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JCP - Q1 2012 J C Penney Co Inc Earnings Conference Call

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OVERVIEW:

JCP reported 1Q12 sales of just under $3.2b and GAAP net loss per share of $0.75. Expects 2012 non-GAAP EPS to be $2.16.

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PRESENTATION

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Hello. Sorry, we started a couple of minutes late, though we heard with the weather there was some traffic in town. Thank you for coming. We have a great turnout. We have about the same number of people here today that we had at our day two of our Fresh Air event back in January.

And we also have people listening and on the telephone. We are broadcasting the slides live, and we are also webcasting live around the world. And I want to give a welcome to all of you here. But also a lot of our vendor partners are listening in, and a lot of the employees and team members at jcpenney are listening in, so welcome.

We are really excited to be here. The last time we spoke together, as you know, was in January when we laid out our vision to become America's favorite store. And when we laid that out we talked about how we had a four-year transformation that would be comprehensive. It would include changes to our pricing; changes to our promotion; ultimately changes to all of the products in the store; how we present products. And creating a whole new experience that will win in the age of a connected world, a digital world with a physical retail store.

And we said it is going to take time. And this is our first chance to update you on how we are doing, and we are very, very excited to be here. Now because all of the things we are doing are interconnected, as you know, we had to make the big bold step on February 1 to change our pricing strategy and to change our promotional strategy. But we had to do that in order to have a chance to really create the exciting products we dream up, to get the presentation right. None of that is possible without what we call Fair and Square pricing.

And so we made a bold move. Today we are going to update you on that. If I were to say what are the -- if I were to write the headline for today, here is what I would say. Our first 90 days are a little tougher than we expected. We expected the sales to be down double digits. They are at the low end of that range, of our expectation.

But the good news is the transformation from my perspective is way ahead of schedule. What the teams at JCP have accomplished internally with our vendor partners in the stores in 90 days has shattered any expectations I had for what a 110-year-old organization to do.

Now we are trying to essentially convert the Titanic into 1,100 wave runners, and that is really hard to do. But we are making a heck of a lot of progress, and I am really pleased with that. And so today we are going to talk about that.

And as we do, I just want to start by putting in perspective how I view where we are right now. As you know, we are an 110-year-old company. And I look at we have had four eras. The first 10 years of our Company -- 13 years, 11 years -- were in -- we weren't even called jcpenney, we were called, as you know, The Golden Rule Store. That is what founded the values on which we are based.

We then went through a period which were among the best years, which I call the Main Street era. JCP, as you know, was one of the first companies to roll out stories as a chain, and did that across The Main Streets of America, a lot of small towns. We all know that history.

From 1960 to 1980 we went through the mall era. That is when shopping malls came up in the US. And because every town had a local department store like Dillard's or Saks or Dayton -- Dayton's or the Foley's, the others that joined where Sears and Penney' and Ward;, the only national chains. And we had a great period. As the malls grew, we grew. In fact, in 1973 we had 2,073 stores. I don't know if people realize that. An interesting time for a company.

Then we went through the last 30 odd years, which I call the promotional era. As the world got more competitive, as the specialty stores grew, as big boxes grew, we competed like many in a promotion way. And during the promotional era, it was actually a tough era for our Company. We massively lost market share. Our stock price was flat to down through the area. The only return to investors was through dividends, right?

And toward the end of the era we concluded that our promotional strategy hit the point where there is only diminishing returns from further promotions. You can't raise the price more and discount more. And there is no way out of the puzzle. And so we made the courageous bet that we are going to go through a year of transformation to get to the other side.

And that is what we are in now. It is one big year that we have to go through. And that is going to pave the way for the next era for jcpenney. It is going to pave the way for our products to change, our presentation to change. Our entire go to market strategy will change as we deliver an all new interface to retail, but we have got to go through a year of transformation.

Now we are not alone. I was out recently and I was with a former senior leader at Audi, and he said -- you got it so lucky. When we got offered $6,000 incentives per car we had to go through the entire cycle of the model, four- and five-year car product cycles. They had to deep promote, cut incentives, took four or five years to get Audi back to where it is.

Now look at Apple in 2002 when -- the Mac platform, our processor roadmap was behind. We had to switch to Intel. We had to take our sales down, because we couldn't compete on a bad platform. And we went through it.

We are proactively going through a year of transformation and we are learning every day. But in the big picture it is year in an historic company's great history.

So we at -- 2012 is our year of transformation. We are in the middle of it. It is really hard. It is hard for me; it is hard for the teams; it is hard for everybody. There are days that are exhilarating and days that provide a lot of anxiety, but we are getting through it.

And we expect 2013, as we said, one year later, will be the year when takeoff starts. We won't have a single coupon to go up against, a single promotion. All we will have is new products, new presentation and a lot better understanding of our strategy. So we are going through one tough year.

We are on day 105. We are 29% of the way. Saturday at noon we will be 30% of the way through, I checked. So we're getting there. And we made two commitments to all of you. Number one, complete transparency. That is why we are here. We are here face-to-face to tell you exactly what we are learning, how we are reacting, and where we're going, right?

And, secondly, that we would earn money through the transformation. This is not a throwaway year. We expected the first quarter to be tough. It is a little tougher than we thought. This is not a throwaway year. We expect to earn money this year, earn good money this year and strengthen our Company during the transformation, and we will. And we will talk about that today.

All right. So the agenda, really short and sweet. But it will take a while, because we have got a lot of slides. First-quarter results, Mike Kramer is going to talk about the first quarter. Then Michael Francis and I will come up and update you on our progress toward our long-term vision. So thanks for coming. Here is Michael Kramer.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

Thanks, Ron. You know, as Ron said, this is not a throwaway year. And thank you for coming out. This has been a very tough quarter for us, but not necessarily unanticipated. A lot of the stuff was anticipated; some of it was not. But what you will see today is you will actually see some real bright spots. And that is my job to point those out.

So let's start at the top. As you saw in the earnings release, we ended the quarter at just under $3.2 billion. That is down from $3.9 billion last year, roughly a drop of 20%. On a comp store basis that represented down 18.9%.

I know what you're thinking. What is the trend here? We will get to that. This represented a loss of $0.75 on a GAAP EPS basis. Embedded in this is $0.15 of qualified pension, $0.20 of restructuring, and $0.15 for an aged inventory reserve. Without those three things, we are posting negative $0.25 on a non-GAAP EPS. I will just walk you through reconciliation there.

So let's start at the top. I said 18.9% of comp store sales decline. We did see modest improvement through the quarter. In February we were down 21%. And through the back half of the quarter we saw roughly about a 300 basis point improvement.

Now let me stop here to remind you what I said in January. This is going to be a tough year. Sales are unpredictable when you're going through this profound of a pricing strategy change. And I said the back half of the year is going to be better than the front half of the year. Keep that in mind.

So let's break it down a little bit. Traffic. Traffic for the quarter was down 10%. When you bifurcate that out between the days of the week, we were down 6% Monday through Thursday, and down 12% on the weekend, which is primarily known for more of a coupon shopper. So we were hit pretty hard on the weekends.

Conversions. Last year 22% of the people that walked in bought something. This year, 21%. Not a lot of difference. This is good, guys, this is good. This means people are seeing the value. Is there room for improvement? Yes. But this is good. With the rising, the signing strategy, people are seeing the value. Conversion is not changing that much.

Average spend per visit. Again, last year it was about $48, this year about $46. Again, not that much. Once again, a sign that tells us that people are seeing the value.

So let's sum it up in terms of the sales. Traffic and conversion down 10%, conversion basically down 5%. Average spend per visit down 5%. The primary issue here is traffic, and Michael and Ron will address that.

What is the source of this? Coupons, that drug, drove traffic and conversions. We did not realize how deep some of the customers were into this. 40% of the transactions last year were not only transactions that would include a product on sale, but it was I call a double down -- sales plus another coupon on top of another 10 off 10. You have gone into a store and you bought something, and you in your mind have actually priced it out and then the cash register comes out and is a whole lot better. This is doubling down. 40% last year.

We have got to wean off this and educate our consumers.

This is something that is very important for you to understand today. There is a real positive nugget here. Gross margin. What I'm going to do is actually walk you through the margin rate, the gross margin rate as reported in the financials from year to year, and then I'm going to break it down.

Last year 40.5%. Is [Paul Wedgeway] here? Hey, Paul. Paul wrote a phenomenal article last week -- Panning for the Pure Merchandise Margin. I agreed with everything, standing ovation. Basically what Paul was saying is everything that gets thrown into the gross margin it is really hard to understand how well a company is performing. Well, I'm going to show you our pure merchandise margin. And it is important, because it speaks to the strategy and it speaks to the go forward gross margin.

Our selling margin impact -- this is a pure margin. It was down 2.4% from quarter to quarter. There is a story there, so hold on. Freight -- like everybody else, freight went up. We also had free delivery. Aged inventory reserve, I'm going to talk a little bit about this. This was that $53 million of the reserve, that $0.15, and the reconciling item from GAAP to non-GAAP. And then net markdown, in other words, a positive impact. Basically what that is is that is the net reserve of fall merchandise as it moves into Q1 year-over-year, retail accounting.

That actually shows a dilution of 290 basis points. Let's reiterate, 290 basis dilution. The biggest piece of that, as I said, was selling margin. 240 basis points of the deterioration with selling margin.

Why is this a good story, Kramer? Well, I will tell you. This slide I want you guys to burn in your memory, because this speaks to the strategy. If you take a look at our everyday month-long, which represents roughly 80% of our sales is growing, growing that is positive movement, 270 basis points, from 48.9% to 51.6%.

Now, as it relates to this quarter's performance -- that is price -- the clearance it really killed us. Let me go back to that. Selling margin down 5.9%. We actually lost -- we actually took a hickey of $2.11 per unit this year compared to $0.40 per unit last year.

Why was that? Well, one, we came into this season the product had already been bought before the best pricing strategy was initiated. So the inventory we had to deal with. But more importantly, the fall goods there was a lot of carryover. You guys know better than I do, it was an extremely warm Q1. We couldn't mark it down enough.

Now if you take a look at our mix, our mix shifted because we were trying to get rid of a lot of the inventory. Our mix went from 88% normalized to 85% this year. Those two things colliding, the mix shift and the deeper discount rate for the fall goods, more than offset the benefit with regards to the margin. Why is this important? Because if we're managing our inventory right those two other things go away or they are nominal. They are nominal. And I will talk to you a little bit about managing inventory.

Restructuring. I'll give you a little detail of the $76 million that we posted in our earnings. Roughly $45 million of restructuring was home office. The majority of that was actually home office, a little bit of that was stores. Leadership, $20 million. That represents some sign-on for some great talent, as well as some severance and termination for some exiting leaders. $6 million in supply chain. We closed a call center. And then miscellaneous, the closure of CLAD and Grace for $76 million.

Okay, another slide that I would like for you to burn into your head. For the quarter we saved year-over-year $121 million. That's a big number. And it is even bigger when you figure out that we really didn't get started until halfway through March.

Now what is important to understand here is what I said when we talked in January. I committed to a $900 million run rate of savings in 2013. Why was I confident with that? Well, some due diligence that I did, but also some comparisons with some other people in the industry. Remember what I said, we were running a 33% SG&A rate. Kohl's was running a 27% SG&A rate. That is 6% differential, times a $17 billion business is $1 billion.

Then when you include the expenses that were allocated to the gross margin in ours that were not included in Kohl's, it takes jcpenney $1.5 billion more on an annual basis to run a $17 billion Company.

Now we do do things differently. We have some higher labor categories within our stores -- Sephora, The Salon. But that doesn't account for $1.5 billion. Clearly there is some inefficiencies. We knew that we could get close to $900 million, and I will tell you why am really confident about that.

Over the course of the last three months we have been able to dig in more, get deeper into it, and really take an understanding of what we inherited. And there are three big opportunities that give me confidence that we can hit that number -- significant confidence. One is inventory management. Inventory is not our friend. Inventory is not our friend. That is the complete difference in strategy or philosophy this management team and the last management team.

We are moving more to a chase mode. It allows our merchants to really go after hits and misses, and be much more fungible from that perspective. It is a mindset.

Not only is inventory not our friend, but old inventory is not our friend. There are very few industries out there that I think old inventory or aged inventory is a good thing. Definitely not in our business. I don't know about you, but I'm not planning on wearing underwear that has been sitting on the shelf for two to three years.

So what we did when we uncovered was 17 weeks of supply. Now is that bad, Kramer? Well, on average in our industry, in the department store industry, they operate anywhere from 15 to 18 weeks of supply. Specialty stores, including some hardgoods specialty stores, like Williams-Sonoma, operate 10 to 13. I'm not convinced that there should be a distinguishment. I am not going to use that as an umbrella. This is important for us to be able to manage our inventory better, manage chase better, manage hits and misses better, and also manage our cash better.

I believe we can actually get this to 13 weeks of inventory. The Company has been operating, at least over the course of the last eight quarters, at 17 weeks. We are well on our way to actually reduce that to 13. What we found when we dug in was the 17 weeks of supply was a little misleading. We had way too many SKUs that had excessive weeks of supply. In fact, I have $0.5 billion of my $3 billion is over one year weeks of supply in certain categories. 200 of that was over two years, i.e. thus the need for some of this write-off of aged inventory.

We also have a lot of SKUs or a lot -- excess inventory in SKUs that represent a very small piece of our business. 20% of our inventory is related to SKUs that represent 5% of our sales. It is all about effective management of inventory.

Thus, by the end of 2012 we will free up $500 million of working capital. So we are committed to this. It is going to be better for the business; it is going to be better for our merchants; and it is going to be better for our bank account.

Legacy systems. I can think of no other thing to say about our systems and our IT infrastructure, and I have seen a lot of them. It is a mess. Why? 492 unique applications it takes to operate jcpenney. And that is not including Excel, and Excel is used a lot. 492. Well, Kramer, how bad is that?

Well, a company of this size with the singular complexity that we have -- keep in mind we don't operate overseas. We don't operate in a lot of different categories -- should roughly be around 100. This is years and years of 100-year-old company band-aiding and band-aiding and band-aiding. So that when you want to make a change in the business -- in the strategy in the business, it takes a lot of unlayering and putting back on, unlayering and putting back on. That costs money. That is what drives headcount. We have to be flexible.

Out of those 492 applications, 88% of them were customized. Customization is not your friend. Now this translates to 90% of my IT spend both on expense and capital basis goes to maintenance. 10% goes to initiatives -- strategic initiatives. That is crazy. That is a lot of money going to maintenance.

Simplify our processes. This comes back from January, I am more convinced now than ever before we have got a lot of opportunity here. Remember me talking about excess granularity creates false precision. Excess layering and excess access bureaucracy creates false precision. Processes -- extra processes being done that don't need to be done creates false precision. There is enormous amount of cost and infrastructure that was going to support false precision.

I'm not going to belabor it today, because I can talk for an hour on the items that we have already identified. What I can tell you is, of that $900 million I have already identified and are executing to $650 million of it.

Now the expenses that you have seen to date are primarily what I would call low hanging fruit. We have done very little change in terms of our processes yet. We are in the process of starting them and we're in the process of even uncovering more. So that gives me an enormous amount of faith that we're going to have significantly more.

So that $900 million that I told you that we would get to a run rate in 2012, it will now exceed $900 million. When I say exceed $900 million I am not talking about $10 million or $20 million, but I'm not going to give you that number. So with that I'm going to turn it back over to Ron.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Let's talk about progress toward our long-term vision. The first thing is cultural. I'm going to talk about three things that are internal, (inaudible) and quick. We are starting to act like a startup. We have been a big company, a lot of layers, a lot of people, a lot of thinking. We are moving a lot quicker.

Startups, which I am very familiar with working in the Apple area, you get assembled teams of really smart people. You set a clear vision. You go and get in the market, and then you learn and you react. And you want to get your learning time and your reaction time to be really close. And that is really important. We've got to be a Company that is nimble and fast.

And we are starting to move really quick. I was talking to Liz today and I said -- are we acting like a startup? And she just about fell on the floor. Yes. And I will give you an example. One of the things we concluded in the last quarter is that our marketing, while it is gaining a lot of mind share, it is getting a lot of attention from people, it is not doing the work it needs to communicate our pricing strategy and to drive our traffic.

Mike showed the challenge of our traffic being down. If your traffic is low you can't start to convert. That is the number one issue. So our marketing is getting our mind share to entertain people. It is not doing the hard work we need it to do right now. And if we are making changes, we've got to get our pricing across.

You might have seen during April we started these ads that we run on the Web. We have done them in ROPs, that really explain, under do the math, our pricing. This item last year was $70, on sale for $49. $10 with that coupon, that 40% [on how] people use. They paid $40. This year it is $35 every day. So we are marketing to try to communicate the price message.

It is even more important on the month-long value. There are a lot of people who think we are an everyday price retailer. We are not. We have promotions. We just don't have 590 of them, we have 12, and they last the entire month.

So people don't understand this yet. So we have got to let people know that we take our great everyday prices, which are about 40% below, and we actually take 20% to 30% off and it lasts the entire month. I think that is one of the best-kept secrets around.

And so just last week we started putting ROPs in the major papers, major markets -- there are double trucks here in New York -- that launched before the weekend that really highlight our month-long values. So as you can see here, JCP month-long values are 20%, 30% lower than our already great everyday prices on the things you need now, no coupons required.

So we learned. Coupons were a drug. They really drove traffic. We have got to offset those without going back to coupons. So it is like we have sale prices every day, and we are even lower on the items you need now without coupons. We will be running ads like this every Thursday or Friday for the weekends going forward.

You will also note we started to put the compare to our everyday. Up until last weekend we never put the comparison. Now we know the customer knows the right price, but they need to understand the value we are offering. And so this comparison you see in our month-long value ad will be rolling into all of our marketing, all of our circulars and different things. We have got to get people to understand our pricing strategy.

Our third type of price is our best price. What started out Best Price Friday, and we learned really quickly they thought it was only available Friday. But best price is when we take the goods down low to start the former clearance process. So we have changed to the big deal starts today to try to let people know it is going to last longer.

We now have TV supporting it. Next weekend you will actually see best price marketing with the items that are going to clearance with the compare. So we have got to work harder to move our marketing from building a brand, which is a long-term great thing to do, in the short run to really helping people understand our pricing strategy.

And we have made big changes. If you walk in the stores during June, it will be the third time we have changed our POS signs that go on top of fixtures. If you walk in the stores now you will see price points on the mannequins that not only have these great-looking items, they can get style and value, because we communicate the pricing.

We didn't have enough impact in the stores of the pricing. So that is what startups do. You have got to get in the marketplace. And then you do your software updates. We are doing our updates on the fly. And Mike talked about the cadence improving. We expect that to have a big impact as we go through the year. So we have got a rapidly evolving culture that is moved fast to click, quick to learn, fast to move.

The second thing, we have really strengthened our team in a short period of time. Over the quarter and a couple -- and maybe part of January, we have added 41 people at the Vice President, Senior Vice President and EVP level. That is almost every two days we have brought a new person or promoted someone to an officer level of the Company. Now 20 of those were internal promotions. These are people we think are really great and are doing great work. 21 were people that came from outside the Company, who wanted to join the cause.

We believe that is a good mix. At the EVP level, for example, we have six new Executive Vice Presidents. Liz Sweeney came, as you know, internal in the company. She was our Head Merchant. We went to one Head Merchant. She is doing a fabulous job helping the merchants get through the change.

We have five others, and I'm not going to go through each of them, but the backgrounds here are not only great people, these are great companies. We have got people who started at General Electric, have worked at Apple, have worked at Abercrombie, have worked at Pepsi, have worked at Nike, have worked at Disney. These are people coming from world-class companies with world-class experience who we think are the best we could find. And that is true at the EVP level; it is also true with the people we brought in from outside at the Senior Vice President and other level. So our team is dramatically different, and we are learning to work together. And that is part one of what we are going through.

As Mike said, internally we have absolutely simplified our structure. We have restructured at headquarters. We had 92 buying teams to start the year, we are at 60. That is simpler, and the teams are more efficient as well. In the stores we have already reduced two layers.

We have already eliminated all commissions, because we want everyone, one team on one mission. We have made a lot of changes in a very short period of time that is going to help our decision-making and help our clarity of purpose going forward.

This is all happening in 90 days. From a customer perspective the big news, and I want you to really understand it, is they love what they see when they come to the store. We have been taking surveys for a long time asking the same questions of those who bought. And here is the data for the first quarter against everything we measure. Aisles uncluttered, an 11 point improvement, all-time high. We all hear about it. The new jcpenney is much more clean, much more interesting to shop.

9 points higher on the return policy. Prices are easy to understand. In the former world of high/low and coupon, might have been a good value perceived, 8 points higher, and I understand the prices.

Friendliness of employees. Because we are not debating which coupon to use, our employees could just do the right thing and help people out. Overall value. The customer sees more value. And overall satisfaction more.

And if you look at the data by month, if you look at April, they are higher than they were in February and March. So what does this tell us? The customer is voting, I like the store. I see the value. I understand the price. We have got to get more traffic when people understand that.

Our Net Promoter score is 76%. Gaining mind share. We are getting mind share. The marketing has worked. Here is the data that shows the changes in brand perceptions over the last 90 days compared to the prior year. Offers great value every day, up 5 points. The right products available, up 5. Is changing for better, up 4. It is fair, it is inspiring, hear others talking about it.

We all know, everyone is sitting -- talking about JCP. I haven't talked about it in a long time. We've got to translate that mind share into store visits, but our brand is moving in the right direction.

Here is another important one I view as a huge opportunity. We have established a predictable sales pattern. If you look at our former sales pattern it is kind of like an EKG, up-and-down with our promotions and coupons. As Wal-Mart taught us all in the '80s, when you get a steady sales process, what happens? You flow your inventory better. You can manage the business better. Your merchants can spend time on products. All good happened from a predictable sales pattern.

And we are doing that with our pricing strategy as the customer shops on their terms. Let's take a look at it. On average during this quarter -- don't put this forward because we will have higher business on back-to-school and holiday -- we did $230 million a week. We only had one week was more than 10% outside the range. Isn't that incredible?

What a difference from when you have anniversary sales and this and weekends, and it is a really different business model. That is why our service stores are going up. Now we got to turn around that 10% lower traffic, which we will. But the benefit of a steady business long-term to the customer service and merchandising is profound, as we saw with Wal-Mart, and that has already been established.

Customers love the everyday price most. Remember, a year ago I said one out of 500 items was bought at regular price. This quarter 67% of the merchandise was bought at our highest ticketed price. Just profound. That is why the selling margin for everyday and month-long values was almost 3 points over last year.

People are now buying at the first price right price. That is the dream of every retailer. We have already established it. No one bought at a full price last year. Two-thirds of the transactions are at full price. Another percent are at the month-long value, and then our best price, which is our mode of clearance, is at 15%.

That was a little higher as we wanted because of our carryover in inventory. But it is all moving the right direction. But as we move forward, and we are going to compete on product, the fact that people know that the pricing is good, shows up in that 67%.

Now 1 percent -- one out of 100 fewer are buying every time they come in. We will fix that with better pricing, better signing, better products, but that is an easy one to fix, right? This is really big news, and it shows that the strategy is going to work.

Fashion. We have had very good success selling fashion. If it is in the book it is out of the store. People are reading the book and coming in to buy. During February launch month, the styles are gone in a few days. The issue we are having, it is not selling this, it is our basics. Well, it turns out if you give someone $10 for the first $10 spend and they have nothing to buy, they are going to fill their sock drawer. They fill their underwear drawer. They buy towels. That is what the coupon did. The coupon was like free money. It is a justification to shop.

So our businesses that are down are the basic businesses in Home, in Men's, in Women's and Kids, the fashion is actually doing quite well. That is encouraging, because we are going to compete on products and presentation. And on fashion we want better merchandise. That is a high order accomplishment.

We all know the best performing retailers are people like Forever 21 and H&M and people that are fast fashion and have credibility for great products. We can sell basics. We've got to reconfigure our assortments.

The technology roadmap has become abundantly clear. As Mike said, we have got a lot of applications. We know exactly where we want to go, right? It is really clear. We got a great team working on it. And we're going to talk more about that in August because we don't have time today. But we know, we have been meeting with Google and eBay and Cisco and Oracle and we have got a dream vision for technology that we are excited to share with you in the future.

And our new store design is way ahead of where I thought it would be. I feel bad for Ben Fay. Ben starts next Monday. We are pretty far along in our design and I feel bad for him.

But this is exciting. We actually have a 60,000 square foot in effect like a warehouse in Dallas, a few minutes from our headquarters. And we are over there every week kicking the tires on our new store design. It is very exciting. It has come together well, and we will talk about that in August as well.

Our shop strategy. One of the dreams was we are going to convert from selling merchandise to putting all into 100 shops. On March 15, just 45 days ago, we posted online a place that vendors working with our merchants could apply for shops. We have room long-term, we think, for about 100 shops. Well, in 45 days we got 110 applications. And that does not include the shops we are working on independent of that with some people, like we have done with Martha Stewart and others that will be in the store.

So we are now in a position of having more choices for content than we have space. Now that 100 shops is going to be delivered over a four-year period. So we have got this unbelievable opportunity to sort through the best of the best and start to roll those out in 2013.

So we are excited and so thrilled that the vendors are behind our strategy. And as hard as it has been for us to be down 19%, it is harder for the vendors. Because not only have they dropped business from the sales shortfall, as we reduce our inventory in the short run that also reduces shipments from vendors. So it is a hard time for everybody supporting this new transformation.

But, as you can see from that number, they want to play. And they want to be part of our vision and that is really exciting. And on the same hand, our merchants have totally embraced the new direction. We have a lot of them here today, but they are loving the chance to complete on product. They never sit in a room. 40% of the time last year was -- what is the price tomorrow, what is the price next week, it never happened. The only question is what is the next great product we are going to develop, how do we present it better, how do we get it in the store and the right inventory, how do we win our merchandise. And the teams are doing a fabulous job.

And we thought it would be fun today to give you a glimpse into some of the merchandise changes you will see starting August 1 and moving through the early spring. So I would like to invite Michael Francis up to do that.

Michael Francis - *J. C. Penney Company, Inc. - President*

Thanks, Ron. Good evening everyone. You know we all realize that for this strategy to win, we are going to win on the assortment. So I'm excited today to share with you some of the great work underway that Ron mentioned. But you know, it is fascinating when I look out at the assortment plans that will be unveiled beginning this fall season just how far we have were able to come. It has exceeded all of our expectations. And beginning in August we will have transformed 47% of our assortment.

And that really has been through thoughtful editing of unproductive private-label and unproductive brands, and also a blend of launching new brands, some of which I will share with you today, powering up existing brands that were part of our assortment, and transforming our private brands to give them greater integrity and greater focus.

As we start this fall, I want to give you a flavor between August and the end of the year just what you can expect to see. Some of this is an update from our presentation in January. And some of the news I will share today is new.

I would like to start by introduction of some new brands that will be launching beginning this fall. The first of which is our jcp brand. We believe that we can leverage our design and sourcing prowess in a way that will enable us to deliver high-quality, fashion key item basics in a manner done so beautifully by the Uniqlo or Joe Fresh, but under our own leadership.

And we feel so strongly about our ability to create powerful assortments that we are going to proudly put this under our own brand name. These concepts will roll out to both Men's and Women's beginning in August of this year.

We also have introduction of a new line called DREAMPOP by Cynthia R. Cynthia Rowley has been known for her design aesthetics for many years. With DREAMPOP she has created a completely new and fresh category collection for girls 7 to 14 that we will bring to life in all stores beginning this fall.

We are also excited to introduce Betseyville by Betsey Johnson. Betsey Johnson has been known for her fun and whimsical and feminine collections for years. And she has created for us an astonishing collection of handbags and accessories that will debut during the fourth quarter.

Another addition to the mix is Lulu Guinness. Lulu Guinness is an esteemed designer from the UK who is known for her witty and clever collections of handbags and accessories. She will bring that same spirited look to life in our assortments beginning this holiday season.

Another fun addition to our mix, Vivienne Tam, beloved in the industry and well known for her East meets West collections, drawing on modality and high fashion. Vivienne has created an exclusive collection of accessories for us which will debut this fall, and we will look to build as we move into 2013.

Royal Velvet is a heritage brand that many of you are familiar with from Bed and Bath. With an exclusive license we are taking the quality of this collection and extending into other categories through the back half of the year in furniture, in window, and tabletop.

DC. This is a vital collection for young men in its heritage of extreme sports, skateboarding and snowboarding and a lure for an active young male guests. We believe that our DC collection debuting this fall season will become a critical foundational element of our young men's category.

And with our ownership of Monet. This 70-year-old store brand will now re-energize and bring to life in our stores with high fashion and innovation, not only for fashion jewelry, but also in categories like handbags and footwear for the first time.

That is just some of the elements that will transform the assortment beginning this fall. We also talk about powering up existing brands. We have had remarkable partnerships. We have had successful private brands for many years, but we saw opportunities to really refresh and renew our assortments beginning this fall season.

The first of which is Liz Claiborne. As we shared with you when we were together in January, our goal here is to return the Liz collection to its heritage, a traditional, affordable, well-designed collection for working American women. And our goal is to really renew our commitment here. Infused with trends with all new style, quality, great fabrications, fresh fit, this collection is truly astonishing and will resonate with our customer.

A brand that we launched earlier this year in March is Puma. Founded in 1920s in Germany this brand is an exquisite collection of athletic footwear and activewear. This collection was so successful for us that we are growing our assortment dramatically through the back half of this year in both footwear for Men's, Women's as well as activewear.

Exertion, this is a brand that we launched just several years ago for active lifestyle. We are refocusing it to ensure that it truly has all of the product and design and functional elements needed to become America's favorite activewear brand for the family -- all new product fabrication, new functionality, including things like moisture wicking and antimicrobial to ensure that we have the right assortment with the right functionality to win with our customers.

Nike. You can't be America's favorite store without America's most influential athletic brand. So what we focused on here is -- you know, we have had a great partnership for years in footwear, and in some instances basic items in our men's sportswear assortment. But beginning in the fall season we will introduce a broader assortment in men's and introduce a collection into women's.

We also talk a bit about our private label, our own brand. As we shared in January and as we have begun to edit our assortments this year, we removed a lot of labels that did nothing more than feed our former promotional strategy. But there are brands within the mix that have had great resonance with customers for many, many years and our goal is to restore them to their integrity, since they are no longer simply there to feed the promotional cadence.

St. John's Bay is the first example. We are restoring this brand to its roots, which was as an active, outdoor brand for men, competing against brands such as Eddie Bauer or Lands' End. Great fabrication, quality and design attributes, and improving the collection completely in time for a launch -- relaunch this fall, including labeling, collateral, and design elements that will bring to life the assortment at point-of-sale.

Worthington. Worthington as a collection has consistently been rated in one of the top 10 women's brands in America. Focused in on modern, career woman, we have rebuilt the entire assortment, leveraging fashion, design and tend to create a compelling assortment that we will bring to life at point-of-sale this September.

Stafford. Here too, our Stafford tailored collection has been in the top 10 national brands in terms of resonance with consumers. We saw an opportunity to return it to the roots, infuse it with better design attributes, better styling, better fabrication, introduce all new modern fit in addition to our classic fit, and introduce new career separates such as sportcoats, to ensure that we have the right assortment for the way our male guests dress today.

I would also like to update you on the 10 new shops that we talked about when we were together in January. These shops when we start to layer them into the mix, will powerfully transform our selling floor and reanimate our buildings in a way that I think is going to be astonishing in department store space.

The first of which I would like to talk about is Arizona Jeans. Here is our number one brand, loved by generations of customers. It really started as a young men's and youth brand and have been allowed to expand. We are giving it back its integrity and creating a powerful all-American assortment of great quality fashion denim and fashion items that will be sure to be mom's favorites.

This concept will roll into men's and women's and will be housed in an all-new shop. This is an example of the menswear shop. It is a similar version for womenswear that will transform our selling floors.

In January we announced a partnership with Phillips-Van Heusen, a tremendous partner, who we have been working with to take a heritage brand -- 80 years IZOD has been a fashion staple in America. And with new design elements and color and trends, we knew we had an opportunity to really position this in a cornerstone manner for our men's assortment. And are tremendously excited, not only by the product that we will be launching, but the fact that we will have one of the most exciting environments in retail to house this wonderful collection of product.

As I mentioned, Liz Claiborne, we have this brand that has been such a critical aspect of our customers' closets for years. Liz original vision when the brand was launched in 1976 was to pull the collection together in a way that was very different and very fresh and allowed the working female consumer to pull a look together with ease.

We really want to honor that, not only through the product that we have completely reimagined by the addition of categories like career and footwear into the mix, we will also bring it to life in this environment rolling out to all stores beginning this fall season.

jcp brand, as I mentioned earlier, in addition to having excellent fashion basics and fashion key items, with great quality, great fabrication at astonishing prices, will help transform our selling floor in both men's and women's with this shop. This is a version of the women's shop. These shops will be rolling out in September of this year in all stores.

Levi's. Founded in 1873, America's favorite denim and really America's uniform today, we can't be America's favorite store without having the most remarkable collection of Levi product. As we move into the fall season we will be opening shops for both men and for women in all of our stores in time for the back-to-school selling season. Now I am not sharing the details of the shop for competitive reasons today, but it will represent the most innovative and unique retail experience for Levi in the country.

We are excited to announce today jeans By Buffalo. This brand started in 1985 by David Bitton, has truly been a hallmark contemporary denim resource, and its empire span the globe from Montreal to London, and now jcp. We will be introducing Buffalo in men's and women's beginning in the fall season. It will be housed in a unique boutique that will create more excitement for our invigorated store base.

That is just a flavor for some of the concepts that lead to this 47% -- complete 47% newness in our merchandise assortment beginning in the fall. But I would also like to spend some time walking you through how spring has begun to come together. Through the remarkable partnership in the market, through the vision and passion of our merchandising, design and sourcing teams, we have had exciting opportunities to rethink how we want to create compelling assortment for the first quarter and beyond.

As Ron already said, we have 110 applications that we have begun to sift through. I promise not to walk you through all of them today. But I want to give you a flavor for some of the things that we will be bringing to life. We have an opportunity starting next year to do 30 of these shops. A few of the examples we will talk about today include the complete transformation of our Home World, which is going to have its cornerstone store by Martha Stewart.

We talked about our excitement of working with the legendary Martha Stewart -- who joins us today. Thank you, Martha -- to really transform our home experience. And you know, several weeks ago Ron and myself and a number of the merchants had the opportunity in a room about twice the size of this to view more than 3,000 items that were so powerful and so compelling and touched every room of the home. And we are tremendously excited to bring Martha's vision to life in a brand-new environment. Here is a rendering of Martha's home. Again, we know that this will be the cornerstone shop within a completely transformed Home World by March 1, 2013.

And, of course, with that as its cornerstone, we also know we have an opportunity to create an exciting neighborhood. So we have a couple of other announcements today, which are going to further transform the home experience for our customers.

We are tremendously excited to announce a partnership with Jonathan Adler for the collection called Happy Chic. Jonathan has been legendary for his aesthetics, bringing joy to home and creating unique remarkable assortments that deliver on style, fun, wit and class. And we believe that his collection will be completely unique, completely fresh and unique in department store retailing.

We are also announcing today that Michael Graves is joining jcpenney as we transform our assortment. I have had the great luxury and honor of working with Michael Graves for many years. He has put together for jcpenney the most comprehensive and innovative assortment of goods that range from functional to giftware that I have seen. Uniting it is Michael's consistent philosophy of great design doesn't have to be expensive. Innovative, fresh, compelling, this will truly be a remarkable addition to our mix. We are delighted to have you here with us today, Michael.

So these iconic elements, it is truly a breathtaking collection of home goods. Another announcement we make today is the partnership with Bodum. Bodum Design started in 1944 in Denmark, currently led by Jorgen Bodum -- with us today. Nice to see you, Jorgen.

This is a brand that many of us are familiar with for its functionality, for its innovation, for its trend, for its quality. And as we look to bring this to life we will do so in a manner that presents items from the collection in a manner never seen on this side of the Atlantic, with an all new shop environment, which will celebrate the uniqueness that is Bodum, the functionality, and allows us to consistently pulse newness and innovation and functionality throughout the assortment and throughout the year.

We are also announcing today a partnership with Sir Terence Conran, founder of Conran, founder of Habitat and legendary retailer, designer and restauranteur from the UK. Sir Terence Conran has created a remarkable retail force, a true lifestyle brand in the UK. And you may have seen it here, for example, at ABC. His collection for us is truly astonishing. It runs the gamut from furnishings to decorative home to lighting. And it is designed to have not only affordability, but great value at every level in terms of the design aesthetic, the functionality and the contemporary nature of the presentation.

We announced in January our collection -- a new collection we were creating with Nanette Lepore, a force in women's contemporary in America today. She is going to be taking her unique point of view and applying it to the younger crowd, the 13- to 19-year-old, for an entirely new and completely differentiated assortment for jcpenney, which will bring her same flirty and fun fashion to life for a younger consumer. We will be sharing more details about the shop concepts and the assortment as we get into the back half of the year.

Also, announcing today a partnership we are forging with Georgina Chapman. Georgina Chapman of Marchesa, you may know, had her first collection at 13. and has gone on to absolutely capture the imagination of both the red carpet and the couture market with her exciting vision and her amazing commitment to quality and design. We are working through specific knowledge we will share with you at a later date, but Georgina's new concept with jcpenney is expected to set in our stores by February of 2013.

Another concept we are announcing today is a licensing agreement with William Rast. William Rast was founded in 2006 by Justin Timberlake and Trace Ayala. Focused on premium denim and also categories -- great key item business in sportswear apparel for contemporary guests, things like -- and hoodies, and outerwear and other categories. This men's contemporary collection will help transform our men's assortment beginning in the spring.

Well, I mentioned that Nike is going to improve its positioning beginning in the fall season as we extend our partnership, as we roll this out into women's, as we take -- as we really create more compelling assortment. In the spring season we will be building out Nike shops for men's and for women's. This will be the most comprehensive and inspired collection of Nike activewear outside of the freestanding Nike shops, and unique for department stores in the country today.

And I'm also tremendously excited to introduce a new concept in partnership with Tourneau. Watch Gear by Tourneau for jcpenney will provide us with such excitement and transform our experience in fine jewelry and accessories.

Tourneau was founded in 1900, the leading purveyor of luxury timepieces. They are concept for jcpenney will give us exposure and access to brands that we have not been able to carry in the past. Will do so in a manner that is both exciting and that it brings to life products never before seen in the United States. As well as a collection of brands that allow us to gain parity with other retailers in the country who have had access to some of these brands in the past. All brought to life in a state-of-the-art shop that follows from the best practices that you have seen on Madison and 57th Street, one of the most exciting concept shops we have seen in a long time.

So that gives you a flavor for the remarkable, in fact, seismic shift in our merchandising assortment that will begin this fall season. Whether that is through the introduction of some thoughtful new brands, the expansion of long-standing brands that has been repositioned and renewed, the repurposing of brands that have been resonant with our consumers for many years that have been given back their integrity. The addition of 10 shops throughout the store, the ability to sift through so many remarkable ideas as we look at our vendor applications that have just come in.

As we start to map out 2013 we expect that we will have even more excitement to share with you in the days and weeks ahead as we finalize plans for fall, and as we begin to roll out concepts that will shape 2013.

So with that I would like to turn it back over to Ron.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Thank you, Michael. So that, I think, gives you a flavor of a lot of the merchandise work that has gone on, and that is in 90 days. There're a lot of activity, and that doesn't include the 110 applications, and it doesn't include a lot of things that are in development. It is just a smattering, but it will be profound.

I think about the home area, which I ran at Target, we are going to have 20,000 square foot home stores that are completely started over from the ground up in all-new shops next March 1. Anchored by Martha, with design partners like Michael Graves and Jorgen Bodum and Jonathan Adler and Terence Conran, it is profound. And then you add all the other houseware names from Cuisinart to Calphalon and all the great cookware, we are creating an experience like none other. And that doesn't talk about the experience we are going to create within the store, which we will talk about in about three months. So the teams are making progress.

Before the Q&A, I just want to make sure we summarize. Transition tougher than anticipated; transformation as scheduled. I hope you get a sense that we're making a lot of progress. We are acting like a startup. We are building a stronger team. The customers love what they find in the store. We are getting our message across. We're making progress on merchandising.

Our expense rate is coming way down. You think of $900 million out of expense rate in one year. Flatter layers, simplification. We are working really hard. And all these things are necessary as we go through the transformation. But we're just getting started. We are 90 days into it -- 105 days today, 109.5 on Saturday when we get to 30% of the way through.

Let me talk about guidance. We still stand by our non-GAAP guidance of $2.16 a share. We believe strongly that our marketing is going to drive more traffic. That 50%, 47% of the merchandise changing for fall will be a big deal. The 10 new shops with products like Levi and others will have a big impact on our business going forward. And that people are starting to understand our pricing strategy word-of-mouth is going to help the business. That combined with our expense savings give us confidence that we can deliver the $2.16.

We are taking off our GAAP guidance, and that is driven because of what we have learned. As an example, the aged inventory that Mike talked about, we think it is really important to convert that to cash. And rather than sitting with merchandise that is two and three years old, we want to convert it to cash to strengthen our balance sheet.

As we discover things like those we want to make the right business decision, and therefore we are going to remove our GAAP guidance, but stand by our non-GAAP guidance, which really is the earnings power of the Company going forward.

On one other note, on the dividend, we announced today that during the transformation as we move forward we will not be paying a dividend. And the reason for that is although we are generating a lot of cash -- you know, this year we're going to spend $800 million in our shops that are not maintenance. Those are big investments in the business.

We are going to repay some debt outstanding. We will generate over $1 billion of cash. We think more cash is better. Because with all of these shop applications we want to transform our store faster, because the ideas are there. And we think all that cash that we invest in the business will provide a higher return for shareholders, quite frankly, than giving a dividend.

And as our cash generation starts to exceed what we want to invest in the business, we will figure out how to give that back. But at this point in time during the transformation we have decided we really want the strongest balance sheet we can have and access to cash. And we have a good idea we can invest and improve the experience for our customer and improve the business for us.

All right. We will see you again back here in about 90 days. And I'm going to give you a quick agenda for that. At that time we will talk about our second-quarter results like we did today. We will give you another update on merchandise. We want to be careful not to get too far ahead. These things are better when you tell them at the moment they are announced. But we will then talk about our new technology platform. How we're going to win with technology and become I think the leading retailer from a technology perspective. And we will introduce you to our new store design and talk about how that rolls into existing stores.

But we have spent about an hour, hour and five minutes just telling you about the first quarter and we think that's enough for today. So I would like to turn it over to Q&A. And I would invite Michael and Kramer to come back up. In the front row we have a lot of other people from jcpenney who can help out. And as they are coming up, I would like to introduce our new CFO, Ken Hannah. If you can welcome him, and maybe Ken could say a word while we are getting set up here.

Ken Hannah - *J. C. Penney Company, Inc. - CFO*

Well, thanks, Ron, and good evening everyone. Look, I am really excited to be part of this leadership team and working together to create America's favorite store. I also look forward to working with each of you to help you understand how we are going to create value through this transformation and beyond. So stay tuned.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Thank you, Ken. All right, thank you, welcome, Ken. All right, we would love to turn it over to questions. We have got microphones on -- in all the aisles, so please go ahead. And I apologize, we do have a hard stop in about 25 minutes. So go ahead, please.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Congratulations on all you have accomplished. I guess --

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Could you introduce yourself for everybody please? I am sorry.

Liz Dunn - *Macquarie - Analyst*

I am Liz Dunn from Macquarie. So congrats. And I guess first question has to do with inventory. So do the charges that you're taking now in the first quarter, does that clean up the inventory so we won't be seeing the aged inventory charges going forward? That is my first question.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

Well, that is to be determined. We think that we have actually done our best guess in terms of evaluation of the aged inventory. But as Ron indicated, we are wanting to get rid of that and we will actually in a lot of cases sell that through other channels. They will not be sold through the store. We are going to try and recover as much as we can. The $53 million represents a realizable value that we estimated based on what we been able to liquidate similar product.

Liz Dunn - *Macquarie - Analyst*

And then just a point of clarification on the $900 million run rate by year-end. So does that mean -- is that a net, is that a gross?

Michael Kramer - *J. C. Penney Company, Inc. - COO*

It is a net. It is a net number. Ron and Michael are going to be inventing and we're going to be investing in the business. So they are -- I do anticipate increased cost structure, but the $900 million is a net number.

Liz Dunn - *Macquarie - Analyst*

Okay, and then just one more if I may and then I will let the rest. For Michael Francis. Sorry, that can get confusing. In terms of it seems like there is a lot on home, a lot on contemporary and a lot on denim. What are your next priorities for merchandise?

Michael Francis - *J. C. Penney Company, Inc. - President*

Those that I shared today do reflect areas where we have had gaps in our assortment in years past, and clearly recognize the opportunity at hand to transform home. When we get into the next round of decisions, as it relates to both ideas that we have been exploring and some of the newness, I think you can expect to see a thoughtful review of legacy brands and heritage brands that we have had in place for years that will simply be reinvigorated and restored within our shop environment, as well as the same degree of thoughtful newness and excitement in every category of the store.

So there has been a goal here to your reach younger consumers, new consumers, but not at the expense of our loyal jcpenney customers and some of the heritage brands that have defined us for so many years. They too will be renewed within this new model as we get into 2013.

Liz Dunn - *Macquarie - Analyst*

Thank you very much.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

If I could add on the inventory. You know, every company has a different philosophy toward inventory. A lot of people in retail have had the old adage, pile it high and watch it fly. You have seen that in a lot of stores, a lot of inventory.

This whole team, we all believe, like Michael said, turning inventory creates a much better business model. And this is a fundamental change for us, and so we are tackling the inventory challenges here.

We have found the aged inventory. We hope there is no more, which will help us get it through. But the big idea is to get the inventory turning faster with more frequency. That is going to strengthen our balance sheet, but it is giving us much more flexibility. And inventory it is a major initiative of ours, and it is going to be profound how much cash that can generate for us.

But when you think of that slide earlier, about we are getting higher margin on our regular selling, as our inventory goes down, we will have less clearance markdowns. So getting that margin over 40% is really tied to an inventory strategy that has much greater flow and much lower absolute levels of inventory. So we are working very hard on that.

Matt Boss - *JPMorgan - Analyst*

Matt Boss, JPMorgan. Can you talk about the store-in-store opportunity? From the perspective of each of these brands should we expect them to be in all stores or is this a relationship in terms of a brand by brand decision?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Sure. I will try, Michael, and you can go ahead. Everything -- we have a little over 1,100 stores. We want to get as much as we came into all stores. But in most cases when we launch a shop it will go on our largest stores, what we call our ABC stores, which total just under 700. And so we will go through that as we give the detail of March launches. But they will go into 700 stores in their full glory.

And the sizes will vary. We have three types of installations we will do. Our largest are called the stores, like we are going to have Martha Stewart, where it almost had a complete storefront. It feels like a big thing. Those are about 2,000 square feet. They are very large. And we will do those in home; we will give them elsewhere, but very selectively.

We then do shops, which are a minimum of 500 square feet. And that is a lot of space in a retail store. The third type of thing we have is called a boutique. A boutique is about 300 square feet. It might not have all the walls, but it gives you a very nice presentation. That is close to what you would see at Selfridges in the UK.

So we have a variety of shops. We will vary by products, things -- how many stores it goes into, but I would count on about 700 stores for most shops.

Matt Boss - *JPMorgan - Analyst*

Okay, and then my second question would be did you see a difference in performance between your A&D doors, as opposed to your C&D doors? And any update on your thoughts around real estate in terms of some of these underperforming stores?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Sure. If you look at the -- we track the performance. A, B, C, D, all the way down to our E and our small stores. Our best performance in the quarter was in our smallest small-town store. So I think they took the time to really understand the pricing strategy.

The performance in all other markets was virtually identical within 1% of the performance. We think that means we have a broad-based opportunity to improve people's understanding of our pricing and drive traffic, if that makes sense.

At this point in time we continue to expect to operate all of our stores. We haven't spent a lot of time looking at productivity of stores. That is clearly a long-term question we have got to get into. With Ben Fay starting next week he will be responsible for store design, real estate and construction. And so one of the priorities with his team is to really start to work and evaluate the portfolio. Ken Hannah is here to do that as well. So we will be able to provide more of an update on that going forward, but that has not been an area that we have put a lot of cycles into this early in the transformation.

Matt Boss - *JPMorgan - Analyst*

Great, thanks.

Bill Drare - *UHUSA - Analyst*

[Bill Drare] from [UHUSA]. At the last meeting in January you mentioned -- or one of your members mentioned that jcpenney could essentially have any customer demographic they wanted. Can you give us a sense as to what you have seen over the course of the quarter and where you think that may be headed?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Michael or John, do you want me to that or it does it matter?

Unidentified Company Representative

Well, I would say as we look at initial data we are seeing whether it is through credit card activation or frequency work, we have engaged a younger customer. Where we have seen -- an offset has been an older guest, particularly those who were so dependent upon the consistent stream of couponing through direct mail programs and our former loyalty initiative.

It is too -- at this early stage it is hard to say with precision how that mix is changing. But when we get into the back half of the year with the additional work we are doing to better manage our database and understand what is happening with consumer preferences, as well as the changes we are making in assortment, we expect will help ensure that we are onboarding new customers. We should be able to provide you with greater detail at our August session.

Bill Drare - *UHUSA - Analyst*

Okay. Just connected with that you announced the Tourneau store. And that might have a -- at their 57th Street store a very high demographic compared to your core customer. Will you be skewing that merchandise selection towards the lower end like you do in the floor stores now?

Michael Francis - *J. C. Penney Company, Inc. - President*

I think with all of the shop concepts we are engineering the assortments that will be relevant and consistent with expectations for our customers. So, yes, all -- pricing becomes an integral piece of the way we are building assortments in all of the examples I shared today, including Tourneau.

Bill Drare - *UHUSA - Analyst*

That's great. Thank you.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

We shared -- we are kind of selective in which shops to share, because a lot of this we're keeping very confidential. But we wanted to show you the range of types of shops. So Tourneau is going to do for watches, as Michael said, what Sephora did for cosmetics. It got us access to all the brands in a really wonderful shopping environment.

We all know Tourneau. There's no place to buy watches like here on 57th and Madison. Everything is presented by brand. You have great assortments. The Tourneau team is working with all their suppliers in talking about which ones that want to be in jcpenney, and which are the right ones for us. We will clearly get into price points we have never been in before, but we won't be as high as 57th Street.

But it will get us a relationship there that brings us to watches the same kind of balance that we have seen an important center core strategy that we had in cosmetics. Does that make sense?

Bill Drare - *UHUSA - Analyst*

It does.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

So we can do retail partners. We can do design partners. We take a design partner like Nanette and we do the sourcing. We can do big brands, and that is a real big part of our focus -- Levi, Nike, that want to put in strong statements. We can do shops in categories we are not in today, and we will tell you about those going forward. There are a variety of categories we are not in, whether that is including beverage or other hard-line categories.

So if you go forward you learn more about our shop strategy, but it is really pretty unlimited once you create separate spaces for products. And we are very excited about that, but for competitive reasons we don't want to do too much of that today.

Bill Drare - *UHUSA - Analyst*

That's great. Thank you.

Carla Casella - *JPMorgan - Analyst*

Carla Casella from JPMorgan. Just one clarification. You mentioned you intended to generate about $1 billion of cash flow, and you're going to put about $800 million in your shops. Is that -- a $1 billion is that before CapEx or is that after?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Before.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

Before.

Carla Casella - *JPMorgan - Analyst*

Okay, and the shops will be included in the CapEx?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Correct.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

Correct.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

What I am trying -- what I want to make sure people understand is during the transformation we are still generating significant amounts of free cash flow. And we are investing in things that we think will provide extraordinary returns going forward, like our shop strategy.

And so we think it is really pretty -- a pretty big accomplishment that during a year of so much change to the business model, we generate cash that we can invest in the business. And that is the point we're trying to make.

Carla Casella - *JPMorgan - Analyst*

Great, thanks.

Chuck Grom - *Deutsche Bank - Analyst*

Chuck Grom, Deutsche Bank. Just so we are on the same page on guidance, what is the expectation for comps for the balance of the year? Are we thinking still down 15%, plus given the SG&A pull forward of $900 million?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

We are not providing any sales guidance. What we said very clearly is we expect sales to improve as we go through the year. And the reasons we have confidence in that is we are going to update our marketing meaningfully, which we think will get our message across. We think over time it is just going to get better as people understand.

Half the assortments will be new. The customer is already voting for fashion in the store. We see that in these first three months. Most of what Michael talked about are changes in our content that update the fashion. Fewer key items because we are not driving the business promotions like you do with key items. We think that will help.

We think inserting 10 shops -- free-standing shops in our stores will help the volume. So for those reasons we believe our sales will improve in the back half. But we are not going to provide guidance as to the pace of how that will improve or the exact number for the fall.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

And let me add to that, with the illusion that we are cutting more expenses because we anticipate, they are mutually exclusive. We are looking at efficiencies in the organization and simplification of process. And we are going to go at the pace that we can to execute well and with the resources that we have. And I'm confident based on what we have uncovered and the resources that I have to actually accelerate.

Chuck Grom - *Deutsche Bank - Analyst*

And then just to follow up. Can you maybe just give us -- shed some light on employee morale at the Company given all the job cuts and the changes to commissions?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Yes, I will take that on. It is really -- it is hard to know from where I sit. My instinct is there are a -- I think most people embrace the change. The store employees love working in the store. It is a much better place to work. They talk about it every day. It is easier to take care of customers. They are not fighting at the registers. The stores are cleaner. Without the big Saturdays, like from the coupon days, we don't have as much recovery.

The employees love it in the store. As we went through the commission change, it is very clear that most employees are thrilled with that, because during this year of transformation our sales are down. They were earning less money. We have reinstated their pay at last year's earn rate in 2011, so it is like giving them a raise in the middle of a transition.

And they are now starting to work in teams. Most people love that. But they are going to be a percentage, whether it is 10 or 20, who might see it as it missed the chance to earn even more. But I know with every bone in my body that a commission -- a noncommissioned force will create better customer service, better teamwork over time.

THOMSON REUTERS

And so I think anytime you go through a lot of change, you're going to have challenges with morale. But overall I am pretty pleased with how the teams are doing. And the ones I work with are very excited about where we are headed. You can talk to them here. But I'm not going to pretend that it is easy at all, because we are putting through a lot of change.

Chuck Grom - *Deutsche Bank - Analyst*

Okay, thanks, good luck.

Adrianne Shapira - *Goldman Sachs - Analyst*

Ron, it is Asrianne Shapira with Goldman Sachs. In January you talked about jcpenney having a 3% share. And if you just kept everyone happy and added two people, 10% lift.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Correct.

Adrianne Shapira - *Goldman Sachs - Analyst*

$30 billion potential. Knowing what you know now, given that you probably underestimated the importance of couponing to the jcpenney customer, how are you rethinking the volumes that you're willing to walk away as you're thinking about 2012 as a transformation year and 2013 as a take-off year?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

That is a great question. I think the argument I have always made is if you can keep the customer you got, that is job number one, and then you layer on new customers. We are clearly going backwards. We don't have great data yet if we are losing a customer. Because remember our customer only came in four times a year last year. People had one chance to come in. And the other thing we know is that the customer hasn't gone to our primary long-term competitors.

If you look at Kohl's performance for the quarter, they comped essentially flat, up 0.2. And that was with more value being offered according to their earnings report. So our customer who didn't get the coupons didn't run over to Kohl's, it doesn't look like.

Macy's have said they saw some evidence that in stores that are related to Penney's they had a little more sales. But they comped at 4.4%. Well, they comped at 5.2% and 5.3% the last two years. So they are actually performing at a slightly lower rate than the past 24 months. So they're not running over to Macy's. So where are they going?

I think the big part of it, quite frankly, is they are not filling their underwear, their sock drawer, their towels with basics. The business set down versus basic. I think we triggered a lot of consumption by our customer that they aren't doing today. But I don't have a lot of evidence that they're going to our competitors.

All of our branded partners say the same thing. When they look at the marketshare by category, they see us being down. They don't see a pickup, obviously, in the market, like they went here. So I don't know that we are giving up customers. Our customer is clearly buying less, with fewer visits in the short term. But we want to earn her back, earn him back, and we're going to work really hard at that.

Adrianne Shapira - *Goldman Sachs - Analyst*

And maybe just a follow-on to that. If volumes are dropping in basic, and it seemed like a lot of the new shops and the new brands that you shared with us were a lot less basic.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Right.

Adrianne Shapira - *Goldman Sachs - Analyst*

It seems like a much more edgier fashion and you are kind of rethinking bringing back a lot more innovation. So how are you thinking about, if you're dropping in basics, how are you going to --?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

We think -- we are going to win in basics. But here is the issue. All of our basics, and we have discovered this -- one of the learnings over the last 90 days. How do we configure them? We configured them for a promotional strategy, which means you want to sell them in big bulk, so you can sell big savings.

So I'll give you an example. In dinnerware, we had 72-piece dinnerware sets. Now I don't know who needs 72 pieces of dinnerware, but that is what we sell. Why do we do that? So you can say save $100 on dinnerware. If you go to Crate & Barrel, Pottery Barn, Sur La Table, they start by selling dinnerware open stock. And if they have sets, they are up to 16. If they do drinkware it is in four packs.

Everything we carry today is in 16, 32 piece, 72 piece set. Because that was our former strategy. We have got to reconfigure all our basics. That is true for underwear. That is true for socks. So we are in the process of doing that. We have got to get our merchandise aligned with our new pricing strategy, and those things just take time. Does that make sense?

Adrianne Shapira - *Goldman Sachs - Analyst*

Yes.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

And we have shops for basics too. We had Gold Toe. Why not put in a Gold Toe shop? And that is something we could do if we want. So the basics are something that are really important to us, and we haven't talked about them yet, but they will be a big part of our future.

Adrianne Shapira - *Goldman Sachs - Analyst*

Okay. And then just a last question. You mentioned Macy's, Kohl's, what they're doing. What has been the competitive response that you are seeing out there in terms of whether it is to the pricing strategy or how you are rethinking the --?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

My instinct is that competitors are competing as they always have. I don't think there has been a major competitive response to our changes that I have picked up, either in the market, from our stores or in the competitor announcements.

And if the business has gone anywhere, when I look at it, it is the higher performing retailers lately in apparel have been -- Target had a little bit better spring in apparel. TJX announced good results today. Old Navy, a little bit.

So what is happening I think is they are all moving to everyday price strategies. Isn't that interesting? TJX and -- they are 40% off every day. Every day is a great day to shop. Target is primarily everyday day a great day to shop. Shallow discounts for a week, like we have shallow discounts for a month.

Old Navy -- so it is interesting that they aren't going to the promotional strategy. We don't know where they're going, it is too hard to tell. But if anyone is benefiting it is people that sell goods at everyday, which is kind of interesting.

Adrianne Shapira - *Goldman Sachs - Analyst*

Thank you.

Deborah Weinswig - *Citigroup - Analyst*

Deborah Weinswig, Citigroup. As you look at the data would you say that there are certain categories where it has been more difficult for the consumer to understand the pricing strategy? And if so, what are some of the changes you are doing to correct course?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Absolutely. Michael (inaudible) do you want to?

Michael Francis - *J. C. Penney Company, Inc. - President*

Well, I think we see it at a macro. We are certainly -- as we said earlier, we are seeing great success in fashion. But I think overall we have a clear opportunity to better communicate our value proposition. You have started to see some changes. You're going to see extensive changes as we move into May, June and July to further that. But really I think it is true throughout the store.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

But if I were to take three categories that we have really struggled with, it would be fine jewelry. And we talked about that, I think, in February on the earnings call. Fine jewelry, the most high low of the things, 60%, 70% off, billion-dollar sales. And we made a mistake there, and I'll talk about that. Home in general has been tough for us, and then basics. Basics, towels, underwear, socks have all been the softest areas of the store.

On the fine jewelry side, we have actually lowered in March all of our fine jewelry prices, so everything went to pure everyday. The team there thought, you know, fine jewelry really is a promotional business, let's do 20% off as a month long value. And they found that in a savings wasn't as good compared to 50%, 60% or 70%. So we made the pricing adjustment in March, I believe -- Pam, is that right? March/April? April 1, changed all the pricing in jewelry. We have seen meaningful improvements in the business.

In the home area the same way. We have repriced a large part of home during April to get price better for everyday. Instead of relying on these month-long values, we have gone much more everyday. We have changed their pricing once already on all women's -- you know, underwear, panties, and all that kind of stuff. We are going to do it again, because we went from eaches to a multiple of 2, and it is very clear they like 5s every day. So we are making adaptations as we go, but I think those are the categories that are the toughest.

Deborah Weinswig - *Citigroup - Analyst*

When I thought about one of the PowerPoint -- one of your PowerPoints when you put on the shared -- so Friday, Saturday Sunday traffic and the opportunity with Town Square, will that be one of the significant drivers as you look forward to 2013 to get some of that traffic back?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Yes, you will learn in August as we talk about our new store design as we talk -- we are going to create what we would like to think of as a new interface for retail. But it is all about creating traffic outside of the products.

And there will be a lot of ways we bring people in. We have got a team that is working on it who is very energized by that. But we will talk about that -- but that is a big part of the magic here. We've got to learn to drive traffic in new ways. The old way was a coupon or a sale. The new way is through different things. It is products; it is service; it is a variety of things, and you will learn about that in August.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

And I might just add that in addition to some of those new initiatives coming on board for August, we are not waiting until August. Beginning last week you'll start to see a regular Win the Weekend strategy that is unveiled first in ROP, but it is rolling out into multimedia, which ensures that we have the right momentum going into every weekend, to ensure that we have focus on our month-long values and clarity around our everyday pricing. So we intend to have a consistent cadence of messaging, which should help us to mitigate the decline in traffic that we have seen for weekends.

Deborah Weinswig - *Citigroup - Analyst*

Great, thanks so much.

Unidentified Company Representative

I'm sorry. We had time for really one more question.

Michael Exstein - *Credit Suisse - Analyst*

Michael Exstein with Credit Suisse. Thank you for the opportunity to meet with you all today. Can you talk about the impact of the SG&A reductions on sales? Every company I have ever followed that has emphasized significant cost saves has had a hard time estimating the impact on sales.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

I will start. What I will tell you is that you have to really take a look at the base from what you're starting from. And I would tell you that historically over the past five years of sales declines, we have not been reducing our labor force in the stores. We have an overly managed labor force in the stores and an over-processed organization within the stores.

We are trying to simplify. We are trying to simplify based on that base. Do you have anything you want to add?

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

I think it is something we are watching very carefully. Clearly we want to develop a high service model. And you'll learn about strategy in August that will enable that, that we put employees that formally did other functions into taking care of customers. But if you look at the data for the spring that Mike showed, the 10% traffic dropped our sales.

The balance was 1 out of 100 fewer people bought something when they came in. We had 21 buy instead of 22. So maybe a little better contact or something might have lifted that up. I think the bigger thing though was not having a coupon in their pocket or their hand, and not really understanding the pricing within the store.

I don't think it was lack of employee contact. As you saw, we had 6 points higher for employee engagement, so I don't think that is causing it. But it is something we have really got to watch going forward, because that connection between the employee and customer is really important, as we have seen in our Sephora shop, as we have to do with Martha's Kitchen, and so that is an issue we care deeply about. I do not think it has impacted us to date. I don't believe it will going forward, but we are going to watch it very carefully.

Michael Kramer - *J. C. Penney Company, Inc. - COO*

And let me add to that too. Back in January when we talked about this, again, using Kohl's as a barometer, we actually had highlighted $400 million of additional payroll in our stores as compared to Kohl's. And they have a higher productivity than we do. $400 million. So there's a lot room there.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

(multiple speakers) mix of business too. (multiple speakers).

Michael Kramer - *J. C. Penney Company, Inc. - COO*

There is definitely some different mix in business. As I said today, we have some much more labor-intensive aspects of our business. And just like Ron said, we are going to monitor that. We are definitely going to monitor that. But I actually think that our stores' organization has performed incredibly well during this transition so far.

Michael Exstein - *Credit Suisse - Analyst*

It has, and the execution in the store is terrific. And just quickly, we've been fortunate enough to be able to monitor some of the comments on Facebook. And the Facebook comments don't be seen to be coinciding with some of the statistics that you-all cited today..

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Can you give us an example?

Michael Exstein - *Credit Suisse - Analyst*

We polled Facebook on Friday, and I think about 80% were negative comments of one variety or another.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

With regard to --?

Michael Exstein - *Credit Suisse - Analyst*

What was going on at jcpenney, whether they missed coupons, whether they didn't like the advertising program. It was not the type of feedback -- and obviously it is an imprecise (multiple speakers).

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Well, I think the -- here is the answer, I believe. I don't know that is a great survey, but it is all information. The best information we have is people who come to the store like what they find. I am 100% confident in that. The surveys have been clear from day one and it is continuing to improve. That is real people just putting in surveys. A year ago we paid them $10 to put a survey in. Today they are just surveying, so there's no incentive.

Secondly, the employees, you go talk to employees, they will tell you that customers like the experience. They will say that some miss their coupons. I heard that. But the broad opinion within the store is they love the experience.

But what we don't know, which is what you are referring to, is the non-buyer. So people who aren't coming with our traffic being less, what are they thinking? We've got to figure that out. But I think realistically people really like what they're finding at jcpenney. I hear it every day. We just got to keep working at it.

Michael Exstein - *Credit Suisse - Analyst*

Thank you.

Ron Johnson - *J. C. Penney Company, Inc. - CEO*

Well, thank you all for coming. We will see you in August. And we really appreciate your coming so late at night.