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J.C. Penney's "Fair and Square" Strategy (C): Back to the Future

Myron E. "Mike" Ullman III had recently *retaken* the reins as chief executive officer of department store J.C. Penney following the ouster of Ron Johnson. Ullman himself had been fired in 2011 and replaced by Johnson, who served as CEO for seventeen months. Johnson witnessed deeply disappointing financial results as he executed his "Fair and Square" strategy. Rehired in April 2013, Ullman was brought back to stabilize the business, which was in free fall. J.C. Penney had lost $4.3 billion in sales under Johnson and its stock price was trading near record low levels. The company was hemorrhaging cash, as it piled up quarter upon quarter of losses while continuing to make expensive capital investments to renovate its retail stores. Some feared that the venerable retailer was facing its final demise.

Johnson's aggressive "Fair and Square" plan was, in part, designed to attract a new audience to J.C. Penney to help shore up its flagging sales. However, in 2012, the first year the plan was executed, J.C. Penney attracted the smallest number of new customers than it had in any of the previous ten years. The strategy designed to attract a new generation of shoppers actually lost more customers than it gained. Could Ullman win back some of these lost customers by regaining their trust in the 100 year old brand? Support for the brand had been badly shaken by Johnson's radical changes to the merchandise, store design, pricing strategy, promotional programming, and marketing communications. The old J.C. Penney brand was hardly recognizable in the newly redesigned "jcp".

As he looked ahead to the challenges he faced, Ullman knew that he would have to find a way to heal the J.C. Penney brand, "While J.C. Penney has faced a difficult period, its legacy as a leader in American retailing is an asset that can be built upon and leveraged. To that end, my plan is to immediately engage with the Company's customers, team members, vendors and shareholders, to understand their needs, views and insights. With that knowledge, I will work with the leadership team and the Board to develop and clearly articulate a game plan to establish a foundation for future success."[1] His game plan would need to be exceptionally strong to dig J.C. Penney out of the deep hole Johnson had fashioned for him.

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Resuscitating the Patient

One of Ullman's first jobs was to report first quarter earnings. Unfortunately, the news was bad. Ullman reported a loss of $348 million for the quarter, with sales down 16.4%. Margins continued to compress, down to 30.8% compared to 37.6% during the same period in 2012. Johnson's $10 gift coupons were being redeemed by customers on their purchases of products carrying everyday low prices. Since these products were already priced at slim margins; the further discount from the coupon eroded their profitability to razor thin levels or perhaps even losses. To make matters worse, the gift coupons didn't appear to be working; customer traffic was down 6% and shopper conversion declined by 1% in the quarter.

Ullman was stoic in his comments to investors, "We are looking forward, not back, and undertaking initiatives to ensure we have a successful future. We are intensely focused on renewing customer excitement and loyalty through a combination of new attractions and long-beloved brands, with a promotional cadence that customers can appreciate and count on."[2]

A pressing issue was the firm's cash supply, which was dwindling to dangerously low levels after eight quarters of escalating losses (see **Exhibit 1**). Analysts predicted that J.C. Penney would run out of cash to fund their operations by the end of the year without an infusion of cash or the implementation of severe cost cutting measures. Carol Levenson, a director of research at Gimme Credit LLC, tolled a warning bell, "Financially, I see Penney in the waiting area of the emergency room but not inside yet."[3]

Ullman felt immense pressure to cut costs, but realized that Johnson had already executed many of the quick wins by drawing down inventories and laying off workers to save $671 million in 2012 (see **Exhibit 2**). While these efforts drove down costs, they also constrained sales as customers faced out-of-stocks in store on core product lines. Ullman would need to rebuild inventories during the second quarter to be ready for the back-to-school selling season. He mentally prioritized the capital expenditures to which Johnson had committed the company to see if there were ways to delay or avoid them altogether. With hundreds of stores currently under construction, the company needed capital to finish the work that Johnson had started. Construction projects were disruptive to the shopping experience and management believed they were dampening traffic and sales in the stores.

Given the continuing operating losses, it was obvious that Ullman had to find alternative sources of funding, quickly. That would be a difficult task in the current business environment. Debt options were looking less viable, as the company's market capitalization had sunk to $3.3 billion. With $3.0 billion of debt already on the books, it was unlikely that the company would be able to secure much more. Equity options were being debated and included selling a minority stake to a private-equity firm or a private group of investors. But equity options would be costly for the company, given the sharp decline in its stock price, down an additional 25% already in 2013, following a loss of 40% in 2012.

A Mea Culpa

In early 2013, in a last ditch attempt to solve the marketing communications problems that had plagued the "Fair and Square" strategy since its inception, Johnson had hired a consultant, Sergio Zyman, a renowned marketing executive and branding specialist, notorious for his role as the manager responsible for New Coke. A fiery personality, Zyman was known for shaking things up. Zyman continued on as chief marketing adviser to Ullman after Johnson's departure. Working together, Zyman and Johnson had crafted a new campaign designed to apologize to J.C. Penney's customers and to invite them to come back. Ullman decided to run it.

The campaign was executed on television and throughout social media in May 2013. It offered customers an apology and invited them to engage in a conversation with J.C. Penney, "It's no secret. We've made some changes. Some you've liked and others you didn't" admitted the company on Facebook. "What matters with mistakes is what we learned. We learned a very simple thing. To listen to you. To hear what you need to make your life more beautiful," proclaimed the company in an ad that ran on television and on YouTube. A dedicated hashtag #jcpListens was launched on Twitter. The campaign implored customers to return with a call to action, "Come back to J.C. Penney. We heard you. Now we'd love to see you. Come back to see us. We're listening." The campaign was popular with consumers and the social media response was largely positive.

The campaign denoted a new communications style for J.C. Penney. "It's quite clear that we owe the customer time to regain her trust, and we have to speak to her at the same time... it's a process of getting back in the business of speaking to her, in a tone that she appreciates. We are not preaching, we are not teaching - we are more or less sharing," claimed Ullman.[4]

Ullman also began listening to his sales associates, the people on the front lines in the retail stores, "I've spent much of the last 700 hours since I've been awake in the job listening to our…customer-facing associates. And they are eager to tell us what they like and what they don't like. And I think we've tried to aggregate that information to be able to act on things that are quite straightforward to fix."[5]

He also began reaching out to customer segments that felt jilted by Johnson, "We are open for all customers. We're not focused on one segment of customers. I think one of the issues over the last year is somehow it became popular wisdom that somehow we didn't want some customers; we wanted other customers."[6] Better understanding the customers who lived in the markets in which J.C. Penney stores were located was of paramount importance to Ullman as he tried to win back consumers' trust. In particular, understanding consumers' purchasing power was critical, given the continuing economic slowdown in the U.S. Only 364 of J.C. Penney's stores were located in markets where consumers had a household income greater than $50,000 per year. The remaining 738 were located in markets where consumers had a household income less than $50,000 (see **Exhibits 3** and **4**).

Reversing the Curse

Ullman executed other changes to reverse the negative outcomes caused by Johnson's strategy. He returned J.C. Penney to a product assortment that relied on a three-pronged merchandising strategy: balancing private label brands (brands, such as St. John's Bay, owned and developed by J.C. Penney and available only in its stores), national brands (brands, such as Levi's, sold broadly in other department stores), and exclusive brands (brands, such as Happy Chic by Jonathan Adler, contracted to be sold only at J.C. Penney). This was in direct opposition to Johnson's overwhelming emphasis on national and exclusive brands in the Shops concept.

Ullman wasn't completely backing off of Johnson's vision for the Shops, calling on his own experience during his first tenure as CEO when he launched the first Sephora Shops into J.C. Penney, "When Sephora first went into the stores…it was very foreign to our customer. And today, it's the most successful thing in the store – very high productivity, repeat business, and actually was the most successful single business during 2012. So we think that these other brands have potential to, as they are accepted by the customer - they are exclusive, and they know that only at J.C. Penney can they find the brand – that these will add to our traffic and our loyalty."[7]

However, he was reluctant to call them "Shops," preferring to label them as "attractions," and hesitated to mandate a strict merchandising template for them, "There will be some that come and go…Whether they have hard walls, soft walls, how they are represented is dependent on the best way to show the customer when they're in the store."[8] Ullman recognized the value in maintaining a flexible retail footprint, especially for fashion categories in which trends emerged and declined quickly. Fast-fashion competitors such as H&M and Zara used flexible merchandising design to remain agile in the rapidly changing marketplace.

Ullman quickly brought back J.C. Penney's popular St. John's Bay private label brand after the brand was voted consumers' favorite in a Facebook poll. Johnson had eliminated St. John's Bay, despite its $1 billion value, in an attempt to modernize J.C. Penney's private label brand portfolio. Ullman saw the value in bringing it back, "Our traditional private label brands have been the core of our business. These brands have been under-emphasized over the last year or so. We're bringing back a number of the brands that customers value. And they have told us, loud and clear, that they intend to return when they are in the store…that they would visit again if we had the products that they enjoyed, and they could buy them at the price promotion and calculus that they were used to."[9] Financially, private label brands helped a lot – delivering a 400-500 basis point gross margin advantage over national brands.

Abandoning the "Fair and Square" everyday low prices propagated by Johnson, he advocated a hybrid strategy that combined everyday low pricing and high/low pricing. Product lines that needed price promotion to move volume, such as J.C. Penney's private label products, would get it, but product lines, such as Sephora that relied on strong branding rather than low prices for their sales, would carry regular prices throughout the year. Clearance sales would be used in every category to sell off outdated or out of fashion merchandise.

While Ullman didn't see the company returning to its prior practice of offering 590 different sale events during the year as it did before Johnson instituted "Fair and Square," he did designate 20+ shopping occasions for price promotion. He reinstituted the J.C. Penney Rewards Program, another program cut by Johnson. Members in the three-tiered program earned reward points when they made purchases in stores or online that generated coupon savings.

To welcome customers back to its stores, J.C. Penney ran deep discount sales for Mother's Day and offered online coupon deals. However, it quickly ran into trouble when a Reuters report revealed that the company had starting raising its everyday prices in order to be able to mark them down during the sales event. Criticism piled up as the bargain-hunting website dealnews reported that J.C. Penney's everyday prices on certain items had increased by 60% or more in the month before the sale. But, Ullman was in good company. Savings.com reported that retailer margins at 31 major department stores and apparel retailers remained constant from 2009-2012, a time period during which the number of deals offered to consumers increased 63% and the average discount rose from 25% to 36%.[10]

Ullman also backed away from the use of the new "jcp" brand moniker, instead restoring the more familiar J.C. Penney brand name and logo. "The change will give our loyal customers a sure sign that we're still the store they know and love…Our customers overwhelmingly confirmed their preference for our classic J.C. Penney logo. The classic J.C. Penney logo is familiar, as it is the same logo displayed in most of our stores today, and reignites pride in J.C. Penney and symbolizes the company who has faithfully served communities across American for over 100 years," said a spokesperson.[11]

After jcp.com experienced sales declines of 32% in 2012, Ullman knew he needed to reinvigorate the ecommerce business. All of the in-store renovations and activities were not having a positive impact on the online business, which was largely disconnected from what was happening in store. The losses continued in the first quarter, as online sales plunged another 30%. Ullman believed part of the problem to be structural, as the online and store businesses were run as separate divisions with little coordination between the two.

The Home Store Launch

J.C. Penney's new home stores debuted in 505 stores in June to high hopes. These 20,000 square foot spaces sold housewares, cookware, small appliances, bedding and bath soft goods, furniture, draperies, and home décor, and were estimated to have cost the company $350-400 million to renovate. The home stores were a potential game changer for J.C. Penney. While the home departments were not hugely profitable themselves, they were a proven traffic driver for the rest of the store. These categories accounted for 21% of its sales in 2007, but, after years of mismanagement, accounted for only 12% of sales in 2012. Home products, down 40% in 2012, accounted for almost a quarter of J.C. Penney's total loss for the year, so fixing the area was essential to future growth.

However, it was quickly evident that the newly redesigned home stores weren't clicking with J.C. Penney's customers. High priced products, such as $2,895 sofas by Jonathan Adler and $1,400 rugs by Martha Stewart, seemed out of reach. The contemporary designs offered by modernist designers Sir Terence Conran and Michael Graves seemed out of step with shoppers' more traditional tastes. The Shops layout that organized products by brand rather than by category was difficult to shop and confused customers. It was an unmitigated disaster, "We actually have less productivity in the new home stores than we do in stores that didn't get a home store... It was apparent quickly that the merchandise wasn't resonating with our core customer, and performance was weaker than we had hoped," said Ullman.[12] The company quickly began restaging the home stores by product category, adjusting the assortment to include more traditional, lower priced products.

One of the cornerstones of the home stores was J.C. Penney's partnership with Martha Stewart, initiated by a 17% investment stake taken by Johnson in Martha Stewart Living Omnimedia. However, much of 2013 was taken up with court hearings as Macy's, who owned the rights to exclusively distribute Martha Stewart branded housewares, sued J.C. Penney. Following months of incendiary court hearings, Ullman signed an agreement that effectively ended the partnership; while J.C. Penney would continue to sell a limited number of Stewart designed product lines, such as party supplies, the retailer ceded victory to Macy's, who would remain the exclusive distributor of her branded products.

Meanwhile, Ullman had other legal problems with which to deal. Bodum, a housewares manufacturer, sued J.C. Penney for breach of contract, claiming that it failed to properly merchandise the upscale brand's products in Bodum branded Shops. Suppliers were tiring of J.C. Penney's broken promises and declining sales volumes.

In a surprising development, the company hired Debra Berman as senior vice president – brand strategy. Berman, a former chief marketing officer at Kraft Foods, was a CPG whiz, but lacked experience in the retailing sector. She would be the company's first marketing executive hire since the departure of Michael Francis the prior year.

Cash worries continued to plague J.C. Penney. To alleviate the cash crunch, Ullman secured a loan of $2.25 billion to fund operational shortfalls and provide a cash cushion going into the second half of the year. With continuing margin compression, the retailer was under pressure to cut marketing and sales costs. Chief financial officer Ken Hannah made the case for continued investment under Berman's guidance, "In a period where we are trying to win back customers, we need to make sure that we are appropriately investing on the marketing side to get the message out…when they come in we want to make sure that we have got the associates there to take care of the customer. So we are less focused right now on how do we reduce those two categories and more interested in how do we make sure we get the return on investment there."[13] An analysis conducted by SaleTally, a company that tracks retail promotions, showed that J.C. Penney offered more promotions and greater savings than its competitors Macy's and Kohl's during the second quarter, indicating that high levels of marketing spending were continuing.

Ackman Stirs the Pot Again

As the second quarter drew to a close, hedge fund manager and activist board member William Ackman agitated for another change in leadership, calling for the replacement of Ullman within 30-45 days. Ironically, Ackman was the original instigator who ousted Ullman the first time from the CEO position to bring in Johnson. Now, it appeared that Ackman was blaming Ullman for J.C. Penney's deteriorating results.

Ackman, who owned 18% of the company, was facing losses of up to $600 million on his investment as J.C. Penney's position continued to collapse. In a letter to the board, he called for Ullman's replacement. A few days later, after he perceived that board chairman Thomas Engibous had dismissed his plan without holding a board meeting to discuss it, Ackman released his letter to the press, along with a new letter in which he reiterated his concerns about the replacement of Ullman, and criticized the company's continuing financial problems, use of cash, recent hiring decisions, and board governance. He called for Engibous to be replaced by Allen Questrom, who served as J.C. Penney's CEO from 2000-2004.

Many on the board viewed this action as highly irregular, rogue, and counterproductive. It was a bold move, one that Ackman himself identified as intentionally disruptive, "I think J.C. Penney is at a very critical stage in its history and its very existence is at risk…. In my history as a board member of many public companies over the last 15 years, I have never before released a public letter to a board of which I am a current member…. Sometimes being 'disruptive' is exactly what a Company and board needs at a critical time."[14]

Howard Schultz, chief executive of Starbucks, quickly jumped to Ullman's defense, "Mike is working tirelessly to save this company, and it is despicable of Ackman to leak a letter asking for his removal…The irony is that Ackman himself has every step of the way severely damaged this company."[15] Ullman and Schultz worked together on the Starbucks board and Schultz believed that Ullman just needed more time to fix J.C. Penney's problems, "Ackman was the primary engineer and architect of recruiting Ron Johnson to the company, and he and Ron Johnson pulled off this strategy that has fractured the company and ruined the lives of thousands of J.C. Penney employees and fractured shareholder value."[16]

After a firestorm of activity that distracted Ullman and the board from the critical issues facing the business, Ackman acrimoniously resigned from the board in mid-August. A few weeks later, he sold his entire stake in the company, incurring a loss of $500 million.

No Quick Fixes

After Ackman's departure, Ullman had to face the rest of Wall Street, as he reported second quarter earnings. Q2 sales were down 12% and the company incurred a loss of $586 million. Despite the fact that this represented J.C. Penney's ninth straight quarter of sales declines, Ullman expressed cautious optimism in the earnings call. Same store sales had improved versus the first quarter and Ullman's efforts in the online business were bearing fruit; online sales were up. The company was excited to share the news that J.C. Penney's website had garnered the #2 position for back-to-school traffic, behind Walmart.

Margin compression continued, down to a shockingly low level of 29.6% for the quarter. Prior to Johnson, J.C. Penney's margins were 40%, and even then, the company was criticized for having lower margin ratios versus its peers. "What is weighing on the margins today is the disposition of merchandise the customer didn't relate to," claimed Ullman in the earnings call, again citing the need to drastically cut prices on items that weren't selling.[17] Despite these low prices, traffic in the stores continued to decline, as did the number of shoppers who purchased.

Paul Lejuez, retail analyst at Wells Fargo Securities, expressed the prevailing sentiment on the Street, "This is a company selling product at lower margins than a year ago, and they still can't drive traffic or conversion, which tells us many of the customers they lost are gone for good."[18]

Ullman encouraged investors to be patient, claiming that he and his team had figured out a winning game plan and were in the process of executing it, "We know where the problems are. We know how to address them, and we have the right plans in place to do the job successfully and get back on a path to profitable growth…we aren't where we need to be yet. This is, however, a journey. There are no quick fixes to correct the errors of the past."[19]

However, when pressed by an analyst to predict a date for a return to profitability, he was hesitant to provide specific guidance, "We have work to do to regain the trust of our customer. So we will certainly take additional volume as they reward us, but to bet the ranch on some kind of wild return to growth in a specific short time period I think wouldn't be prudent."[20]

Hedge fund Perry Capital LLC had amassed a 7.3% stake in the company and began lobbying to bring in Foot Locker chief Kenneth Hicks as CEO. Prior to Foot Locker, Hicks had been the president and chief merchandising officer at J.C. Penney, but he had left the company in 2009. J. Kyle Bass, a Dallas hedge fund manager, bought J.C. Penney's secured loans, betting that the stock would improve over time. These investments buoyed J.C. Penney's stock price in the short run.

Then, in a surprising move, J.C. Penney issued 84 million shares of stock in a secondary equity offering at $9.65 per share that raised $786 million in the weeks following the earnings release. This shocked investors, who had listened to Hannah's reassurances during the earnings call that the company would not need additional financing. Shareholders filed a class-action suit against the company claiming that it misled them when it concealed knowledge about its liquidity problems. The deal was dilutive, driving J.C. Penney's stock price down to $6.72 by October, a 33-year low. Some analysts were predicting that the stock would fall to $1.00.

Going Back to School

J.C. Penney's back-to-school sales showed some signs of life. "The turnaround at J.C. Penney is beginning to take hold. We're making significant strides toward restoring J.C. Penney to its rightful place in retail…It's hard work, with no quick fixes, but our teams are rising to the challenge and our customers tell us they love the progress we're making," claimed Ullman in his November earnings call with investors.[21] Ullman reported positive sales momentum, an optimistic signal that things were improving, especially given the flagging retail environment and sluggish economy that were continuing to plague the sector. Online sales were up 24.5% year over year illustrating that the efforts to refocus on the e-commerce side of the business were paying off. Conversion rates were up.

Gross margins remained low at 29.5% of sales and continued to be negatively impacted by the aggressive markdown of inventory brought in by Johnson that was failing to resonate with consumers. While some Shops were selling well, others were failing to capture customers' interest. Purging the stores of this inventory was proving costly. "There's always going to be clearance when you're buying and selling merchandise across 40 different businesses. But what we're talking about now is something that you wouldn't expect to have in a business unless all of a sudden you were going 60 miles an hour [in] one direction and you turn around and go 60 miles an hour [in] the other direction. There's some dislocation in that turnaround," explained Ullman.[22]

Ullman was confident though that margin improvement was coming shortly in the future, as private label brand merchandise sales returned to their former levels and as the retailer continued to mark up regular prices throughout the store. However, he was plagued by rumors on the Street that J.C. Penney was sacrificing margin to drive store traffic. He vigorously denied the claim, "I would like to point out, since there's a lot of people saying that we are 'giving the merchandise away' there's no remarkable difference between the margins we're obtaining on promotional markdowns through our major events than there was in 2011."[23]

In the month of October, the retail stores posted positive sales comparisons year over year, the first time they had done so since December 2011. A new Disney Shop drove traffic from families. Renewed energy among the sales associates contributed to the achievement of the highest customer service scores in J.C. Penney's history. This was impressive given the $800 million in SG&A expenses the retailer had taken out of the business in the past seven quarters. November's sales appeared to be following the positive trend, driven by "The Biggest Sale of Them All," a Veteran's Day Weekend promotional program offering customers 25% off all merchandise, including sale and clearance items, in the new home stores as well as Door Buster deals.

Black Friday was just around the corner and J.C. Penney was planning to open stores at 8:00 p.m. on Thanksgiving Day with 60% off Door Buster deals to get a jump on its competitors. Free Disney snowglobes would greet early morning shoppers on Friday beginning at 4:00 a.m. Starting at 2:00 p.m., customers could receive an additional 15% off any merchandise with a coupon. Online, free shipping was offered for the full weekend. Berman's team was finishing up a new advertising campaign that Ullman deemed "innovative and disruptive and quite family-oriented". It featured taglines riffed from classic Christmas songs, such as "More Fa-La-Lah for Less Mou-La-Lah" and "All I Want for Christmas is My Two-Day-Sale." Berman explained the strategy, "The freer we become and the more sass J.C. Penney lets out, the deeper the connection to the customers…This is a brand that people are waiting to have fun with."[24] Heading into the all-important weekend, Ullman was anxiously watching how J.C. Penney's pricing compared to Kohl's and Macy's (see **Exhibit 5**).

The company's financials remained grim (see **Exhibits 6** and **7** for a summary). Would the holiday season be strong enough to keep J.C. Penney from bankruptcy? Or, would soft sales signal that the end was near? Could Ullman or his eventual successor save the flailing retailer? Was Ullman's plan working or was it too little too late? Were there other solutions that hadn't yet been considered?

Former J.C. Penney CEO Allen Questrom was mournful as he considered the fate of the once beloved brand, "Every day that goes on, it gets more and more difficult to see how this is possible [to turn J.C. Penney around]. I mean, it's a great brand. There's been a lot of bad decisions over the last several years, but, you know – let me put it another way. It's such a great history that you wouldn't want to give up until it was dead."[25]

Exhibit 1 J.C. Penney's Statement of Cash Flows

SUMMARY STATEMENTS OF CASH FLOWS

(Amounts in $ millions)

	Q2 2013 Three months ended		Q1 2013 Three months Ended		Q4 2012 Three months ended		Full Year Twelve months ended	
	Aug. 3, 2013	July 28, 2012	May 4, 2013	Apr 28, 2012	Feb. 2, 2013	Jan. 28, 2012	Feb. 2, 2013	Jan. 28, 2012
STATEMENTS OF CASH FLOWS:								
Cash flows from operating activities:								
Net income/(loss)	(586)	(147)	(348)	(163)	(552)	(87)	(985)	(152)
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities								
Restructuring and management transition	31	78	37	12	19	84	121	314
Asset impairments and other charges	7	3	2	1	107	59	117	67
Net gain on sale of operating assets	(2)	-	(16)	-	-	(6)	-	(6)
Net gain on sale or redemption of non-operating assets	(62)	(200)	-	-	-	-	(397)	-
Loss on extinguishment of debt	114	-	-	-	-	-	-	-
Depreciation and amortization	143	128	136	125	157	135	543	518
Benefit plans	24	41	17	38	162	9	272	55
Stock-based compensation	11	14	5	12	12	13	50	46
Excess tax benefits from stock-based compensation	-	(12)	-	(11)	5	(5)	(12)	(10)
Deferred taxes	(25)	(153)	(164)	21	(243)	(57)	(467)	(153)
Change in cash from:								
Inventory	(357)	91	(457)	(168)	1,021	1,460	575	297
Prepaid expenses and other assets	(9)	(22)	50	7	36	19	(5)	(67)
Merchandise accounts payable	29	31	85	(38)	(246)	-809	140	(111)
Current income taxes	5	113	55	(144)	9	19	117	(15)
Accrued expenses and other	(31)	5	(154)	(269)	158	119	(79)	37
Net cash provided by/(used in) operating activities	(708)	(30)	(752)	(577)	645	953	(10)	820

Cash flows from investing activities:								
Capital expenditures	(439)	(132)	(214)	(107)	(230)	(165)	(810)	(634)
Proceeds from the sale or redemption of non-operating assets	55	246	-	-	1	-	526	-
Acquisition	-	-	-	(9)	-	(268)	(9)	(268)
Proceeds from sale of operating assets	1	-	18	-	-	14	-	15
Cost investment, net	-	-	-	-	-	(36)	-	(36)
Proceeds from joint venture distribution	-	-	-	-	-	-	-	53
Net cash provided by/(used in) investing activities	(383)	114	(196)	(116)	(229)	(455)	(293)	(870)
Cash flows from financing activities:								
Proceeds from short-term borrowings	-	-	850	-	-	-	-	-
Net proceeds from issuance of long-term debt	2,180	-	-	-	-	-	-	-
Premium on early retirement of long-term debt	(110)	-	-	-	-	-	-	-
Payment of long-term debt	(245)	-	-	-	-	-	(230)	-
Payment of capital leases and note payable	(14)	-	(5)	-	(7)	-	(20)	-
Financing costs	(4)	(2)	(8)	(2)	-	(5)	(4)	(20)
Stock repurchase program	-	-	-	-	-	-	-	(900)
Proceeds from issuance of stock warrant	-	-	-	-	-	-	-	50
Proceeds from stock options exercised	2	1	5	68	1	6	71	18
Other changes in stockholders' equity	(4)	9	(3)	2	(5)	(34)	(5)	(35)
Dividends paid	-	(43)	-	(43)	-	(43)	(86)	(178)
Net cash provided by/(used in) financing activities	1,805	(35)	839	25	(11)	(76)	(274)	(1,065)
Net increase/(decrease) in cash and cash equivalents	714	49	(109)	(668)	405	422	(577)	(1,115)
Cash and cash equivalents at beginning of period	821	839	930	1,507	525	1,085	1,507	2,622
Cash and cash equivalents at end of period	1,535	888	821	839	930	1,507	930	1,507

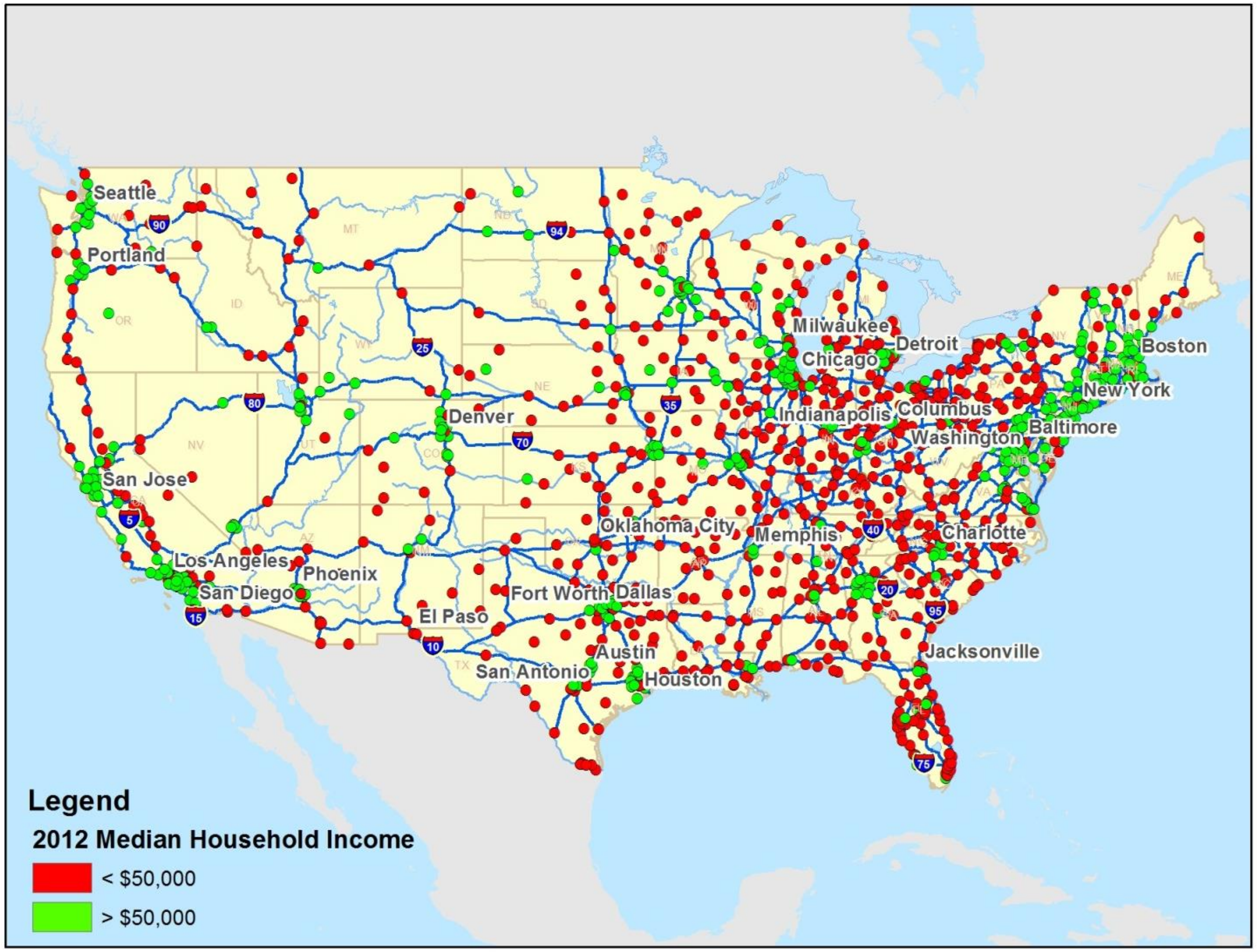
Source: Casewriters; compiled from Company's public financial statements, http://ir.jcpenney.com/phoenix.zhtml?c=70528&p=irol-irHome, accessed November 21, 2013.

Exhibit 2 J.C. Penney's Summary Balance Sheets (amounts in $ millions)

	Current Year Quarter Close				Last Year Quarter Close			
	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2011	Q1 2012	Q2 2012	Q3 2012
	Feb. 2, 2013	May 4, 2013	Aug 3, 2013	Nov 2, 2013	Jan. 28, 2012	Apr. 28 2012	July 28, 2012	Oct. 27, 2012
SUMMARY BALANCE SHEETS:								
Current assets								
Cash in banks and in transit	121	163	198	151	175	184	171	141
Cash short-term investments	809	658	1,337	1,076	1,332	655	717	384
Cash and cash equivalents	930	821	1,535	1,227	1,507	839	888	525
Merchandise inventory	2,341	2,798	3,155	3,747	2,916	3,084	2,993	3,362
Income tax receivable	57	1	-	-	168	386	209	69
Deferred income taxes	106	113	115	119	245	156	407	409
Prepaid expenses and other	249	199	209	249	245	217	239	265
Total current assets	3,683	3,932	5,014	5,342	5,081	4,682	4,736	4,630
Property and equipment, net	5,353	5,690	5,820	5,753	5,176	5,126	5,153	5,493
Prepaid Pension		7	22	36	-	-	-	-
Other assets	745	743	798	744	1,167	1,231	923	767
Total assets	9,781	10,372	11,654	11,875	11,424	11,039	10,812	10,890
Liabilities and stockholders' equity								
Current liabilities								
Merchandise accounts payable	1,162	1,248	1,276	1,409	1,022	984	1,015	1,408
Other accounts payable and accrued expenses	1,395	1,524	1,346	1,269	1,503	1,222	1,219	1,344
Short-term borrowings	-	850	850	650	-	-	-	-
Current maturities of capital leases and notes payable	26	26	27	27	1	1	20	22
Current maturities of long-term debt	-	-	23	23	230	230	230	-
Current taxes payable	-	-	4	-	-	-	-	-
Total current liabilities	2,583	3,648	3,526	3,378	2,756	2,437	2,484	2,774
Long-term capital leases and note payable	88	82	71	67	3	3	33	75
Long-term debt	2,868	2,868	4,850	4,845	2,868	2,868	2,868	2,868
Deferred taxes	388	250	242	250	888	924	904	786
Other liabilities	683	658	645	688	899	871	852	885
Total liabilities	6,610	7,506	9,334	9,228	7,414	7,103	7,141	7,388
Stockholders' equity	3,171	2,866	2,320	2,647	4,010	3,936	3,671	3,502
Total liabilities and stockholders' equity	9,781	10,372	11,654	11,875	11,424	11,039	10,812	10,890

Source: Casewriters; compiled from Company's public financial statements, http://ir.jcpenney.com/phoenix.zhtml?c=70528&p=irol-irHome, accessed November 21, 2013.

Exhibit 3 The Average Income of Households within Ten Miles of a J.C. Penney Store



Source: Map created by Scott Walker of the Harvard Map Collection using ESRI Business Analyst Software package.

Exhibit 4 Household Income Growth over Time

Household Income Distributions 2000 thru 2011

	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Quintile	Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean
Lowest	$11,239	$10,994	$11,552	$11,656	$11,551	$11,352	$10,655	$10,224	$9,996	$9,990	$10,136	$10,190
Second	$29,204	$28,532	$29,257	$29,517	$29,442	$28,777	$27,357	$26,212	$25,678	$25,400	$25,468	$25,334
Third	$49,842	$49,167	$49,534	$50,132	$49,968	$48,223	$46,301	$44,411	$43,588	$42,802	$42,629	$42,361
Fourth	$80,080	$78,877	$78,694	$79,760	$79,111	$76,329	$72,825	$70,026	$68,994	$67,326	$66,839	$65,729
Highest Fifth	$178,020	$169,391	$170,844	$171,057	$167,971	$168,170	$159,583	$151,438	$147,078	$143,743	$145,970	$141,620
Top 5%	$311,444	$287,201	$295,388	$294,709	$287,191	$297,405	$281,155	$263,896	$253,239	$251,010	$260,464	$250,146

Source: Census Bureau Historical Income Tables, Table H-1, and H-3, http://www.census.gov/hhes/www/income/data/historical/household/, accessed November 18, 2013.

Note: Households as of March of the following year.

Exhibit 5 Retail Price Comparisons

	Tea Kettles		Sofas		Women's Jeans		Women's Leather Jacket	
	Offering	**Price**	**Offering**	**Price**	**Offering**	**Price**	**Offering**	**Price**
J.C. Penney								
Low	Farberware	$ 22.00	Dream On	$ 595.00	St. John's Bay	$ 17.00	Joe Fresh Faux Leather	$ 33.99
Mid	Michael Graves	$ 58.00	Happy Chic by Jonathan Adler	$1,735.00	Levi's 512 Skinny	$ 45.00	jcpTM Leather	$ 124.99
High	Chantal	$ 220.00	Signature Leather	$2,995.00	MNG by Mango	$ 50.00	Excelled Leather	$ 324.99
Macy's								
Low	Tools of the Trade	$ 9.99	Chloe	$ 499.00	INC International Concepts	$ 13.99	Maralyn & Me Faux Leather	$ 42.99
Mid	Martha Stewart (with bonus gift)	$ 20.99	Martha Stewart	$1,098.00	Levis's 512 Skinny	$ 39.99	MICHAEL Michael Kors Leather	$ 309.99
High	Nambe	$ 125.00	Hampton Leather	$2,749.00	Armani	$ 250.00	Lauren Jeans Co. Leather	$ 523.99
Kohl's								
Low	Kitchen a la carte	$ 17.99	Adesso Velvet	$ 363.99	SONOMA	$ 10.80	Jou Jou Faux Leather	$ 33.99
Mid	Rachael Ray	$ 41.99	Handy Living	$ 479.99	Levi's 512 Skinny	$ 39.99	Apt 9 Faux Leather	
High	BergHOFF	$ 101.99	HomeVance	$ 727.50	Rock + Republic	$ 61.60	Excelled Leather	$ 372.00

Source: Casewriters; compiled from pricing data accessed on www.jcp.com, www.macys.com, and www.kohls.com on November 21, 2013.

Exhibit 6 J.C. Penney's Stock Price since Ullman took Over (April 8, 2013–November 27, 2013)

Source: Bloomberg Charts

Exhibit 7 J.C. Penney's Financial Results

SUMMARY OF OPERATING RESULTS

(Amounts in $ millions, except per share data)

	Q4 2012 Three Months Ended Feb. 2, 2013	Q4 2011 Three Months Ended Jan. 28, 2012	Q1 2013 Three Months Ended May 4, 2013	Q1 2012 Three Months Ended Apr. 28, 2012	Q2 2013 Three Months Ended Aug. 3, 2013	Q2 2012 Three Months Ended July 28, 2012	Q3 2013 Three Months Ended Nov. 2, 2013	Q3 2012 Three Months Ended Oct. 27, 2012
Total net sales	3,884	5,425	2,635	3,152	2,663	3,022	2,779	2,927
Cost of goods sold	2,960	3,788	1,823	1,966	1,876	2,018	1,960	1,975
Gross margin	924	1,637	812	1,186	787	1,004	819	952
% gross margin	23.8%	30.2%	30.8%	37.6%	29.6%	33.2%	29.5%	32.5%
Operating expenses								
SG&A	1,209	1,343	1,078	1,160	1,026	1,050	1,006	1,087
Total pension	186	33	34	58	34	58	34	51
Depreciation and amortization	157	135	136	125	143	128	161	133
Real estate and other, net	88	45	(22)	(7)	(68)	(208)	(27)	(197)
Restructuring and management transition	29	154	72	76	47	159	46	34
Total operating expenses	1,669	1,710	1,298	1,412	1,182	1,187	1,220	1,108
Operating income/(loss)	(745)	(73)	(486)	(226)	(395)	(183)	(401)	(156)
% operating margin	-19.2%	-1.3%	-18.4%	-7.2%	-14.8%	-6.1%	-14.4%	-5.3%
Loss on extinguishment of debt	-	-	-	-	114	-	-	-
Net interest expense	57	57	61	56	95	58	99	55
Income (loss) before income taxes	(802)	(130)	(547)	(282)	(604)	(241)	(500)	(211)
Income tax expense/(benefit)	(250)	(43)	(199)	(119)	(18)	(94)	(11)	(88)
Net income (loss)[1]	(552)	(87)	(348)	(163)	(586)	(147)	(489)	(123)
% net income margin	-14.2%	-1.6%	-13.2%	-5.2%	-22.0%	-4.9%	-17.6%	-4.2%
Earnings/(loss) per share - basic and diluted	$ (2.51)	$ (0.41)	$ (1.58)	$ (0.75)	$ (2.66)	$ (0.67)	$ (1.94)	$ (0.56)
Comparable store sales increase/(decrease)	-31.7%	-1.8%	-16.6%	-18.9%	-11.9%	-21.7%	-4.8%	-26.1%

Source: Casewriters; compiled from Company's public financial statements, http://ir.jcpenney.com/phoenix.zhtml?c=70528&p=irol-irHome, accessed November 18, 2013.

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