

J C PENNEY CO INC
Form 10-Q
December 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended November 1, 2014

or

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

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

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

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

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

75024 - 3698
(Zip Code)

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 304,851,973 shares of Common Stock of 50 cents par value, as of December 5, 2014.

J. C. PENNEY COMPANY, INC.
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 For the Quarterly Period Ended November 1, 2014
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Part I. Financial Information

Item 1. Unaudited Interim Consolidated Financial Statements

J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions, except per share data)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Total net sales	\$2,764	\$2,779	\$8,364	\$8,077
Cost of goods sold	1,751	1,960	5,417	5,659
Gross margin	1,013	819	2,947	2,418
Operating expenses/(income):				
Selling, general and administrative (SG&A)	988	1,006	2,961	3,110
Pension	1	34	4	102
Depreciation and amortization	156	161	474	440
Real estate and other, net	(90	) (27	) (160	) (117
Restructuring and management transition	12	46	39	165
Total operating expenses	1,067	1,220	3,318	3,700
Operating income/(loss)	(54	) (401	) (371	) (1,282
Loss on extinguishment of debt	34	—	34	114
Net interest expense	103	99	306	255
Income/(loss) before income taxes	(191	) (500	) (711	) (1,651
Income tax expense/(benefit)	(3	) (11	) 1	(228
Net income/(loss)	\$(188	) \$(489	) \$(712	) \$(1,423
Earnings/(loss) per share:				
Basic	\$(0.62	) \$(1.94	) \$(2.33	) \$(6.17
Diluted	\$(0.62	) \$(1.94	) \$(2.33	) \$(6.17
Weighted average shares – basic	305.3	251.8	305.1	230.8
Weighted average shares – diluted	305.3	251.8	305.1	230.8

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

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J. C. PENNEY COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(Unaudited)

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income/(loss)	\$(188	) \$(489	) \$(712	) \$(1,423
Other comprehensive income/(loss), net of tax:				
Retirement benefit plans				
Reclassification for amortization of net actuarial (gain)/loss	10	26	30	81
Reclassification for amortization of prior service (credit)/cost	(1	) —	(1	) (1
Total other comprehensive income/(loss), net of tax	9	26	29	80
Total comprehensive income/(loss), net of tax	\$(179	) \$(463	) \$(683	) \$(1,343

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

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CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	November 1, 2014 (Unaudited)	November 2, 2013 (Unaudited)	February 1, 2014
Assets			
Current assets:			
Cash in banks and in transit	\$141	\$151	\$113
Cash short-term investments	543	1,076	1,402
Cash and cash equivalents	684	1,227	1,515
Merchandise inventory	3,358	3,747	2,935
Deferred taxes	175	119	193
Prepaid expenses and other	223	249	190
Total current assets	4,440	5,342	4,833
Property and equipment (net of accumulated depreciation of \$3,558, \$3,178 and \$3,315)	5,312	5,753	5,619
Prepaid pension	695	36	663
Other assets	718	744	686
Total Assets	\$11,165	\$11,875	\$11,801
Liabilities and Stockholders' Equity			
Current liabilities:			
Merchandise accounts payable	\$1,289	\$1,409	\$948
Other accounts payable and accrued expenses	1,163	1,269	1,198
Short-term borrowings	—	650	650
Current portion of capital leases and note payable	30	27	27
Current maturities of long-term debt	28	23	23
Total current liabilities	2,510	3,378	2,846
Long-term capital leases and note payable	40	67	62
Long-term debt	5,329	4,845	4,839
Deferred taxes	357	250	335
Other liabilities	499	688	632
Total Liabilities	8,735	9,228	8,714
Stockholders' Equity			
Common stock ⁽¹⁾	152	153	152
Additional paid-in capital	4,597	4,575	4,571
Reinvested earnings/(accumulated deficit)	(1,720)	(1,043)	(1,008)
Accumulated other comprehensive income/(loss)	(599)	(1,038)	(628)
Total Stockholders' Equity	2,430	2,647	3,087
Total Liabilities and Stockholders' Equity	\$11,165	\$11,875	\$11,801

1,250 million shares of common stock are authorized with a par value of \$0.50 per share. The total shares issued (1) and outstanding were 304.8 million, 304.6 million and 304.6 million as of November 1, 2014, November 2, 2013 and February 1, 2014, respectively.

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

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

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Cash flows from operating activities				
Net income/(loss)	\$(188	) \$(489	) \$(712	) \$(1,423
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:				
Restructuring and management transition	2	48	5	109
Asset impairments and other charges	5	3	9	12
Net gain on sale of non-operating assets	(2	) (24	) (23	) (86
Net gain on sale of operating assets	(90	) —	(91	) (18
Loss on extinguishment of debt	34	—	34	114
Depreciation and amortization	156	161	474	440
Benefit plans	(5	) 16	(18	) 57
Stock-based compensation	8	6	24	22
Deferred taxes	(5	) (14	) (24	) (203
Change in cash from:				
Inventory	(510	) (592	) (423	) (1,406
Prepaid expenses and other assets	(15	) (30	) (34	) 11
Merchandise accounts payable	305	133	341	247
Current income taxes	2	2	6	62
Accrued expenses and other	(17	) 43	(22	) (135
Net cash provided by/(used in) operating activities	(320	) (737	) (454	) (2,197
Cash flows from investing activities				
Capital expenditures	(61	) (161	) (202	) (814
Net proceeds from sale of non-operating assets	2	33	28	88
Net proceeds from sale of operating assets	66	—	68	19
Joint venture return of investment	—	—	8	—
Net cash provided by/(used in) investing activities	7	(128	) (98	) (707
Cash flows from financing activities				
Proceeds from short-term borrowings	—	—	—	850
Payments on short-term borrowings	—	(200	) (650	) (200
Net proceeds from issuance of long-term debt	393	—	893	2,180
Premium on early retirement of debt	(33	) —	(33	) (110
Payments of capital leases and note payable	(4	) (5	) (22	) (24
Payments of long-term debt	(394	) (5	) (405	) (250
Financing costs	(1	) (18	) (61	) (30
Net proceeds from common stock issued	—	786	—	786
Proceeds from stock options exercised	—	—	—	7
Tax withholding payments for vested restricted stock	—	(1	) (1	) (8
Net cash provided by/(used in) financing activities	(39	) 557	(279	) 3,201
Net increase/(decrease) in cash and cash equivalents	(352	) (308	) (831	) 297
Cash and cash equivalents at beginning of period	1,036	1,535	1,515	930
Cash and cash equivalents at end of period	\$684	\$1,227	\$684	\$1,227

Supplemental cash flow information

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Income taxes received/(paid), net	(1) (1) (20) 87
Interest received/(paid), net	(160) (125) (343) (361
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	(2	) (53	) (7	) 49
Financing costs withheld from proceeds of long-term debt	7	—	7	70
Purchase of property and equipment and software through capital leases and a note payable	—	1	3	4
Issuance costs withheld from proceeds of common stock issued	—	24	—	24
Return of shares of Martha Stewart Living Omnimedia Inc. previously acquired by the Company	—	36	—	36

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

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J. C. PENNEY COMPANY, INC.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Consolidation

Basis of Presentation

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

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

These unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The accompanying unaudited Interim Consolidated Financial Statements, in our opinion, include all material adjustments necessary for a fair presentation and should be read in conjunction with the audited Consolidated Financial Statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended February 1, 2014 (2013 Form 10-K). We follow substantially the same accounting policies to prepare quarterly financial statements as are followed in preparing annual financial statements. A description of such significant accounting policies is included in the 2013 Form 10-K. The February 1, 2014 financial information was derived from the audited Consolidated Financial Statements, with related footnotes, included in the 2013 Form 10-K. Because of the seasonal nature of the retail business, operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

Fiscal Year

Our fiscal year ends on the Saturday closest to January 31. As used herein, “three months ended November 1, 2014” and “three months ended November 2, 2013” refer to the 13-week periods ended November 1, 2014 and November 2, 2013, respectively. “Nine months ended November 1, 2014” and “nine months ended November 2, 2013,” refer to the 39-week periods ended November 1, 2014 and November 2, 2013, respectively. Fiscal years 2014 and 2013 contain 52 weeks.

Basis of Consolidation

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

Use of Estimates and Assumptions

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

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2. Earnings/(Loss) per Share

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

(in millions, except per share data)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Earnings/(loss)				
Net income/(loss)	\$ (188)	\$ (489)	\$ (712)	\$ (1,423)
Shares				
Weighted average common shares outstanding (basic shares) ⁽¹⁾	305.3	251.8	305.1	230.8
Adjustment for assumed dilution:				
Stock options, restricted stock awards and warrant	—	—	—	—
Weighted average shares assuming dilution (diluted shares)	305.3	251.8	305.1	230.8
EPS				
Basic	\$ (0.62)	\$ (1.94)	\$ (2.33)	\$ (6.17)
Diluted	\$ (0.62)	\$ (1.94)	\$ (2.33)	\$ (6.17)

⁽¹⁾ On October 1, 2013, we issued 84 million shares of common stock with a par value of \$0.50 per share.

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

(Shares in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Stock options, restricted stock awards and warrant	26.9	23.9	26.1	24.6

3. Credit Facility

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into a \$2,350 million asset-based senior credit facility (2014 Credit Facility), comprised of a \$1,850 million revolving line of credit (Revolving Facility) and a \$500 million term loan (2014 Term Loan). 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 an asset-based senior 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 the third quarter of 2014, we had \$499 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 the third quarter of 2014, we had \$429 million in standby and import letters of credit outstanding under the

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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 the third quarter of 2014, based on our September 2014 borrowing base, we had \$1,421 million available for future borrowing, of which \$1,236 million was accessible due to the minimum excess availability threshold.

4. Long-Term Debt

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 ⁽¹⁾	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.

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 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.

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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.

5. Fair Value Disclosures

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

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Significant observable inputs other than quoted prices in active markets for similar assets and liabilities, such as quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 — Significant unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants.

REIT Assets Measured on a Recurring Basis

During 2013, we sold our remaining investments in public REIT assets. The market value of our investment in public REIT assets were accounted for as available-for-sale securities and were carried at fair value on an ongoing basis in Other assets in the unaudited Interim Consolidated Balance Sheets. We determined the fair value of our investments in REITs using quoted market prices. There were no transfers in or out of any levels during any period presented. Our REIT assets measured at fair value were as follows:

(\$ in millions)	Cost Basis	REIT Assets at Fair Value		
		Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
November 1, 2014	\$—	\$—	\$—	\$—
November 2, 2013	7	32	—	—
February 1, 2014	—	—	—	—

Other Financial Instruments

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

(\$ in millions)	November 1, 2014		November 2, 2013		February 1, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	\$5,357	\$4,910	\$4,868	\$4,252	\$4,862	\$4,209

The fair value of long-term debt was estimated by obtaining quotes from brokers or was based on current rates offered for similar debt. As of November 1, 2014, November 2, 2013 and February 1, 2014, the fair values of cash and cash equivalents, accounts payable and short-term borrowings approximated their carrying values due to the short-term nature of these instruments. In addition, the fair values of capital lease commitments and the note payable approximated their carrying values. These items have been excluded from the table above.

Concentrations of Credit Risk

We have no significant concentrations of credit risk.

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6. Stockholders' Equity

The following table shows the change in the components of stockholders' equity for the nine months ended November 1, 2014:

(in millions)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Reinvested Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
February 1, 2014	304.6	\$152	\$4,571	\$(1,008	) \$(628	) \$3,087
Net income/(loss)	—	—	—	(712	) —	(712
Other comprehensive income/(loss)	—	—	—	—	29	29
Stock-based compensation	0.2	—	26	—	—	26
November 1, 2014	304.8	\$152	\$4,597	\$(1,720	) \$(599	) \$2,430

Comprehensive Income

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

(\$ in millions)	Three Months Ended November 1, 2014			November 2, 2013		
	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount
REITs						
Unrealized gain/(loss)	\$—	\$—	\$—	\$(1	) \$1	\$—
Retirement benefit plans						
Reclassification for amortization of net actuarial (gain)/loss	16	(6	) 10	43	(17	) 26
Reclassification for amortization of prior service (credit)/cost	(1	) —	(1	) (1	) 1	—
Total	\$15	\$(6	) \$9	\$41	\$(15	) \$26

(\$ in millions)	Nine Months Ended November 1, 2014			November 2, 2013		
	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount	Gross Amount	Income Tax (Expense)/ Benefit	Net Amount
REITs						
Unrealized gain/(loss)	\$—	\$—	\$—	\$(1	) \$1	\$—
Retirement benefit plans						
Reclassification for amortization of net actuarial (gain)/loss	49	(19	) 30	\$131	(50	) 81
Reclassification for amortization of prior service (credit)/cost	(1) —	(1) (2) 1	(1
Total	\$48	\$(19) \$29	\$128	\$(48) \$80

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The following table shows the changes in accumulated other comprehensive income/(loss) balances for the nine months ended November 1, 2014:

(\$ in millions)	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Accumulated Other Comprehensive Income/(Loss)
February 1, 2014	\$(609	) \$(19	) \$(628
Other comprehensive income/(loss) before reclassifications	—	—	—
Amounts reclassified from accumulated other comprehensive income	30	(1	) 29
Net current-period other comprehensive income	30	(1	) 29
November 1, 2014	\$(579	) \$(20	) \$(599

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 Unaudited Interim Consolidated Statements of Operations
	Three Months Ended		Nine Months Ended		
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013	
Amortization of retirement benefit plans					
Actuarial loss/(gain) ⁽¹⁾	\$16	\$44	\$49	\$132	Pension
Prior service cost/(credit) ⁽¹⁾	1	1	5	4	Pension
Actuarial loss/(gain) ⁽¹⁾	—	(1	) —	(1	) SG&A
Prior service cost/(credit) ⁽¹⁾	(2	) (2	) (6	) (6	) SG&A
Tax (expense)/benefit	(6	) (16	) (19	) (49	) Income tax expense/(benefit)
Total, net of tax	9	26	29	80	
Total reclassifications	\$9	\$26	\$29	\$80	

(1) These accumulated other comprehensive components are included in the computation of net periodic benefits expense/(income). See Note 8 for additional details.

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.

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7. 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 2014 Plan, all grants made after January 31, 2014 reduce the shares available for grant under the 2014 Plan. As of November 1, 2014, a maximum of 24.0 million shares of stock were available for future grant under the 2014 Plan.

Stock-based compensation expense for the three months ended November 1, 2014 and November 2, 2013 was \$10 million and \$7 million, respectively. Stock-based compensation expense for the nine months ended November 1, 2014 and November 2, 2013 was \$31 million and \$39 million, respectively. Through the first nine months of 2014, the Company granted the following stock-based compensation awards:

Grant Date	Restricted Stock Units (RSU)		Stock Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
	Time-based	Performance-based	Performance-based		
March 3, 2014	25,000	—	—	\$—	\$7.96
March 20, 2014	2,328,000	329,000	2,322,000	8.36	6.09
March 27, 2014	84,000	—	185,000	8.97	5.59
May 20, 2014 ⁽¹⁾	306,000	—	—	—	8.93
August 19, 2014	883,000	—	—	—	10.25
Total	3,626,000	329,000	2,507,000	8.41	6.78

(1)Includes approximately 224,000 RSUs that were granted under the 2014 Equity Inducement Plan.

Performance-based stock options and awards that ultimately vest are dependent on market performance targets measured by either the performance of the Company's common stock (market condition) or on the achievement of a 2014 internal profitability target (performance condition).

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 \$7.61 per share as of November 1, 2014. 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. On May 21, 2014, we also granted approximately 157,000 RSUs to directors with a fair value of \$8.60 per RSU award. Additionally, on October 9, 2014, we granted approximately 13,000 RSUs to a new director with a fair value of \$7.64 per RSU award.

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8. Retirement Benefit Plans

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

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Primary Pension Plan				
Service cost	\$15	\$20	\$46	\$59
Interest cost	53	51	158	153
Expected return on plan assets	(87	) (85	) (261	) (255
Amortization of actuarial loss/(gain)	13	38	38	114
Amortization of prior service cost/(credit)	1	1	5	4
Loss/(gain) on transfer of benefits	6	—	6	—
Net periodic benefit expense/(income)	\$1	\$25	\$(8	) \$75
Supplemental Pension Plans				
Service cost	\$—	\$—	\$—	\$—
Interest cost	3	3	7	9
Amortization of actuarial loss/(gain)	3	6	11	18
Amortization of prior service cost/(credit)	—	—	—	—
Loss/(gain) on transfer of benefits	(6	) —	(6) —
Net periodic benefit expense/(income)	\$—	\$9	\$12	\$27
Primary and Supplemental Pension Plans Total				
Service cost	\$15	\$20	\$46	\$59
Interest cost	56	54	165	162
Expected return on plan assets	(87	) (85	) (261	) (255
Amortization of actuarial loss/(gain)	16	44	49	132
Amortization of prior service cost/(credit)	1	1	5	4
Loss/(gain) on transfer of benefits	—	—	—	—
Net periodic benefit expense/(income)	\$1	\$34	\$4	\$102
Postretirement Health and Welfare Plan				
Service cost	\$—	\$—	\$—	\$—
Interest cost	—	1	—	1
Amortization of actuarial loss/(gain)	—	(1	) —	(1
Amortization of prior service cost/(credit)	(2	) (2	) (6	) (6
Net periodic benefit expense/(income)	\$(2	) \$(2	) \$(6	) \$(6
Retirement Benefit Plans Total				
Service cost	\$15	\$20	\$46	\$59
Interest cost	56	55	165	163
Expected return on plan assets	(87	) (85	) (261	) (255
Amortization of actuarial loss/(gain)	16	43	49	131
Amortization of prior service cost/(credit)	(1	) (1	) (1	) (2
Loss/(gain) on transfer of benefits	—	—	—	—
Net periodic benefit expense/(income)	\$(1) \$32	\$(2) \$96

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Net periodic benefit expense/(income) for our noncontributory postretirement health and welfare plan was predominantly included in SG&A expense in the unaudited Interim Consolidated Statements of Operations. During the third quarter of 2014, we transferred \$25 million of supplemental pension plan benefits, as allowed under the Employee Retirement Income Security Act of 1974, out of one of our supplemental pension plans and into our Primary Pension Plan. The transfer did not have a significant impact on our unaudited Interim Consolidated Financial Statements.

Defined Contribution Plans

Our defined contribution plans include a qualified Savings, Profit-Sharing and Stock Ownership Plan (401(k) plan), which includes a non-contributory retirement account, and a non-qualified contributory unfunded mirror savings plan offered to certain members of management. Total expense for our defined contribution plans for both of the third quarters of 2014 and 2013 was \$12 million and was predominantly included in SG&A expenses in the unaudited Interim Consolidated Statements of Operations. Total expense for the first nine months for both of 2014 and 2013 was \$38 million.

9. Restructuring and Management Transition

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

(\$ in millions)	Three Months Ended		Nine Months Ended		Cumulative Amount Through November 1, 2014
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013	
Home office and stores	\$3	\$(6)	\$15	\$26	\$217
Store fixtures	—	10	—	55	133
Management transition	7	3	15	32	223
Other	2	39	9	52	132
Total	\$12	\$46	\$39	\$165	\$705

Home Office and Stores

During the nine months ended November 1, 2014 and November 2, 2013, we recorded \$15 million and \$26 million, respectively, of charges for actions taken to reduce our home office and store expenses. In January 2014, we announced the closing of 33 department stores as part of our turnaround efforts. Through the first nine months of 2014, we incurred charges of \$13 million for employee termination benefits and lease termination costs associated with the closure of those stores. Additionally, we incurred \$2 million of other miscellaneous store restructuring costs.

The \$32 million of charges through the first half of 2013 were associated with employee termination benefits for both store and home office associates. The \$6 million credit for the third quarter of 2013 resulted from termination benefits paid that were lower than expected primarily because employees found other positions within the Company and revisions were made to the restructuring plan.

Store Fixtures

During the three months ended November 2, 2013, we recorded \$2 million for the impairment of certain store fixtures related to our former shops strategy that were used in our prototype department store and \$8 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that were replaced during 2013.

During the nine months ended November 2, 2013, we recorded \$7 million of charges for the write-off of store fixtures related to the renovations in our home department and \$37 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that were replaced during 2013. In addition, during the nine months ended November 2, 2013, we recorded \$11 million of charges for the impairment of certain store fixtures related to our former shops strategy that were used in our prototype department store.

Management Transition

During the three months ended November 1, 2014 and November 2, 2013, we implemented several changes within our management leadership team that resulted in management transition costs of \$7 million and \$3 million, respectively, for both incoming and outgoing members of management. During the nine months ended November 1, 2014 and November 2, 2013, we recorded charges of \$15 million and \$32 million, respectively.

Other

During the three months ended November 1, 2014 and November 2, 2013, we recorded \$2 million and \$39 million, respectively, of miscellaneous restructuring charges. During the nine months ended November 1, 2014 and November 2, 2013,

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we recorded \$9 million and \$52 million, respectively, of miscellaneous restructuring charges. The charges during both years were related primarily to contract termination costs associated with our previous marketing and shops strategy, including a non-cash charge of \$36 million during the third quarter of 2013 relating to the return of shares of Martha Stewart Living Omnimedia Inc. previously acquired by the Company.

Activity for the restructuring and management transition liability for the nine months ended November 1, 2014 was as follows:

(\$ in millions)	Home Office and Stores	Management Transition	Other	Total	
February 1, 2014	\$—	\$3	\$30	\$33	
Charges	15	15	9	39	
Cash payments	(6) (11) (21) (38)
Non-cash	(2) (3) —	(5)
November 1, 2014	\$7	\$4	\$18	\$29	

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

10. Real Estate and Other, Net

Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments and other non-operating charges and credits. In addition, during the first quarter of 2014, we entered into a joint venture agreement in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture). The new joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities will be recorded in Real estate and other, net. For the three months ended November 1, 2014 and November 2, 2013, Real estate and other, net was income of \$90 million and \$27 million, respectively. For the nine months ended November 1, 2014 and November 2, 2013, Real estate and other, net was income of \$160 million and \$117 million, respectively. Real estate and other, net was comprised primarily of sales of non-operating and operating assets and our proportional share of net income from the Home Office Land Joint Venture as detailed below.

Non-Operating Assets

During the first quarter of 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 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 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 2013, we sold our investment in a joint venture that owns regional mall properties for \$55 million, resulting in a net gain of \$62 million. The gain exceeded the cash proceeds as a result of distributions of cash related to refinancing transactions 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 2013, we sold our investment in three joint ventures for \$32 million, resulting in a net gain of \$23 million and we sold approximately 10 acres of excess land for net proceeds and gain of \$1 million.

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 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 first quarter of 2013, we sold our leasehold interest in 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, realizing a gain of \$2 million.

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Other

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.

11. Income Taxes

Income taxes for the three months ended November 1, 2014 was a benefit of \$3 million compared to a benefit of \$11 million for the three months ended November 2, 2013. The effective tax rate for the three months ended November 1, 2014 was (1.6)% as compared to (2.2)% for the three months ended November 2, 2013. Income taxes for the nine months ended November 1, 2014 was an expense of \$1 million compared to a benefit of \$228 million for the nine months ended November 2, 2013. The effective tax rate for the nine months ended November 1, 2014 was 0.1% as compared to (13.8)% for the nine months ended November 2, 2013. Our effective tax rate for the nine months ended November 1, 2014 was impacted by a net increase to the tax valuation allowance for deferred tax assets of \$255 million.

In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our assessment, we concluded that, beginning in the second quarter of 2013, our estimate of the realization of deferred tax assets would be based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring carryforwards. Accordingly, in the third quarter of 2014, the valuation allowance was increased to offset the net deferred tax assets created in the quarter relating primarily to the increase in net operating loss (NOL) carryforwards. A valuation allowance of \$559 million has been recorded against our deferred tax assets as of November 1, 2014, which resulted in an increase to the valuation allowance during the quarter ended November 1, 2014 of \$107 million.

The net tax benefit of \$3 million for the third quarter of 2014 consisted of state and foreign tax expenses of \$1 million and \$2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$6 million non-cash benefit relating to other comprehensive income. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. Application of this guidance required the recognition of a non-cash income tax benefit of \$6 million in operating results, offset by a \$6 million charge to other comprehensive income for the quarter.

The net tax expense of \$1 million for the nine months ended November 1, 2014 consisted of a federal audit adjustment of \$12 million, state and foreign tax expenses of \$6 million and \$6 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$19 million non-cash benefit relating to other comprehensive income and a \$4 million benefit on settlement of certain state audits. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. Application of this guidance required the recognition of a non-cash income tax benefit of \$19 million in operating results, offset by a \$19 million charge to other comprehensive income for the quarter.

As of November 1, 2014, we have approximately \$2.7 billion of net operating losses available for U.S. federal income tax purposes, which expire in 2032 through 2034 and \$46 million of tax credit carryforwards that expire at various dates through 2034. For these NOL and tax credit carryforwards a net deferred tax asset of \$567 million has been recorded, net of a valuation allowance of \$393 million. A valuation allowance of \$166 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034.

12. 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 March 7, 2013, the judge adjourned the trial until April 8, 2013, and ordered the parties into mediation. The parties did not reach a settlement, and the trial continued on April 8, 2013. The parties concluded their presentations of evidence on April 26, 2013, and completed post-trial briefs in late May, 2013. The court held closing arguments on August 1, 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

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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 has cross-appealed a portion of the decision. While no assurance can be given as to the ultimate outcome of this matter, we currently believe that the final resolution of this action will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Other Legal Proceedings

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

Contingencies

As of November 1, 2014, we estimated our total potential environmental liabilities to range from \$18 million to \$24 million and recorded our best estimate of \$20 million in Other accounts payable and accrued expenses and Other liabilities in the unaudited Interim Consolidated Balance Sheet as of that date. This estimate covered potential liabilities primarily related to underground storage tanks, remediation of environmental conditions involving our former drugstore locations and asbestos removal in connection with approved plans to renovate or dispose of our facilities. We continue to assess required remediation and the adequacy of environmental reserves as new information becomes available and known conditions are further delineated. If we were to incur losses at the upper end of the estimated range, we do not believe that such losses would have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Guarantees

As of November 1, 2014, we had a 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 addition, in connection with the sale of the operations of our catalog 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 exited 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 November 1, 2014, our maximum liability in connection with the assigned leases was \$5 million.

13. 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

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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 individually significant component of an entity that does not qualify for discontinued operations reporting. This ASU is effective for us prospectively beginning in fiscal 2015, with early adoption permitted.

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 the third quarter of 2014 of \$46 million between Deferred taxes and Other liabilities and did not have a significant impact on our financial condition, results of operations or cash flows.

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

General

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

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

This discussion is intended to provide information that will assist the reader in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, how operating results affect the financial condition and results of operations of our Company as a whole, as well as how certain accounting principles affect the financial statements. It should be read in conjunction with our consolidated financial statements as of February 1, 2014, and for the year then ended, and related Notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), all contained in the Annual Report on Form 10-K for the fiscal year ended February 1, 2014 (2013 Form 10-K). Unless otherwise indicated, all references to earnings/(loss) per share (EPS) are on a diluted basis and all references to years relate to fiscal years rather than to calendar years.

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Third Quarter Summary and Key Developments

For the third quarter of 2014, sales were \$2,764 million with comparable store sales flat for the third quarter of 2014 and up 4.3% for the first nine months of 2014.

For the third quarter of 2014, gross margin as a percentage of sales increased to 36.6% compared to 29.5% in the same period last year and was positively impacted by a significant improvement in our mix and margin on clearance sales and higher margins on regular and promotional priced merchandise compared to the prior year quarter.

Selling, general and administrative (SG&A) expenses decreased \$18 million, or 1.8%, for the third quarter of 2014 as compared to the corresponding quarter in 2013. These savings were primarily driven by lower store expenses and corporate overhead costs.

In the third quarter of 2014, we recognized a tax benefit of \$3 million, reflecting a significant reduction in tax benefits typically recognized from federal and state loss carryforwards due to the recognition of a net \$107 million tax valuation allowance during the quarter, which negatively impacted EPS by \$0.35.

For the third quarter of 2014, earnings before interest expense, income tax (benefit)/expense and depreciation and amortization (EBITDA) was \$102 million, a \$342 million improvement from the same period last year. EBITDA for the quarter included a gain of \$88 million related to the sale of certain store assets.

For the third quarter of 2014, our net loss was \$188 million, or \$0.62 per share, compared to a net loss of \$489 million, or \$1.94 per share, for the corresponding prior year quarter. Results for this quarter included the following amounts that are not directly related to our ongoing core business operations:

\$12 million, or \$0.04 per share, of restructuring and management transition charges;

\$1 million, or \$0.00 per share, of expense from our qualified defined benefit pension plan (Primary Pension Plan);

\$34 million, or \$0.11 per share, for the loss on extinguishment of debt;

\$2 million, or \$0.01 per share, for the net gain on the sale of non-operating assets;

\$88 million, or \$0.28 per share, for certain net gains; and

\$6 million, or \$0.02 per share, of tax benefit related to the Primary Pension Plan that resulted from our other comprehensive income allocation between our operating loss and the amortization of net actuarial losses and prior service credits from Accumulated other comprehensive income.

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 above 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.

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Results of Operations

(\$ in millions, except EPS)	Three Months Ended		Nine Months Ended		
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013	
Total net sales	\$2,764	\$2,779	\$8,364	\$8,077	
Percent increase/(decrease) from prior year	(0.5	)% (5.1	)% 3.6	% (11.3)%
Comparable store sales increase/(decrease) ⁽¹⁾	0.0	% (4.1	)% 4.3	% (11.0)%
Gross margin	1,013	819	2,947	2,418	
Operating expenses/(income):					
Selling, general and administrative	988	1,006	2,961	3,110	
Primary pension plan	1	25	(8	) 75	
Supplemental pension plans	—	9	12	27	
Total pension	1	34	4	102	
Depreciation and amortization	156	161	474	440	
Real estate and other, net	(90	) (27	) (160	) (117)
Restructuring and management transition	12	46	39	165	
Total operating expenses	1,067	1,220	3,318	3,700	
Operating income/(loss)	(54	) (401	) (371	) (1,282)
Adjusted operating income/(loss) (non-GAAP) ⁽²⁾	(131	) (354	) (494	) (1,128)
Loss on extinguishment of debt	34	—	34	114	
Net interest expense	103	99	306	255	
Income/(loss) before income taxes	(191	) (500	) (711	) (1,651)
Income tax expense/(benefit)	(3	) (11	) 1	(228)
Net income/(loss)	\$(188	) \$(489	) \$(712	) \$(1,423)
EBITDA (non-GAAP) ⁽²⁾	\$102	\$(240	) \$103	\$(842)
Adjusted EBITDA (non-GAAP) ⁽²⁾	\$25	\$(193	) \$(20	) \$(688)
Adjusted net income/(loss) (non-GAAP) ⁽²⁾	\$(235	) \$(457	) \$(816	) \$(1,223)
Diluted EPS	\$(0.62	) \$(1.94	) \$(2.33	) \$(6.17)
Adjusted diluted EPS (non-GAAP) ⁽²⁾	\$(0.77	) \$(1.81	) \$(2.67	) \$(5.30)
Ratios as a percent of sales:					
Gross margin	36.6	% 29.5	% 35.2	% 29.9	%
SG&A	35.7	% 36.2	% 35.4	% 38.5	%
Total operating expenses	38.6	% 43.9	% 39.6	% 45.8	%
Operating income/(loss)	(2.0	)% (14.4	)% (4.4	)% (15.9)%
Adjusted operating income/(loss) (non-GAAP) ⁽²⁾	(4.7	)% (12.7	)% (5.9	)% (14.0)%

Comparable store sales include sales from all stores that have been open for 12 consecutive full fiscal months and Internet sales through jcp.com. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations.

(1) Beginning in the first quarter of 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.

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

Non-GAAP Financial Measures

We report our financial information in accordance with generally accepted accounting principles in the United States (GAAP). However, we present certain financial measures and ratios identified as non-GAAP under the rules of the Securities and Exchange Commission (SEC) to assess our results. We believe the presentation of these non-GAAP

financial measures and ratios is useful in order to better understand our financial performance as well as to facilitate the comparison of our results to the results of our peer companies. In addition, management uses these non-GAAP financial measures and ratios to assess the

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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 restructuring and management transition charges, the impact of our Primary Pension Plan, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains and 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). Unlike other operating expenses, restructuring and management transition charges, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains and the proportional share of net income from the Home Office Land Joint Venture are not directly related to our ongoing core business operations. Primary Pension Plan expense/(income) is determined using numerous complex assumptions about changes in pension assets and liabilities that are subject to factors beyond our control, such as market volatility. Accordingly, we eliminate our Primary Pension Plan expense/(income) in its entirety as we view all components of net periodic benefit expense/(income) as a single, net amount, consistent with its presentation in our Consolidated Financial Statements. We believe it is useful for investors to understand the impact of restructuring and management transition charges, Primary Pension Plan expense/(income), the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains and the proportional share of net income from the Home Office Land Joint Venture on our financial results and therefore are presenting the following non-GAAP financial measures: (1) adjusted operating income/(loss); (2) adjusted EBITDA (3) adjusted net income/(loss); and (4) adjusted diluted EPS.

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. Adjusted Operating Income/(Loss). The following table reconciles operating income/(loss), the most directly comparable GAAP financial measure, to adjusted operating income/(loss), a non-GAAP financial measure:

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Operating income/(loss)	\$(54)	\$(401)	\$(371)	\$(1,282)
As a percent of sales	(2.0)%	(14.4)%	(4.4)%	(15.9)%
Add: Restructuring and management transition charges	12	46	39	165
Add: Primary pension plan expense/(income)	1	25	(8)	75
Less: Net gain on sale of non-operating assets	(2)	(24)	(23)	(86)
Less: Proportional share of net income from joint venture	—	—	(43)	—
Less: Certain net gains ⁽¹⁾	(88)	—	(88)	—
Adjusted operating income/(loss) (non-GAAP)	\$(131)	\$(354)	\$(494)	\$(1,128)
As a percent of sales	(4.7)%	(12.7)%	(5.9)%	(14.0)%

(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.

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

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income/(loss)	\$ (188)	\$ (489)	\$ (712)	\$ (1,423)
Add: Net interest expense	103	99	306	255
Add: Loss on extinguishment of debt	34	—	34	114
Total interest expense	137	99	340	369
Add: Income tax expense/(benefit)	(3)	(11)	1	(228)
Add: Depreciation and amortization	156	161	474	440
EBITDA (non-GAAP)	102	(240)	103	(842)
Add: Restructuring and management transition charges	12	46	39	165
Add: Primary pension plan expense/(income)	1	25	(8)	75
Less: Net gain on the sale of non-operating assets	(2)	(24)	(23)	(86)
Less: Proportional share of net income from joint venture	—	—	(43)	—
Less: Certain net gains	(88)	—	(88)	—
Adjusted EBITDA (non-GAAP)	\$ 25	\$ (193)	\$ (20)	\$ (688)

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

(\$ in millions, except per share data)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income/(loss)	\$ (188)	\$ (489)	\$ (712)	\$ (1,423)
Diluted EPS	\$ (0.62)	\$ (1.94)	\$ (2.33)	\$ (6.17)
Add: Restructuring and management transition charges, net of tax of \$-, \$-, \$- and \$28	12	(1) 46	(1) 39	(1) 137
Add: Primary pension plan expense/(income), net of tax of \$-, \$-, \$- and \$10	1	(3) 25	(3) (8)	(3) 65
Add: Loss on extinguishment of debt, net of tax of \$-, \$-, \$- and \$-(1)	34	—	34	114
Less: Net gain on sale of non-operating assets, net of tax of \$-, \$-, \$- and \$1 (5)	(2)	(24)	(23)	(85)
Less: Proportional share of net income from joint venture, net of tax of \$-, \$-, \$- and \$-(1)	—	—	(43)	—
Less: Certain net gains, net of tax of \$2, \$-, \$2 and \$-(5)	(86)	—	(86)	—
Less: Tax benefit for the primary pension plan resulting from other comprehensive income allocation(6)	(6)	(15)	(17)	(31)
Adjusted net income/(loss) (non-GAAP)	\$ (235)	\$ (457)	\$ (816)	\$ (1,223)

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Adjusted diluted EPS (non-GAAP) \$(0.77) \$(1.81) \$(2.67) \$(5.30)

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

For the three months ended May 4, 2013, tax effect was calculated using the Company's statutory rate of 38.82%.

(2) The six months ended November 2, 2013, reflects no tax effect due to the impact of the Company's tax valuation allowance.

(3) The tax effect is included in the line item Tax benefit for the primary pension plan resulting from other comprehensive income allocation. See footnote 6 below.

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(4) For the three months ended May 4, 2013, tax effect was calculated using the Company's statutory rate of 38.82%. Tax benefit for the six months ended November 2, 2013 is included in the line item Tax benefit resulting from other comprehensive income allocation. See footnote 6 below.

(5) Tax effect represents state taxes payable in separately filing states.

(6) Tax benefit for the three and nine months ended November 1, 2014 and for the three and six months ended November 2, 2013 resulted from our other comprehensive income allocation between our operating loss and the amortization of net actuarial losses and prior service credits from Accumulated other comprehensive income. For the three months ended May 4, 2013, tax effect was calculated using the Company's statutory rate of 38.82%.

Total Net Sales

(\$ in millions)	Three Months Ended		Nine Months Ended		
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013	
Total net sales	\$2,764	\$2,779	\$8,364	\$8,077	
Sales percent increase/(decrease):					
Total net sales	(0.5)% (5.1)% 3.6	% (11.3)%
Comparable store sales ⁽¹⁾	0.0	% (4.1)% 4.3	% (11.0)%

(1) Beginning in the first quarter of 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.

Total net sales decreased \$15 million in the third quarter of 2014 compared to the third quarter of 2013. For the first nine months of 2014, total net sales increased \$287 million from the same period last year. The following table provides the components of the net sales increase/(decrease):

(\$ in millions)	Three Months Ended November 1, 2014	Nine Months Ended November 1, 2014
Comparable store sales increase/(decrease)	\$—	\$346
New and closed stores, net	(24	) (52
Other revenues and sales adjustments	9	(7
Total net sales increase/(decrease)	\$(15	) \$287

Store Count

The following table compares the number of stores and gross selling space for the three and nine months ended November 1, 2014 and November 2, 2013:

	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
JCPenney department stores				
Beginning of period	1,062	1,095	1,094	1,104
Stores opened	1	—	1	—
Closed stores	(1	) —	(33	) (9
End of period ⁽¹⁾	1,062	1,095	1,062	1,095
The Foundry Big and Tall Supply Co. ⁽²⁾	8	10	8	10

(1) Gross selling space was 108 million square feet as of November 1, 2014 and 111 million square feet as of November 2, 2013.

(2)

Gross selling space was 41 thousand square feet as of November 1, 2014 and 51 thousand square feet as of November 2, 2013. During the nine months ended November 1, 2014, we closed two store locations.

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Comparable store sales were flat during the third quarter of 2014. Total net sales decreased 0.5% to \$2,764 million in the third quarter of 2014, compared with \$2,779 million in last year's third quarter. Internet sales increased 3.4% to \$280 million in the third quarter of 2014. The month of August was the best performing month during the quarter. We experienced a slowdown in our business in the months of September and October as a result of unseasonably warm weather which negatively affected our sales on fall and cold-weather merchandise. In addition, last year's third quarter had benefited from higher clearance sales volumes as we liquidated certain brands and spring merchandise, primarily in Home and Children's, that did not resonate with our customers.

For the nine months ended November 1, 2014, comparable store sales increased 4.3%, while total net sales increased 3.6% to \$8,364 million compared with \$8,077 million for the nine months ended November 2, 2013. Internet sales increased 13.9% to \$797 million during the nine months ended November 1, 2014 compared to the prior year corresponding period. 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. Both total net sales and comparable store sales increased during the first nine months of 2014 as we continue to experience a positive response to these efforts. Internet sales experienced a larger increase primarily as a result of better merchandise in-stock positions and mix, improvements in site performance and a favorable response to our promotional activity as compared to the prior year corresponding period.

Based on a sample of our mall and off-mall stores, our store traffic decreased, but our conversion rate increased during the third quarter and through the first nine months of 2014 as compared to the prior year corresponding periods. While still negative for the quarter and through the first nine months of 2014, store traffic improved sequentially each quarter. For the third quarter and through the first nine months of 2014, the average transaction value and average unit retail increased, while the units per transaction decreased as compared to the corresponding prior year periods. Home and Fine Jewelry were our merchandise divisions that experienced the highest sales gains during the quarter and the first nine months of 2014. Sephora inside JCPenney also continued its strong performance with significant growth during the periods. Geographically, the western and northeastern regions of the country delivered the best performance during the quarter.

Gross Margin

Gross margin for the third quarter of 2014 was \$1,013 million, an increase of \$194 million compared to \$819 million in the third quarter of 2013. Gross margin as a percentage of sales in the third quarter of 2014 increased to 36.6% compared to 29.5% in the third quarter of 2013. The 710 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 margins on regular and promotional priced merchandise.

Gross margin for the nine months ended November 1, 2014 was \$2,947 million, an increase of \$529 million compared to \$2,418 million for the nine months ended November 2, 2013. Gross margin as a percentage of sales for the nine months ended November 1, 2014 was 35.2% compared to 29.9% for the nine months ended November 2, 2013. The 530 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 corresponding prior year period as a result of moving back to a promotional strategy. These improvements were slightly offset by lower margins on regular and promotional priced merchandise.

SG&A Expenses

For the three months ended November 1, 2014, SG&A expenses were \$18 million lower compared to the three months ended November 2, 2013. As a percent of sales, SG&A expenses decreased to 35.7% compared to 36.2% in the third quarter of 2013. Through the first nine months of 2014, SG&A expenses were \$149 million lower than the corresponding prior period of 2013. Through the first nine months of 2014, as a percent of sales, SG&A expenses

decreased to 35.4% compared to 38.5% in the corresponding prior period of 2013. For both the third quarter and through the first nine months of 2014, SG&A expenses were leveraged as we were able to better manage our expenses throughout the business. The net decrease in SG&A expenses for the third quarter of 2014 as compared to the corresponding prior period was driven primarily by lower store expenses and corporate overhead costs. The net decrease in SG&A expenses for the first nine months of 2014 as compared to the corresponding prior period was driven primarily by lower store expenses, advertising costs and corporate overhead.

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Pension Expense

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Primary Pension Plan	\$1	\$25	\$(8	) \$75
Supplemental pension plans	—	9	12	27
Total pension expense	\$1	\$34	\$4	\$102

Total pension expense, which consists of expense/(income) from our Primary Pension Plan and our supplemental pension plans, is based on our 2013 year-end measurement of pension plan assets and benefit obligations. For the first nine months of 2014, we had income of \$8 million compared to expense of \$75 million in the prior year corresponding period. The change to income for our Primary Pension Plan was primarily a result of improved asset performance in prior periods, a higher base of plan assets and a 70 basis point increase in our discount rate. For the first nine months of 2014, our supplemental pension plans expense decreased \$15 million to \$12 million.

During the third quarter of 2014, we transferred \$25 million of supplemental pension plan benefits, as allowed under the Employee Retirement Income Security Act of 1974, out of one of our supplemental pension plans and into our Primary Pension Plan. The transfer did not have a significant impact on our unaudited Interim Consolidated Financial Statements; however, the transfer of benefits resulted in a one-time expense of \$6 million to our Primary Pension Plan and an offsetting \$6 million benefit to our supplemental pension plans during the third quarter of 2014. These one-time charges in the third quarter of 2014, including our regular quarterly pension expense for each plan, resulted in \$1 million of expense related to our Primary Pension Plan and no expense for our supplemental pension plans during the quarter.

Depreciation and Amortization Expense

Depreciation and amortization expense in the third quarter of 2014 decreased \$5 million to \$156 million from \$161 million for the comparable 2013 period. For the first nine months of 2014, depreciation and amortization expense increased \$34 million to \$474 million from \$440 million last year. The increase for the first nine months of 2014 is a result of our investment and replacement of store fixtures in connection with the implementation of our former shops strategy. Depreciation and amortization expense for the three and nine months ended November 2, 2013 excludes \$8 million and \$37 million, respectively, of increased depreciation as a result of shortening the useful lives of store fixtures in our department stores that were replaced during 2013 with the build out of our home department and other attractions. This amount is included in the line Restructuring and management transition in the unaudited Interim Consolidated Statements of Operations.

Restructuring and Management Transition

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

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Home office and stores	\$3	\$(6	) \$15	\$26
Store fixtures	—	10	—	55
Management transition	7	3	15	32
Other	2	39	9	52
Total	\$12	\$46	\$39	\$165

Home Office and Stores

During the nine months ended November 1, 2014 and November 2, 2013, we recorded \$15 million and \$26 million, respectively, of charges for actions taken to reduce our home office and store expenses. In January 2014, we announced the closing of 33 department stores as part of our turnaround efforts. Through the first nine months of 2014, we incurred charges of \$13 million for employee termination benefits and lease termination costs associated

with the closure of those stores. Additionally, we incurred \$2 million of other miscellaneous store restructuring costs.

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The \$32 million of charges through the first half of 2013 were associated with employee termination benefits for both store and home office associates. The \$6 million credit for the third quarter of 2013 resulted from termination benefits paid that were lower than expected primarily because employees found other positions within the Company and revisions were made to the restructuring plan.

Store Fixtures

During the three months ended November 2, 2013, we recorded \$2 million for the impairment of certain store fixtures related to our former shops strategy that were used in our prototype department store and \$8 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that were replaced during 2013.

During the nine months ended November 2, 2013, we recorded \$7 million of charges for the write-off of store fixtures related to the renovations in our home department and \$37 million of increased depreciation as a result of shortening the useful lives of fixtures in our department stores that were replaced during 2013. In addition, during the nine months ended November 2, 2013, we recorded \$11 million of charges for the impairment of certain store fixtures related to our former shops strategy that were used in our prototype department store.

Management Transition

During the three months ended November 1, 2014 and November 2, 2013, we implemented several changes within our management leadership team that resulted in management transition costs of \$7 million and \$3 million, respectively, for both incoming and outgoing members of management. During the nine months ended November 1, 2014 and November 2, 2013, we recorded charges of \$15 million and \$32 million, respectively.

Other

During the three months ended November 1, 2014 and November 2, 2013, we recorded \$2 million and \$39 million, respectively, of miscellaneous restructuring charges. During the nine months ended November 1, 2014 and November 2, 2013, we recorded \$9 million and \$52 million, respectively, of miscellaneous restructuring charges. The charges during both years were related primarily to contract termination costs associated with our previous marketing and shops strategy, including a non-cash charge of \$36 million during the third quarter of 2013 relating to the return of shares of Martha Stewart Living Omnimedia Inc. previously acquired by the Company.

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. For the three months ended November 1, 2014 and November 2, 2013, Real estate and other, net was income of \$90 million and \$27 million, respectively. For the nine months ended November 1, 2014 and November 2, 2013, Real estate and other, net was income of \$160 million and \$117 million, respectively. Real estate and other, net was comprised primarily of sales of non-operating and operating assets and our proportional share of net income from the Home Office Land Joint Venture as detailed below.

Non-Operating Assets

During the first quarter of 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 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 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 2013, we sold our investment in a joint venture that owns regional mall properties for \$55 million, resulting in a net gain of \$62 million. The gain exceeded the cash proceeds as a result of distributions of cash related to refinancing transactions 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 2013, we sold our investment in three joint ventures for \$32 million, resulting in a net gain of \$23 million and we sold approximately 10 acres of excess land for net proceeds and gain of \$1 million.

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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 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 first quarter of 2013, we sold our leasehold interest in 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, realizing a gain of \$2 million.

Other

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.

Operating Income/(Loss) and Adjusted Operating Income/(Loss) (non-GAAP)

For the third quarter of 2014, we reported an operating loss of \$54 million compared to an operating loss of \$401 million in the prior year corresponding period. Excluding restructuring and management transition charges, the impact of our Primary Pension Plan expense/(income), the net gain on the sale of non-operating assets and certain net gains, adjusted operating income/(loss) was a loss of \$131 million for the third quarter of 2014, an improvement of \$223 million compared to an adjusted operating loss of \$354 million for the prior year corresponding period.

For the nine months ended November 1, 2014, we reported an operating loss of \$371 million compared to an operating loss of \$1,282 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 operating income/(loss) was a loss of \$494 million for the nine months ended November 1, 2014, an improvement of \$634 million compared to an adjusted operating loss of \$1,128 million for the prior year corresponding period.

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 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 for the third quarters of 2014 and 2013 was \$103 million and \$99 million, respectively. For the nine months ended November 1, 2014, net interest expense was \$306 million compared to \$255 million in the prior year corresponding period. The increase in net interest expense for the periods is primarily related to the increased interest expense associated with the previous borrowings under our revolving credit facility, the \$2.25 billion five-year

senior secured term loan that was entered into on May 22, 2013 (2013 Term Loan), the \$500 million five-year asset-based senior term loan that was entered into on June 20, 2014 (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 the \$2.35 billion asset-based senior credit facility that was entered into on June 20, 2014 (2014 Credit Facility).

Income Taxes

Income taxes for the three months ended November 1, 2014 was a benefit of \$3 million compared to a benefit of \$11 million for the three months ended November 2, 2013. Income taxes for the nine months ended November 1, 2014 was an expense of \$1 million compared to a benefit of \$228 million for the nine months ended November 2, 2013.

Income taxes for the three and

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nine months ended November 1, 2014 were impacted by a net increase to the tax valuation allowance for deferred tax assets of \$107 million and \$255 million, respectively.

In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. Beginning in the second quarter of 2013 and for each quarter thereafter, our estimate of the realization of deferred tax assets was based solely on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring net operating loss (NOL) and tax credit carryforwards. Accordingly, in the third quarter of 2014, the valuation allowance was increased to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards. As of November 1, 2014, a valuation allowance of \$559 million has been recorded against our deferred tax assets.

The net tax benefit of \$3 million for the third quarter of 2014 consists of state and foreign tax expenses of \$1 million and \$2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$6 million non-cash benefit relating to other comprehensive income. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. Application of this guidance required the recognition of a non-cash income tax benefit of \$6 million in operating results, offset by a \$6 million charge to other comprehensive income for the quarter.

The net tax expense of \$1 million for the nine months ended November 1, 2014 consists of a federal audit adjustment of \$12 million, state and foreign tax expenses of \$6 million and \$6 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a \$19 million non-cash benefit relating to other comprehensive income and a \$4 million benefit on settlement of certain state audits. In accordance with accounting standards, we are required to allocate a portion of our tax provision between operating losses and accumulated other comprehensive income. Application of this guidance required the recognition of a non-cash income tax benefit of \$19 million in operating results, offset by a \$19 million charge to other comprehensive income for the quarter.

EBITDA and Adjusted EBITDA (non-GAAP)

For the third quarter of 2014, EBITDA was a positive \$102 million, an improvement of \$342 million compared to a negative EBITDA of \$240 million in the prior year corresponding period. Excluding restructuring and management transition charges, the impact of our Primary Pension Plan expense/(income), the net gain on the sale of non-operating assets and certain net gains, adjusted EBITDA was still positive, improving \$218 million to an adjusted EBITDA of \$25 million for the third quarter of 2014 compared to a negative adjusted EBITDA of \$193 million for the prior year corresponding period.

For the nine months ended November 1, 2014, EBITDA was a positive \$103 million, an improvement of \$945 million compared to a negative EBITDA of \$842 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 improved \$668 million to a negative adjusted EBITDA of \$20 million for the nine months ended November 1, 2014 compared to a negative adjusted EBITDA of \$688 million for the prior year corresponding period.

Overall, EBITDA and adjusted EBITDA improved significantly for the three and nine months ended November 1, 2014 as compared to the corresponding prior year periods as we were able to improve sales, achieve higher margins and reduce our operating costs.

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Liquidity and Capital Resources

Overview

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our revolving credit facility. Our cash flows may be impacted by many factors including the economic environment, consumer confidence, competitive conditions in the retail industry and the success of our strategies. During the first nine months of 2014, we completed the following transactions to enhance our liquidity:

On June 20, 2014, J. C. Penney Company, Inc., JCP and J. C. Penney Purchasing Corporation (Purchasing) entered into the 2014 Credit Facility, comprised of a \$1,850 million revolving line of credit (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; and

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.

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 third quarter of 2014 with \$684 million of cash and cash equivalents. As of the end of the third quarter of 2014, based on our September 2014 borrowing base, we had \$1,421 million available for future borrowing, of which \$1,236 million was accessible due to the minimum excess availability threshold, which limits the borrowing base by the greater of 10% of the borrowing base or \$150 million. As of the end of the third quarter of 2014, our total available liquidity was \$1,920 million.

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

(\$ in millions)	Nine Months Ended		
	November 1, 2014	November 2, 2013	
Cash and cash equivalents	\$684	\$1,227	
Merchandise inventory	3,358	3,747	
Property and equipment, net	5,312	5,753	
Total debt ⁽¹⁾	5,427	5,612	
Stockholders' equity	2,430	2,647	
Total capital	7,857	8,259	
Maximum capacity under our revolving facility	1,850	1,850	
Short-term borrowings under our revolving facility	—	650	
Cash flow from operating activities	(454)	(2,197)	
Free cash flow (non-GAAP) ⁽²⁾	(588)	(2,992)	
Capital expenditures ⁽³⁾	202	814	
Ratios:			
Total debt-to-total capital ⁽⁴⁾	69	% 68	%

Cash-to-total debt ⁽⁵⁾	13	%	22	%
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(1) Total debt includes long-term debt, including current maturities, capital leases, note payable and any current borrowings under our revolving credit facility.

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

(3) As of the end of the third quarters of 2014 and 2013, we had accrued capital expenditures of \$18 million and \$102 million, respectively.

(4) Total debt divided by total capitalization.

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

Free Cash Flow (Non-GAAP)

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

(\$ in millions)	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net cash provided by/(used in) operating activities (GAAP)	\$(320)	\$(737)	\$(454)	\$(2,197)
Add:				
Proceeds from sale of operating assets	66	—	68	19
Less:				
Capital expenditures ⁽¹⁾	(61)	(161)	(202)	(814)
Free cash flow (non-GAAP)	\$(315)	\$(898)	\$(588)	\$(2,992)

(1) As of the end of the third quarters of 2014 and 2013, we had accrued capital expenditures of \$18 million and \$102 million, respectively.

Free cash flow for the three months ended November 1, 2014 improved \$583 million to an outflow of \$315 million compared to an outflow of \$898 million in the same period last year. Free cash flow for the nine months ended November 1, 2014 improved \$2,404 million to an outflow of \$588 million compared to an outflow of \$2,992 million in the same period last year. 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 the third quarter and through the first nine months of 2014 when compared to the corresponding prior year periods.

Operating Activities

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

Cash flow from operating activities for the three months ended November 1, 2014, improved \$417 million to an outflow of \$320 million compared to an outflow of \$737 million for the same period last year. Cash flow from operating activities for the nine months ended November 1, 2014, improved \$1,743 million to an outflow of \$454 million compared to an outflow of \$2,197 million for the same period in 2013. Our net loss of \$712 million for the nine months ended November 1, 2014 includes significant income and expense items that do not impact operating cash flow including depreciation and amortization, the gain on the sale of assets, the loss on extinguishment of debt

and deferred taxes. The overall decrease in cash used in operations was driven primarily by the increase in sales and operating performance of the Company, including higher margins and better expense management.

Merchandise inventory decreased \$389 million to \$3,358 million, or 10.4%, as of the end of the third quarter of 2014 compared to \$3,747 million as of the end of the third quarter last year and increased \$423 million from year-end. For the first nine months

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and third quarter of 2014, the increase in inventory was slightly offset by a benefit in the related corresponding merchandise accounts payable. Consistent with the prior year, the significant investment in our inventory levels during the third quarter is in preparation for the holiday season. The first nine months of 2013 reflects a higher investment in inventory as we worked to re-stock basic and private branded categories and replenish low inventory levels that resulted from the prior strategy.

Investing Activities

Investing activities for the three months ended November 1, 2014 was a cash inflow of \$7 million compared to an outflow of \$128 million for the same period in 2013. Investing activities through the first nine months of 2014 was a cash outflow of \$98 million compared to an outflow of \$707 million for the same nine month period of 2013. The decrease in the cash outflow from investing activities was primarily a result of decreased capital expenditures partially offset by proceeds from the sale of operating and non-operating assets.

Cash capital expenditures were \$202 million for the nine months ended November 1, 2014 compared to \$814 million for the nine months ended November 2, 2013. In addition, as of the end of the third quarter of 2014 and 2013, we had \$18 million and \$102 million, respectively, of accrued capital expenditures. Through the first nine months of 2014, capital expenditures 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.

For the nine months ended November 2, 2013, capital expenditures related primarily to the opening of the women's and kid's Joe Fresh® attractions in nearly 700 of our department stores, the opening of Disney® and giggleBaby™ in approximately 560 stores and renovations in our home department in approximately 500 of our department stores.

During the three and nine months ended November 2, 2013, we opened 30 and 60, respectively, Sephora inside jpenney stores. Accrued capital expenditures at the end of the third quarter of 2013 primarily related to the renovation of our home department. During the first nine months of 2013, we sold our investments in four real estate joint ventures, a leasehold interest in a former department store location and three properties for a total of \$107 million in net proceeds.

Full year 2014 capital expenditures are expected to be approximately \$250 million. Capital expenditures for the remainder of 2014 include accrued expenditures of \$18 million at the end of the third quarter.

Financing Activities

Financing activities for the three months ended November 1, 2014 was a cash outflow of \$39 million compared to an inflow of \$557 million for the same period in 2013. Financing activities for the nine months ended November 1, 2014 resulted in an outflow of \$279 million compared to an inflow of \$3,201 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 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.

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 facility. In addition, we incurred \$60 million of financing costs relating to the 2014 Credit Facility. Through the first nine months of 2014, we repaid \$22 million on our capital leases and note payable and \$17 million on our 2013 Term Loan.

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 incurred financing costs of \$8 million primarily to amend and restate our revolving credit facility and borrowed \$850 million under our 2013 asset-based credit facility of which \$200 million was repaid during the third quarter of 2013.

Table of Contents**Cash Flow Outlook**

During the first nine months of 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 the remainder of 2014, 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 an asset-based senior 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 the third quarter of 2014, we had \$499 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 the third quarter of 2014, we had \$429 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 the third quarter of 2014, based on our September 2014 borrowing base, we had \$1,421 million available for future borrowing, of which \$1,236 million was accessible due to the minimum excess availability threshold.

Credit Ratings

Our credit ratings and outlook as of December 5, 2014 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

Aggregate information about our obligations and commitments to make future payments under contractual or contingent arrangements was disclosed in the 2013 Form 10-K. Our unrecorded contractual obligations related to merchandise have

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decreased approximately 15% since year end primarily due to the seasonality of our business and updates to our supplier base in the ordinary course of business.

Inflation

Our business is affected by general economic conditions, including changes in prices for labor and commodities such as petroleum, energy and cotton. In 2014, there are inflationary pressures primarily from increases to minimum wages in Southern and Southeastern Asia. Offsetting these pressures is our overall structure and sourcing strategy and improved freight rates due to increased vessel capacity especially in the transpacific. We believe the net impact of these will have a modest impact to overall costs in the fall of 2014.

Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations is based upon our unaudited Interim Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and use judgments that affect reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on other assumptions that are believed to be reasonable under the circumstances. On an ongoing basis, we evaluate estimates used, including those related to inventory valuation under the retail method, valuation of long-lived assets, estimation of reserves and valuation allowances specifically related to closed stores, insurance, income taxes, litigation and environmental contingencies and pension accounting. While actual results could differ from these estimates, we do not expect the differences, if any, to have a material effect on the unaudited Interim Consolidated Financial Statements. There were no changes to our critical accounting policies during the nine months ended November 1, 2014. For a further discussion of the judgments we make in applying our accounting policies, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our 2013 Form 10-K.

Recently Issued Accounting Pronouncements

Recently issued accounting pronouncements are discussed in Note 13 to the unaudited Interim Consolidated Financial Statements.

Seasonality

While a significant portion of our sales, profit and operating cash flows have historically been realized in the fiscal fourth quarter, our quarterly results of operations may fluctuate significantly as a result of many factors, including seasonal fluctuations in customer demand, product offerings, inventory levels and our promotional activity. The results of operations and cash flows for the nine months ended November 1, 2014 are not necessarily indicative of the results for future quarters or the entire year.

Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements made within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current view of future events and financial performance. Words such as "expect" and similar expressions identify forward-looking statements, which include, but are not limited to, statements regarding sales trends, gross margin, liquidity and cost savings. 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 turnaround strategy, customer acceptance of our new 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, 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

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customer, employee or Company information, legal and regulatory proceedings and the Company's ability to access the debt or equity markets on favorable terms or at all. There can be no assurances that the Company will achieve expected results, and actual results may be materially less than expectations. While we believe that our assumptions are reasonable, we caution that it is impossible to predict the degree to which any such factors could cause actual results to differ materially from predicted results.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks in the normal course of business due to changes in interest rates. Our market risks related to interest rates at November 1, 2014 are similar to those disclosed in the 2013 Form 10-K.

Item 4. Controls and Procedures

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (the Exchange Act)) as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer concluded our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. There were no changes in our internal control over financial reporting during the third quarter ended November 1, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

Macy's Litigation

On August 16, 2012, Macy's, Inc. and Macy's Merchandising Group, Inc. (together the Plaintiffs) filed suit against J. C. Penney Corporation, Inc. in the Supreme Court of the State of New York, County of New York, alleging that the Company tortiously interfered with, and engaged in unfair competition relating to a 2006 agreement between Macy's and Martha Stewart Living Omnimedia, Inc. (MSLO) by entering into a partnership agreement with MSLO in December 2011. The Plaintiffs sought primarily to prevent the Company from implementing our partnership agreement with MSLO as it related to products in the bedding, bath, kitchen and cookware categories. The suit was consolidated with an already-existing breach of contract lawsuit by the Plaintiffs against MSLO, and a bench trial commenced on February 20, 2013. On March 7, 2013, the judge adjourned the trial until April 8, 2013, and ordered the parties into mediation. The parties did not reach a settlement, and the trial continued on April 8, 2013. The parties concluded their presentations of evidence on April 26, 2013, and completed post-trial briefs in late May, 2013. The court held closing arguments on August 1, 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 has cross-appealed a portion of the decision. While no assurance can be given as to the ultimate outcome of this matter, we currently 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 193rd 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. On August 5, 2013, the trial court preliminarily approved the settlement, and notice was mailed to shareholders soon thereafter. The trial court finally approved the settlement at a hearing on October 28, 2013 and, despite objection, awarded the plaintiff \$3.1 million in attorneys' fees and costs. The Company and named individuals have appealed the award of attorneys' fees and costs. Oral argument on the appeal occurred on October 15, 2014. While no assurance can be given as to the ultimate outcome of this matter, we currently 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

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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 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 currently 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 currently 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, 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.

Other Legal Proceedings

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

Item 1A. Risk Factors

The risk factors listed below update and supersede the risk factors associated with our business previously disclosed in Part II, Item 1A of our Quarterly Report on Form 10-Q for the fiscal quarter ended August 2, 2014.

Our ability to return to profitable growth is subject to both the risks affecting our business generally and the inherent difficulties associated with shifting 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 recover from our previous negative sales trends and operating results, 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;

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- 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 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 and updating their store environment. 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, 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. The merchandise assortment under our prior strategy did not resonate with customers so we are re-establishing brands that our customers want. 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 predictions 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

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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 the 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. Our stores have been experiencing a decline in traffic. There is no assurance that this trend will reverse or that increases in Internet sales will offset the decline. We may need to respond to any declines in customer traffic or conversion rates by increasing markdowns or promotions to attract customers to our stores, 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, adjusting our merchandise mix between our private and exclusive brands and national brands, appropriately changing the allocation of floor space of stores among product categories to respond to customer demand and effectively managing pricing and markdowns. If we overestimate customer demand for our merchandise, we will likely need to record inventory markdowns and move the excess inventory to be sold 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, we cannot be assured 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 customers or our 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 litigation, 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 with historically high rates of turnover. As a result of restructuring activities taken during the past few years, we now operate with significantly fewer individuals 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

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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. 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, 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 in Internet sales and have an adverse impact on our results of operations.

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

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

Beginning in fiscal 2013, 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

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availability of credit and our credit ratings, as well as the possibility that lenders could develop a negative perception of us. There is no assurance that we will be able to obtain additional financing, on favorable terms or at all.

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

Our merchandise is sourced from a wide variety of suppliers, and our business depends on being able to find qualified suppliers and access products in a timely and efficient manner. Inflationary pressures on commodity prices and other input costs could increase our cost of goods, and an inability to pass such cost increases on to our customers or a change in our merchandise mix as a result of such cost increases could have an adverse impact on our profitability. Additionally, the impact of economic conditions on our suppliers cannot be predicted and our suppliers may be unable to access financing or become insolvent and thus become unable to supply us with products.

Our arrangements with our suppliers and vendors may be impacted by our financial results or financial position.

Substantially all of our merchandise suppliers and vendors sell to us on open account purchase terms. There is a risk that our key suppliers and vendors could respond to any actual or apparent decrease in or any concern with our financial results or liquidity by requiring or conditioning their sale of merchandise to us on more stringent or more costly payment terms, such as by requiring standby letters of credit, earlier or advance payment of invoices, payment upon delivery or other assurances or credit support or by choosing not to sell merchandise to us on a timely basis or at all. Our arrangements with our suppliers and 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.

In May 2013, we entered into 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.

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

Our obligations under the revolving credit facility are secured by liens with respect to inventory, accounts receivable, deposit accounts and certain related collateral. In the event of a default that is not cured or waived within any applicable cure periods, the lenders' commitment to extend further credit under our revolving credit facility could be terminated, our outstanding obligations could become immediately due and payable, outstanding letters of credit may be required to be cash collateralized and remedies may be exercised against the collateral, which generally consists of the Company's inventory, accounts receivable and deposit accounts and cash credited thereto. If we are unable to borrow under our revolving credit facility, we may not have the necessary cash resources for our operations and, if any event of default occurs, there is no assurance that we would have the cash resources available to repay such accelerated obligations, refinance such indebtedness on commercially reasonable terms, or at all, or cash collateralize our letters of credit, which would have a material adverse effect on our business, financial condition, results of operations and liquidity.

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

As of November 1, 2014, we have \$5.427 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.

We cannot assure 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 have sold a substantial amount of non-operating assets over the past two years. We expect our ability to generate cash through the sale of non-operating assets to diminish as the size of 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, we cannot assure 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. We cannot assure 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 we cannot assure would be obtainable. Any additional financing or refinancing could also be extended only at higher

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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 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;

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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 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

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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.

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

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

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

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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 \$2.1 billion as of February 1, 2014. This NOL carryforward (expiring in 2032 and 2033) is available to offset future taxable income. The Company may recognize additional NOLs for the 2015 fiscal year.

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 3.5% at February 1, 2014. To the extent that a company has a net unrealized built-in gain at the time of an ownership change, which is realized or deemed recognized during the five-year period following the ownership change, there is an increase in the annual limitation for each of the first five-years that is cumulative to the extent it is not all utilized in a year.

The Company has an ongoing study of the rolling three-year testing periods. Based upon the elections the Company has made and the information that has been filed with the Securities and Exchange Commission through December 5, 2014, the Company has not had a Section 382 ownership change through December 5, 2014.

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Effective October 22, 2013, the Internal Revenue Service made final certain proposed regulations under Section 382. These regulations are generally more taxpayer favorable as to measuring the impact of an ownership shift and allow a corporate taxpayer to apply the new regulations to prior testing dates as long as an ownership change had not occurred under the old regulations in any testing period ending on or before October 22, 2013. The Company has revised its ongoing study of the rolling three-year testing periods so that all ownership shifts are determined under the new regulations.

Avoiding an initial ownership shift by staying under a cumulative 50 percentage point shift in the rolling three year testing periods is preferable to being subject to the Section 382 NOL limitations. If an ownership change is encountered at some point, it is generally preferable that it be at a time when the value of the company and built-in gains to be recognized are such that the Section 382 limitations are at their highest levels as compared to the NOL and credit carryforwards. Losses incurred after an ownership change are not subject to limitation except where there is a new cumulative 50 percentage point change under the rolling three year testing periods. The Company plans to continue its analysis of the elections available to it in filing its federal income tax return and the impact of the new regulations.

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.

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Item 6. Exhibits

Exhibit Index

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed (†) Herewith (as indicated)
		Form	SEC File No.	Exhibit		
3.1	Restated Certificate of Incorporation of J. C. Penney Company, Inc., as amended to May 20, 2011	10-Q	001-15274	3.1	6/8/2011	
3.2	J. C. Penney Company, Inc. Bylaws, as amended to July 23, 2013	8-K	001-15274	3.1	7/26/2013	
3.3	Certificate of Designation, Preferences and Rights of Series C Junior Participating Preferred Stock	8-K	001-15274	3.1	8/22/2013	
4.1	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	
4.2	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	
10.1	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	
10.2	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	
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					†
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					†
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					†
101.INS	XBRL Instance Document					†
101.SCH	XBRL Taxonomy Extension Schema Document					†
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					†
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					†

101.LAB	XBRL Taxonomy Extension Label Linkbase Document	†
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	†

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SIGNATURES

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

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

Date: December 9, 2014