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JCP - Q4 2016 J C Penney Company Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 24, 2017 / 1:30PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to JCPenney's fourth-quarter 2016 conference call.

(Operator Instructions)

As a reminder, today's conference call is being recorded. I would now like to introduce your first speaker for today, Trent Kruse. You have the floor, sir.

Trent Kruse - *J.C. Penney Company, Inc. - VP, IR & Communications*

Thank you, Andrew. Good morning everyone.

As a reminder, the presentation this morning includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 which reflects the Company's current view of future events and financial performance. The words expect, plan, anticipate, believe and similar expressions identify forward-looking statements.

Any such forward-looking statements are subject to risks and uncertainties and the Company's future results of operations could differ materially from historical results or current expectations. For more details on these risks please refer to the Company's Form 10-Q and other SEC filings.

Please note that no portion of this presentation may be rebroadcast in any form without the prior written consent of JCPenney. For those listening after February 24, 2017 please note that this presentation will not be updated and it is possible that the information discussed will no longer be current.

Also, supplemental reference slides are available on our investor relations website. While management will not be speaking directly to the slides, these slides are meant to facilitate your review of the Company's results and to be used as a reference document following the call.

Joining us on today's call are Marvin Ellison, Chairman and CEO of JCPenney, and Ed Record, our CFO. Following our prepared remarks we look forward to taking your questions. With that I will now turn the call over to our Chairman and CEO Marvin Ellison.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Thank you, Trent, and good morning everyone. First off, I'm proud of our associates at all levels of the organization who committed each and every day to the ongoing success of JCPenney.

Back in 2013 the conventional wisdom was that JCPenney would not survive as a Company. As some of you may remember, at that time the Company had a net loss of nearly $1.3 billion, a loss per share of $5.13 per share, a negative EBITDA of over $600 million and a debt to EBITDA ratio I described as infinity because we had $5 billion in debt and negative EBITDA.

Due to hard work of many men and women that I'm pleased to represent, the Company ended 2016 with an EBITDA exceeding $1 billion, delivered positive net income for the first time since 2010 and a debt to EBITDA ratio of 3.7 times with a forecast to be approximately 3 times in 2017. Although there is much work that remains to be done I'm very proud to say that the hard work of the JCPenney team represents one of the greatest financial turnarounds in retail history. And although I am not satisfied with where we are as a Company, I will be remiss as a leader if I didn't take a moment to thank the JCPenney team for their commitment, their hard work and their resilience.

Now let me transition to our fourth-quarter results. We were encouraged by the positive comp performance achieved during the critical six weeks of the holiday selling season which started Thanksgiving week and continued through the end of December. However, it was not enough to fully offset the first three weeks of the quarter which proved extremely challenging in our stores.

Even with a tough start to November our new growth initiatives delivered another quarter of strong performance, particularly Appliances, Sephora, Salon, Fine Jewelry and Toys. Toys is another great example of the power of listening to our customer and adding categories she's asking for that will enable us to drive our revenue per customer initiative. We had toys in our assortment this holiday season for the first time in many years and the response was excellent.

Based on these results we will continue to offer toys in 100 stores during the first half of 2017 and will significantly expand the toy assortment in all stores for back-to-school this year. While all of our growth initiatives continue to perform well, we are exceptionally pleased with the performance of our over 500 new Appliance showrooms which continue to drive increased sales and gross margin dollar productivity. Appliances reinforce the ongoing strength of our growth initiative as we pivot our retail strategy towards non-apparel and growing categories.

For the fourth quarter our comp sales were negative 0.7% versus last year but on a two-year stack our comp sales performance was a plus 3.4%. December was our best performing month in the quarter, and we are pleased that we delivered positive comps in the low single-digit range for the combined December and January period.

Our online business remains strong and delivered double-digit growth for both the quarter and the full year. In Q4 BOPUS and ship to store represented approximately 40% of all online sales and this demonstrates the power of connecting the digital and the physical environments for our customers. For the year JCPenney achieved flat sales comps and a positive net income, an over $500 million improvement for the year.

Now let me discuss some of the more difficult results for our quarter sales and gross margin. All apparel categories, men's, kids and women's, performed below the Company comp for the quarter with men's and kids significantly outperforming our women's business. Although sales in women's apparel remained challenged throughout the entire quarter we did deliver positive comps in dresses, activewear and outerwear for the quarter.

We remain intently focused on improving our women's assortment and we implemented operational and leadership changes as we moved into the new year. While it's not clearly evident in our fourth-quarter results, we are already seeing improvement in our new spring merchandise and it's selling well. We are encouraged by this performance. And as a point of reference, had women's apparel performed at the same level as men's and kids our fourth-quarter comp would have been positive.

Now let's zoom to gross margin. We are also disappointed in our overall gross margin results for the quarter which declined 100 basis points on a year-over-year basis to 33.1% of sales. While we were pleased with the continued growth of our dotcom business, aggressional promotional activity had a negative impact on our gross margin rate.

In addition, store gross margin was negatively impacted by the actions we took in the quarter with couponing and increased promotional activity. Although I believe that it's important to be nimble and to quickly react to competition and market dynamics to drive sales candidly, many of the Q4 decisions we made diluted gross margin while providing limited top-line sales. In retrospect, these were poor decisions that will not be repeated in the future.

While we fell short on our sales and gross margin expectations for the fourth quarter and the full year we are pleased with our ability to generate our EBITDA target of $1 billion for 2016. This is a reflection to the fiscal discipline culture that's been adopted at JCPenney.

Now let me address our announcement from earlier this morning regarding actions across our portfolio and our supply chain network. While we delivered our goal of returning JCPenney to profitability in 2016 we believe taking these proactive actions with our store portfolio will better align our retail operations for the future. During the year it became evident that the stores where we could fully implement our growth initiatives are beauty, home refresh and special sizes and generated higher sales and provided a more vibrant in-store shopping environment.

We believe the relevance of our brick-and-mortar portfolio will be enhanced by creating a more inviting environment in our physical stores. So having Sephora, appliance showrooms and InStyle Salons are example of this type of environment we want to create in more of our stores.

So our decision to close approximately 130 to 140 stores will allow us to raise the overall brand standard of JCPenney and allocate capital more efficiently to a smaller base of stores. This will also allow us to implement our growth initiatives in a larger percent of our stores.

Although closing stores is always a very difficult decision, we purposely coordinated the store closing process with a recently announced voluntary early retirement program or VERP. This VERP will open up as many as 6,000 positions that could be filled by many of the outstanding full-time associates impacted by the store closing. My goal is to ensure that we find a position at JCPenney for all outstanding associates impacted by the Company's decision to close stores.

Before I discuss our plans to improve our performance in 2017 I will hand the call over to Ed to provide more detail on 2016, specifically our year-end balance sheet, the successes we achieved in the capital markets this past year as well as our financial guidance for 2017.

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Thank you, Marvin, and good morning everyone. As you just heard from Marvin, we are pleased that in a very tough retail environment we achieved a positive net income for the first time in six years. In fact, just three years ago we reported a net loss of nearly $1.3 billion and reported negative EBITDA of over $600 million.

This year we reported positive net income and delivered on our $1 billion EBITDA target for 2016. Considering how far we have come in the last few years, this was no small task. While we faced many challenges in 2016 we also had many wins and we continue to build on our growth strategies that are laying the foundation for sustainable growth in 2017 and beyond.

Marvin just walked you through most of our financial results for the quarter and full year, and we will spend a lot of time going through all the numbers again. However, I will touch on a couple of key areas and provide more details on our results. After that I will recap what we have achieved in the capital markets this year to strengthen our balance sheet and deleverage our debt position. I will then discuss our year-end balance sheet and we will conclude with our financial guidance for 2017.

Turning now to our recent financial results. Comparable store sales declined 0.7% for the fourth quarter and were flat for the full year of 2016. On a two-year stack basis our comparable sales increased 3.4% and 4.5% respectively.

For the quarter, units per transaction and average unit retail were both up versus last year while transaction counts were down. Gross margin in the fourth quarter was 33.1% of sales, down 100 basis points to last year. This decline was primarily due to increased couponing and higher promotional activity than expected in an effort to improve our sales trend.

Gross margin was also negatively impacted by the continued growth of both our dotcom and major appliance businesses. For the year gross margin decreased 30 basis points to 35.7% of sales.

Marvin will go into further detail on a few of our 2017 initiatives in a moment, but as a reminder, we have made significant -- sorry, we have significant gross margin opportunities in areas such as pricing analytics which include a more controlled approach to couponing and regional pricing initiatives which we are currently testing in 60 stores. We also have opportunities in reducing shortage, modernizing our replenishment, improving the profitability of our private grants through design, sourcing and speed-to-market initiatives.

In addition, we continue to optimize our supply chain, including the pending sale and relocation of our Buena Park supply chain facility and the closure of our Lakeland, Florida distribution center announced earlier this morning. We expect these initiatives will allow us to offset the expected pressure from our appliances and online businesses and drive margin up 20 to 40 basis points for the year.

SG&A expenses for the quarter declined $37 million and leveraged 70 basis points as a percentage of sales. These savings were primarily driven by lower incentive compensation and store controllable costs.

For the full year, SG&A expenses decreased $237 million and were 28.2% of sales, a 170 basis point improvement compared to 2015. This is on top of the 270 basis point improvement last year.

In addition, we drove an over 200 basis point improvement in private label credit penetration to end the year at 40%. We have more work to do in driving this penetration even higher, but we are pleased with our results. In fact, we have increased our private label credit penetration by almost 600 basis points in the last three years and we expect to increase penetration by another 200 basis points in 2017.

As Marvin said moments ago, while we fell short of our sales and gross margin expectations for the fourth quarter and full year we are pleased with our ability to deliver on our $1 billion EBITDA target and generate positive earnings in 2016. In fact, we improved our full-year net income by $514 million, and for the first time in six years we delivered positive net income.

Let's turn now to our liquidity position and capital structure. In December we fully repaid the $162 million of outstanding borrowings from last quarter and made no additional draws on our ABL during the period. As such, our liquidity position at the end of the year was approximately $2.8 billion.

Looking back on the full year we significantly improved our capital structure which enabled us to strengthen our balance sheet and deleverage our debt position. We are very pleased with the upgrades we received throughout the year from the rating agencies which raised our credit rating several notches to the B plus area. Clearly this demonstrates that these agencies recognize the progress we have made from our deleveraging efforts and the strategic initiatives we have in place to continue driving sustainable growth and profitability.

Let me recap our debt reduction and refinancing initiatives from the last year. Over the course of 2016 we utilized available cash to retire approximately $160 million of outstanding debt. As you know, our goal is to retire $400 million to $500 million in debt, but the timing of our home office sale was delayed to the end of 2016. In a moment I will discuss our plans to use these proceeds to further reduce outstanding debt in 2017.

In the second quarter we successfully refinanced our $2.2 billion real estate backed term loan that was previously due in 2018. This term loan was replaced in totality with a $1.7 billion term loan and a $500 million fixed rate secured bond, extending both maturities five years to 2023. With this refinance we achieved better pricing which lowered our interest expense by $24 million on an annualized basis.

In the fourth quarter we completed the sale of our home office building and the surrounding 45 acres of land for a gross sale price of approximately $350 million before closing and transaction costs. This transaction represents a significant financial milestone for us.

The sale was comprised of two individual transactions. The first transaction included the surrounding land for net proceeds of approximately $80 million and resulted in a gain of approximately $62 million in the fourth quarter.

The second transaction was a sale-leaseback for the home office building for $266 million which was comprised of $216 million in cash and a $50 million note receivable due in four years. This transaction was accounted for as financing which is similar to a capital lease. As such, long-term capital leases are up approximately $200 million at the end of 2016.

Also, we subsequently entered into an arrangement with the new owner to leaseback approximately 65% of the space we previously owned. As a reminder, we expect the new lease arrangement to be EBITDA neutral and accretive to our net income.

Our ability to successfully deliver on our $1 billion EBITDA target for 2016 coupled with our reduced debt levels brought our net debt to EBITDA ratio down to 3.7 times by the end of 2016 compared to 5.4 times just one year ago at the end of 2015. And looking ahead, we expect to further reduce outstanding debt and continue to delever our debt position.

As part of this we expect the $220 million of borrowings that mature in the coming weeks to be paid with cash on hand at maturity and, in turn, lower our annualized interest expense by approximately $17 million. Finally, we plan to make continued progress on our leverage ratio and expect our 2017 net debt to EBITDA ratio to be approximately 3 times by the end of the year.

Let's move now to cash and inventory. Cash and cash equivalents at the end of the year were $887 million, $13 million below last year. We utilized approximately $165 million in available cash to reduce our outstanding debt.

Capital expenditures net of landlord allowances in 2016 were $384 million, $81 million higher than in 2015. In addition, the approximate $400 million swing in accrued expenses and others on the cash flow statement is primarily driven by the large accruals in 2015 related to incentive compensation and restructuring that were paid in 2016. It did not re-accrue at nearly the same levels this year.

While we were disappointed in our free cash flow of $3 million we are pleased to have produced positive cash flow in a tough environment. In addition, we expect to generate between $300 million and $400 million in free cash flow in 2017. This range includes the expected cash impacts from our store closings and charges related to our voluntary early retirement program as well as expected gains on sales of operating assets.

Inventory at year-end was $2.854 billion, up 4.9% from last year-end. Approximately 370 basis points of this increase was driven by non-apparel-related inventory including the floor samples we own for major appliances and higher inventory levels to support our continued investment in new Sephora shops.

Other basic replenishment inventory accounted for another 260 basis points of the increase in inventory. These increases were partially offset by decreases in fashion and seasonal apparel and other inventory levels.

We continue to make progress with our current inventory position. And including the impact from our store closures we expect total inventory at the end of 2017 to be down 5% or more versus 2016. Merchandise accounts payables was $977 million, up $52 million from last year-end, primarily due to our improved vendor payment terms.

As Marvin discussed, the decision to close a large number of stores and a distribution center was difficult but necessary. The store closures represent between 13% and 14% of our current store portfolio but less than 5% of total annual sales.

Before realizing any corporate overhead benefits related to these closings, these stores contributed less than 2% of EBITDA and 0% of our net income in 2016. Of note, we expect an approximate 15 to 20 basis point impact to our gross margin for the full year as we liquidate these locations. This expectation is included in our gross margin guidance for the year.

Lastly, we are continuing to see asset monetization opportunities as mentioned in our release, and we have incorporated two such expected transactions in our earning guidance for 2017. In a few moments Marvin will outline key initiatives that support the foundation of our 2017 financial plan. But first, let me walk you through our financial guidance for the full-year 2017.

And as a reminder, 2017 is a 53-week year. We expect the 53rd week to be worth approximately 120 basis points to total sales.

Our comparable-store sales will be calculated on a 52-week basis. Our guidance incorporates both the impact of the 53rd week as well as the impact from the store closures announced earlier this morning. As such, for fiscal 2017 comparable-store sales are expected to be down 1% to up 1%.

Gross margin is expected to be up 20 to 40 basis points versus last year. SG&A dollars are expected to be down 1% to 2% versus last year and adjusted earnings per share is expected to be in the range of $0.40 to $0.65.

In addition, the following metrics are intended to assist you in filling out your models. Total pension expense will be an approximate $12 million credit before the expected charges from our recently announced VERP and any year-end mark-to-market adjustments. Depreciation and amortization will be approximately $575 million before the expected write-off related to the recently announced store closures.

Interest expense is expected to be approximately $330 million and does not include any costs for debt retirement premiums. Income tax expense is expected to be approximately $20 million. Finally, CapEx net of landlord allowances is expected to be approximately $400 million.

In closing, our commitment and continued focus on becoming a more efficient and leaner organization through permanent expense reductions remains strong. Our teams are focused on effectively executing our strategic growth initiatives and achieving meaningful long-term gross margin expansion. We continue to expect to deleverage our balance sheet and deliver increased shareholder returns.

With that I'd like to now turn the call back over to Marvin.

Marvin Ellison *- J.C. Penney Company, Inc. - Chairman & CEO*

Thank you, Ed. Now let me make a few comments on the guidance that Ed just shared.

While we are very optimistic on our growth initiatives and our 2017 plans, our 2017 guidance is conservative as we expect elements of the retail environment to remain uncertain. But clearly if we see improvement in the environment relative to our current expectations we would expect to beat our sales guidance. But we want to plan the business conservatively based on what we saw in 2016.

Let me give you some thoughts on how we plan to achieve our financial results this year. While we will remain focused on our strategic framework of private brands, omnichannel and increasing revenue per customer, I'd like to close with five initiatives that give us confidence in our financial plan performance for 2017.

First, our beauty categories continue to deliver significant comp sales growth and a key component of our beauty strategy is Sephora. The performance in both our existing and new Sephora inside JCPenney shops remains strong and we once again achieved incredible results in Q4 and 2016.

As a reminder, in 2016 we opened 61 new Sephora locations and ended the year with 577 Sephora inside JCPenney shops. In 2017 we will add an additional 70 new Sephora locations, expand 32 highly productive existing locations and continue to roll out and launch new and exciting brands.

With these plans every single Sephora location we operate will be enhanced in 2017 either through an expansion or an updated assortment of brands. We remain very excited on the unique partnership we have with Sephora and look forward to providing you with more details on these new brand launches in the coming months.

Another component of our beauty strategy is Salon. The JCPenney Salon business once again delivered positive comps in the quarter and we continue to see benefits from the rebranding to Salon by InStyle. We also recently implemented new exciting functionality to jcpenney.com and our mobile app, allowing customers to book salon services appointments easily and more conveniently.

The experiences we are able to create for our customers in-store through our Sephora and Salon growth initiatives are hard to replicate online and magnify the importance of physical stores. These areas continue to be clear differentiators for us while driving significant traffic and frequency of visit to our stores.

Second, our home refresh initiative continues to provide strong results and we delivered positive comps in our Home division for the fourth quarter and the full year. And as we mentioned earlier, we were extremely pleased with the strength and performance of our over 500 appliance showrooms. Appliance sales both in-store and online continue to drive significant comp growth and improve productivity in our Home Store.

We plan to leverage this performance by opening approximately 100 new appliance showrooms in early 2017 and adding new brand partners to our showrooms throughout 2017. We will keep you updated on the continued expansion of our appliance business which has been a key component to increase our revenue per customer.

As you have also read, we are conducting several tests within our Home Store focused on home installed services program. Many years ago JCPenney was a strong player in the home install space. Now that we have a large mall competitor donating market share in this category we feel the timing is right for us to test a series of home install initiatives.

One of the test programs include an HVAC install program through our partnership with Trane as well as several other programs. JCPenney is in an interesting position. Over 70% of our customers are female and 70% of our customers are also homeowners.

And with the increasingly share of wallet going toward beautifying their home we feel this is a terrific opportunity for us to grow revenue and further improve our sales productivity in our Home Store. We look forward to providing more details on these home services tests as well as to update you on new services programs in the near future.

And, third, we remain committed to becoming a world-class omnichannel retailer. Our online business remains strong, delivering double-digit growth in both the quarter and the full year.

We are also pleased with the overall improvement in functionality of our website. To that point, ForeSee, which provides an annual customer service experience ranking of e-commerce sites, ranked jcpenney.com as the fifth highest rated website for 2016, highlighting a 300 basis point improvement over last year, making JCPenney one of the most improved websites in 2016.

In the fourth quarter we increased our online SKUs by 40% and we have plans for continued SKU expansion throughout 2017. In fact, in Q1 of this year we have plans to increase our online SKU assortment by over 140% versus last year.

We feel our omnichannel strategy is working. For the full-year 2016 approximately 77% of all online orders touched a physical store. That's right, over 77%. As we improve site functionality, enhance ship from store capabilities and develop a much improved mobile app we will continue to drive increased online revenue in 2017.

Our fourth initiative is that we are focused on our pricing strategy initiatives. We have discussed this quite a bit. We are now ready to move from discussion to execution. Once fully implemented we expect our pricing initiatives to significantly enhance our gross margin performance in 2017 and beyond.

Earlier I spoke about how our efforts to improve our sales trends through the couponing and increased promotional activity had a negative impact on gross margin in Q4. Historically, decisions on pricing and promotions have been more instinctively and with very few analytics to drive our decisions. But in 2017 we restructured the internal pricing process, now all of our pricing and promotional decisions will be made using a more data-driven approach.

Although this may seem like a small change, it's a massive cultural change within JCPenney and one that will deliver improved gross margin performance in 2017. Late in 2016 we tested certain categories using this new pricing framework, resulting in positive gross margin and top-line sales growth. We've hired a team of experts in this field who have identified more opportunities than we imagine and we expect to see improved gross margin benefit in 2017.

Lastly, we will fix our negative trends in women's apparel. The areas we are most excited to see improvement in 2017 are, number one, activewear. As we previously announced we are enhancing our partnership with Nike to create inspiring brand shops and offering a vastly improved assortment of apparel, accessories and footwear across all divisions.

We are particularly excited about what we are seeing in women's area. In Q1 we will have Nike in all doors, and this is an increase of over 400 stores from 2016.

We will also expanding one of the hottest brands right now, Adidas. We will be adding Adidas apparel in women's to over 100 stores in March and we will have strong Adidas apparel statements in over 400 stores by back-to-school.

Footwear will also be a big focus in 2017. In 2015 we transitioned to an open sale concept in only 375 of our women's shoe areas. But given the outstanding performance of the open sale environment we are in the process of converting all women shoe areas to open sale fixtures this year.

Next is plus size. This is one of our strategic growth initiatives for fiscal year 2017 and beyond. The plus size community remains underserved, and we want to become the destination for providing style, value and an appealing shopping environment.

Our women's plus boutique shop continues to resonate with our plus size customers and we plan to lean into this strategy for 2017 by launching swimwear and other exciting accessories later this year. In addition, we are taking steps in women's apparel to simplify the floor, better balance our casual and career offerings and creating a stronger value statement with pricing. We are also utilizing customer and trend data more effectively to ensure we better understand the desires of the customer in advance of the season.

We are also pleased with our new speed-to-market initiative. And this initiative will allow us to reduce our private brands timeline by 40% in some of our more fashion-oriented brands. A specific example of the benefit of the speed-to-market initiative is the timing of our back-to-school buys for 2017.

Last year we made buys for back-to-school pre-holiday over nine months before the actual selling period. This year we are placing back-to-school orders post-holiday significantly closer to the event, and this gives us the ability to read the holiday selling results to better inform our decisions for back-to-school. Although this may seem like an only marginal improvement, it is significant for us and this change will allow us to be more accurate to avoid end-of-season markdowns.

Therefore, as we think about improving our business in 2017, we are confident in our initiatives of beauty, home, refreshed omnichannel pricing analytics and fixing our women's apparel business. We believe that this will allow us to build on our exceptional profit performance in 2016.

In closing, we believe we have developed a series of growth initiatives that not only serve the needs of our value-oriented customer, they provide us with the differentiation from our traditional competitors. Our strategy also better insulates us from pure play e-commerce competition while allowing JCPenney to capitalize on market share made available by struggling mall-based competitors.

With that, Andrew, we will open the line up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lorraine Hutchinson, Bank of America.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Thank you, good morning. You had mentioned in the past EBITDA of $1.2 billion for 2017. I was just curious if that's off the table and what the primary driver of that was?

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Hi, Lorraine. This is Ed. I will take that.

You know, if you look at our guidance at $0.40 to $0.65, if you look at the midpoint that equates to about $1.1 billion in EBITDA. I would not say the $1.2 billion is off the table. We need somewhere north, slightly north of a 2% comp to keep the $1.2 billion on the table.

But given the uncertainty in the environment we wanted to be very conservative in our top-line guidance. And so we gave guidance where it is but, obviously, with the initiatives we feel like we can beat that guidance as Marvin laid out. And if we do, we think $1.2 billion is still very achievable.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Lorraine, also, this is Marvin. In the past because we did not have positive earnings EBITDA was really the only measurement we could track toward that. Because we expect to deliver positive earnings for 2017 we will continue to talk about earnings as our key guidepost, but EBITDA remains important.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Great. Then you mentioned that there were two real estate transactions in your guidance for 2017. Can you quantify the benefit that you are including?

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Yes, so, obviously, neither of those are nailed down right now. So we think it's slightly over $100 million is what we are counting on.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Mark Altschwager, Robert W. Baird.

Mark Altschwager - *Robert W. Baird - Analyst*

Great, good morning. Thanks for taking the question.

Marvin, clearly a tough environment out there. And in that context the comp guidance for the minus 1 and plus 1 makes sense. However, the industry has been facing headwinds for some time and the comp outlook does represent a pretty big delta from what you outlined last August.

So I guess the question is, has your view of the longer-term growth opportunity shifted at all in the recent months? Or maybe what gives you the confidence to say that the flattish comp outlook is conservative in light of some of these rapid shifts we are seeing and the consumer shopping preferences?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

When we go back to the Investor Conference we had last summer we are pleased that every growth initiative we outlined is, in fact, working. We outlined the importance of appliances at Sephora, our Salon business. We talked about the whole beauty category including fine jewelry and just a whole home refresh initiative. So every growth initiative is working as we outlined.

Obviously, there has been an underlying softness in the apparel side of the business, specifically for women's apparel. As I mentioned, although the Q4 results don't reflect it we are seeing early signs that some of the strategic changes made from a leadership and from an assortment standpoint are working. So we believe that we can still perform well relative to our growth initiatives.

But our apparel business is the category that we are going to have to focus on. And we believe really good about the initiatives we have in place. But, again, I take through five areas that give us confidence in 2017 to allow us to meet or exceed our guidance.

Ed mentioned it very well. We want to be conservative. There still remains a degree of uncertainty in the marketplace, and we feel that it's prudent to be conservative with the expectation if things turn our way that we can exceed the guidance that we laid out.

Mark Altschwager - *Robert W. Baird - Analyst*

Thank you. Any quick comment on February? A lot of conversation out there on the traffic data and delayed tax refund, just any insight on how that might be impacting your customer?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

No, it's early. What we can say is our guidance of negative 1 to plus 1 is something that we feel we can achieve. We think Q1 will be on the lower end of the guidance, but we feel very confident that we will be able to achieve our guidance for 2017.

Mark Altschwager - *Robert W. Baird - Analyst*

That's great, thank you and best of luck.

Operator

David Glick, Buckingham Research.

David Glick - *Buckingham Research Group - Analyst*

Thank you, good morning. Marvin, I was wondering if you could walk us through your thought process on your decision to close stores. Obviously, last year that was not a strategy and what were the criteria you used to identify these stores and what kind of potential sales recapture, if any, are you assuming in your guidance?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

David, I will take the first part of really the rationale behind it. I will pass it to Ed to give you some of the financials supporting the decision.

And you are right, David, when you look back historically at our rationale on store closures, kind of a litmus test has been four-wall free cash flow. But as we start to look at how the business was tracking and really understanding the importance of growing the store base it became apparent to us that in the stores where we had invested in our growth initiatives, initiatives like new Sephora, appliance showrooms, our plus size environment as well as some of the other capital investments that those stores were performing significantly better than stores without those investments.

And as we start to think about the strategic future of the Company and we start to better understand omnichannel, remember we didn't roll out buy-online-pick-up-in-store same day companywide until back-to-school of last year. So we needed to understand how that resonated with the customers, how we could leverage our physical stores to really serve the customers in an efficient way.

When we started to look at that data understanding where growth was coming from how our customers responded to the new initiatives as well as how we could leverage our physical stores to serve our digital customers, it became apparent to us that our footprint was too large. So as we started to make those decisions on which stores we would close it came down to a couple of really basic criteria.

First, stores that we believed the growth initiatives could be implemented in and that they would work. Secondly, when we think about geographicals we believe that transfer sales could benefit us. Third, we wanted to make sure that we could justify the financial investments in stores that those stores were operating at enough profit level that a capital investment would actually benefit them.

So strategically we feel like this is the right decision. These decisions are very tough.

That's why we coordinated the closing with a voluntary early retirement program to minimize the impact on the loss of full-time associates. But we believe it's the right thing to do for our Company, this transition to an omnichannel Company versus just a traditional brick-and-mortar Company.

With that I will lead Ed give you some supporting data on the financials.

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Yes, David, I think your question was around sales recapture. A lot of these, as Marvin said, are small stores that cannot support the Company growth initiatives, so as you would expect a lot of them are in rural markets. So we don't expect a lot of sales recapture.

I will tell you there is also a negative hit to dotcom as we close these stores. But net-net we think it's positive 10, maybe 20 basis points. And I would tell you that's not baked into our guidance.

David Glick - *Buckingham Research Group - Analyst*

Okay, and then just a follow-up if I could, a lot of moving parts in the outlook but the 53rd week you gave us the sales impact. What is the additional SG&A impact in Q4, and what if any, are you running it as an earnings neutral week or how should we think about that? And then I have one last follow-up.

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Yes, we estimated the SG&A to be about $30 million for the 53rd week. Honestly, I don't have the profitability of that week.

We haven't run that yet. I would expect that it's neutral to maybe a penny or two profitable. I don't think it's going to be significant either way.

David Glick - *Buckingham Research Group - Analyst*

And my last question, just so understand what is going on with the women's business, Marvin, just if you can recap what do you think happened? Obviously, that was a negative surprise, and what are the areas that really were most negatively impacted and how long do you really think it's going to take to get the business back in line with the rest of the apparel businesses? Thanks.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Well, David as you know well this is a long leadtime business and this business is probably higher penetrated in private brands than any other apparel category, really any category in the store. So it takes a while to work your way through bad decisions, to be just blunt. But what we believe is that we've made the right assortment changes to better balance career and casual.

It is no surprise that JCPenney is a very traditional retailer from an apparel standpoint. We have been really dominant in career-oriented apparel. But I think we were slow to really adjust to some of the trend changes in the I call it the casualization of America, and we were one of the last retailers to really to get into the activewear trend in a big way.

We feel great about the changes we've made, specifically in activewear with Nike and Adidas, and also our Xersion private brand activewear category is performing exceptionally well. So it's all about transitioning to a good balance between career and casual. It's also about looking at the fact that we said we were over-assorted, and when you are over-assorted with private branded goods you end up taking more markdowns to get out of the goods.

And with that speed initiative of reducing design to floor, significant women's apparel, as I mentioned, we are able to make back-to-school buys after holidays is going to really inform us better. And, again, these are some self-inflicted issues. I think some is the change in how customers are shopping.

But net-net we think that we are going to see improvements in the business in the spring and we think that we will see even more improvement in the fall season. And remember, the speed initiative is reducing our design to sell time by 40%, and you know that's significant in a category like women's apparel.

David Glick - *Buckingham Research Group - Analyst*

Thank you very much. Good luck.

Operator

Bob Drbul, Guggenheim.

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Bob Drbul - *Guggenheim Securities LLC - Analyst*

Hi guys, good morning. Just a question that I'd like you to spend some time on is you talk about the higher levels of couponing in the fourth quarter and some of the promotional activity and the decision not to do it going forward. When you think about your consumer, the status and the positioning of your consumer how do you think that's really going to impact the business next year in terms of traffic in this environment that we are operating in?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Bob, it's a good question. And let me define it more specifically. It's not that couponing was a bad idea, because I think our customers have voted historically that that matters to them.

It's how we did it. As I mentioned in my prepared remarks, historically we tend to do things based on the year-over-year calendar and it's more instinctive based on what we did last year and a lot of it is not data-driven. And, again, there is a lot to be said about the art and science of retail.

I talked about that. But we had way too much art and not enough science, and in some cases we took couponing to a level that was unhealthy and we didn't advertise it in a way that we could drive traffic. And other decisions we made, we took additional percents off clearance, and when you do that, that's okay but you need to have a marketing strategy to communicate that so you can drive traffic.

So there were some tactical decisions we made in the attempt to drive top line. And I applaud the team's desire and eagerness to drive top line, that is what we are here to do. But some of the decisions were not as well thought out and they were not data-driven.

So we are not saying we are going to eliminate couponing. What we are saying is that we are going to have a more data-driven approach. We are going to have more elasticity managements on what prices should be.

We will have a better data set on our competitors' price. We will have a better marketing calendar to communicate the activity to have specific categories where we drive traffic and specific categories where we are driving more impulse purchases. Said another way, it is just a more strategic, data-driven process to take what JCPenney does well but do it in a way that we can protect our margin more efficiently in the future.

Bob Drbul - *Guggenheim Securities LLC - Analyst*

Great. And just on the active business, the investment in Nike and the addition of Adidas, is Under Armour on the dock at anytime soon for you guys?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

No, it's not something that we are prepared to talk about now. But what we are pleased with we are pleased that Nike is the number one brand in the world and they are eager to expand the number of stores and the number of categories with us.

We are going to have accessories and we are going to have goods for women's, kids and men's that we've never had before. And we are very excited about that.

And Adidas, as you know, is performing well across many retail categories and we are really pleased to accelerate them into roughly 400 stores and we will see what happens in the future. We are always open, the merchants are spending a ton of time talking to other suppliers and if we have an opportunity to bring in another big supplier we will definitely be open to looking into that.

Bob Drbul - *Guggenheim Securities LLC - Analyst*

Great. Thank you very much. Good luck, Marvin.

Operator

Paul Trussell, Deutsche Bank.

Paul Trussell

Good morning, gentlemen. So Ed, just some clarifying modeling questions, please. Real estate gains or asset sales, I should say, represent roughly about $100 million of EBITDA guidance and $300 million of free cash flow guidance for 2017.

I just want to make sure that is correct. And if so just wanted to understand the timing of that.

Then lastly on SG&A, just want to understand the expense declines year over year look to be less than what we've seen in the past despite the closing of 13% of the store base. So what is maybe some of the offsets there?

Then big picture, Marvin, and certainly you have touched on this throughout the call but 2016 was a tough year, your 2017 comp guidance is below the long-term plan. Just what is your honest view at this juncture of the state of the consumer, the mall and the department store experience and how do we get out of this rut?

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

So Paul, this is Ed, I will take my first two. Regarding real estate gains, yes, in EBITDA there is a little over $100 million expected this year. That is comparable to $62 million last year, so it's not all incremental.

From a free cash flow standpoint it's the same $100 million. It may be slightly higher because the sale price would be higher than the gain, but not much.

We do have $300 million from the sale of the home office that's already in our free cash flow from 2016 that we expect to pay down debt within 2017. But that will not be counted as free cash flow. The $300 million to $400 million that I laid out earlier is all driven by operational improvements this year, and the sales of $100 million of it from the gain on sales.

From an SG&A standpoint yes, it's 13% or 14% of our chain but, again, it was less than 5% of our sales base. We expect, give or take, $100 million worth of SG&A reductions next year due to the store closures and the timing of those closures. I think annually the number is a little larger than that, it's closer to $200 million.

But given the timing of the closures we expect it to be about $100 million next year. 53rd week is an increase to that. Obviously, there is also pressures on us.

This was not a great incentive comp year. So as we expect to pay out target performance in that go forward, there was a steep hill to climb there.

But at the high end of our guidance on SG&A it's down $70 million. We feel really good about that.

If you remember, last year I think we guided SG&A dollars down and we took $240 million out. So we are committed to continuing to take SG&A out of this building and become more and more efficient, but that's where our guidance is right now.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

So, Paul, on a more of a big picture perspective on where we are in this industry, I will give you my thoughts. I think the state of the consumer, from every measurement we look at there are no red flags out there why the consumer should be pulling back. Unemployment is stable, wages are relatively up.

And so we don't see anything from a macro standpoint that gives us any concern. There has been some noise about delayed tax returns in February, but we know that those things will balance itself out throughout this quarter, so it's not something we are spending a ton of time on. But relative to JCPenney and our 2017 guidance and where we believe we are going as a Company, we actually feel pretty good about our strategy and we feel great about the things we control.

So let me just restate why we have confidence in 2017. First and foremost, we have a beauty strategy that is working. We are going to add 70 new Sephoras in 2017.

We are going to touch every single store that has a Sephora in it and we have new launches coming that we think is incredibly powerful. Our Salon business was one of our best businesses in 2016, and that business for years has been dragging behind the overall retail business but we turned it around with great leadership and really a great focus in 2016.

Part of that now is growing that business by creating a digital interface for customers to interact, set up appointments and for our Salon associates to engage the customers in a much more modern way. This is working and it's also creating a loyalty factor that is as effective as any customer acquisition strategy that we have. And you can't replicate these two initiatives online, so that's important.

Secondly is home. We talk a lot about home refresh, but the data is pretty compelling that customers are spending a disproportionate amount of their wallet on beautifying their home, and we feel like we are perfectly positioned. We share over 400 malls with a struggling retailer that was once dominant in this category, and we have some in-house talent that understands this space really well.

We are not going to get over our skis and do things that our customers won't respond to, but appliances is a great example of customers will respond to initiatives if done correctly. We have some exciting tests from a home install standpoint we will talk more about in the future. But we think this is a way for us to grow our business, improve productivity and create some newness in our stores we currently don't have.

In addition to that, we talk a lot about the underserved customer with plus size and we think that we can be dominant in this category. And we learned a lot of lessons in 2016. And just a reminder, we are number three in market share in men's big and tall and we are not trying very hard, to be honest with you.

So we are going to get more serious about all these initiatives, women's plus size, men's big and tall, juniors plus, etc. And we think that we had the right geographic location, the right customer demographic to really be dominant in this.

And value with private brands is important because we've increased our speed to market. This gives us differentiation and it helps us once and for all to start to really drive the gross margin performance we've talked about.

The reason why gross margin performance in private brands has not performed as well as it should have is because the leadtimes have been too long and it's hard to plan correctly and you end up taking too many markdowns at the end of the season. But with the more compressed 40% reduction in design to floor it's going to allow us to make better decisions closer to the set time and closer to the season which will minimize markdowns.

So in summary, our growth initiatives are real. They allow us to go against some of the conventional wisdom of mall retail, allow us to take advantage of market share opportunities but also allow us to be good at the things we are strong at. So we think our guidance is conservative because there is uncertainty in the market, but we have every expectation that we are going to be able to achieve it if not beat it if things go our way in 2017.

Paul Trussell - *Deutsche Bank - Analyst*

I appreciate the sincere comments. Best of luck to you.

Operator

Oliver Chen, Cowen and Company.

Oliver Chen - *Cowen and Company - Analyst*

Hi, regarding apparel, are there any noteworthy trends on apparel online versus apparel in store? And does that help inform how strategically you think of factors within your control in terms of divergent trends of online performance versus in-store?

Then as you analyze you've done a lot of in-depth marketing analysis about your customer types. Could you speak to what kind of learnings you have there versus what you just experienced? Because your program and what you've articulated is quite advanced about increasing revenue per customer and knowing your customer very well. Thank you.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Online apparel is our best performing category online, so we are pleased with that and we are learning a lot. We are in a unique cyclical environment with apparel. Customers are changing the way they shop.

And so online and in-store is becoming an increasingly powerful equation. And I mentioned in my prepared comments roughly 77% of all online purchases and transactions touch the physical store. So we think we are learning a lot from what's happening online, but we also are learning by making sure that we are representing those assortment choices in the store better, and you are going to see more of that in 2017.

That is why we are confident that we will get the women's apparel business turned around in 2017. Relative to market segmentation, we have learned a lot and we spent a lot of time on this. Historically we were just executing based on gut instinct and what had worked in the past.

But we hadn't done any real detailed marketing segmentation until this past year. And from that, what we've learned is over 70% of our customers are female. As I mentioned 70% are homeowners, and we understand that our growing segment is the segment that we coined the modern American mom who is this multicultural female in her early 30s with on average two kids and she works and she manages most of her life through her mobile device and she's in tune to social media.

The reason why that's important is because it instructs how we communicate with this customer and it allows us to understand what we can put in the store and online that's going to satisfy her desires. But in addition to that, we have a mature customer that still shops us that's very loyal, and we have to understand how we serve the needs of that customer, as well.

So those learnings have allowed us to understand how we reset key areas from an assortment perspective, how we market, the marketing media we use and the effectiveness of how we can communicate. And we learned a lot of lessons in 2016.

We made some mistakes, but we learned and we think are 2017 strategy is designed from the lessons learned and 2016 but also from the successes. And we are confident that because of that the growth initiatives that we've laid out will actually continue to bear fruit for us for 2017.

Oliver Chen - *Cowen and Company - Analyst*

Marvin, what is your hypothesis on apparel performance in-store versus online? Why was there a divergence there and are there -- what are some of the steps you think?

Also, regarding the plan to optimize your retail operations, how does that interplay with making sure that the fulfillment and the speed and the non-linear supply chain is in the right place and your framework for interlacing those two ideas?

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Well, from an online perspective I think the simple answer is it's just ease of shopping and convenience. It's easier if you are shopping online to find the style that resonates best for your desires. It's easy to find your size, your color.

And so those are things that we have to replicate in store as best we can. But that's why buy-online-pick-up-in-store and buy-online-ship-to-store are so important initiatives because we can still leverage the store to benefit the online experience.

As a reminder, over 90% of all of our online returns actually take place in the store which creates convenience and also gives the customer a reason to come to the store to buy additional items. And so part of our challenge is learning how we simplify the in-store environment and some of our recent customer survey data is telling us that the customers are responding very well to some of the store changes that the team has made to create an ease-of-shopping environment in the store.

And relative to optimizing the network from an omnichannel standpoint as we close stores, one of the key decision-making points that we made in deciding which stores we would close was to make sure that we still could service our omnichannel customer effectively. We will be very aggressive this year rolling out a ship from store initiative that's going to allow fulfillment of online orders from a significantly higher percent of stores than what we've ever done in the past.

In addition to that, we rolled out Droid-based mobile devices to all stores this past holiday season that allows the associate to process a buy-online-pick-up-in-store order remotely on the sales floor without having the customer to stand in line or go to any type of a service desk. We are going to continue to lean into BOPUS and lean into ship to store and we have some exciting initiatives we will be announcing in the next coming months around the optimization of our store and digital platforms to create just a unique and really ease-of-shopping environment for our customers.

Oliver Chen - *Cowen and Company - Analyst*

Thanks for those details. Best regards.

Operator

Brian Nagel, Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Hi, good morning. So maybe a bit of a follow-up, Marvin.

But you talked a lot about gross margin and really going from a weaker performance in 2016 to presumably a better performance in 2017. But if you think about maybe you could rank order some of the drivers there that will fuel that performance as we think about it from 2016 to 2017.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Okay, Brian, I will take a shot at that and I will let Ed provide any additional data if I miss anything. But from our perspective I think what we are most excited about is this whole data-driven approach to pricing and just centralized pricing analytics.

Again, this sounds simple but it is countercultural here because we tend to have pricing and promotions embedded in the functions. And it's not done as centrally as you would think for a Company our size, and our early test results have been very, very positive from a gross margin benefit and a top-line benefit. So we think that's very important.

In addition to that, this whole speed-to-market initiative is significant. Anytime you cut 40% of the time from design to sales floor out of a private brand's process it just gives you much better visibility on the trends and gives you better visibility on what the customers are buying. And that's going to limit the number of markdowns that we are going to see at the end of the season.

The third thing is supply chain efficiency. We are working to make sure that we continue to optimize the supply chain. We made tremendous improvements this past year, but we are going to start to have a better replenishment process domestically and not be so dependent on a very long supply chain shipping products from overseas to the store, and we will have more domestic holdback and we will flow closer to point of sale for real-time replenishment than traditionally what we've done, and we think that's going to balance inventory and also minimize markdowns.

We also have a bigger opportunity with shrink reduction from an inventory perspective that we are working on. And we have made tremendous improvements in our store operations in an asset protection standpoint. And we are expecting to see those benefits pay off.

The last thing I will mention is the merchandising systems that we've been working on for the last couple of years, we are going to start to see those systems implemented in 2017 and we expect to bear some fruit from that. These are all real initiatives, we have specific targets that we are tracking on a month-to-month basis to ensure that we hit the target, and we walk away with some confidence that we will start to see this gross margin turn in a positive direction in 2017.

Ed, did I'm miss anything?

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

No, I think you got it all. I would just give a little bit more on pricing. We've got numerous strategies under pricing going that we have been testing throughout 2016.

You know, we basically categorized every item we have into defined pricing rules and we will use that to really drive not only be competitively priced or better than competitively priced on traffic drivers, but then allowing us to capture margin on more impulse-type items. We talked about couponing, as well, and not giving away margin as we have in the past around couponing but still being aggressive to drive traffic with that.

Then we think regional pricing can be a really big opportunity for us. We are testing that right now in 60 doors as I mentioned in my prepared remarks, and it's too early to declare victory there but the initial results are really strong.

And as Marvin said in the past we price Manhattan the same as we price rural Alabama and that probably doesn't make sense. So we know we have big opportunities around that.

Then on private brands Marvin talked about the opportunities we have there with speed to market and the supply chain impacts to that and I would add design to value. Our private brand margins still aren't where they need to be.

They still, frankly, trail our national brands. Although in fourth quarter they did exceed our national brands. So we continue to make progress there.

And we know there's continued opportunities there. But we have, obviously, the pricing initiatives we have impact the private brands as well, but as Marvin said the speed to market, our design to value initiatives we have going on, and then the sourcing opportunities we have around private brands, we think all of that adds up to a pretty big opportunity for us in 2017.

Brian Nagel - *Oppenheimer & Co. - Analyst*

That's very helpful, thanks. And then in response to a prior question I think you had mentioned that sales right now are tracking at the lower end of your guidance for negative 1 to plus 1. As we think about gross margin, any comments how we should think about the cadence of gains for 2017 relative to the annual guidance of 20 to 40 basis points?

Ed Record - *J.C. Penney Company, Inc. - EVP & CFO*

Yes, this is Ed. Obviously, appliances has a big impact on our margin. So the impact in Q1 and Q2 is larger than it is in Q3 and then, obviously, in Q4 it was fully rolled out.

So aside from the additional doors we roll out it is baked into our history. So that is a headwind in the first part of the year.

In addition to that, we have the store closings. We will start liquidation in Q1 and those will finish up in Q2 and that will have an impact, probably predominantly in Q2 but there will be some in Q1. So right now we see margin on the back half of the year slightly stronger than the front half of the year as compared to relation to last year.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Got it. Thank you.

Operator

Ladies and gentlemen, that's all the time we have for questions today. So I'd like to turn the call back over to management for closing comments.

Marvin Ellison - *J.C. Penney Company, Inc. - Chairman & CEO*

Thank you for your time this morning for us to discuss our results. Again, we are confident in our performance for 2017, and I have to be remiss if I didn't think the team again for the outstanding profit performance in 2017.

Thank you and we will talk to you on our Q2 call. Q1 call rather.

Operator

Ladies and gentlemen, thank you again for your participation in today's conference. This now concludes the program and you may now disconnect at this time. Everyone have a great day.

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