showing

Table of Contents

future U.S. taxable income for purposes of assessing the need for a valuation allowance. As a result of our assessment, we concluded that, beginning in the second quarter of 2013, our estimate of the realization of deferred tax assets would be based solely on future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring carryforwards.

Future book pre-tax losses will require additional valuation allowances to offset the deferred tax assets created. A sustained period of profitability is required before we would change our need for a valuation allowance against our net deferred tax assets.

See Note 17 to the Consolidated Financial Statements for more information regarding income taxes and also Risk Factors, Item 1A.

**Environmental Reserves**

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

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

**Pension****Pension Accounting**

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

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

	2014		2013		2012	
Expected return on plan assets	7.0	%	7.0	%	7.5	%
Discount rate for pension expense	4.89	%	4.19	%	4.82	% <sup>(1)</sup>
Discount rate for pension obligation	3.87	%	4.89	%	4.19	%

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

**Return on Plan Assets and Impact on Earnings**

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



The expected return on plan assets is based on the plan's long-term asset allocation policy, historical returns for plan assets and overall capital market returns, taking into account current and expected market conditions. In 2012 and 2011, the expected return on plan assets was 7.5%, which was reduced from the 2010 rate of 8.4% to align our expected rate of return with our new asset allocation targets. The expected return assumption for 2013 and 2014 is further reduced from 7.5% to 7.0% given our new asset allocation targets and updated expected capital markets return assumptions.

#### Discount Rate

The discount rate used to measure pension expense each year is the rate as of the beginning of the year (i.e., the prior measurement date). For the 2011 year-end remeasurement, used to calculate 2012 expense, the discount rate used was based on

## Table of Contents

an externally published yield curve determined by the plan's actuary. The yield curve is a hypothetical AA yield curve represented by a series of bonds maturing from six months to 30 years, designed to match the corresponding pension benefit cash payments to retirees. Beginning with the remeasurement on September 30, 2012, the discount rate used, determined by the plan actuary, was based on a hypothetical AA yield curve represented by a series of bonds maturing over the next 30 years, designed to match the corresponding pension benefit cash payments to retirees.

For 2014, the discount rate to measure pension expense was 4.89% compared to 4.19% in 2013. The discount rate to measure the pension obligations decreased to 3.87% as of January 31, 2015 from 4.89% as of February 1, 2014.

### Sensitivity

The sensitivity of pension expense to a plus or minus one-half of one percent of expected return on assets is a decrease or increase in pension expense of approximately \$26 million. An increase in the discount rate of one-half of one percent would decrease the 2015 pension expense by approximately \$21 million and a decrease in the discount rate of one-half of one percent would increase pension expense by approximately \$23 million.

### Pension Funding

Funding requirements for our Primary Pension Plan are determined under Employee Retirement Income Security Act of 1974 (ERISA) rules, as amended by the Pension Protection Act of 2006. As a result of the funded status of the Primary Pension Plan, we are not required to make cash contributions in 2015.

### Recent Accounting Pronouncements

Refer to Note 3 to the Consolidated Financial Statements.

### Cautionary Statement Regarding Forward-Looking Information

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current view of future events and financial performance. Words such as "expect" and similar expressions identify forward-looking statements, which include, but are not limited to, statements regarding sales, gross margin, selling, general and administrative expenses, cash flows and liquidity. Forward-looking statements are based only on the Company's current assumptions and views of future events and financial performance. They are subject to known and unknown risks and uncertainties, many of which are outside of the Company's control, that may cause the Company's actual results to be materially different from planned or expected results. Those risks and uncertainties include, but are not limited to, general economic conditions, including inflation, recession, unemployment levels, consumer confidence and spending patterns, credit availability and debt levels, changes in store traffic trends, the cost of goods, more stringent or costly payment terms and/or the decision by a significant number of vendors not to sell us merchandise on a timely basis or at all, trade restrictions, the ability to monetize non-core assets on acceptable terms, the ability to implement our strategic plan, customer acceptance of our strategies, our ability to attract, motivate and retain key executives and other associates, the impact of cost reduction initiatives, our ability to generate or maintain liquidity, implementation of new systems and platforms, changes in tariff, freight and shipping rates, changes in the cost of fuel and other energy and transportation costs, disruptions and congestion at ports through which we import goods, increases in wage and benefit costs, competition and retail industry consolidations, interest rate fluctuations, dollar and other currency valuations, the impact of weather conditions, risks associated with war, an act of terrorism or pandemic, the ability of the federal government to fund and conduct its operations, a systems failure and/or security breach that results in the theft, transfer or unauthorized disclosure of customer, employee or Company information, legal and regulatory proceedings and the Company's ability to access the debt or equity markets on favorable terms or at all. There can be no assurances that the Company will achieve expected results, and actual results may be materially less than expectations. While we believe that our assumptions are reasonable, we caution that it is impossible to predict the degree to which any such factors could cause actual results to differ materially from predicted results. For additional discussion on risks and uncertainties, see Item 1A, Risk Factors. We intend the forward-looking statements in this Annual Report on Form 10-K to speak only

as of the date of this report and do not undertake to update or revise these projections as more information becomes available.

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

All of our outstanding notes and debentures as of January 31, 2015 are at fixed interest rates and would not be affected by interest rate changes. On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million senior asset-based credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and a \$500 million term loan (2014 Term Loan).

Borrowings under the Revolving Facility, to the extent that fluctuating rate loans are used, and our 2014 Term Loan, which bears interest at LIBOR plus 4%, are affected by interest rate changes. In addition, in May 2013, we entered into a \$2.25 billion senior secured term loan facility (2013 Term Loan Facility), which bears interest at a rate of LIBOR plus 5.0%. As of January 31, 2015, we had \$498 million outstanding under our 2014 Term Loan and \$2.216 billion outstanding under the 2013 Term Loan Facility, which are both subject to fluctuating interest rates, and no borrowings outstanding under our Revolving Facility. Accordingly, a 100 basis point increase in interest rates would result in additional annual interest expense of \$5 million under the 2014 Term Loan and \$22 million under the 2013 Term Loan Facility.

The fair value of long-term debt is estimated by obtaining quotes from brokers or is based on current rates offered for similar debt. As of January 31, 2015, long-term debt had a carrying value of \$5.4 billion and a fair value of \$4.8 billion. As of February 1, 2014, long-term debt, including current maturities, had a carrying value of \$4.9 billion and a fair value of \$4.2 billion.

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

Item 8. Financial Statements and Supplementary Data

See the Index to Consolidated Financial Statements on Page 59.

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

None.

Table of Contents

Item 9A. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

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

Management's Report on Internal Control over Financial Reporting

The management of our Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f) and 15d-15(f). The management of our Company has assessed the effectiveness of our Company's internal control over financial reporting as of January 31, 2015. In making this assessment, management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control–Integrated Framework (1992). Based on its assessment, the management of our Company believes that, as of January 31, 2015, our Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm, KPMG LLP, has audited the financial statements included in this Annual Report on Form 10-K and has issued an audit report on the effectiveness of our Company's internal control over financial reporting. Their report follows.

There were no changes in our Company's internal control over financial reporting during the fourth quarter ended January 31, 2015, that have materially affected, or are reasonably likely to materially affect, our Company's internal control over financial reporting.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
J. C. Penney Company, Inc.:

We have audited J. C. Penney Company, Inc.'s internal control over financial reporting as of January 31, 2015, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). J. C. Penney Company, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, J. C. Penney Company, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 31, 2015, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of J. C. Penney Company, Inc. and subsidiaries as of January 31, 2015 and February 1, 2014, and the related consolidated statements of operations, comprehensive income/(loss), stockholders' equity, and cash flows for each of the years in the three year period ended January 31, 2015, and our report dated March 23, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Dallas, Texas  
March 23, 2015

Table of Contents

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 with respect to executive officers is included within Item 1 in Part I of this Annual Report on Form 10-K under the caption “Executive Officers of the Registrant.”

The information required by Item 10 with respect to directors, audit committee, audit committee financial experts and Section 16(a) beneficial ownership reporting compliance is included under the captions “Board Committees–Audit Committee,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Proposal 1 - Election of Directors” in our definitive proxy statement for 2015, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A and is incorporated herein by reference.

Code of Ethics and Corporate Governance Guidelines

We have adopted a code of ethics for officers and employees, which applies to, among others, our principal executive officer, principal financial officer, and principal accounting officer, and which is known as the “Statement of Business Ethics.” We have also adopted certain ethical principles and policies for our directors, which are set forth in Article V of our Corporate Governance Guidelines. The Statement of Business Ethics and Corporate Governance Guidelines are available on our website at [www.jcpenney.com](http://www.jcpenney.com). Additionally, we will provide copies of these documents without charge upon request made to:

J. C. Penney Company, Inc.  
Office of Investor Relations  
6501 Legacy Drive  
Plano, Texas 75024  
(Telephone 972-431-5500)

Our Company intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to or waiver of any provision of the Statement of Business Ethics that applies to any officer of the Company by posting such information on our website at [www.jcpenney.com](http://www.jcpenney.com).

Item 11. Executive Compensation

The information required by Item 11 is included under the captions “Compensation Committee Interlocks and Insider Participation,” “Compensation Discussion and Analysis,” “Report of the Human Resources and Compensation Committee,” “Summary Compensation Table,” “Grants of Plan-Based Awards for Fiscal 2014,” “Outstanding Equity Awards at Fiscal Year-End 2014,” “Option Exercises and Stock Vested for Fiscal 2014,” “Pension Benefits,” “Nonqualified Deferred Compensation for Fiscal 2014,” “Potential Payments and Benefits on Termination of Employment,” and “Director Compensation for Fiscal 2014” in our Company’s definitive proxy statement for 2015, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 with respect to beneficial ownership of our Company’s common stock is included under the caption “Beneficial Ownership of Common Stock” in our Company’s definitive proxy statement for 2015, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A and is incorporated herein by reference.

The following table shows the number of options and other awards outstanding as of January 31, 2015 under the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan (2014 Plan) and subsequent plans, as well as the number of

shares remaining available for grant under the 2014 Plan.



Table of Contents

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights		Weighted-average exercise price of outstanding options, warrants and rights		Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))	
	(a)		(b)		(c)	
Equity compensation plans approved by security holders	22,370,649	(1)	\$ 32	(2)	23,216,767	(3)
Equity compensation plans not approved by security holders	2,290,080	(4)	\$ —		—	
Total	24,660,729		\$ 32	(2)	23,216,767	

(1) Includes 7,795,440 restricted stock units.

(2) Represents the weighted-average exercise price of outstanding stock options only and the weighted-average remaining term is 4.4 years.

(3) At the May 16, 2014 Annual Meeting of Stockholders, our stockholders approved the 2014 Plan, which has a fungible share design in which each stock option will count as one share issued and each stock award will count as two shares issued. The 2014 Plan reserved 16,000,000 shares or 32,000,000 options for issuance to associates and non-employee directors. In addition, shares underlying any outstanding stock award or stock option grant from prior plans that are canceled prior to vesting or exercise become available for use under the 2014 Plan. No shares remain available for future issuance from prior plans.

(4) On May 20, 2014, the Company made an inducement equity award of 223,964 restricted stock units to our Chief Financial Officer, Edward J. Record, which vests one-third on May 20, 2015, May 20, 2016 and May 20, 2017. On November 17, 2014, the Company made an inducement equity award of 2,066,116 restricted stock units to our President and Chief Executive Officer-Designee, Marvin R. Ellison, which vests one-third on November 17, 2015, November 17, 2016 and November 17, 2017.

#### Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 is included under the captions “Policies and Procedures with Respect to Related Person Transactions” and “Board Independence” in our Company’s definitive proxy statement for 2015, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A and is incorporated herein by reference.

#### Item 14. Principal Accounting Fees and Services

The information required by Item 14 is included under the captions “Audit and Other Fees” and “Audit Committee’s Pre-Approval Policies and Procedures” in our Company’s definitive proxy statement for 2015, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A and is incorporated herein by reference.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report:

1. Consolidated Financial Statements:

The Consolidated Financial Statements of J. C. Penney Company, Inc. and subsidiaries are listed in the accompanying "Index to Consolidated Financial Statements" on page 59.

2. Financial Statement Schedules:

Schedules have been omitted as they are inapplicable or not required under the rules, or the information has been submitted in the Consolidated Financial Statements and related financial information contained otherwise in this Annual Report on Form 10-K.

3. Exhibits:

See separate Exhibit Index beginning on page 105. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Annual Report on Form 10-K is specifically identified in the separate Exhibit Index beginning on page 105 and filed with or incorporated by reference in this report.

(b) See separate Exhibit Index beginning on page 105.

(c) Other Financial Statement Schedules. None.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.  
(Registrant)

By /s/ Edward J. Record  
Edward J. Record  
Executive Vice President and Chief Financial Officer

Date: March 23, 2015

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
Myron E. Ullman, III*	Chief Executive Officer	March 23, 2015
Myron E. Ullman, III	(principal executive officer); Director	
Marvin Ellison*	President and CEO-Designee;	March 23, 2015
Marvin Ellison	Director	
Edward J. Record*	Executive Vice President and	March 23, 2015
Edward J. Record	Chief Financial Officer (principal financial officer)	
/s/ Dennis P. Miller	Senior Vice President and	March 23, 2015
Dennis P. Miller	Controller (principal accounting officer)	
Thomas J. Engibous*	Chairman of the Board;	March 23, 2015
Thomas J. Engibous	Director	
Colleen C. Barrett*	Director	March 23, 2015
Colleen C. Barrett		
Kent B. Foster*	Director	March 23, 2015
Kent B. Foster		
B. Craig Owens*	Director	March 23, 2015
Craig Owens		
Leonard H. Roberts*	Director	March 23, 2015
Leonard H. Roberts		



Table of Contents

Signatures	Title	Date
Stephen I. Sadove* Stephen I. Sadove	Director	March 23, 2015
Javier G. Teruel* Javier G. Teruel	Director	March 23, 2015
R. Gerald Turner* R. Gerald Turner	Director	March 23, 2015
Ronald W. Tysoe* Ronald W. Tysoe	Director	March 23, 2015
Mary Beth West* Mary Beth West	Director	March 23, 2015

\*By: /s/ Dennis P. Miller  
Dennis P. Miller  
Attorney-in-fact

Table of Contents

J. C. PENNEY COMPANY, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	<u>60</u>
<u>Consolidated Statements of Operations for the Fiscal Years Ended January 31, 2015, February 1, 2014 and February 2, 2013</u>	<u>61</u>
<u>Consolidated Statements of Comprehensive Income/(Loss) for the Fiscal Years Ended January 31, 2015, February 1, 2014 and February 2, 2013</u>	<u>62</u>
<u>Consolidated Balance Sheets as of January 31, 2015 and February 1, 2014</u>	<u>63</u>
<u>Consolidated Statements of Stockholders' Equity for the Fiscal Years Ended January 31, 2015, February 1, 2014 and February 2, 2013</u>	<u>64</u>
<u>Consolidated Statements of Cash Flows for the Fiscal Years Ended January 31, 2015, February 1, 2014 and February 2, 2013</u>	<u>65</u>
<u>Notes to Consolidated Financial Statements</u>	
1. <u>Basis of Presentation and Consolidation</u>	<u>66</u>
2. <u>Significant Accounting Policies</u>	<u>66</u>
3. <u>Effect of New Accounting Standards</u>	<u>71</u>
4. <u>Earnings/(Loss) per Share</u>	<u>72</u>
5. <u>Other Assets</u>	<u>72</u>
6. <u>Other Accounts Payable and Accrued Expenses</u>	<u>73</u>
7. <u>Other Liabilities</u>	<u>73</u>
8. <u>Fair Value Disclosures</u>	<u>73</u>
9. <u>Credit Facility</u>	<u>75</u>
10. <u>Long-Term Debt</u>	<u>76</u>
11. <u>Stockholders' Equity</u>	<u>78</u>
12. <u>Stock-Based Compensation</u>	<u>80</u>
13. <u>Leases and Note Payable</u>	<u>82</u>
14. <u>Retirement Benefit Plans</u>	<u>84</u>
15. <u>Restructuring and Management Transition</u>	<u>95</u>
16. <u>Real Estate and Other, Net</u>	<u>97</u>
17. <u>Income Taxes</u>	<u>99</u>
18. <u>Supplemental Cash Flow Information</u>	<u>102</u>
19. <u>Litigation, Other Contingencies and Guarantees</u>	<u>102</u>
20. <u>Quarterly Results of Operations (Unaudited)</u>	<u>103</u>

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

J. C. Penney Company, Inc.:

We have audited the accompanying consolidated balance sheets of J. C. Penney, Inc. and subsidiaries as of January 31, 2015 and February 1, 2014, and the related consolidated statements of income, comprehensive income/(loss), stockholders' equity, and cash flows for each of the years in the three year period ended January 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of J. C. Penney, Inc. and subsidiaries as of January 31, 2015 and February 1, 2014, and the results of their operations and their cash flows for each of the years in the three year period ended January 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), J. C. Penney Company, Inc.'s internal control over financial reporting as of January 31, 2015, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 23, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Dallas, Texas

March 23, 2015

Table of Contents

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share data)

	2014	2013	2012
Total net sales	\$12,257	\$11,859	\$12,985
Cost of goods sold	7,996	8,367	8,919
Gross margin	4,261	3,492	4,066
Operating expenses/(income):			
Selling, general and administrative (SG&A)	3,993	4,114	4,506
Pension	6	137	353
Depreciation and amortization	631	601	543
Real estate and other, net	(148)	) (155	) (324 )
Restructuring and management transition	87	215	298
Total operating expenses	4,569	4,912	5,376
Operating income/(loss)	(308)	) (1,420	) (1,310 )
Loss on extinguishment of debt	34	114	—
Net interest expense	406	352	226
Income/(loss) before income taxes	(748)	) (1,886	) (1,536 )
Income tax expense/(benefit)	23	(498	) (551 )
Net income/(loss)	\$(771)	) \$(1,388	) \$(985 )
Earnings/(loss) per share:			
Basic	\$(2.53	) \$(5.57	) \$(4.49 )
Diluted	(2.53	) (5.57	) (4.49 )
Weighted average shares – basic	305.2	249.3	219.2
Weighted average shares – diluted	305.2	249.3	219.2

See the accompanying notes to the Consolidated Financial Statements.



Table of Contents

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(\$ in millions)	2014	2013	2012	
Net income/(loss)	\$(771	) \$(1,388	) \$(985	)
Other comprehensive income/(loss), net of tax:				
Real estate investment trusts (REITs)				
Unrealized gain/(loss)	—	(1	) 36	
Reclassification adjustment for realized (gain)/loss	—	(16	) (184	)
Foreign currency translation				
Unrealized gain/(loss)	(2	) —	—	
Retirement benefit plans				
Net actuarial gain/(loss) arising during the period	(293	) 404	37	
Prior service credit/(cost) arising during the period	(12	) (4	) (26	)
Reclassification of net prior service (credit)/cost from a curtailment	—	—	(3	)
Reclassification of net actuarial (gain)/loss from a settlement	—	—	91	
Reclassification for amortization of net actuarial (gain)/loss	40	108	148	
Reclassification for amortization of prior service (credit)/cost	(1	) (1	) (8	)
Deferred tax valuation allowance	(169	) —	—	
Total other comprehensive income/(loss), net of tax	(437	) 490	91	
Total comprehensive income/(loss), net of tax	\$(1,208	) \$(898	) \$(894	)

See the accompanying notes to the Consolidated Financial Statements.

Table of Contents

## CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)

	2014	2013
Assets		
Current assets:		
Cash in banks and in transit	\$ 119	\$ 113
Cash short-term investments	1,199	1,402
Cash and cash equivalents	1,318	1,515
Merchandise inventory	2,652	2,935
Deferred taxes	172	193
Prepaid expenses and other	189	190
Total current assets	4,331	4,833
Property and equipment	5,148	5,619
Prepaid pension	220	663
Other assets	705	686
Total Assets	\$ 10,404	\$ 11,801
Liabilities and Stockholders' Equity		
Current liabilities:		
Merchandise accounts payable	\$ 997	\$ 948
Other accounts payable and accrued expenses	1,188	1,198
Short-term borrowings	—	650
Current portion of capital leases and note payable	28	27
Current maturities of long-term debt	28	23
Total current liabilities	2,241	2,846
Long-term capital leases and note payable	38	62
Long-term debt	5,322	4,839
Deferred taxes	363	335
Other liabilities	526	632
Total Liabilities	8,490	8,714
Stockholders' Equity		
Common stock <sup>(1)</sup>	152	152
Additional paid-in capital	4,606	4,571
Reinvested earnings/(accumulated deficit)	(1,779)	(1,008)
Accumulated other comprehensive income/(loss)	(1,065)	(628)
Total Stockholders' Equity	1,914	3,087
Total Liabilities and Stockholders' Equity	\$ 10,404	\$ 11,801

(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 304.9 million and 304.6 million as of January 31, 2015 and February 1, 2014, respectively.

See the accompanying notes to the Consolidated Financial Statements.

Table of Contents

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(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)	—	—	—	(985)	—	(985)
Other comprehensive income/(loss)	—	—	—	—	91	91
Dividends declared, common	—	—	—	(47)	—	(47)
Stock-based compensation	3.4	2	100	—	—	102
February 2, 2013	219.3	\$ 110	\$ 3,799	\$ 380	\$(1,118)	\$ 3,171
Net income/(loss)	—	—	—	(1,388)	—	(1,388)
Other comprehensive income/(loss)	—	—	—	—	490	490
Common stock issued	84.0	42	744	—	—	786
Stock-based compensation	1.3	—	28	—	—	28
February 1, 2014	304.6	\$ 152	\$ 4,571	\$(1,008)	\$(628)	\$ 3,087
Net income/(loss)	—	—	—	(771)	—	(771)
Other comprehensive income/(loss)	—	—	—	—	(437)	(437)
Stock-based compensation	0.3	—	35	—	—	35
January 31, 2015	304.9	\$ 152	\$ 4,606	\$(1,779)	\$(1,065)	\$ 1,914

See the accompanying notes to the Consolidated Financial Statements.

Table of Contents

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)	2014	2013	2012
Cash flows from operating activities			
Net income/(loss)	\$(771	) \$(1,388	) \$(985
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:			
Restructuring and management transition	32	132	121
Asset impairments and other charges	39	30	117
Net gain on sale or redemption of non-operating assets	(25	) (132	) (397
Net gain on sale of operating assets	(92	) (17	) —
Loss on extinguishment of debt	34	114	—
Depreciation and amortization	631	601	543
Benefit plans	(24	) 70	272
Stock-based compensation	33	28	50
Excess tax benefits from stock-based compensation	—	—	(12
Other comprehensive income tax benefits	—	(303	) —
Deferred taxes	3	(164	) (467
Change in cash from:			
Inventory	283	(594	) 575
Prepaid expenses and other assets	(1	) 74	(5
Merchandise accounts payable	49	(214	) 140
Current income taxes	(10	) 50	117
Accrued expenses and other	58	(101	) (79
Net cash provided by/(used in) operating activities	239	(1,814	) (10
Cash flows from investing activities			
Capital expenditures	(252	) (951	) (810
Proceeds from sale or redemption of non-operating assets	35	143	526
Acquisition	—	—	(9
Proceeds from sale of operating assets	70	19	—
Joint venture return of investment	5	—	—
Net cash provided by/(used in) investing activities	(142	) (789	) (293
Cash flows from financing activities			
Proceeds from short-term borrowings	—	850	—
Payment on short-term borrowings	(650	) (200	) —
Net proceeds from issuance of long-term debt	893	2,180	—
Premium on early retirement of debt	(33	) (110	) —
Payments of capital leases and note payable	(26	) (29	) (20
Payments of long-term debt	(412	) (256	) (230
Financing costs	(65	) (31	) (4
Net proceeds from common stock issued	—	786	—
Dividends paid, common	—	—	(86
Proceeds from stock options exercised	—	7	71
Excess tax benefits from stock-based compensation	—	—	12
Tax withholding payments for vested restricted stock	(1	) (9	) (17
Net cash provided by/(used in) financing activities	(294	) 3,188	(274
Net increase/(decrease) in cash and cash equivalents	(197	) 585	(577
Cash and cash equivalents at beginning of period	1,515	930	1,507
Cash and cash equivalents at end of period	\$1,318	\$1,515	\$930

See the accompanying notes to the Consolidated Financial Statements.

## Table of Contents

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Basis of Presentation and Consolidation

##### Nature of Operations

Our Company was founded by James Cash Penney in 1902 and has grown to be a major national retailer, operating 1,062 department stores in 49 states and Puerto Rico, as well as through our Internet website at jcpenny.com. We sell family apparel and footwear, accessories, fine and fashion jewelry, beauty products through Sephora inside JCPenny, and home furnishings. In addition, our department stores provide services, such as styling salon, optical, portrait photography and custom decorating, to customers.

##### Basis of Presentation and Consolidation

The Consolidated Financial Statements present the results of J. C. Penney Company, Inc. and our subsidiaries (the Company or JCPenny). All significant intercompany transactions and balances have been eliminated in consolidation.

We are 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 direct subsidiaries other than JCP, and has no independent assets or operations.

The Company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP's outstanding debt securities. We guarantee certain of JCP's outstanding debt securities fully and unconditionally.

##### Fiscal Year

Our fiscal year ends on the Saturday closest to January 31. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Fiscal Year	Ended	Weeks
2014	January 31, 2015	52
2013	February 1, 2014	52
2012	February 2, 2013	53

##### Use of Estimates and Assumptions

The preparation of financial statements, in conformity with generally accepted accounting principles in the United States of America (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, specifically permanent reductions to retail prices (markdowns), permanent devaluation of inventory (markdown accruals) and adjustments for shortages (shrinkage); valuation of long-lived assets and indefinite-lived intangible assets for impairments; reserves for closed stores, workers' compensation and general liability (insurance), environmental contingencies, income taxes and litigation; and pension and other post retirement benefits accounting. Such estimates and assumptions are subject to inherent uncertainties, which may result in actual amounts differing from reported amounts.

##### Reclassifications

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. Significant Accounting Policies

#### Merchandise and Services Revenue Recognition

Total net sales, which exclude sales taxes and are net of estimated returns, are recorded at the point of sale when payment is received and the customer takes possession of the merchandise in department stores, at the point of shipment of merchandise ordered through the Internet, or, in the case of services, at the time the customer receives the benefit of the service, such as salon, portrait, optical or custom decorating. Commissions earned on sales generated by licensed departments are included as a component of total net sales. Shipping and handling fees charged to customers are also included in total net sales with

Table of Contents

corresponding costs recorded as cost of goods sold. We provide for estimated future returns based primarily on historical return rates and sales levels.

Based on how we categorized our divisions in 2014, our merchandise mix of total net sales over the last three years was as follows:

	2014		2013		2012	
Women's apparel	24	%	24	%	24	%
Men's apparel and accessories	22	%	22	%	21	%
Home	12	%	11	%	12	%
Women's accessories, including Sephora	12	%	11	%	10	%
Children's apparel	10	%	11	%	12	%
Family footwear	8	%	9	%	9	%
Fine jewelry	7	%	7	%	7	%
Services and other	5	%	5	%	5	%
	100		100		100	%

**Gift Card Revenue Recognition**

At the time gift cards are sold, no revenue is recognized; rather, a liability is established for the face amount of the card. The liability remains recorded until the earlier of redemption, escheatment or 60 months. The liability is relieved and revenue is recognized when gift cards are redeemed for merchandise or services. We escheat a portion of unredeemed gift cards according to Delaware escheatment requirements that govern remittance of the cost of the merchandise portion of unredeemed gift cards over five years old. After reflecting the amount escheated, any remaining liability (referred to as breakage) is relieved and recognized as a reduction of SG&A expenses as an offset to the costs of administering the gift card program. Though our gift cards do not expire, it is our historical experience that the likelihood of redemption after 60 months is remote. The liability for gift cards is recorded in other accounts payable and accrued expenses on the Consolidated Balance Sheets.

**Customer Loyalty Program**

Customers who spend a certain amount with us using our private label card or registered third party credit cards receive JCP Rewards® certificates, redeemable for merchandise or services in our stores the following two months. We estimate the net cost of the rewards that will be redeemed and record this as cost of goods sold as rewards points are accumulated. Other administrative costs of the loyalty program are recorded in SG&A expenses as incurred.

**Cost of Goods Sold**

Cost of goods sold includes all costs directly related to bringing merchandise to its final selling destination. These costs include the cost of the merchandise (net of discounts or allowances earned), sourcing and procurement costs, buying and brand development costs, including buyers' salaries and related expenses, royalties and design fees, freight costs, warehouse operating expenses, merchandise examination, inspection and testing, store merchandise distribution center expenses, including rent, and shipping and handling costs incurred on sales via the Internet.

**Vendor Allowances**

We receive vendor support in the form of cash payments or allowances for a variety of reimbursements such as cooperative advertising, markdowns, vendor shipping and packaging compliance, defective merchandise and the purchase of vendor specific fixtures. We have agreements in place with each vendor setting forth the specific conditions for each allowance or payment. Depending on the arrangement, we either recognize the allowance as a reduction of current costs or defer the payment over the period the related merchandise is sold. If the payment is a reimbursement for costs incurred, it is generally offset against those related costs; otherwise, it is treated as a reduction to the cost of merchandise.



Markdown reimbursements related to merchandise that has been sold are negotiated and documented by our buying teams and are credited directly to cost of goods sold in the period received. Vendor allowances received prior to merchandise being sold are deferred and recognized as a reduction of inventory and credited to cost of goods sold based on an inventory turnover rate.

Vendor compliance credits reimburse us for incremental merchandise handling expenses incurred due to a vendor's failure to comply with our established shipping or merchandise preparation requirements. Vendor compliance credits are recorded as a reduction of merchandise handling costs.

## Table of Contents

### Selling, General and Administrative Expenses

SG&A expenses include the following costs, except as related to merchandise buying, sourcing, warehousing or distribution activities: salaries, marketing costs, occupancy and rent expense, utilities and maintenance, pre-opening expenses, costs related to information technology, administrative costs related to our home office and district and regional operations, real and personal property and other taxes (excluding income taxes) and credit card fees.

### Advertising

Advertising costs, which include newspaper, television, Internet search marketing, radio and other media advertising, are expensed either as incurred or the first time the advertisement occurs. For cooperative advertising programs offered by national brands that require proof-of-advertising to be provided to the vendor to support the reimbursement of the incurred cost, we offset the allowances against the related advertising expense. Programs that do not require proof-of-advertising are monitored to ensure that the allowance provided by each vendor is a reimbursement of costs incurred to advertise for that particular vendor's label. Total advertising costs, net of cooperative advertising vendor reimbursements of \$1 million, \$4 million and \$2 million for 2014, 2013 and 2012, respectively, were \$886 million, \$919 million and \$933 million, respectively.

### Income Taxes

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized. We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense in our Consolidated Statements of Operations.

### Earnings/(Loss) per Share

Basic earnings/(loss) per share (EPS) is computed by dividing net income/(loss) by the weighted-average number of common shares outstanding during the period. Diluted EPS is computed by dividing net income/(loss) by the weighted-average number of common shares outstanding during the period plus the number of additional common shares that would have been outstanding if the potentially dilutive shares had been issued. Potentially dilutive shares include stock options, unvested restricted stock units and awards and a warrant outstanding during the period, using the treasury stock method. Potentially dilutive shares are excluded from the computations of diluted EPS if their effect would be anti-dilutive.

### Cash and Cash Equivalents

Cash and cash equivalents include cash short-term investments that are highly liquid investments with original maturities of three months or less. Cash short-term investments consist primarily of short-term U.S. Treasury money market funds and a portfolio of highly rated bank deposits and are stated at cost, which approximates fair market value due to the short-term maturity. Cash in banks and in transit also include credit card sales transactions that are settled early in the following period.

### Merchandise Inventory

Inventories are valued at the lower of cost (using the first-in, first-out or "FIFO" method) or market. For department stores, regional warehouses and store distribution centers, we value inventories using the retail method. Under the retail method, retail values are converted to a cost basis by applying specific average cost factors to groupings of merchandise. For Internet, we use standard cost, representing average vendor cost, to determine lower of cost or market.

Physical inventories are taken on a staggered basis at least once per year at all store and supply chain locations, inventory records are adjusted to reflect actual inventory counts and any resulting shortage (shrinkage) is recognized. Following inventory counts, shrinkage is estimated as a percent of sales, based on the most recent physical inventory, in combination with current events and historical experience. We have loss prevention programs and policies in place that are intended to mitigate shrinkage.

Table of Contents

## Property and Equipment, Net

(\$ in millions)	Estimated	2014	2013
	Useful Lives (Years)		
Land	N/A	\$274	\$309
Buildings	50	4,899	4,951
Furniture and equipment	3-20	2,175	2,242
Leasehold improvements <sup>(1)</sup>		1,301	1,318
Capital leases (equipment)	3-5	116	114
Accumulated depreciation		(3,617)	(3,315)
Property and equipment, net		\$5,148	\$5,619

(1) Leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the term of the lease, including renewals determined to be reasonably assured.

Property and equipment is stated at cost less accumulated depreciation. Depreciation is computed primarily by using the straight-line method over the estimated useful lives of the related assets.

We expense routine maintenance and repairs when incurred. We capitalize major replacements and improvements. We remove the cost of assets sold or retired and the related accumulated depreciation or amortization from the accounts and include any resulting gain or loss in net income/(loss).

We recognize a liability for the fair value of our conditional asset retirement obligations, which are primarily related to asbestos removal, when incurred if the liability's fair value can be reasonably estimated.

## Capitalized Software Costs

We capitalize costs associated with the acquisition or development of major software for internal use in other assets in our Consolidated Balance Sheets and amortize the asset over the expected useful life of the software, generally between three and seven years. We only capitalize subsequent additions, modifications or upgrades to internal-use software to the extent that such changes allow the software to perform a task it previously did not perform. We expense software maintenance and training costs as incurred.

## Impairment of Long-Lived and Indefinite-Lived Assets

We evaluate long-lived assets such as store property and equipment and other corporate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. Factors considered important that could trigger an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results and significant changes in the manner of use of the assets or our overall business strategies. Potential impairment exists if the estimated undiscounted cash flows expected to result from the use of the asset plus any net proceeds expected from disposition of the asset are less than the carrying value of the asset. The amount of the impairment loss represents the excess of the carrying value of the asset over its fair value and is included in Real estate and other, net in the Consolidated Statements of Operations. We estimate fair value based on either a projected discounted cash flow method using a discount rate that is considered commensurate with the risk inherent in our current business model or appraised value, as appropriate. We also take other factors into consideration in estimating the fair value of our stores, such as local market conditions, operating environment, mall performance and other trends.

We assess the recoverability of indefinite-lived intangible assets at least annually during the fourth quarter of our fiscal year or whenever events or changes in circumstances indicate that the carrying amount of the indefinite-lived intangible asset may not be fully recoverable. Examples of a change in events or circumstances include, but are not

limited to, a decrease in the market price of the asset, a history of cash flow losses related to the use of the asset or a significant adverse change in the extent or manner in which an asset is being used. GAAP provides the option to first perform a qualitative assessment in our evaluation of our indefinite-lived intangible assets in order to determine whether the fair value of the indefinite-lived intangible asset is more likely than not impaired. When a quantitative analysis is performed, we test our indefinite-lived intangible assets utilizing the relief from royalty method to determine the estimated fair value for each indefinite-lived intangible asset. The relief from royalty method estimates our theoretical royalty savings from ownership of the intangible asset. Key assumptions used in this model include discount rates, royalty rates, growth rates, sales projections and terminal value rates. Discount rates, royalty rates, growth rates and sales projections are the assumptions most sensitive and susceptible to change as they require significant

## Table of Contents

management judgment. Discount rates used are similar to the rates estimated by the weighted average cost of capital considering any differences in company-specific risk factors. Royalty rates are established by management based on comparable trademark licensing agreements in the market. Operational management, considering industry and company-specific historical and projected data, develops growth rates and sales projections associated with each indefinite-lived intangible asset. Terminal value rate determination follows common methodology of capturing the present value of perpetual sales estimates beyond the last projected period assuming a constant weighted average cost of capital and low long-term growth rates.

### Leases

We use a consistent lease term when calculating amortization of leasehold improvements, determining straight-line rent expense and determining classification of leases as either operating or capital. For purposes of recognizing incentives, premiums, rent holidays and minimum rental expenses on a straight-line basis over the terms of the leases, we use the date of initial possession to begin amortization, which is generally when we take control of the property. Renewal options determined to be reasonably assured are also included in the lease term. Some leases require additional payments based on sales and are recorded in rent expense when the contingent rent is probable.

Some of our lease agreements contain developer/tenant allowances. Upon receipt of such allowances, we record a deferred rent liability in other liabilities on the Consolidated Balance Sheets. The allowances are then amortized on a straight-line basis over the remaining terms of the corresponding leases as a reduction of rent expense.

### Exit or Disposal Activity Costs

Costs associated with exit or disposal activities are recorded at their fair values when a liability has been incurred. Reserves for operating leases are established at the time of closure for the present value of any remaining operating lease obligations (PVOL), net of estimated sublease income. Severance is recorded over the service period required to be rendered in order to receive the termination benefits or, if employees will not be retained to render future service, a reserve is established when communication has occurred to the affected employees. Other exit costs are accrued either at the point of decision or the communication date, depending on the nature of the item.

### Retirement-Related Benefits

We recognize the funded status – the difference between the fair value of plan assets and the plan’s benefit obligation – of our defined benefit pension and postretirement plans directly on the Consolidated Balance Sheet. Each overfunded plan is recognized as an asset and each underfunded plan is recognized as a liability. We adjust other comprehensive income/(loss) to reflect prior service cost or credits and actuarial gain or loss amounts arising during the period and reclassification adjustments for amounts being recognized as components of net periodic pension/postretirement cost, net of tax. Other comprehensive income/(loss) is amortized over the average remaining service period, a period of about eight years for the primary plan.

We measure the plan assets and obligations annually at the adopted measurement date of January 31 to determine pension expense for the subsequent year. The factors and assumptions affecting the measurement are the characteristics of the population and salary increases, with the most important being the expected return on plan assets and the discount rate for the pension obligation. We use actuarial calculations for the assumptions, which require significant judgment.

### Stock-Based Compensation

Stock options are valued primarily using the binomial lattice option pricing model and are granted with an exercise price equal to the closing price of our common stock on the grant date. Time-based and performance-based restricted stock awards are valued using the closing price of our common stock on the grant date. For awards that have market conditions, such as attaining a specified stock price or based on total shareholder return, we use a Monte Carlo simulation model to determine the value of the award. Our current plan does not permit awarding stock options below

grant-date market value nor does it allow any repricing subsequent to the date of grant.

Stock options are valued using the following assumptions:

**Valuation Method.** We estimate the fair value of stock option awards on the date of grant using primarily the binomial lattice model. We believe that the binomial lattice model is a more accurate model for valuing employee stock options since it better reflects the impact of stock price changes on option exercise behavior.

**Expected Term.** Our expected option term represents the average period that we expect stock options to be outstanding and is determined based on our historical experience, giving consideration to contractual terms, vesting schedules, anticipated stock prices and expected future behavior of option holders.

## Table of Contents

**Expected Volatility.** Our expected volatility is based on a blend of the historical volatility of JCPenney stock combined with an estimate of the implied volatility derived from exchange traded options.

**Risk-Free Interest Rate.** Our risk-free interest rate is based on zero-coupon U.S. Treasury yields in effect at the date of grant with the same period as the expected option life.

**Expected Dividend Yield.** The dividend assumption is based on our current expectations about our dividend policy.

Employee stock options and time-based and performance-based restricted stock awards typically vest over periods ranging from one to three years and employee stock options have a maximum term of 10 years. Estimates of forfeitures are incorporated at the grant date and are adjusted if actual results are different from initial estimates. For awards that have performance conditions, the probability of achieving the performance condition is evaluated each reporting period, and if the performance condition is expected to be achieved, the related compensation expense is recorded over the service period. In addition, certain performance-based restricted stock awards may be granted where the number of shares may be increased to the maximum or reduced to the minimum threshold based on the results of the performance metrics in accordance with the terms established at the time of the award. In the event that performance conditions are not achieved and the awards do not vest, compensation expense is reversed. For market based awards, we record expense over the service period, regardless of whether or not the market condition is achieved.

Awards with graded vesting that only have a time vesting requirement and awards that vest entirely at the end of the vesting requirement are expensed on a straight-line basis for the entire award. Expense for awards with graded vesting that incorporate a market or performance requirement is attributed separately based on the vesting for each tranche.

### 3. Effect of New Accounting Standards

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern. This ASU requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued or are available to be issued. This ASU also requires management to disclose certain information depending on the results of the going concern evaluation. The provisions of this ASU are effective for annual periods ending after December 15, 2016, and for interim and annual periods thereafter. Early adoption is permitted. This amendment is applicable to us beginning in the first quarter of 2017. We do not expect the adoption of this standard to have a material impact on our financial condition, results of operations or cash flows.

In June 2014, the FASB issued ASU 2014-12, Compensation - Stock Compensation, an amendment to FASB Accounting Standards Codification (ASC) Topic 718, Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved after the Requisite Service Period. ASU 2014-12 requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. We do not expect the adoption of this standard to have a material impact on our financial condition, results of operations or cash flows.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, issued as a new Topic, ASC Topic 606. 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 ASU is effective for us beginning in fiscal 2017 and can be adopted by the Company either retrospectively or as a cumulative-effect adjustment as of the date of adoption. 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 April 2014, the FASB issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, an amendment to FASB ASC Topic 205, Presentation of Financial Statements, and FASB ASC Topic 360, Property, Plant and Equipment. The update revises the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results, removing the lack of continuing involvement criteria and requiring discontinued operations reporting for the disposal of an equity method investment that meets the definition of discontinued operations. The update also requires expanded disclosures for discontinued operations, including disclosure of pretax profit or loss of an

Table of Contents

individually significant component of an entity that does not qualify for discontinued operations reporting. We early adopted this ASU during the fourth quarter of 2014.

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward or Tax Credit Carryforward Exists. This update provides that an entity is required to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. If a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The provisions of this update were effective February 2, 2014 for the Company and were applied prospectively. The implementation of this guidance resulted in a reclassification as of the end of 2014 of \$49 million between Deferred taxes and Other liabilities and did not have a significant impact on our financial condition, results of operations or cash flows.

#### 4. Earnings/(Loss) per Share

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

(in millions, except per share data)	2014	2013	2012
Earnings/(loss)			
Net income/(loss)	\$(771)	) \$(1,388	) \$(985)
Shares			
Weighted average common shares outstanding (basic shares)	305.2	249.3	219.2
Adjustment for assumed dilution:			
Stock options, restricted stock awards and warrant	—	—	—
Weighted average shares assuming dilution (diluted shares)	305.2	249.3	219.2
EPS			
Basic	\$(2.53)	) \$(5.57	) \$(4.49)
Diluted	\$(2.53)	) \$(5.57	) \$(4.49)

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)	2014	2013	2012
Stock options, restricted stock awards and warrant	26.8	24.3	25.0

#### 5. Other Assets

(\$ in millions)	2014	2013
Capitalized software, net	\$230	\$267
Indefinite-lived intangible assets, net <sup>(1)</sup>	268	268
Realty investments (Note 16)	26	4
Debt issuance costs, net	82	92
Revolving credit facility issuance costs, net	62	23
Other	37	32
Total	\$705	\$686

<sup>(1)</sup> Amounts are net of an accumulated impairment loss of \$9 million which was recorded in 2013 (Note 8 and Note 16) in the line item Real estate and other, net in the Consolidated Statements of Operations.

Our indefinite-lived intangible assets, which we acquired in November 2011, consists of our worldwide rights for the Liz Claiborne® family of trademarks and related intellectual property and our ownership of the U.S. and Puerto Rico rights of the monet® trademarks and related intellectual property. In February 2012, we acquired the right to source

and sell Liz Claiborne branded shoes for \$9 million. In connection with our annual indefinite-lived intangible assets impairment tests performed

Table of Contents

during the fourth quarter of 2014, we did not record an impairment for our indefinite-lived intangible assets as the estimated fair values exceeded the carrying values of the underlying assets.

## 6. Other Accounts Payable and Accrued Expenses

(\$ in millions)	2014	2013
Accrued salaries, vacation and bonus	\$212	\$209
Customer gift cards	217	218
Taxes other than income taxes	75	89
Occupancy and rent-related	139	132
Interest	88	91
Advertising	91	49
Current portion of workers' compensation and general liability insurance	56	59
Restructuring and management transition (Note 15)	19	29
Current portion of retirement plan liabilities (Note 14)	17	46
Capital expenditures	12	25
Unrecognized tax benefits (Note 17)	5	2
Other	257	249
Total	\$1,188	\$1,198

## 7. Other Liabilities

(\$ in millions)	2014	2013
Supplemental pension and other postretirement benefit plan liabilities (Note 14)	\$185	\$187
Long-term portion of workers' compensation and general liability insurance	160	169
Deferred developer/tenant allowances	107	116
Unrecognized tax benefits (Notes 3 and 17)	8	68
Restructuring and management transition (Note 15)	7	4
Other	59	88
Total	\$526	\$632

## 8. 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.

Table of Contents

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

The following table presents fair values for those assets measured at fair values and gains or losses during 2014 and 2013 on a non-recurring basis, and remaining on our Consolidated Balance Sheet:

(\$ in millions)	Carrying Value	Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
As of January 31, 2015					
Store assets	\$2	\$—	\$—	\$2	\$(30 )
Total	\$2	\$—	\$—	\$2	\$(30 )
As of February 1, 2014					
Store assets	\$2	\$—	\$—	\$2	\$(18 )
Intangible asset (Note 5)	5	—	—	5	(9 )
Total	\$7	\$—	\$—	\$7	\$(27 )

In 2014, assets of 19 underperforming department stores that continued to operate with carrying values of \$32 million were written down to their estimated fair values of \$2 million resulting in impairment charges of \$30 million. Store impairment charges are recorded in the line item Real estate and other, net in the Consolidated Statements of Operations. Key assumptions used to determine fair values were future cash flows including, among other things, expected future operating performance and changes in economic conditions as well as other market information obtained from brokers.

In 2013, assets of 25 underperforming department stores that continued to operate with carrying values of \$20 million were written down to their estimated fair values of \$2 million resulting in impairment charges of \$18 million.

During the fourth quarter of 2013, as a result of sales performance below our expectations, we decided to reduce our future product offerings under the monet trade name, indicating a possible impairment. We tested our indefinite-lived intangible asset monet utilizing the relief from royalty method to determine the estimated fair value. The relief from royalty method estimates our theoretical royalty savings from ownership of the intangible asset. Key assumptions in determining relief from royalty include, among other things, discount rates, royalty rates, growth rates, sales projections and terminal value rates. In 2013, our ownership of the U.S. and Puerto Rico rights of the monet trade name, with a carrying amount of \$14 million, was written down to its estimated fair value of \$5 million, resulting in an impairment charge of \$9 million recorded in the line item Real estate and other, net in the Consolidated Statements of Operations.

## 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:

(\$ in millions)	As of January 31, 2015		As of February 1, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	\$5,350	\$4,834	\$4,862	\$4,209

The fair value of long-term debt is estimated by obtaining quotes from brokers or is based on current rates offered for similar debt. As of January 31, 2015 and February 1, 2014, the fair values of cash and cash equivalents, accounts payable and short-term borrowings 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.

74

---

## Table of Contents

### 9. Credit Facility

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million senior asset-based credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and a \$500 million term loan (2014 Term Loan). The 2014 Credit Facility, which matures on June 20, 2019, replaced the Company's prior credit agreement entered into in February 2013 and contains a letter of credit sublimit of \$750 million. Proceeds from the 2014 Term Loan, in addition to \$150 million of cash on hand, were used to pay down the \$650 million cash borrowings that were outstanding under the previous facility. The 2014 Credit Facility is a senior asset-based 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 Revolving Facility is available for general corporate purposes, including the issuance of letters of credit. Pricing under the Revolving Facility is tiered based on our utilization under the line of credit. JCP's obligations under the 2014 Credit Facility are guaranteed by J. C. Penney Company, Inc.

The borrowing base under the Revolving Facility, which is limited to a maximum of 85% of eligible accounts receivable, plus 90% of eligible credit card receivables, plus 90% 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 addition, the maximum availability is limited by a minimum excess availability threshold which is the greater of 10% of the borrowing base or \$150 million.

As of the end of 2014, we had \$498 million outstanding on the 2014 Term Loan and no borrowings outstanding under the Revolving Facility. The 2014 Term Loan bears interest at a rate of LIBOR plus 4.0% and requires quarterly repayments in a principal amount equal to \$1.25 million during the five-year term beginning October 1, 2014. As of the end of 2014, we had \$397 million in standby and import letters of credit outstanding under the Revolving Facility, the majority of which were standby letters of credit that support our merchandise initiatives and workers' compensation. None of the standby or import letters of credit have been drawn on. The applicable rate for standby and import letters of credit was 2.75% and 1.375%, respectively, while the required commitment fee was 0.375% for the unused portion of the Revolving Facility. As of the end of 2014, based on our borrowing base, we had \$923 million available for future borrowing, of which \$773 million was accessible due to the minimum excess availability threshold.

Table of Contents

## 10. Long-Term Debt

(\$ in millions)	2014	2013
Issue:		
5.65% Senior Notes Due 2020 <sup>(1)</sup>	\$400	\$400
5.75% Senior Notes Due 2018 <sup>(1)</sup>	300	300
6.375% Senior Notes Due 2036 <sup>(1)</sup>	400	400
6.875% Medium-Term Notes Due 2015	—	200
6.9% Notes Due 2026	2	2
7.125% Debentures Due 2023	10	10
7.4% Debentures Due 2037	326	326
7.625% Notes Due 2097	500	500
7.65% Debentures Due 2016	78	200
7.95% Debentures Due 2017	220	285
8.125% Senior Notes Due 2019	400	—
2013 Term Loan Facility	2,216	2,239
2014 Term Loan	498	—
Total debt, excluding capital leases and note payable	5,350	4,862
Less: current maturities	28	23
Total long-term debt, excluding capital leases and note payable	\$5,322	\$4,839
Weighted-average interest rate at year end	6.4	% 6.5
Weighted-average maturity (in years)	14 years	

These debt issuances contain a change of control provision that would obligate us, at the holders' option, to (1) repurchase the debt at a price of 101%. These provisions trigger if there were a beneficial ownership change of 50% or more of our common stock.

## 2014 Debt Issuance and Tender Offers

In September 2014, we issued \$400 million aggregate principal amount of 8.125% Senior Notes due 2019 and used the majority of the \$393 million of proceeds from the offering, net of underwriting discounts, to pay the tender consideration and related transaction fees and expenses for our contemporaneous cash tender offers (2014 Tender Offers) to purchase approximately \$327 million aggregate principal amount of the three outstanding series of debt securities described below (collectively, the Securities).

Title of Security	Principal Amount Outstanding Prior to 2014 Tender Offers (\$ in millions)	Tender Premium <sup>(1)</sup>	Principal Amount Tendered (\$ in millions)	Principal Amount Accepted for Purchase (\$ in millions)	Principal Amount Outstanding After the 2014 Tender Offers (\$ in millions)
6.875% Medium-Term Notes due 2015	\$200	\$67.50	\$140	\$140	\$60
7.65% Debentures due 2016	200	105.00	122	122	78
7.95% Debentures due 2017	285	97.50	194	65	220
Total	\$685		\$456	\$327	\$358

(1) Per \$1,000 principal amount of Securities.

We paid approximately \$362 million aggregate consideration, including \$6 million of accrued interest, for the accepted Securities in October 2014. The 2014 Tender Offers resulted in a loss on extinguishment of debt of \$30 million which includes the premium paid over face value of the accepted Securities of \$29 million and reacquisition costs of \$1 million.





Table of Contents

## 2014 Debt Defeasance

In October 2014, subsequent to the completion of the 2014 Tender Offers, we deposited approximately \$64 million with Wilmington Trust, National Association, as Trustee under the Indenture with respect to our 6.875% Medium-Term Notes due 2015 (2015 Notes), to effect a legal defeasance of the remaining outstanding principal amount of 2015 Notes. As a result of depositing funds with the Trustee sufficient to make all payments of interest and principal on the outstanding 2015 Notes through October 15, 2015, the stated maturity of the 2015 Notes, the Company has satisfied and discharged all of its obligations under the terms of the 2015 Notes and with respect to the 2015 Notes under the Indenture. The defeasance resulted in a loss on extinguishment of debt of \$4 million which represents the portion of the deposited funds for future interest payments on the 2015 Notes.

## 2013 Tender Offer

On April 30, 2013 we announced the commencement of a cash tender offer (2013 Tender Offer) and consent solicitation for our 7.125% Debentures Due 2023 (2023 Notes). We also solicited consents to effect certain proposed amendments to the indenture governing the 2023 Notes (2023 Notes Indenture) that would eliminate most of the restrictive covenants and certain events of default and other provisions in the 2023 Notes Indenture (Proposed Amendments).

On May 22, 2013, we accepted for purchase \$243 million in aggregate principal amount of the 2023 Notes, representing 95.41% of the outstanding principal amount, for aggregate Amended Tender Offer Consideration of \$352 million. On June 5, 2013, we accepted for purchase an additional \$2 million in aggregate principal amount of the 2023 Notes, for aggregate tender offer consideration of \$3 million. The 2013 Tender Offer resulted in a loss on the extinguishment of debt of \$114 million which includes the premium paid over face value of the accepted 2023 Notes of \$110 million, reacquisition costs of \$2 million and the write-off of unamortized debt issue costs of \$2 million. As a result of receiving the requisite consent of the holders of at least 66 2/3% of aggregate principal amount of 2023 Notes outstanding, the Proposed Amendments were approved and became operative.

## 2013 Term Loan Facility

On May 22, 2013, JCP entered into a \$2.25 billion five-year senior secured term loan facility (2013 Term Loan Facility). The 2013 Term Loan Facility is guaranteed by J. C. Penney Company, Inc. and certain subsidiaries of JCP, and is secured by mortgages on certain real estate of JCP and the guarantors, in addition to substantially all other assets of JCP and the guarantors. Proceeds of the 2013 Term Loan Facility were used to fund the 2013 Tender Offer and will be used to fund ongoing working capital requirements and general corporate purposes. The 2013 Term Loan Facility bears interest at a rate of LIBOR plus 5.0%. We are required to make quarterly repayments in a principal amount equal to \$5.625 million during the five-year term, subject to certain reductions for mandatory and optional prepayments.

Scheduled Annual Principal Payments on Long-Term Debt, Excluding Capital Leases and Note Payable  
(\$ in millions)

2015	\$28
2016	106
2017	248
2018	2,454
2019	878
Thereafter	1,636
Total	\$5,350

Table of Contents

## 11. Stockholders' Equity

## Other Comprehensive Income/(Loss)

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

	2014			2013			2012		
(\$ in millions)	Gross Amount	Income Tax (Expense)/Benefit	Net Amount	Gross Amount	Income Tax (Expense)/Benefit	Net Amount	Gross Amount	Income Tax (Expense)/Benefit	Net Amount
REITs									
Unrealized gain/(loss)	\$—	\$ —	\$—	\$(2 )	\$ 1	\$(1 )	\$56	\$ (20 )	\$36
Reclassification adjustment for (gain)/loss	—	—	—	(24 )	8	(16 )	(285 ) <sup>(4)</sup>	101	(184 )
Foreign currency									
Unrealized gain/(loss)	(2 )	—	(2 )	—	—	—	—	—	—
Retirement benefit plans									
Net actuarial gain/(loss) arising during the period	(479 )	186	(293 )	659	(255 )	404	60	(23 )	37
Prior service credit/(cost) arising during the period	(20 )	8	(12 )	(7 )	3	(4 )	(42 )	16	(26 )
Reclassification of net prior service (credit)/cost from a curtailment	—	—	—	—	—	—	(5 )	2	(3 )
Reclassification of net actuarial (gain)/loss from a settlement	—	—	—	—	—	—	148	(57 )	91
Reclassification for amortization of net actuarial (gain)/loss	65	(25 )	40	175	(67 )	108	242	(94 )	148
Reclassification for amortization of prior service (credit)/cost	(1 )	—	(1 )	(1 )	—	(1 )	(13 )	5	(8 )
Deferred tax valuation allowance	—	(169 )	(169 )	—	—	—	—	—	—
Total	\$(437 )	\$ —	\$(437 )	\$800	\$ (310 )	\$490	\$161	\$ (70 )	\$91

- (1) When we have a loss in operations and a loss in other comprehensive income/(loss), the tax benefits associated with each loss are fully offset by a valuation allowance (Note 17).

When assessing valuation allowance needs, accounting standards require us to record in other comprehensive income/(loss) the tax expense on other comprehensive income and a corresponding tax benefit in operations (Note 17).

- (3) In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating income/(loss) and other comprehensive income/(loss).

(4) 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 (Note 16).

Table of Contents

## Accumulated Other Comprehensive Income/(Loss)

The following table shows the changes in accumulated other comprehensive income/(loss) balances for 2014 and 2013:

(\$ in millions)	Unrealized Gain/(Loss) on REITs	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Foreign Currency Translation	Accumulated Other Comprehensive Income/(Loss)
February 2, 2013	\$17	\$(1,121)	\$(14)	\$—	\$(1,118)
Current period change	(17)	512	(5)	—	490
February 1, 2014	\$—	\$(609)	\$(19)	\$—	\$(628)
Current period change	—	(414)	(21)	(2)	(437)
January 31, 2015	\$—	\$(1,023)	\$(40)	\$(2)	\$(1,065)

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

(\$ in millions)	Amount Reclassified from Accumulated Other Comprehensive Income/(Loss)			Line Item in the Consolidated Statements of Operations
	2014	2013	2012	
Realized (gain)/loss on REITs				
Sale or redemption of SPG REIT units	\$—	\$(24)	\$(270)	Real estate and other, net
Sale of CBL REIT shares	—	—	(15)	Real estate and other, net
Tax (expense)/benefit	—	8	101	Income tax expense/(benefit)
Total, net of tax	—	(16)	(184)	
Retirement benefit plans				
Amortization of actuarial (gain)/loss <sup>(1)</sup>	66	176	243	Pension
Amortization of prior service (credit)/cost <sup>(1)</sup>	7	7	1	Pension
Amortization of actuarial (gain)/loss <sup>(1)</sup>	(1)	(1)	(1)	SG&A
Amortization of prior service (credit)/cost <sup>(1)</sup>	(8)	(8)	(14)	SG&A
Prior service (credit)/cost from a curtailment	—	—	(5)	Restructuring and management transition (Note 15)
Actuarial (gain)/loss from a settlement <sup>(1)</sup>	—	—	148	Pension
Tax (expense)/benefit	(25)	(67)	(144)	Income tax expense/(benefit)
Decrease in deferred tax valuation allowance	25	—	—	Income tax expense/(benefit)
Total, net of tax	64	107	228	
Total reclassifications	\$64	\$91	\$44	

(1) These accumulated other comprehensive components are included in the computation of net periodic benefits expense/(income). See Note 14 for additional details.

## Common Stock

On a combined basis, our 401(k) savings plan, including our employee stock ownership plan (ESOP), held approximately 14 million shares, or approximately 4.0% of outstanding Company common stock, at January 31, 2015. For the years 2014, 2013 and 2012, we declared dividends of \$0.00, \$0.00 and \$0.20 per share, respectively.

## Issuance of Common Stock

On October 1, 2013, we issued 84 million shares of common stock with a par value of \$0.50 per share for \$9.65 per share for total net proceeds of \$786 million after \$24 million of fees.

Preferred Stock

We have authorized 25 million shares of preferred stock; no shares of preferred stock were issued and outstanding as of January 31, 2015 or February 1, 2014.

## Table of Contents

### Stock Warrant

On June 13, 2011, prior to his employment, we entered into a warrant purchase agreement with Ronald B. Johnson pursuant to which Mr. Johnson made a personal investment in the Company by purchasing a warrant to acquire approximately 7.3 million shares of J. C. Penney Company, Inc. common stock for a purchase price of approximately \$50 million at a mutually determined fair value of \$6.89 per share. The warrant has an exercise price of \$29.92 per share, subject to customary adjustments resulting from a stock split, reverse stock split, or other extraordinary distribution with respect to J. C. Penney Company, Inc. common stock. The warrant has a term of seven and one-half years and was initially exercisable after the sixth anniversary, or June 13, 2017; however, the warrant became immediately exercisable upon the termination of Mr. Johnson's employment with us in April 2013. The warrant is also subject to transfer restrictions. The proceeds from the sale of the warrant were recorded as additional paid-in capital and the dilutive effect of the warrant has been included in the EPS calculation from the date of issuance.

### Stockholders' Rights Agreement

As authorized by our Company's Board of Directors (the Board), on January 27, 2014, the Company entered into an Amended and Restated Rights Agreement (Amended Rights Agreement) with Computershare Inc., as Rights Agent (Rights Agent), amending, restating and replacing the Rights Agreement, dated as of August 22, 2013 (Original Rights Agreement), between the Company and the Rights Agent. Pursuant to the terms of the Original Rights Agreement, one preferred stock purchase right (a Right) was attached to each outstanding share of Common Stock of \$0.50 par value of the Company (Common Stock) held by holders of record as of the close of business on September 3, 2013. The Company has issued one Right in respect of each new share of Common Stock issued since the record date. The Rights, registered on August 23, 2013, trade with and are inseparable from our Common Stock and will not be evidenced by separate certificates unless they become exercisable.

The purpose of the Amended Rights Agreement is to diminish the risk that the Company's ability to use its net operating losses and other tax assets to reduce potential future federal income tax obligations would become subject to limitations by reason of the Company's experiencing an "ownership change" as defined under Section 382 of the Internal Revenue Code of 1986, as amended (the Code). Ownership changes under Section 382 generally relate to the cumulative change in ownership among stockholders with an ownership interest of 5% or more (as determined under Section 382's rules) over a rolling three year period. The Amended Rights Agreement is intended to reduce the likelihood of an ownership change under Section 382 by deterring any person or group from acquiring beneficial ownership of 4.9% or more of the outstanding Common Stock. The amendments to the Original Rights Agreement also extended the expiration date of the Rights from August 20, 2014 to January 26, 2017 and amended certain other provisions, including the definition of "beneficial ownership" to include terms appropriate for the purpose of preserving tax benefits.

Each Right entitles its holder to purchase from the Company 1/1000th of a share of a newly authorized series of participating preferred stock at an exercise price of \$55.00, subject to adjustment in accordance with the terms of the Amended Rights Agreement, once the Rights become exercisable. In general terms, under the Amended Rights Agreement, the Rights become exercisable if any person or group acquires 4.9% or more of the Common Stock or, in the case of any person or group that owned 4.9% or more of the Common Stock as of January 27, 2014, upon the acquisition of any additional shares by such person or group. In addition, the Company, its subsidiaries, employee benefit plans of the Company or any of its subsidiaries, and any entity holding Common Stock for or pursuant to the terms of any such plan, are excepted. Upon exercise of the Right in accordance with the Amended Rights Agreement, the holder would be able to purchase a number of shares of Common Stock from the Company having an aggregate market value (as defined in the Amended Rights Agreement) equal to twice the then-current exercise price for an amount in cash equal to the then-current exercise price. The Rights will not prevent an ownership change from occurring under Section 382 of the Code or a takeover of the Company, but may cause substantial dilution to a person that acquires 4.9% or more of our Common Stock.

### 12. Stock-Based Compensation

We grant stock-based compensation awards to employees and non-employee directors under our equity compensation plan. On May 16, 2014, our stockholders approved the J. C. Penney Company, Inc. 2014 Long-Term Incentive Plan (2014 Plan), which has a fungible share design in which each stock option will count as one share issued and each stock award will count as two shares issued. The 2014 Plan reserved 16 million shares or 32 million options for future grants and will terminate on May 31, 2019. In addition, shares underlying any outstanding stock award or stock option grant canceled prior to vesting or exercise become available for use under the 2014 Plan. On May 21, 2014, the Company also approved an equity inducement award plan (2014 Equity Inducement Plan) which reserved 750,000 restricted stock units to grant to an incoming executive officer of the Company. Our prior 2012 Long-Term Incentive Plan (2012 Plan) terminated on May 16, 2014, except for outstanding awards, and all subsequent awards have been granted under the 2014 Plan or the 2014 Equity Inducement Plan. Under the terms of the



Table of Contents

2014 Plan, all grants made after January 31, 2014 reduce the shares available for grant under the 2014 Plan. As of January 31, 2015, a maximum of 23.2 million shares of stock were available for future grant under the 2014 Plan.

Our stock option and restricted stock award grants have averaged about 2.3% of outstanding stock over the past three years. Authorized shares of the Company's common stock are used to settle the exercise of stock options, granting of restricted shares and vesting of restricted stock units.

**Stock-based Compensation Cost**

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

(\$ in millions)	2014	2013	2012
Stock awards	\$20	\$14	\$33
Stock options	13	14	17
Total stock-based compensation <sup>(1)</sup>	\$33	\$28	\$50
Total income tax benefit recognized for stock-based compensation arrangements	\$—	\$—	\$19

(1) Excludes \$3 million, \$18 million and \$11 million for 2014, 2013 and 2012, respectively, of stock-based compensation costs reported in restructuring and management transition charges (Note 15).

**Stock Options**

The following table summarizes stock option activity during the year ended January 31, 2015:

	Shares (in thousands)	Weighted - Average Exercise Price Per Share	Weighted - Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (\$ in millions)(1)
Outstanding at February 1, 2014	14,029	\$36		
Granted <sup>(2)</sup>	2,507	8		
Exercised	—	—		
Forfeited/canceled	(1,961)	) 33		
Outstanding at January 31, 2015	14,575	32	4.4	\$—
Exercisable at January 31, 2015	10,527	39	2.9	\$—

The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the (1) exercise price of the option at year end. As of January 31, 2015, all outstanding stock options had an exercise price above the closing price of JCPenney common stock of \$7.27.

All stock options granted during 2014 had a market condition related to achieving and maintaining a 50% or more (2) increase in the Company's stock price over the grant date closing price for 20 consecutive days. The market condition must be met within four years of the grant date.

If all outstanding options were exercised, common stock outstanding would increase by 4.8%.

Cash proceeds, tax benefits and intrinsic value related to total stock options exercised are provided in the following table:

(\$ in millions)	2014	2013	2012
Proceeds from stock options exercised	\$—	\$7	\$71
Intrinsic value of stock options exercised	—	2	38
Tax benefit related to stock-based compensation	—	—	15
Excess tax benefits realized on stock-based compensation	—	—	12

As of January 31, 2015, we had \$11 million of unrecognized and unearned compensation expense, net of estimated forfeitures, for stock options not yet vested, which will be recognized as expense over the remaining weighted-average vesting period of approximately two years.

Table of Contents

Our weighted-average fair value of stock options at grant date was \$3.78 in 2014, \$7.15 in 2013 and \$11.49 in 2012. We used the Monte Carlo simulation model in 2014 and the binomial lattice valuation model in 2013 and 2012 to determine the fair value of the stock options granted using the following assumptions:

	2014	2013	2012
Weighted-average expected option term	4.1 years	4.3 years	4.8 years
Weighted-average expected volatility	60.00%	62.00%	45.30%
Weighted-average risk-free interest rate	1.60%	0.64%	0.87%
Weighted-average expected dividend yield	—%	—%	1.40%
Expected dividend yield range	—%	—%	2.0% – 2.1%

## Stock Awards

The following table summarizes our non-vested stock awards activity during the year ended January 31, 2015:

(shares in thousands)	Time-Based Stock Awards		Performance-Based Stock Awards	
	Number of Units	Weighted-Average Grant Date Fair Value	Number of Units	Weighted-Average Grant Date Fair Value
Non-vested at February 1, 2014	1,357	\$ 23	73	\$ 7
Granted	6,289	8	497	6
Vested	(460)	) 18	(37)	) 7
Forfeited/canceled	(417)	) 12	—	—
Non-vested at January 31, 2015	6,769	10	533	7

As of January 31, 2015, we had \$46 million of unrecognized compensation expense related to unearned employee stock awards, which will be recognized over the remaining weighted-average vesting period of approximately two years. The aggregate market value of shares vested during 2014, 2013 and 2012 was \$4 million, \$25 million and \$26 million, respectively, compared to an aggregate grant date fair value of \$9 million, \$42 million and \$29 million, respectively.

In addition to the grants above, on March 20, 2014, we granted approximately 2.3 million phantom units as part of our management incentive compensation plan, which are similar to RSUs in that the number of units granted was based on the price of our stock, but the units will be settled in cash based on the value of our stock on the vesting date, limited to \$16.72 per phantom unit. The fair value of the awards is remeasured at each reporting period and was \$7.27 per share as of January 31, 2015. Compensation expense, which is variable, is recognized over the vesting period with a corresponding liability, which is recorded in Other liabilities in our unaudited Interim Consolidated Balance Sheets, of \$6 million as of January 31, 2015.

## 13. Leases and Note Payable

We conduct a major part of our operations from leased premises that include retail stores, store distribution centers, warehouses, offices and other facilities. Almost all leases will expire during the next 20 years; however, most leases will be renewed, primarily through an option exercise, or replaced by leases on other premises. We also lease data processing equipment and other personal property under operating leases of primarily three to five years. Rent expense, net of sublease income, was as follows:

(\$ in millions)	2014	2013	2012
Real property base rent and straight-lined step rent expense	\$233	\$237	\$240
Real property contingent rent expense (based on sales)	8	5	10
Personal property rent expense	53	65	67
Total rent expense	\$294	\$307	\$317
Less: sublease income <sup>(1)</sup>	(13)	) (16	) (16
Net rent expense	\$281	\$291	\$301

(1) Sublease income is reported in Real estate and other, net.

Table of Contents

As of January 31, 2015, future minimum lease payments for non-cancelable operating leases, including lease renewals determined to be reasonably assured and capital leases, including our note payable, were as follows:

(\$ in millions)	Operating Leases	
2015	\$237	
2016	216	
2017	185	
2018	153	
2019	132	
Thereafter	1,896	
Less: sublease income	(39	)
Total minimum lease payments	\$2,780	
(\$ in millions)	Capital Leases and Note Payable	
2015	\$33	
2016	27	
2017	10	
2018	—	
2019	—	
Thereafter	—	
Less: sublease income	—	
Total minimum lease payments	70	
Less: amounts representing interest	(4	)
Present value of net minimum lease obligations	\$66	

## Table of Contents

### 14. Retirement Benefit Plans

We provide retirement pension benefits, postretirement health and welfare benefits, as well as 401(k) savings, profit-sharing and stock ownership plan benefits to various segments of our workforce. Retirement benefits are an important part of our total compensation and benefits program designed to retain and attract qualified, talented employees. Pension benefits are provided through defined benefit pension plans consisting of a non-contributory qualified pension plan (Primary Pension Plan) and, for certain management employees, non-contributory supplemental retirement plans, including a 1997 voluntary early retirement plan. Retirement and other benefits include:

Defined Benefit Pension Plans

Primary Pension Plan – funded

Supplemental retirement plans – unfunded

Other Benefit Plans

Postretirement benefits – medical and dental

Defined contribution plans:

401(k) savings, profit-sharing and stock ownership plan

Deferred compensation plan

#### Defined Benefit Pension Plans

##### Primary Pension Plan — Funded

The Primary Pension Plan is a funded non-contributory qualified pension plan, initiated in 1966 and closed to new entrants on January 1, 2007. The plan is funded by Company contributions to a trust fund, which are held for the sole benefit of participants and beneficiaries.

##### Supplemental Retirement Plans — Unfunded

We have unfunded supplemental retirement plans, which provide retirement benefits to certain management employees. We pay ongoing benefits from operating cash flow and cash investments. The plans are a Supplemental Retirement Program and a Benefit Restoration Plan. Participation in the Supplemental Retirement Program is limited to employees who were annual incentive-eligible management employees as of December 31, 1995. Benefits for these plans are based on length of service and final average compensation. The Benefit Restoration Plan is intended to make up benefits that could not be paid by the Primary Pension Plan due to governmental limits on the amount of benefits and the level of pay considered in the calculation of benefits. The Supplemental Retirement Program is a non-qualified plan that was designed to allow eligible management employees to retire at age 60 with retirement income comparable to the age 65 benefit provided under the Primary Pension Plan and Benefit Restoration Plan. In addition, the Supplemental Retirement Program offers participants who leave between ages 60 and 62 benefits equal to the estimated social security benefits payable at age 62. The Supplemental Retirement Program also continues Company-paid term life insurance at a declining rate until it is phased out at age 70. Employee-paid term life insurance through age 65 is continued under a separate plan (Supplemental Term Life Insurance Plan for Management Profit-Sharing Employees).

#### 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 Consolidated Statements of Operations (Note 16). The curtailments resulted in reductions in the 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.

Table of Contents**Primary Pension Plan Lump-Sum Payment Offer**

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

**Pension Expense/(Income) for Defined Benefit Pension Plans**

Pension expense is based upon the annual service cost of benefits (the actuarial cost of benefits attributed to a period) and the interest cost on plan liabilities, less the expected return on plan assets for the Primary Pension Plan.

Differences in actual experience in relation to assumptions are not recognized immediately but are deferred and amortized over the average remaining service period of approximately eight years for the Primary Pension Plan, subject to a corridor as permitted under GAAP pension plan accounting.

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

(\$ in millions)

Primary Pension Plan	2014	2013	2012
Service cost	\$61	\$78	\$87
Interest cost	211	204	242
Expected return on plan assets	(348)	) (340	) (382
Amortization of actuarial loss/(gain)	52	152	220
Amortization of prior service cost/(credit)	7	6	—
Settlement expense	—	—	148
Loss/(gain) on transfer of benefits	15	—	—
Net periodic benefit expense/(income)	\$(2	) \$100	\$315

**Supplemental Pension Plans**

Service cost	\$—	\$—	\$1
Interest cost	9	12	13
Amortization of actuarial loss/(gain)	14	24	23
Amortization of prior service cost/(credit)	—	1	1
Loss/(gain) on transfer of benefits	(15	) —	—
Net periodic benefit expense/(income)	\$8	\$37	\$38

**Primary and Supplemental Pension Plans Total**

Service cost	\$61	\$78	\$88
Interest cost	220	216	255
Expected return on plan assets	(348)	) (340	) (382
Amortization of actuarial loss/(gain)	66	176	243
Amortization of prior service cost/(credit)	7	7	1
Settlement charge	—	—	148
Loss/(gain) on transfer of benefits	—	—	—



Edgar Filing: J C PENNEY CO INC - Form 10-K

Net periodic benefit expense/(income)	\$6	\$137	\$353
---------------------------------------	-----	-------	-------

The defined benefit plan pension expense shown in the above table is included as a separate line item in the Consolidated Statements of Operations.

Table of Contents

During 2014, we transferred \$56 million of supplemental pension plan benefits, as allowed under the Employee Retirement Income Security Act of 1974, out of our supplemental pension plans and into our Primary Pension Plan. The transfer did not have a significant impact on our Consolidated Financial Statements; however, it did result in a gain of \$15 million for our supplemental pension plans and loss of \$15 million for our Primary Pension Plan.

Assumptions

The weighted-average actuarial assumptions used to determine expense were as follows:

	2014		2013		2012	
Expected return on plan assets	7.0	%	7.0	%	7.5	%
Discount rate	4.89	%	4.19	%	4.82	% <sup>(1)</sup>
Salary increase	3.5	%	4.7	%	4.7	%

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

The expected return on plan assets is based on the plan's long-term asset allocation policy, historical returns for plan assets and overall capital market returns, taking into account current and expected market conditions. In 2012 and 2011, the expected return on plan assets was 7.5%, which was reduced from the 2010 rate of 8.4% to align our expected rate of return with our new asset allocation targets. The expected return assumption for 2013 and 2014 was further reduced from 7.5% to 7.0% given our new asset allocation targets and updated expected capital markets return assumptions.

The discount rate used to measure pension expense each year is the rate as of the beginning of the year (i.e., the prior measurement date). For the 2011 year-end remeasurement, used to calculate 2012 expense, the discount rate used was based on an externally published yield curve determined by the plan's actuary. The yield curve is a hypothetical AA yield curve represented by a series of bonds maturing from six months to 30 years, designed to match the corresponding pension benefit cash payments to retirees. Beginning with the remeasurement on September 30, 2012, the discount rate used, determined by the plan actuary, was based on a hypothetical AA yield curve represented by a series of bonds maturing over the next 30 years, designed to match the corresponding pension benefit cash payments to retirees.

The salary progression rate to measure pension expense was based on age ranges and projected forward.

Funded Status

As of the end of 2014, the funded status of the Primary Pension Plan was 104%. The PBO is the present value of benefits earned to date by plan participants, including the effect of assumed future salary increases. Under the Employee Retirement Income Security Act of 1974 (ERISA), the funded status of the plan exceeded 100% as of December 31, 2014 and 2013, the qualified pension plan's year end.

Table of Contents

The following table provides a reconciliation of benefit obligations, plan assets and the funded status of the Primary Pension Plan and supplemental pension plans:

(\$ in millions)	Primary Pension Plan		Supplemental Plans	
	2014	2013	2014	2013
Change in PBO				
Beginning balance	\$4,477	\$5,042	\$219	\$303
Service cost	61	78	—	—
Interest cost	211	204	9	12
Amendments	20	17	—	(8)
Transfer of benefits	56	—	(56)	—
Actuarial loss/(gain)	818	(442)	39	(34)
Benefits (paid)	(389)	(422)	(20)	(54)
Balance at measurement date	\$5,254	\$4,477	\$191	\$219
Change in fair value of plan assets				
Beginning balance	\$5,140	\$5,035	\$—	\$—
Company contributions	—	—	20	54
Actual return on assets <sup>(1)</sup>	723	527	—	—
Benefits (paid)	(389)	(422)	(20)	(54)
Balance at measurement date	\$5,474	\$5,140	\$—	\$—
Funded status of the plan	\$220	<sup>(2)</sup> \$663	<sup>(2)</sup> \$(191)	<sup>(3)</sup> \$(219)

(1) Includes plan administrative expenses.

(2) Presented as Prepaid pension in the Consolidated Balance Sheets.

\$16 million in 2014 and \$44 million in 2013 were included in Other accounts payable and accrued expenses on the Consolidated Balance Sheets, and the remaining amounts were included in Other liabilities.

In 2014, the funded status of the Primary Pension Plan decreased by \$443 million primarily due to a 102 basis point decline in our discount rate and the adoption of the RP-2014 mortality table and MP-2014 improvement scale issued by the Society of Actuaries in October 2014. The updated mortality assumptions used for the majority of the participants reflects longer life expectations and anticipated rates of improvement in life expectancy compared to previous mortality assumptions. The actual one-year return on pension plan assets at the measurement date was 15.1% in 2014, bringing the cumulative return since inception of the plan to 9.1%.

The following pre-tax amounts were recognized in Accumulated other comprehensive income/(loss) in the Consolidated Balance Sheets as of the end of 2014 and 2013:

(\$ in millions)	Primary Pension Plan		Supplemental Plans	
	2014	2013	2014	2013
Net actuarial loss/(gain)	\$1,331	\$898	\$110	\$127
Prior service cost/(credit)	65	53	(4)	(6)
Total	\$1,396	<sup>(1)</sup> \$951	\$106	<sup>(1)</sup> \$121

In 2015, approximately \$111 million for the Primary Pension Plan and \$13 million for the supplemental plans are (1) expected to be amortized from Accumulated other comprehensive income/(loss) into net periodic benefit expense/(income) included in Pension in the Consolidated Statement of Operations.

#### Assumptions to Determine Obligations

The weighted-average actuarial assumptions used to determine benefit obligations for each of the years below were as follows:

Edgar Filing: J C PENNEY CO INC - Form 10-K

	2014	2013	2012	
Discount rate	3.87	% 4.89	% 4.19	%
Salary progression rate	3.5	% 3.5	% 4.7	%

87

---

Table of Contents**Accumulated Benefit Obligation (ABO)**

The ABO is the present value of benefits earned to date, assuming no future salary growth. The ABO for our Primary Pension Plan was \$4.9 billion and \$4.2 billion as of the end of 2014 and 2013, respectively. At the end of 2014, plan assets of \$5.5 billion for the Primary Pension Plan were above the ABO. The ABO for our unfunded supplemental pension plans was \$166 million and \$200 million as of the end of 2014 and 2013, respectively.

**Primary Pension Plan Asset Allocation**

The target allocation ranges for each asset class as of the end of 2014 and the fair value of each asset class as a percent of the total fair value of pension plan assets were as follows:

Asset Class	2014 Target Allocation Ranges	Plan Assets		
		2014	2013	
Equity	20% - 40%	29	% 44	%
Fixed income	50% - 60%	58	% 42	%
Real estate, cash and other investments	0% - 20%	13	% 14	%
Total		100	% 100	%

**Asset Allocation Strategy**

In 2009, we began implementing a liability-driven investment (LDI) strategy to lower the plan's volatility risk and minimize the impact of interest rate changes on the plan funded status. The implementation of the LDI strategy is phased in over time by reallocating the plan's assets more towards fixed income investments (i.e., debt securities) that are more closely matched in terms of duration to the plan liability. In 2014, we increased the plan's target allocation to fixed income from 40% to 55%.

The plan's asset portfolio is actively managed and primarily invested in fixed income balanced with investments in equity securities and other asset classes to maintain an efficient risk/return diversification profile. The risk of loss in the plan's equity portfolio is mitigated by investing in a broad range of equity types. Equity diversification includes large-capitalization and small-capitalization companies, growth-oriented and value-oriented investments and U.S. and non-U.S. securities. Investment types, including high-yield debt securities, illiquid assets such as real estate, the use of derivatives and Company securities are set forth in written guidelines established for each investment manager and monitored by the plan's management team. The plan's asset allocation policy is designed to meet the plan's future pension benefit obligations. Under the policy, asset classes are periodically reviewed and rebalanced as necessary, to ensure that the mix continues to be appropriate relative to established targets and ranges.

We have an internal Benefit Plans Investment Committee (BPIC), which consists of senior executives who have established a review process of asset allocation and investment strategies and oversee risk management practices associated with the management of the plan's assets. Key risk management practices include having an established and broad decision-making framework in place, focused on long-term plan objectives. This framework consists of the BPIC and various third parties, including investment managers, an investment consultant, an actuary and a trustee/custodian. The funded status of the plan is monitored on a continuous basis, including quarterly reviews with updated market and liability information. Actual asset allocations are monitored monthly and rebalancing actions are executed at least quarterly, if needed. To manage the risk associated with an actively managed portfolio, the plan's management team reviews each manager's portfolio on a quarterly basis and has written manager guidelines in place, which are adjusted as necessary to ensure appropriate diversification levels. Also, annual audits of the investment managers are conducted by independent auditors. Finally, to minimize operational risk, we utilize a master custodian for all plan assets, and each investment manager reconciles its account with the custodian at least quarterly.

Table of Contents

## Fair Value of Primary Pension Plan Assets

The tables below provide the fair values of the Primary Pension Plan's assets as of the end of 2014 and 2013, by major class of asset.

(\$ in millions)	Investments at Fair Value at January 31, 2015			Total
	Level 1 <sup>(1)</sup>	Level 2 <sup>(1)</sup>	Level 3	
Assets				
Cash	\$10	\$2	\$—	\$12
Common collective trusts	—	38	—	38
Cash and cash equivalents total	10	40	—	50
Common collective trusts – domestic	—	222	—	222
Common collective trusts – international	—	197	—	197
Equity securities – domestic	733	—	—	733
Equity securities – international	104	—	—	104
Private equity	—	—	281	281
Equity securities total	837	419	281	1,537
Common collective trusts	—	1,695	—	1,695
Corporate bonds	—	1,319	7	1,326
Swaps	—	415	—	415
Government securities	—	167	—	167
Corporate loans	—	69	5	74
Municipal bonds	—	66	—	66
Mortgage backed securities	—	5	—	5
Other fixed income	—	21	—	21
Fixed income total	—	3,757	12	3,769
Public REITs	100	—	—	100
Private real estate	—	20	153	173
Real estate total	100	20	153	273
Hedge funds	—	—	314	314
Other investments total	—	—	314	314
Total investment assets at fair value	\$947	\$4,236	\$760	\$5,943
Liabilities				
Swaps	\$—	\$(428	) \$—	\$(428 )
Other fixed income	(2	) (3	) —	(5 )
Fixed income total	(2	) (431	) —	(433 )
Total liabilities at fair value	\$(2	) \$(431	) \$—	\$(433 )
Accounts payable, net				(36 )
Total net assets				\$5,474

(1) There were no significant transfers in or out of level 1 or 2 investments.

Table of Contents

(\$ in millions)	Investments at Fair Value at February 1, 2014			Total
	Level 1 <sup>(1)</sup>	Level 2 <sup>(1)</sup>	Level 3	
Assets				
Cash	\$158	\$—	\$—	\$158
Common collective trusts	—	32	—	32
Cash and cash equivalents total	158	32	—	190
Common collective trusts – domestic	—	224	—	224
Common collective trusts – international	—	335	—	335
Equity securities – domestic	1,206	—	—	1,206
Equity securities – international	197	6	—	203
Private equity	—	—	298	298
Equity securities total	1,403	565	298	2,266
Common collective trusts	—	1,099	—	1,099
Corporate bonds	—	838	11	849
Swaps	—	238	—	238
Municipal bonds	—	50	—	50
Mortgage backed securities	—	6	—	6
Corporate loans	—	27	6	33
Government securities	—	106	—	106
Other fixed income	1	12	—	13
Fixed income total	1	2,376	17	2,394
Public REITs	118	—	—	118
Private real estate	—	19	204	223
Real estate total	118	19	204	341
Hedge funds	—	—	153	153
Other investments total	—	—	153	153
Total investment assets at fair value	\$1,680	\$2,992	\$672	\$5,344
Liabilities				
Swaps	\$—	\$(237)	\$—	\$(237)
Other fixed income	(2)	(2)	—	(4)
Fixed income total	(2)	(239)	—	(241)
Total liabilities at fair value	\$(2)	\$(239)	\$—	\$(241)
Accounts payable, net				37
Total net assets				\$5,140

(1) There were no significant transfers in or out of level 1 or 2 investments.

Following is a description of the valuation methodologies used for Primary Pension Plan assets measured at fair value.

Cash – Cash is valued at cost which approximates fair value, and is classified as level 1 of the fair value hierarchy.

Common Collective Trusts – Common collective trusts are pools of investments within cash equivalents, equity and fixed income that are benchmarked relative to a comparable index. They are valued on the basis of the relative interest of each participating investor in the fair value of the underlying assets. The underlying assets are valued at net asset value (NAV) and are classified as level 2 of the fair value hierarchy.

Equity Securities – Equity securities are common stocks and preferred stocks valued based on the price of the security as listed on an open active exchange and classified as level 1 of the fair value hierarchy, as well as warrants and preferred stock that are valued at a price, which is based on a broker quote in an over-the-counter market, and are

classified as level 2 of the fair value hierarchy.

90

---



Table of Contents

**Private Equity** – Private equity is composed of interests in private equity funds valued on the basis of the relative interest of each participating investor in the fair value of the underlying assets and/or common stock of privately held companies. There are no observable market values for private equity funds. The valuations for the funds are derived using a combination of different methodologies including (1) the market approach, which consists of analyzing market transactions for comparable assets, (2) the income approach using the discounted cash flow model, or (3) cost method. Private equity funds also provide audited financial statements. Private equity investments are classified as level 3 of the fair value hierarchy.

**Corporate Bonds** – Corporate bonds and Corporate loans are valued at a price which is based on observable market information in primary markets or a broker quote in an over-the-counter market, and are classified as level 2 or level 3 of the fair value hierarchy.

**Swaps** – swap contracts are based on broker quotes in an over-the-counter market and are classified as level 2 of the fair value hierarchy.

**Government, Municipal Bonds and Mortgaged Backed Securities** – Government and municipal securities are valued at a price based on a broker quote in an over-the-counter market and classified as level 2 of the fair value hierarchy. Mortgage backed securities are valued at a price based on observable market information or a broker quote in an over-the-counter market and classified as level 2 of the fair value hierarchy.

**Other fixed income** – non-mortgage asset backed securities, collateral held in short-term investments for derivative contract and derivatives composed of futures contracts, option contracts and other fix income derivatives valued at a price based on observable market information or a broker quote in an over-the-counter market and classified as level 2 of the fair value hierarchy.

**Real Estate** – Real estate is comprised of public and private real estate investments. Real estate investments through registered investment companies that trade on an exchange are classified as level 1 of the fair value hierarchy. Investments through open end private real estate funds that are valued at the reported NAV are classified as level 2 of the fair value hierarchy. Private real estate investments through partnership interests that are valued based on different methodologies including discounted cash flow, direct capitalization and market comparable analysis are classified as level 3 of the fair value hierarchy.

**Hedge Fund** – Hedge funds exposure is through fund of funds, which are made up of over 30 different hedge fund managers diversified over different hedge strategies. The fair value of the hedge fund is determined by the fund's administrator using valuation provided by the third party administrator for each of the underlying funds.

The following tables set forth a summary of changes in the fair value of the Primary Pension Plan's level 3 investment assets:

	2014				
(\$ in millions)	Private Equity	Real Estate	Corporate Loans	Corporate Bonds	Hedge Funds
Balance, beginning of year	\$298	\$204	\$6	\$11	\$153
Transfers, net	—	—	—	—	—
Realized gains/(loss)	57	3	—	—	13
Unrealized (losses)/gains	(8	) 17	—	(1	) (4
Purchases and issuances	31	3	4	5	467
Sales, maturities and settlements	(97	) (74	) (5	) (8	) (315
Balance, end of year	\$281	\$153	\$5	\$7	\$314



Table of Contents

(\$ in millions)	2013 Private Equity	Real Estate	Corporate Loans	Corporate Bonds	Hedge Funds
Balance, beginning of year	\$297	\$231	\$12	\$10	\$—
Realized gains/(loss)	38	5	—	—	—
Unrealized (losses)/gains	3	11	—	(1	) 3
Purchases and issuances	33	4	2	2	150
Sales, maturities and settlements	(73	) (47	) (8	) —	—
Balance, end of year	\$298	\$204	\$6	\$11	\$153

**Contributions**

Our policy with respect to funding the Primary Pension Plan is to fund at least the minimum required by ERISA rules, as amended by the Pension Protection Act of 2006, and not more than the maximum amount deductible for tax purposes. Due to our past funding of the pension plan and overall positive growth in plan assets since plan inception, there will not be any required cash contribution for funding of plan assets in 2015 under ERISA, as amended by the Pension Protection Act of 2006.

Our contributions to the unfunded non-qualified supplemental retirement plans are equal to the amount of benefit payments made to retirees throughout the year and for 2015 are anticipated to be approximately \$16 million. Benefits are paid in the form of five equal annual installments to participants and no election as to the form of benefit is provided for in the unfunded plans. The following sets forth our estimated future benefit payments:

(\$ in millions)	Primary Plan Benefits	Supplemental Plan Benefits
2015	\$388	\$16
2016	333	44
2017	333	22
2018	334	15
2019	336	14
2020-2024	1,682	67

**Other Benefit Plans****Postretirement Benefits — Medical and Dental**

We provide medical and dental benefits to retirees through a contributory medical and dental plan based on age and years of service. We provide a defined dollar commitment toward retiree medical premiums.

Effective June 7, 2005, we amended the medical plan to reduce our subsidy to post-age 65 retirees and spouses by 45% beginning January 1, 2006, and then fully eliminated the subsidy after December 31, 2006. As disclosed previously, the postretirement benefit plan was amended in 2001 to reduce and cap the per capita dollar amount of the benefit costs that would be paid by the plan. Thus, changes in the assumed or actual health care cost trend rates do not materially affect the accumulated postretirement benefit obligation or our annual expense.

**Postretirement Plan (Income)**

(\$ in millions)	2014	2013	2012
Interest cost	\$1	\$1	\$1
Amortization of actuarial loss/(gain)	(1	) (1	) (1
Amortization of prior service cost/(credit)	(8	) (8	) (14
Net periodic benefit expense/(income)	\$(8	) \$(8	) \$(14

The net periodic postretirement benefit is included in SG&A expenses in the Consolidated Statements of Operations. The discount rates used for the postretirement plan are the same as those used for the defined benefit plans, as disclosed on page 86 for all periods presented.

Table of Contents

## Funded Status

The table below provides a reconciliation of benefit obligations, plan assets and the funded status of the postretirement plan. The accumulated postretirement benefit obligation (APBO) is the present value of benefits earned to date by plan participants.

## Obligations and Funded Status

(\$ in millions)	2014		2013	
Change in APBO				
Beginning balance	\$15		\$18	
Interest cost	1		1	
Participant contributions	9		13	
Actuarial (gain)/loss	(3	)	—	
Benefits (paid)	(11	)	(17	)
Balance at measurement date	\$11		\$15	
Change in fair value of plan assets				
Beginning balance	\$—		\$—	
Participant contributions	9		13	
Company contributions	2		4	
Benefits (paid)	(11	)	(17	)
Balance at measurement date	\$—		\$—	
Funded status of the plan	\$(11	) <sup>(1)</sup>	\$(15	) <sup>(1)</sup>

Of the total accrued liability, \$1 million for 2014 and \$2 million for 2013 was included in Other accounts payable (1) and accrued expenses in the Consolidated Balance Sheets, and the remaining amounts were included in Other liabilities.

The following pre-tax amounts were recognized in Accumulated other comprehensive income/(loss) in the Consolidated Balance Sheets as of the end of 2014 and 2013:

(\$ in millions)	2014		2013	
Net actuarial loss/(gain)	\$(8	)	\$(6	)
Prior service cost/(credit)	(7	)	(15	)
Total	\$(15	) <sup>(1)</sup>	\$(21	)

(1) In 2015, approximately \$(1) million of net actuarial loss/(gain) and \$(7) million of prior service cost/(credit) for the postretirement plan are expected to be amortized from Accumulated other comprehensive income/(loss) into net periodic postretirement benefit (income) included in SG&A in the Consolidated Statement of Operations.

## Cash Contributions

The postretirement benefit plan is not funded and is not subject to any minimum regulatory funding requirements. We estimate that in 2015 we will contribute \$1 million toward retiree medical premiums.

Table of Contents

## Estimated Future Benefit Payments

(\$ in millions)	Other Postretirement Benefits
2015	\$1
2016	1
2017	1
2018	1
2019	1
2020-2024	5

## Defined Contribution Plans

The Savings, Profit-Sharing and Stock Ownership Plan (Savings Plan) is a qualified defined contribution plan, a 401(k) plan, available to all eligible employees. Effective January 1, 2007, all employees who are age 21 or older are immediately eligible to participate in and contribute a percentage of their pay to the Savings Plan. Eligible employees, who have completed one year and at least 1,000 hours of service within an eligibility period, are offered a fixed matching contribution each pay period equal to 50% of up to 6% of pay contributed by the employee. Matching contributions are credited to employees' accounts in accordance with their investment elections and fully vest after three years. We may make additional discretionary matching contributions.

The Savings Plan includes a non-contributory retirement account. Participants who are hired or rehired on or after January 1, 2007 and who have completed at least 1,000 hours of service within an eligibility period receive a Company contribution in an amount equal to 2% of the participants' annual pay. This Company contribution is in lieu of the primary pension benefit that was closed to employees hired or rehired on or after that date. Participating employees are fully vested after three years.

In addition to the Savings Plan, we sponsor the Mirror Savings Plan, which is a non-qualified contributory unfunded defined contribution plan offered to certain management employees. This plan supplements retirement savings under the Savings Plan for eligible management employees who choose to participate in it. The plan's investment options generally mirror the traditional Savings Plan investment options. As of the end of 2014, the unamortized pre-tax balance within Accumulated other comprehensive income/(loss) for the plan was \$18 million. Similar to the supplemental retirement plans, the Mirror Savings Plan benefits are paid from our operating cash flow and cash investments.

The expense for these plans, which was predominantly included in SG&A expenses in the Consolidated Statements of Operations, was as follows:

(\$ in millions)	2014	2013	2012
Savings Plan – 401(k)	\$37	\$38	\$43
Savings Plan – retirement account	13	11	11
Mirror Savings Plan	3	3	3
Total	\$53	\$52	\$57

Table of Contents

## 15. Restructuring and Management Transition

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

				Cumulative Amount From Program Inception Through
(\$ in millions)	2014	2013	2012	2014
Supply chain	\$—	\$—	\$19	\$60
Home office and stores	45	48	109	247
Software and systems	—	—	36	36
Store fixtures	—	55	78	133
Management transition	16	37	41	224
Other	26	75	15	149
Total	\$87	\$215	\$298	\$849

**Supply chain**

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

**Home office and stores**

During 2014, 2013 and 2012, we recorded \$45 million, \$48 million and \$109 million, respectively, of costs to reduce our store and home office expenses. During the nine months ended November 1, 2014, we recorded \$15 million of charges for actions taken to reduce our home office and store expenses. In January 2015, we announced the closing of 40 department stores, and as a result, during the fourth quarter of 2014, we incurred charges of \$20 million related to asset impairments and \$1 million of employee termination benefit costs. Additionally, we incurred \$9 million of other miscellaneous store restructuring costs during 2014.

During the first three quarters of 2013, we recorded \$26 million of employee termination benefits for both store and home office associates. In addition, in January 2014, we announced a strategic initiative to close 33 underperforming stores as part of our turnaround efforts. In conjunction with this initiative, during the fourth quarter of 2013, we incurred charges of \$21 million related to asset impairments and \$1 million of employee termination benefit costs.

In 2012, charges of \$116 million associated with employee termination benefits for both store and home office associates were offset by a net curtailment gain of \$7 million (Note 14) related to our retirement benefit plans, which was incurred during the third quarter of 2012 when substantially all employee exits related to 2012 were completed, for a net charge of \$109 million.

**Software and systems**

During 2012, we recorded a charge of \$36 million related to the disposal of software and systems that based on our evaluation no longer supported our operations. This amount included \$3 million of consulting fees related to that evaluation.

**Store fixtures**

During 2013, we recorded a total charge of \$55 million related to store fixtures which consisted of \$37 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced throughout 2013, \$11 million of charges for the impairment of certain store fixtures related to our former shops strategy that had been used in our prototype department store and a \$7 million asset write down of store fixtures

related to the renovations in our home department.

During 2012, we recorded a total charge of \$78 million related to store fixtures which consisted of a \$53 million asset write-off related to the removal of store fixtures in our department stores and \$25 million of increased depreciation as a result of shortening the useful lives of department store fixtures that were replaced throughout 2013 with the build out of additional shops.



Table of Contents

## Management transition

During 2014, 2013 and 2012, we implemented several changes within our management leadership team that resulted in management transition costs of \$16 million, \$37 million and \$41 million, respectively, for both incoming and outgoing members of management.

## Other

During 2014, 2013 and 2012, we recorded miscellaneous restructuring charges of \$26 million, \$75 million and \$15 million, respectively. The charges during 2014 and 2013 were primarily related to contract termination costs and other costs associated with our previous marketing and shops strategy, including a non-cash charge of \$36 million during the third quarter of 2013 related to the return of shares of Martha Stewart Living Omnimedia, Inc. (MSLO) previously acquired by the Company, which was accounted for as a cost investment. The 2012 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 2014 and 2013 was as follows:

(\$ in millions)	Supply Chain	Home Office and Stores	Store Fixtures	Management Transition	Other	Total
February 2, 2013	\$2	\$4	\$—	\$—	\$12	\$18
Charges	—	48	55	37	75	215
Cash payments	(2	) (29	) —	(18	) (19	) (68
Non-cash	—	(23	) (55	) (16	) (38	) (132
February 1, 2014	—	—	—	3	30	33
Charges	—	45	—	16	26	87
Cash payments	—	(8	) —	(16	) (38	) (62
Non-cash	—	(28	) —	(3	) (1	) (32
January 31, 2015	\$—	\$9	\$—	\$—	\$17	\$26

Non-cash amounts represent charges that do not result in cash expenditures including increased depreciation and write-off of store fixtures and IT software and systems, stock-based compensation and a non-cash charge for the return of shares of MSLO.

Table of Contents

## 16. Real Estate and Other, Net

Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments and other non-operating charges and credits. In addition, during the first quarter of 2014, we formed a joint venture to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture) in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas. The new joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities will be recorded in Real estate and other, net.

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

(\$ in millions)	2014	2013	2012
Gain on sale or redemption of non-operating assets, net:			
Sale or Redemption of Simon Property Group, L.P. (SPG) REIT units	\$—	\$(24)	\$(200)
Sale of CBL & Associates Properties, Inc. (CBL) REIT shares	—	—	(15)
Sale of leveraged leases	—	—	(28)
Sale of investments in joint ventures	—	(85)	(151)
Sale of non-operating assets	(25)	(23)	(3)
Net gain on sale or redemption of non-operating assets	(25)	(132)	(397)
Dividend income from REITs	—	(1)	(6)
Investment income from home office land joint venture	(53)	—	—
Investment income from joint ventures	(1)	(6)	(11)
Net gain from sale of operating assets	(92)	(17)	—
Store impairments (Note 8)	30	18	26
Intangible asset impairment (Note 8)	—	9	—
Operating asset impairments	—	—	60
Other	(7)	(26)	4
Real estate and other (income)/expense, net	\$(148)	\$(155)	\$(324)

**Sale or Redemption of REIT Assets**

On July 20, 2012, SPG redeemed two million of our REIT units at a price of \$124.00 per unit for a total redemption price of \$246 million, net of fees. As of the market close on July 19, 2012, the SPG REIT units had a fair market value of \$158.13 per unit. In connection with the redemption, we realized a net gain of \$200 million determined using the first-in-first-out method for determining the cost of REIT units sold. Following the transaction, we continued to hold approximately 205,000 REIT units in SPG. In November 2013, we converted our remaining 205,000 REIT units into SPG shares, which were sold in December 2013 at an average price of \$151.97 per share for a total price of \$31 million, net of fees, and a realized net gain of \$24 million.

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

See Note 11 for net unrealized gains on our REIT assets.

**Sale of Leveraged Leases**

During the third quarter of 2012, we sold all of our leveraged leases for \$146 million, net of fees. The investments in the leveraged leases as of the dates of the sales were \$118 million and were recorded in Other assets in the Consolidated Balance Sheets. In connection with the sales, we recorded a net gain of \$28 million.

#### Sale of Investments in Joint Ventures

During the third quarter of 2013, we sold our investment in three joint ventures for \$32 million, resulting in a net gain of \$23 million. During the second quarter of 2013, we sold our investment in one joint venture for \$55 million, resulting in a net gain of \$62 million. The gain for this transaction exceeded the cash proceeds as a result of distributions of cash related to refinancing activities in prior periods that were recorded as net reductions in the carrying amount of the investment. The net book value of the joint venture investment was a negative \$7 million and was included in Other liabilities in the Consolidated Balance Sheets.

## Table of Contents

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

### Sale of Non-operating Assets

During the fourth quarter of 2014, we sold two properties used in our former auto center operations and excess property adjacent to our home office facility not contributed to the Home Office Land Joint Venture for net proceeds of \$7 million, resulting in net gains totaling \$2 million.

During the third quarter of 2014, we sold one closed store and one additional property used in our former auto center operations for net proceeds and a gain of \$2 million.

During the second quarter of 2014, we sold four additional properties used in our former auto center operations for net proceeds of \$11 million, resulting in net gains totaling \$9 million.

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

During the fourth quarter of 2013, we sold 10 properties used in our former auto center operations for net proceeds of \$25 million, resulting in net gains totaling \$22 million. During the third quarter of 2013, we sold approximately 10 acres of excess land for net proceeds and gain of \$1 million.

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

### Sale of Operating Assets

During the first quarter of 2014, we sold a former department store location with a net book value of \$1 million for net proceeds of \$2 million, realizing a gain of \$1 million. During the third quarter of 2014, we sold three department store locations and recognized a net gain on a payment received from a landlord to terminate an existing lease prior to its original expiration date for total net proceeds of \$66 million and a net gain of \$90 million. During the fourth quarter of 2014, we sold one department store location for net proceeds of \$2 million, resulting in a net gain of \$1 million.

During the first quarter of 2013, we sold our leasehold interest of a former department store location with a net book value of \$2 million for net proceeds of \$18 million, realizing a gain of \$16 million. During the second quarter of 2013, we sold two properties for total net proceeds and gain of \$1 million.

### Impairments

In 2014, store impairments totaled \$30 million and related to 19 underperforming department stores that continued to operate (Note 8).

In 2013, store impairments totaled \$18 million and related to 25 underperforming department stores that continued to operate. In addition, during the fourth quarter of 2013, we recorded a \$9 million impairment charge for our ownership of the U.S. and Puerto Rico rights of the monet trade name (Note 8).

In 2012, store impairments totaled \$26 million and related to 13 underperforming department stores that continued to operate. In addition, during the fourth quarter of 2012, we wrote off \$60 million of store-related operating assets that

were no longer being used in our operations.

#### Investment Income from Joint Ventures

During the second quarter of 2014, the Company recorded \$43 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$51 million. During the fourth quarter of 2014, the Company recorded \$10 million for our proportional share of net income from the Home Office Land Joint Venture and received an aggregate cash distribution of \$7 million.

Table of Contents

## 17. Income Taxes

The components of our income tax expense/(benefit) were as follows:

(\$ in millions)	2014	2013	2012
Current			
Federal and foreign	\$12	\$(16)	\$(95)
State and local	8	(8)	79
Total current	20	(24)	(16)
Deferred			
Federal and foreign	9	(428)	(465)
State and local	(6)	(46)	(70)
Total deferred	3	(474)	(535)
Total	\$23	\$(498)	\$(551)

A reconciliation of the statutory federal income tax rate to our effective rate is as follows:

(percent of pre-tax income/(loss))	2014	2013	2012
Federal income tax at statutory rate	(35.0)	)% (35.0	)% (35.0
State and local income tax, less federal income tax benefit	(4.2)	) (4.1	) (3.7
Increase in valuation allowance federal and state	41.6	28.6	4.3
Tax benefit resulting from OCI allocation	—	(16.1	) —
Tax effect of dividends on ESOP shares	—	—	(0.1
Other, including permanent differences and credits	0.7	0.2	(1.4
Effective tax rate	3.1	% (26.4	)% (35.9

Table of Contents

Our deferred tax assets and liabilities were as follows:

(\$ in millions)	2014	2013	
Assets			
Merchandise inventory	\$35	\$49	
Accrued vacation pay	24	28	
Gift cards	76	69	
Stock-based compensation	76	69	
State taxes	25	36	
Workers' compensation/general liability	87	93	
Accrued rent	35	32	
Mirror savings plan	18	21	
Net operating loss and tax credit carryforwards	1,100	918	
Other	51	68	
Total deferred tax assets	1,527	1,383	
Valuation allowance	(784	) (304	)
Total net deferred tax assets	743	1,079	
Liabilities			
Depreciation and amortization	(851	) (973	)
Pension and other retiree obligations	(3	) (172	)
Tax benefit transfers	(59	) (63	)
Long-lived intangible assets	(21	) (13	)
Total deferred tax liabilities	(934	) (1,221	)
Total net deferred tax liabilities	\$(191	) \$(142	)

Deferred tax assets and liabilities included in our Consolidated Balance Sheets were as follows:

(\$ in millions)	2014	2013	
Other current assets	\$172	\$193	
Other long-term liabilities	(363	) (335	)
Total net deferred tax liabilities	\$(191	) \$(142	)

As of January 31, 2015, a valuation allowance of \$784 million has been recorded against our deferred tax assets. In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our assessment, we concluded that, beginning in the second quarter of 2013, our estimate of the realization of deferred tax assets would be based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring net operating loss (NOL) and tax credit carryforwards.

In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and Accumulated other comprehensive income/(loss). As a result, for the year ended February 1, 2014, we recorded a \$303 million tax benefit in the Consolidated Statements of Operations offset by income tax expense on actuarial gains recorded in Other comprehensive income/(loss). For the year ended January 31, 2015, the company did not benefit any of its operating loss and incurred an actuarial loss in Other comprehensive income/(loss), the tax benefit on which was fully offset by a valuation allowance within Other comprehensive income/(loss).

For U.S. federal income tax purposes, we have \$2.6 billion of gross NOL carryforwards that expire in 2032 through 2034 and \$53 million of tax credit carryforwards that expire at various dates through 2034. These NOL carryforwards include an unrealized gross tax deduction of \$23 million (tax effect \$9 million) related to the implementation of share-based compensation accounting guidance that will be recorded in equity when realized.





Table of Contents

These carryforwards have a potential to be used to offset future taxable income and reduce future cash tax liabilities by approximately \$1.1 billion. The Company's ability to utilize these carryforwards will depend upon the availability of future taxable income during the carryforward period and, as such, there is no assurance the Company will be able to realize such tax savings.

The Company's ability to utilize NOL carryforwards could be further limited if it were to experience an "ownership change," as defined in Section 382 of the Code and similar state provisions. An ownership change can occur whenever there is a cumulative shift in the ownership of a company by more than 50 percentage points by one or more "5% stockholders" within a three-year period. The occurrence of such a change generally limits the amount of NOL carryforwards a company could utilize in a given year to the aggregate fair market value of the company's common stock immediately prior to the ownership change, multiplied by the long-term tax-exempt interest rate in effect for the month of the ownership change.

As discussed in Note 11, on January 27, 2014, the Board adopted the Amended Rights Agreement to help prevent acquisitions of the Company's common stock that could result in an ownership change under Section 382 which helps preserve the Company's ability to use its NOL and tax credit carryforwards. The Amended Rights Agreement was ratified by the shareholder vote on May 16, 2014 and remains effective through January 26, 2017. Approval required an affirmative vote of the shares of common stock present in person or by proxy at the Annual Meeting. At a later date, the Company's Board of Directors may consider resubmitting the Amended Rights Agreement for stockholder approval of a subsequent term.

The Amended Rights Agreement is designed to prevent acquisitions of the Company's common stock that would result in a stockholder owning 4.9% or more of the Company's common stock (as calculated under Section 382), or any existing holder of 4.9% or more of the Company's common stock acquiring additional shares, by substantially diluting the ownership interest of any such stockholder unless the stockholder obtains an exemption from the Board.

A reconciliation of unrecognized tax benefits is as follows:

(\$ in millions)	2014	2013	2012
Beginning balance	\$70	\$76	\$110
Additions for tax positions of prior years	10	6	5
Reductions for tax positions of prior years	—	(1	) (11
Settlements and effective settlements with tax authorities	(16	) (9	) (24
Expirations of statute	(2	) (2	) (4
Balance at end of year	\$62	\$70	\$76

Unrecognized tax benefits included in our Consolidated Balance Sheets were as follows:

(\$ in millions)	2014	2013
Deferred taxes (current assets) (Note 3)	\$49	\$—
Accounts payable and accrued expenses (Note 6)	5	2
Other liabilities (Note 7)	8	68
Total	\$62	\$70

As of the end of 2014, 2013 and 2012, the unrecognized tax benefits balance included \$36 million, \$49 million and \$54 million, respectively, that, if recognized, would be a benefit in the income tax provision after giving consideration to the offsetting effect of \$13 million, \$17 million and \$19 million, respectively, related to the federal tax deduction of state taxes. The remaining amounts reflect tax positions for which the ultimate deductibility is highly certain, but for which there is uncertainty about the timing. Accrued interest and penalties related to unrecognized tax benefits included in income tax expense as of the end of 2014, 2013 and 2012 were \$3 million, \$6 million and \$4 million, respectively.

We file income tax returns in U.S. federal and state jurisdictions and certain foreign jurisdictions. Our U.S. federal returns have been examined through 2012. We are audited by the taxing authorities of many states and certain foreign countries and are subject to examination by these taxing jurisdictions for years generally after 2008. The tax authorities may have the right to examine prior periods where federal and state NOL and tax credit carryforwards were generated, and make adjustments up to the amount of the NOL and credit carryforward amounts.

Table of Contents

## 18. Supplemental Cash Flow Information

(\$ in millions)	2014	2013	2012
Supplemental cash flow information			
Income taxes received/(paid), net	\$(30	) \$81	\$202
Interest received/(paid), net	(401	) (414	) (230
Supplemental non-cash investing and financing activity			
Property contributed to joint venture	30	—	—
Increase/(decrease) in other accounts payable related to purchases of property and equipment	(14	) (29	) 12
Financing costs withheld from proceeds of long-term debt	7	70	—
Purchase of property and equipment and software through capital leases and a note payable	3	4	129
Issuance costs withheld from proceeds of common stock issued	—	24	—
Return of shares of Martha Stewart Living Omnimedia, Inc. previously acquired by the Company	—	36	—

## 19. Litigation, Other Contingencies and Guarantees

## Litigation

## Macy's Litigation

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

## Other Legal Proceedings

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

## Contingencies

As of January 31, 2015, we estimated our total potential environmental liabilities to range from \$20 million to \$25 million and recorded our best estimate of \$22 million in Other accounts payable and accrued expenses and Other liabilities in the Consolidated Balance Sheet as of that date. This estimate covered potential liabilities primarily related to underground storage tanks, remediation of environmental conditions involving our former drugstore locations and asbestos removal in connection with approved plans to renovate or dispose of our facilities. We continue to assess required remediation and the adequacy of environmental reserves as new information becomes available and known conditions are further delineated. If we were to incur losses at the upper end of the estimated range, we do not believe that such losses would have a material effect on our financial condition, results of operations or liquidity.

Table of Contents

## Guarantees

In January 2015, we were released of our guarantee totaling \$20 million for the maximum exposure on insurance reserves established by a former subsidiary included in the sale of our Direct Marketing Services business.

In connection with the sale of the operations of our outlet stores, we assigned leases on certain outlet store locations to the purchaser. In the event that the purchaser fails to make the required lease payments, we continue for a period of time to be liable for lease payments to the landlords of several of the leased stores. The purchaser's obligations under the lease are guaranteed to us by certain principals and affiliates of the purchaser. However, the purchaser has elected to exit the outlet business and is attempting to terminate the leases with the landlords. Consequently, we expect that our continuing obligations under each lease will be extinguished in connection with each termination. As of January 31, 2015, our maximum liability in connection with the assigned leases is \$4 million.

## 20. Quarterly Results of Operations (Unaudited)

The following is a summary of our quarterly unaudited consolidated results of operations for 2014 and 2013:

2014				
(\$ in millions, except EPS)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total net sales	\$2,801	\$2,799	\$2,764	\$3,893
Gross margin	926	1,008	1,013	1,314
SG&A expenses	1,009	964	988	1,032
Restructuring and management transition <sup>(1)</sup>	22	5	12	48
Net income/(loss) <sup>(2)</sup>	(352 )	(172 )	(188 )	(59 )
Diluted earnings/(loss) per share <sup>(3)</sup>	\$(1.15 )	\$(0.56 )	\$(0.62 )	\$(0.19 )
2013				
(\$ in millions, except EPS)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total net sales	\$2,635	\$2,663	\$2,779	\$3,782
Gross margin	812	787	819	1,074
SG&A expenses	1,078	1,026	1,006	1,004
Restructuring and management transition <sup>(5)</sup>	72	47	46	50
Net income/(loss)	(348 )	(586 ) <sup>(6)</sup>	(489 ) <sup>(6)</sup>	35
Diluted earnings/(loss) per share <sup>(3)</sup>	\$(1.58 )	\$(2.66 )	\$(1.94 )	\$0.11

(1) Restructuring and management transition charges (Note 15) by quarter for 2014 consisted of the following:

(\$ in million)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Home office and stores	\$12	\$—	\$3	\$30
Management transition	7	1	7	1
Other	3	4	2	17
Total	\$22	\$5	\$12	\$48

The first, second, third and fourth quarters of 2014 contained increases to our tax valuation allowance of \$120 million, \$28 million, \$107 million and \$56 million, respectively. The first, second, third and fourth quarters of 2014 contained gains from non-operating assets sales (Note 16) of \$12 million, \$9 million, \$2 million and \$2 million, respectively. The fourth quarter of 2014 includes \$30 million of store impairments charges recorded in Real estate and other, net (Note 16).

(3) EPS is computed independently for each of the quarters presented. The sum of the quarters may not equal the total year amount due to the impact of changes in average quarterly shares outstanding.

(4) Includes a negative impact of \$72 million related to the discontinuation of brands that are not part of our go-forward merchandising strategy.



Table of Contents

(5) Restructuring and management transition charges (Note 15) by quarter for 2013 consisted of the following:

(\$ in millions)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Home office and stores	\$28	\$4	\$(6)	) \$22
Store fixtures	28	17	10	—
Management transition	16	13	3	5
Other	—	13	39	23
Total	\$72	\$47	\$46	\$50

The second and third quarters of 2013 contained increases to our tax valuation allowance of \$218 million and \$184 million, respectively and a decrease of \$178 million to our valuation allowance in the fourth quarter. The second, third and fourth quarters of 2013 contained gains from non-operating assets sales (Note 16) of \$62 million, \$24 million and \$46 million, respectively. The fourth quarter of 2013 includes \$12 million of store impairments charges and a \$9 million impairment to our monet trade name recorded in Real estate and other, net (Note 16) Additionally, during the fourth quarter of 2013 we recognized a tax benefit of \$270 million from income related to actuarial gains included in other comprehensive income. This tax benefit was offset by tax expense recorded for such gains in other comprehensive income.

Table of Contents

## Exhibit Index

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
2.1	Agreement and Plan of Merger dated as of January 23, 2002, between JCP and Company	8-K	001-15274	2	1/28/2002	
3.1	Restated Certificate of Incorporation of the Company, as amended to May 20, 2011	10-Q	001-15274	3.1	6/8/2011	
3.2	Bylaws of the Company, as amended to July 23, 2013	8-K	001-15274	3.1	7/26/2013	
3.3	Certificate of Designation, Preferences and Rights of Series C Junior Participating Preferred Stock	8-K	001-15274	3.1	8/22/2013	
4.1	Indenture, dated as of October 1, 1982, between JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National Association, as Successor Trustee to Bank of America National Trust and Savings Association)	10-K	001-00777	4(a)	4/19/1994	
4.2	First Supplemental Indenture, dated as of March 15, 1983, between JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National Association, as Successor Trustee to Bank of America National Trust and Savings Association)	10-K	001-00777	4(b)	4/19/1994	
4.3	Second Supplemental Indenture, dated as of May 1, 1984, between JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National Association, as Successor Trustee to Bank of America National Trust and Savings Association)	10-K	001-00777	4(c)	4/19/1994	
4.4	Third Supplemental Indenture, dated as of March 7, 1986, between JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National Association, as Successor Trustee to Bank of America National Trust and Savings Association)	S-3	033-03882	4(d)	3/11/1986	
4.5	Fourth Supplemental Indenture, dated as of June 7, 1991, between JCP and U.S.	S-3	033-41186	4(e)	6/13/1991	



4.6	Bank National Association, Trustee (formerly First Trust of California, National Association, as Successor Trustee to Bank of America National Trust and Savings Association) Fifth Supplemental Indenture, dated as of January 27, 2002, among the Company, JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National	10-K	001-15274	4(o)	4/25/2002
	Association, as Successor Trustee to Bank of America National Trust and Savings Association) to Indenture dated as of October 1, 1982				
4.7	Sixth Supplemental Indenture, dated as of May 20, 2013, among J. C. Penney Corporation, Inc., J. C. Penney Company, Inc., as co-obligor, and Wilmington Trust, National Association, as successor trustee	8-K	001-15274	4.1	5/24/2013
	Indenture, dated as of April 1, 1994, between JCP and U.S. Bank National Association, Trustee (formerly First Trust of California, National				
4.8	Association, as Successor Trustee to Bank of America National Trust and Savings Association) First Supplemental Indenture dated as of January 27, 2002, among the Company, JCP and U.S. Bank National	S-3	033-53275	4(a)	4/26/1994
	Association, Trustee (formerly Bank of America National Trust and Savings Association) to Indenture dated as of April 1, 1994				
4.9	First Supplemental Indenture dated as of January 27, 2002, among the Company, JCP and U.S. Bank National Association, Trustee (formerly Bank of America National Trust and Savings Association) to Indenture dated as of April 1, 1994	10-K	001-15274	4(p)	4/25/2002

Other instruments evidencing long-term debt have not been filed as exhibits hereto because none of the debt authorized under any such instrument exceeds 10% of the total assets of the Registrant and its consolidated subsidiaries. The Registrant agrees to furnish a copy of any of its long-term debt instruments to the Securities and Exchange Commission upon request.

Table of Contents

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
4.10	Second Supplemental Indenture dated as of July 26, 2002, among the Company, JCP and U.S. Bank National Association, Trustee (formerly Bank of America National Trust and Savings Institution) to Indenture dated as of April 1, 1994	10-Q	001-15274	4	9/6/2002	
4.11	Indenture, dated September 15, 2014, among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc. and Wilmington Trust, National Association	8-K	001-15274	4.1	9/15/2014	
4.12	First Supplemental Indenture (including the form of Note), dated September 15, 2014, among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., and Wilmington Trust, National Association	8-K	001-15274	4.2	9/15/2014	
4.13	Warrant Purchase Agreement dated June 13, 2011 between J. C. Penney Company, Inc. and Ronald B. Johnson	8-K	001-15274	4.1	6/14/2011	
4.14	Warrant dated as of June 13, 2011 between J. C. Penney Company, Inc. and Ronald B. Johnson	8-K	001-15274	4.2	6/14/2011	
4.15	Amended and Restated Rights Agreement, dated as of January 27, 2014, by and between J. C. Penney Company, Inc. and Computershare Inc., as Rights Agent	8-K	001-15274	4.1	1/28/2014	
10.1	Credit and Guaranty Agreement, dated as of May 22, 2013, among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., the subsidiary guarantors party thereto, the financial institutions party thereto as lenders, Goldman Sachs Bank USA, as administrative agent, collateral agent and lead arranger, the other joint arrangers and joint bookrunners party thereto and the other agents party thereto	10-Q	001-15274	10.3	9/10/2013	
10.2	Pledge and Security Agreement, dated as of May 22, 2013, among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., the subsidiary guarantors party thereto and Goldman Sachs Bank USA, as collateral agent	10-Q	001-15274	10.4	9/10/2013	
10.3		10-Q	001-15274	10.5	9/10/2013	

10.4	<p>Intercreditor and Collateral Cooperation Agreement, dated as of May 22, 2013, among JPMorgan Chase Bank, N.A., as representative with respect to the ABL credit agreement, Goldman Sachs Bank USA, as representative with respect to the term loan agreement, J. C. Penney Company, Inc., J. C. Penney Corporation, Inc. and the subsidiary guarantors party thereto Representative Joinder Agreement No. 1 dated as of June 20, 2014 to the Intercreditor and Collateral Agreement dated as of May 22, 2013, among JPMorgan Chase Bank, N. A., as existing representative with respect to the ABL credit Agreement, Goldman Sachs Bank USA, as representative with respect to the term loan agreement, J. C. Penney Corporation, Inc. and each of the other grantors party thereto</p>									†
10.5	<p>Credit Agreement dated as of June 20, 2014 among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., J. C. Penney Purchasing Corporation, the Lenders party thereto, Wells Fargo Bank, National Association, as Administrative Agent, Revolving Agent and Swingline Lender, Bank of America, N.A., as Term Agent, Wells Fargo Bank, National Association and Bank of America, N.A., as Co-Collateral Agents and Wells Fargo Bank, National Association, as LC Agent</p>	8-K	001-15274	10.1					6/23/2014	
10.6	<p>Guarantee and Collateral Agreement dated as of June 20, 2014 among J. C. Penney Company, Inc., J. C. Penney Corporation, Inc., J. C. Penney Purchasing Corporation, the Subsidiaries of J. C. Penney Company, Inc. identified therein, and Wells Fargo Bank, National Association, as Administrative Agent</p>	8-K	001-15274	10.2					6/23/2014	

Other instruments evidencing long-term debt have not been filed as exhibits hereto because none of the debt authorized under any such instrument exceeds 10% of the total assets of the Registrant and its consolidated subsidiaries. The Registrant agrees to furnish a copy of any of its long-term debt instruments to the Securities and Exchange Commission upon request.

Table of Contents

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
10.7	Asset Purchase Agreement dated as of April 4, 2004, among J. C. Penney Company, Inc., Eckerd Corporation, Thrift Drug, Inc., Genovese Drug Stores, Inc., Eckerd Fleet, Inc., CVS Pharmacy, Inc. and CVS Corporation	10-K	001-15274	10(i)(e)	4/8/2004	
10.8	Stock Purchase Agreement dated as of April 4, 2004, among J. C. Penney Company, Inc., TDI Consolidated Corporation, and The Jean Coutu Group (PJC) Inc.	10-K	001-15274	10(i)(f)	4/8/2004	
10.9	Amendment and Waiver No. 1 to Asset Purchase Agreement dated as of July 30, 2004, among CVS Pharmacy, Inc., CVS Corporation, J. C. Penney Company, Inc., Eckerd Corporation, Thrift Drug, Inc., Genovese Drug Stores, Inc., and Eckerd Fleet, Inc.	10-Q	001-15274	10.1	9/8/2004	
10.10	First Amendment to Stock Purchase Agreement dated as of July 30, 2004, among The Jean Coutu Group (PJC) Inc., J. C. Penney Company, Inc., and TDI Consolidated Corporation	10-Q	001-15274	10.2	9/8/2004	
10.11	CN Rescission Agreement dated as of August 25, 2004, among CVS Corporation, CVS Pharmacy, Inc., certain CVS affiliates, and J.C. Penney Company, Inc.	10-Q	001-15274	10.3	9/8/2004	
10.12	Consumer Credit Card Program Agreement by and between JCP and GE Money Bank, as amended and restated as of November 5, 2009	8-K	001-15274	10.1	11/6/2009	
10.13	First Amendment, dated as of October 29, 2010, to Consumer Credit Card Program Agreement by and between J. C. Penney Corporation, Inc. and GE Money Bank, as amended and restated as of November 5, 2009	8-K	001-15274	10.1	10/29/2010	
10.14	Second Amendment dated as of January 30, 2013 to Consumer Credit Card Program Agreement by and between J. C. Penney Corporation, Inc. and GE Capital Retail Bank, as amended and restated as of November 5, 2009 and as amended by the First Amendment thereto dated as of October 29, 2010	8-K	001-15274	10.1	2/4/2013	

	Third Amendment dated as of October 11, 2013 to Consumer Credit Card Program Agreement by and between J. C. Penney Corporation, Inc. and GE Capital Retail Bank, as amended and restated as of November 5, 2009, as amended by the First Amendment thereto dated as of October 29, 2010 and the Second Amendment thereto dated as of January 30, 2013	8-K	001-15274	10.1	10/15/2013
10.15	Fourth Amendment dated February 25, 2014 to Consumer Credit Card Program Agreement by and between J. C. Penney Corporation, Inc. and GE Capital Retail 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 and the Third Amendment thereto dated October 11, 2013	10-Q	001-15274	10.1	6/3/2014
10.16	Registration Rights Agreement dated August 13, 2013, among J. C. Penney Company, Inc., Pershing Square Capital Management, L.P., PS Management GP, LLC, Pershing Square GP, LLC, William A. Ackman and certain affiliated Pershing Square funds	8-K	001-15274	10.1	8/16/2013
10.17	J. C. Penney Company, Inc. Directors' Equity Program Tandem Restricted Stock Award/Stock Option Plan	10-K	001-00777	10(k)	4/24/1989
10.18**	J. C. Penney Company, Inc. 1993 Non-Associate Directors' Equity Plan	Def. Proxy Stmt.	001-00777	B	4/20/1993
10.19**	February 1995 Amendment to J. C. Penney Company, Inc. 1993 Non-Associate Directors' Equity Plan	10-K	001-00777	10(ii)(m)	4/18/1995
10.20**	Directors' Charitable Award Program	10-K	001-00777	10(r)	4/25/1990
10.21**	J. C. Penney Company, Inc. 1997 Equity Compensation Plan	Def. Proxy Stmt.	001-00777	A	4/11/1997
10.22**	J. C. Penney Company, Inc. 2001 Equity Compensation Plan	Def. Proxy Stmt.	001-00777	B	4/11/2001
10.23**	J. C. Penney Company, Inc. 2005 Equity Compensation Plan, as amended through 12/10/2008	10-K	001-15274	10.65	3/31/2009

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference		Filing Date	Filed (†) Herewith (as indicated)
			SEC	Exhibit		
10.25**	J. C. Penney Company, Inc. 2009 Long-Term Incentive Plan	Def. Proxy Stmt.	001-15274	Annex A	3/31/2009	
10.26**	J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	Def. Proxy Stmt.	001-15274	Annex A	3/28/2012	
10.27**	2014 J. C. Penney Company, Inc. Long-Term Incentive Plan	Def. Proxy Stmt.	001-15274	Annex A	3/21/2014	
10.28**	JCP Supplemental Term Life Insurance Plan for Management Profit-Sharing Associates, as amended and restated effective July 1, 2007	10-Q	001-15274	10.1	9/12/2007	
10.29**	Form of Notice of Grant of Stock Option(s) under the J. C. Penney Company, Inc. 2001 Equity Compensation Plan	8-K	001-15274	10.3	2/15/2005	
10.30**	Form of Director's election to receive all/portion of annual cash retainer in J. C. Penney Company, Inc. common stock (J. C. Penney Company, Inc. 2001 Equity Compensation Plan)	8-K	001-15274	10.4	2/15/2005	
10.31**	Form of Notice of Restricted Stock Award – Non-Associate Director Annual Grant under the J. C. Penney Company, Inc. 2001 Equity Compensation Plan	8-K	001-15274	10.5	2/15/2005	
10.32**	Form of Notice of Non-Associate Director Restricted Stock Unit Award under the J. C. Penney Company, Inc. 2001 Equity Compensation Plan	8-K	001-15274	10.1	5/24/2005	
10.33**	Form of Notice of Grant of Stock Option(s), Special Stock Option Grant under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan	8-K	001-15274	10.1	5/31/2005	
10.34**	Form of Notice of Non-Associate Director Restricted Stock Unit Award under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan	8-K	001-15274	10.1	11/18/2005	
10.35**	JCP Form of Executive Termination Pay Agreement, as amended and restated effective September 21, 2007	8-K	001-15274	10.1	9/26/2007	
10.36**	JCP Form of Executive Termination Pay Agreement, as amended and restated effective December 3, 2013	10-Q	001-15274	10.3	12/5/2013	
10.37**		8-K	001-15274	10.4	3/27/2006	

Edgar Filing: J C PENNEY CO INC - Form 10-K

	Form of Notice of Grant of Stock Options under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan				
10.38**	Form of Election to Receive Stock in Lieu of Cash Retainer(s) (J. C. Penney Company, Inc. 2005 Equity Compensation Plan)	8-K	001-15274	10.1	5/19/2006
10.39**	Form of Notice of Election to Defer under the J. C. Penney Company, Inc. Deferred Compensation Plan for Directors	8-K	001-15274	10.2	5/19/2006
10.40**	Form of Notice of Change of Factor for Deferral Account under the J. C. Penney Company, Inc. Deferred Compensation Plan for Directors	8-K	001-15274	10.8	2/15/2005
10.41**	Form of Notice of Change in the Amount of Fees Deferred under the J. C. Penney Company, Inc. Deferred Compensation Plan for Directors	8-K	001-15274	10.3	5/19/2006
10.42**	Form of Notice of Termination of Election to Defer under the J. C. Penney Company, Inc. Deferred Compensation Plan for Directors	8-K	001-15274	10.4	5/19/2006
10.43**	Form of Notice of Grant of Stock Options for Executive Officers subject to Executive Termination Pay Agreements under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan	8-K	001-15274	10.1	8/7/2006
10.44**	Form of Notice of Grant of Stock Options under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan	8-K	001-15274	10.1	3/15/2007
10.45**	2008 Form of Notice of Grant of Stock Options under the J. C. Penney Company, Inc. 2005 Equity Compensation Plan	8-K	001-15274	10.1	3/7/2008
10.46**	JCP Change in Control Plan, as amended and restated effective March 27, 2008	8-K	001-15274	10.1	4/2/2008
10.47**	JCP 2009 Change in Control Plan	10-K	001-15274	10.60	3/31/2009

Table of Contents

Exhibit No.	Exhibit Description	Incorporated by Reference				Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit	Filing Date	
10.48**	J. C. Penney Corporation, Inc. Change in Control Plan, effective January 10, 2011	8-K	001-15274	10.1	6/14/2011	
10.49**	Form of Indemnification Trust Agreement between JCP and JPMorgan Chase Bank (formerly Chemical Bank) dated as of July 30, 1986, as amended March 30, 1987	Def. Proxy Stmnt.	001-00777	Exhibit 1 to Exhibit B	4/24/1987	
10.50**	Second Amendment to Indemnification Trust Agreement between JCP and JPMorgan Chase Bank, effective as of January 27, 2002	10-K	001-15274	10.53	3/31/2009	
10.51**	Third Amendment to Indemnification Trust Agreement between Company, JCP and JPMorgan Chase Bank, effective as of June 1, 2008	10-Q	001-15274	10.2	9/10/2008	
10.52**	Form of Indemnification Agreement between Company, JCP and individual Indemnities, as amended through January 27, 2002	10-K	001-15274	10(ii)(ab)	4/25/2002	
10.53**	Special Rules for Reimbursements Subject to Code Section 409A under Indemnification Agreement between Company, JCP and individual Indemnities, adopted December 9, 2008	10-K	001-15274	10.56	3/31/2009	
10.54**	JCP Mirror Savings Plan, amended and restated effective December 31, 2007 and as further amended through December 9, 2008	10-K	001-15274	10.60	3/31/2009	
10.55**	J. C. Penney Company, Inc. Deferred Compensation Plan for Directors, as amended and restated effective February 27, 2008 and as further amended through December 10, 2008	10-K	001-15274	10.62	3/31/2009	
10.56**	Form of Notice of Grant of Stock Options under the J. C. Penney Company, Inc. 2009 Long-Term Incentive Plan	10-Q	001-15274	10.2	9/9/2009	
10.57**	Form of Notice of Restricted Stock Unit Grant under the J. C. Penney Company, Inc. 2009 Long-Term Incentive Plan	10-Q	001-15274	10.3	9/9/2009	
10.58**	Form of Notice of Non-Associate Director Restricted Stock Unit Award under the J. C. Penney Company, Inc. 2009 Long-Term Incentive Plan	10-Q	001-15274	10.4	9/9/2009	
10.59**	J. C. Penney Corporation, Inc., Management Incentive Compensation	8-K	001-15274	10.1	1/10/2011	



Edgar Filing: J C PENNEY CO INC - Form 10-K

	Program, effective January 30, 2011				
10.60**	Letter Agreement between J. C. Penney Company, Inc. and Edward J. Record	8-K	001-15274	10.1	2/18/2014
10.61**	Notice of Restricted Stock Unit Grant for Edward J. Record				†
10.62**	Letter Agreement dated October 10, 2014 between J. C. Penney Company, Inc. and Marvin R. Ellison	8-K	001-15274	10.1	10/14/2014
10.63**	Form of Executive Termination Pay Agreement between J. C. Penney Company, Inc. and Marvin R. Ellison	8-K	001-15274	10.2	10/14/2014
10.64**	Notice of Restricted Stock Unit Grant for Marvin R. Ellison				†
10.65**	Form of Notice of Grant of Stock Options under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	10-K	001-15274	10.80	3/20/2013
10.66**	Form of Notice of Restricted Stock Unit Grant under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	10-K	001-15274	10.81	3/20/2013
10.67**	Form of Notice of Non-Associate Director Restricted Stock Unit Award under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	10-K	001-15274	10.82	3/20/2013
10.68**	Form of Notice of 2013 Performance Unit Grant under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	8-K	001-15274	10.1	4/4/2013
10.69**	Form of Notice of 2014 Performance-Contingent Stock Option Grant under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan for Myron E. Ullman, III	8-K	001-15274	10.1	3/24/2014
10.70**	Form of Notice of 2014 Performance-Contingent Stock Option Grant under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	8-K	001-15274	10.2	3/24/2014
10.71**	Form of Notice of 2014 Performance-Based Restricted Stock Unit Grant under the J. C. Penney Company, Inc. 2012 Long-Term Incentive Plan	8-K	001-15274	10.3	3/24/2014

Table of Contents

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
12	Computation of Ratios of Earnings to Fixed Charges					†
21	Subsidiaries of the Registrant					†
23	Consent of Independent Registered Public Accounting Firm					†
24	Power of Attorney					†
31.1	Certification by CEO pursuant to 15 U.S.C. 78m(a) or 780(d), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
31.2	Certification by CFO pursuant to 15 U.S.C. 78m(a) or 780(d), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
32.1	Certification by CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					†
32.2	Certification by CFO pursuant to 18 U.S.C. Section 1350, as adopted 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					†
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					†
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					†
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					†

\*\* Indicates a management contract or compensatory plan or arrangement.