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Transcript of JC Penney
Updated Fourth Quarter and Year End 2011 Earnings
February 21, 2012

Participants

Kristin Hays – Vice President, Investor Relations
Michael Dastugue – Chief Financial Officer
Michael Kramer – Chief Operating Officer
Ron Johnson – Chief Executive Officer

Presentation

Operator
Greetings, and welcome to the JC Penney Fourth Quarter and Year End 2011 Earnings Conference Call. It is now my pleasure to introduce your host, Kristin Hays, Vice President of Investor Relations for JC Penney. Thank you. Ms. Hays, you may begin.

Kristin Hays – Vice President, Investor Relations
The presentation this morning includes forward-looking statements within the meanings 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 operation could differ materially from historical results or current expectations. For more details on these risks please refer to the Company's form 10-K and other SEC filings.

Also, please note that no portion of this presentation may be rebroadcast in any form without the prior written consent of JC Penney. Replays of today's Webcast will be available for 90 days. For those listening after February 24, 2012, please note that this recording will not be updated and it is possible that the information discussed will no longer be current.

With that, I would like to turn it over to our Chief Financial Officer, Michael Dastugue.

Michael Dastugue – Chief Financial Officer
Thank you and good morning, everyone. This morning we reported fourth quarter earnings in line with our expectations and our most recent guidance. On a GAAP basis we posted a net loss of $87 million or $0.41 per share including previously announced restructuring and management transition charges of $0.56 per share, as well as the financial impact of actions taken to execute the Company's new pricing strategy, which lowered our fourth quarter earnings by an additional $0.59 per share.

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While it was a challenging quarter from a sales and margins standpoint, the overarching theme in Q4 was the preparation and completion of the groundwork necessary to begin the execution of our new transformational strategy, which we launched on February 1st of 2012.

Now, as we wrap up 2012 let me quickly walk you through our Q4 results. Comp store sales declined 1.8% in the fourth quarter compared to our guidance for sales to be flat to down slightly. Gross margin, however, decreased approximately 740 basis points to 30.2% of sales. Our gross margin in the fourth quarter was impacted by the softer than expected selling environment, which resulted in higher promotional activity and more markdowns in the quarter. Margins were also impacted by the costs associated with the conversion to our new Fair and Square pricing strategy.

We recorded approximately $207 million related to the actions we took to convert to our new pricing strategy. The markdown accrual represents a large portion of this charges, and the rest is mostly related to the merchandise re-ticketing costs. To be consistent with our accounting practices, the cost of the pricing conversion flowed through our gross margin lowering the rate by approximately 370 basis points.

SG&A for the quarter came in better than we anticipated, decreasing $122 million year-over-year to $1.34 billion or 24.8% of sales. This was largely driven by lower marketing spend, decreased incentive compensation, and lower credit costs, as well as the benefits realized from our expense reduction initiatives. We also recorded $154 million charge related to the management transition, supply chain, and other restructuring expenses and initiatives.

A couple of other things to note—our real estate and other line items reflects a $58 million impairment charge related to several of our stores. As you know, it is our normal course of business to test for impairments in the fourth quarter. Additionally, our effective tax rate came in around 33% versus our guidance of 48% reflecting a loss in the quarter versus our initial expectations.

Now, let's touch on 2011 overall. In 2011, comparable store sales increased 0.2% and total sales decreased 2.8% for the year. As a reminder, the impact of the discontinuation of the catalogue and outlet businesses impacted our sales by over $500 million and accounted for the 300 basis point difference between comps and total sales. For the full year, the Company's gross margin dollars decreased $742 million over the last year. As a percent of sales, gross margin decreased 320 basis points to 36% when compared to last year. SG&A was leveraged for the year at approximately 29.6% of sales. This is about $249 million below a year ago and 60 basis points lower as a percent of sales.

We generated $23 million in free cash flow and have $1.5 billion in cash on the balance sheet even after completion of our $900 million buyback program, purchasing Liz Claiborne brands, and investing in Martha Stewart Living. Capital expenditures for the year was $634 million, slightly lower than our guidance of $650 million. Our inventory at year-end was down approximately 9.2%. As Ron mentioned during our analyst event in January, we edited our assortments, cleaned up the stores, and reduced clutter. We want to be in a good position to chase goods in the future.

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Now, moving to our 2012 expectations—on a GAAP reported basis, the company expects full year earnings for fiscal 2012 to meet or exceed $1.59 per share including approximately $15 million of restructuring charges to complete the realignment of the company's supply chain operations, and approximately $197 million of non-cash qualified pension plan expense. We're also starting to simplify our business models and in 2012 expect to incur additional restructuring management transition strategies associated with that. We will update you as we go along.

Our non-cash pension expense will increase in 2012 primarily due to the decline in interest rates. However, the company is not required nor is it expected to make any cash contributions to the pension plan this year. Capital expenditures for the year are expected to be approximately $800 million to support the company's transformational efforts. We look forward to updating you on our transformation with each of the quarterly release.

With that, I'll turn it over to Mike Kramer.

Michael Kramer – Chief Operation Officer
Thank you, Michael. Good morning, everyone. It's been only a few weeks since the meeting in New York where Ron and Michael Francis shared with you our blueprint for becoming America's favorite store. While we clearly are in the very early days of this transformation, I do want to take a few moments to provide you with an update on the actions we are already taking.

When I spoke to you on January 26th, I talked about the simplification of JC Penney's business model and ultimately the infrastructure that supports that model. By simplifying our processes across the entire organization, we will optimize our expense structure, flow more margin through to the bottom line, and ultimately enhance JC Penney's profit formula for the long-term. We are committed to this and the teams are already taking action.

For example, in stores we empowered our store leaders to eliminate work and processes that were required under the old JC Penney business model that are not needed under the new model. They have already eliminated unnecessary work in stores. For example, we no longer ask our associates to spend hours making pricing and signing changes across the store. In addition, we no longer overstaff our cash reps. This saves salary dollars but more importantly this enables our store associates to spend more time on actions that add value, like serving the customer. Customers are already noticing the change and Ron will share a few of those highlights with you in a moment.

In the home office, the leadership teams are working to reorganize their teams to align with the new simplified business model. It's early but I'm already seeing organizational changes that will eliminate unproductive processes and work allowing the teams to work smarter, saving time and money. One example comes from our supply chain. The supply chain team is working to finish a better alignment with the JC Penney's inventory flow process with the new strategy. By simplifying processes throughout our supply chain, we can reduce the level of inventory we carry to support

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our stores and jcp.com, reduce the number of times we touch that merchandise before it arrives at the store and reduce the labor hours spent getting that merchandise from the truck to the sales floor.

Another example is JC Penney's legacy technology infrastructure. In just the short time since Kristen Blum joined us, she and her teams have identified significant opportunities to simplify and improve our IT infrastructure. This is absolutely necessary if we are going to be more nimble and a faster organization going forward. By simplifying the infrastructure Kristen will significantly improve the systems that support our HR, finance, and planning functions, jcp.com, and ultimately the in-store and digital experiences for our customers. I am thrilled to have Kristen on board. She can move mountains, and I have complete faith in her ability to drive the change needed at JCP. Of course, like any change of this magnitude it takes time to implement, but I am confident that we can save significant dollars in stores and home office over the next 24 months. We will create a winning organization built on efficiency. I can already feel the culture changing and it’s very exciting.

Now, Michael spoke to you a few moments ago about our results for 2011 and our outlook for 2012. I want to elaborate on that for a moment. First, we will meet or exceed $1.59 in earnings per share in 2012. Our GAAP earnings guidance is unchanged from the analyst meeting a few weeks ago. We are committed to delivering shareholder value throughout this transformation including the first year. Second, as I said at the analyst meeting, we expect a much stronger performance in the second half of 2012 than in the first half. Not only does executing change like this take time but we also have to acknowledge the tougher compares in the first half especially in Q1. Finally, 2011 was a year of transition; 2012 is a year of transformation. We will be transforming JC Penney month-by-month, quarter-by-quarter, and we will update you on that transformation each quarter going forward with live Q&A in New York City.

This leadership team has a bias to action but with every decision we make we are focusing on delivering long-term value—value to our customers, our associates, and our shareholders. We are focusing on the long-term prize—becoming America's favorite store.

With that, I will turn the call over to Ron.

Ron Johnson – Chief Executive Officer

Thanks, Mike, and good morning, everyone. As you all know, in late January, we announced that were going to throw open the windows and let in some fresh air. Over the course of two days, we’ve shared with you our strategic blueprint to become America’s favorite store. So, on February 1st, we introduced a new Fair and Square pricing strategy, a unique and exciting monthly promotional calendar, and plans for a reimagined store environment all designed to create an experience that allows customers to shop on their terms in the rhythm of their lives and not ours. While it is way too early to jump to any conclusions on our new pricing strategy as we are only 3 weeks into a 52 week transition, I would like to take this opportunity to share with you some of the learnings we’ve experienced thus far.

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First, February sales are trending below last year. This is especially true on the days we are up against major promotional marketing from a year ago, such as our extra discounts and coupon events. As we said in January, sales would be an unknown in the early phase of executing our new strategy, especially as we cycled in … promotional activity from a year ago. Regardless, we are confident that the benefits of our simplified business model will more than offset the sales decline so we can meet or exceed our 2012 earnings guidance.

Second, we are learning that customers have responded well to our fashion apparel pricing highlighted in the monthly book. Whether it is offered as an everyday price or a month-long value in the book, fashion apparel and accessories are performing as hoped. This has been true in mens, womens, childrens, shoes and accessories.

Third, we had struggled during the first three weeks in home and fine jewelry. This is in part due to the lack of catalogues that we deployed last year, but it is also clear we need to be more—to more strongly communicate our value strategy in these historically promotional categories. We are working to strengthen our in-store assigning and make other adjustments to better communicate the value we offer. We'll also be dedicating more advertising to fine jewelry beginning in April.

Finally, the shop strategy is doing exceptionally well. The four inside JC Penney continues to outperform the rest of the store running strong, double-digit comparable store sales increases and … has significantly improved over last year. We believe our strong performance in these two businesses validates our shop strategy going forward and provides early evidence that we are bringing a new customer to JCP with our all new marketing and updated personality. We are excited to roll out additional shops later this year and we will update you on that progress in our next quarterly earnings call.

As important as the early sales indicators, it is empirical evidence about how the customer perceives our changes in pricing, promotion and in-store presentation and here we have some encouraging news. Within the first couple of weeks of implementing our new strategy, we've seen some meaningful improvements in our customer surveys of the same period in the prior year. For example, customers are giving high marks for the attention they are receiving, the availability and assistance, and the courtesy and respect extended by our associates. Customers are also telling us that they love the presentation of our new store environment, which has less clutter, wider aisles to better showcase our merchandise and make everything easier to find.

To give you a better idea of these metrics, the percent of highly satisfied customers happy about uncluttered aisles is up 900 basis points over the prior year. Also, by removing a lot of the in-store signage, the majority of our customers say they are highly satisfied with how pricing are communicated. They find the new pricing model "easy to understand." These early readings are significant because it means the customer have seen their value and know that the price is right. They have greater confidence so they can shop in their terms, which is what we want them to do.

Ultimately, we know our success is tied to simplicity. Our new corporate strategy requires that we dramatically simplify our operations and realign our organization so that associates are in the right positions to do their best work and deliver on our vision.

Thank you for taking the time to listen in today. We look forward to updating our shareholders, vendors, and other key stakeholders on our progress throughout the year beginning in May when we'll share our first quarter 2012 earnings results and meet with you in person in New York. Let me close this call with sharing how proud I am of our associates who worked so tirelessly throughout the fourth quarter to get our stores ready for the February 1st launch date and to lead our transformation from the front. It was not an easy feat especially in the midst of a busy holiday season, but their hard work and dedication paid off, and for that we are extremely grateful.

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