THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

JCP - Q2 2019 J C Penney Company Inc Earnings Call

EVENT DATE/TIME: AUGUST 15, 2019 / 12:30PM GMT

OVERVIEW:

JCP reported 2Q19 adjusted net loss of $56m, or $0.18 per share.

CORPORATE PARTICIPANTS

Bill Wafford *J. C. Penney Company, Inc. - Executive VP & CFO*

Jill Ann Soltau *J. C. Penney Company, Inc. - CEO & Director*

Kelley Buchhorn

CONFERENCE CALL PARTICIPANTS

Charles P. Grom *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Damon Joseph Polistina *Deutsche Bank AG, Research Division - Research Associate*

Heather Nicole Balsky *BofA Merrill Lynch, Research Division - VP*

Richard Frederick Magnusen *B. Riley FBR, Inc., Research Division - Associate Analyst*

Ross A. Collins *Cowen and Company, LLC, Research Division - Associate*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the JCPenney Second Quarter 2019 Earnings Conference Call.

(Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Kelley Buchhorn, Director of Investor Relations. Ma'am, you may begin.

Kelley Buchhorn

Thank you, Shannon. And good morning, everyone.

As a reminder, the presentation this morning includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which reflects the company's current view of future events and financial performance. The words expect, plan, anticipate, believe; and other similar expressions identify forward-looking statements. Any such forward-looking statements are subject to risks and uncertainties, and the company's future results of operations could differ materially from historical results or current expectations. For more details on these risks, please refer to the company's Form 10-K and other SEC filings.

Please note that no portion of this presentation may be rebroadcast in any form without the prior written consent of JCPenney. For those listening after August 15, 2019, please note that this presentation will not be updated, and it is possible that the information discussed will no longer be current. Also, supplemental reference slides are available on our investor relations website. While management will not be speaking directly to all the slides presented, these slides are meant to facilitate your review of the company's results and to be used as a reference document following the call.

Joining us on today's call are Jill Soltau, Chief Executive Officer of JCPenney; and Bill Wafford, our Chief Financial Officer. Following our prepared remarks, we look forward to taking your questions.

With that, I would now like to turn the call over to our CEO, Jill Soltau.

Jill Ann Soltau - *J. C. Penney Company, Inc. - CEO & Director*

Thank you, Kelley. And good morning, everyone.

Today, we will begin sharing more insights from where we have been as a company and the holistic approach we are taking to reposition JCPenney to its rightful place in the retail landscape. We are rebuilding our foundational practices and applying discipline throughout all areas of our business. I am confident we will return sustainable, profitable growth to JCPenney. Before I go further, I want to take a moment to briefly comment on a recent situation with the China tariffs and our New York Stock Exchange listing status, and then I'll turn to our second quarter performance.

As I discussed last quarter, given the strengths of our internal sourcing capabilities, we have been proactive in developing contingencies for sourcing our private brands for nearly a decade and meaningfully diversifying our country of origin. This has allowed us to significantly reduce our exposure to China, which is already lower than apparel industry averages. As a reminder, there is minimal impact on our business resulting from the first 3 tariff tranches that are already in place, including the increase on the third tranche that went into effect in May. We are currently evaluating the details related to the fourth tranche of tariffs recently announced, and our teams continue to work through derisking efforts.

Turning to our New York Stock Exchange listing status. As we shared in our release on August 8, our 30-day average closing share price fell below $1 on August 5. We have every intention of increasing our share price to above $1 through the improvements in our operating performance or, if necessary, via other remedies available to us.

Now on to second quarter performance.

Our critical focus on generating cash flow and maintaining ample liquidity remain top priorities for JCPenney. We are reestablishing and rebuilding the foundational practices needed to strengthen our day-to-day business. The expectations we set for 2019 are built with a deliberate focus on restoring the discipline required to enhance inventory management and productivity, lower our cost of goods sold and return growth in a sustainable and profitable manner. I am pleased with the results we delivered this quarter and the progress we are making against our plan. While we still have work to do on our top line, I strongly believe that growing sales in an unprofitable way is simply not an option. The only way to reconstruct the business is through a holistic approach across all the key tenets of strategic, purposeful and effective retailing. Notably, this quarter, the meaningful improvement we delivered in cost of goods sold was driven by lower permanent markdowns, improved shrink results, increased store and online selling margins and the exit of major appliance and in-store furniture categories. Additionally, we reduced inventory by 12.5%, as we continue to reinstate the discipline required to improve the inventory management and productivity. Bill will provide an in-depth financial update on the quarter, including our sales, merchandise category and gross margin results later on the call.

Let's move now to the discussion on the evolution of our company by sharing some details on what we have been doing. This is a critical time for JCPenney, and I want to be clear that we are tackling challenges while shaping the future of this company. Everything we are doing at JCPenney continues to be guided by our key objectives. We are committed to serving the customer and growing in a sustainable and profitable manner; prioritizing what we do and applying discipline to ensure we're focused on work that adds the most long-term value; building capabilities to support our priorities so the team is equipped to deliver on these goals; and finally, developing a results-minded culture focused on accountability, urgency and innovative problem-solving at all levels of the organization. We can only accomplish this if every associate at every location and at every level is working towards these goals. We are setting this expectation, starting at the top.

I am energized by the senior leaders we have added since I joined JCPenney. We have attracted top talent in the industry, and each of these passionate leaders made a choice to come to JCPenney at this pivotal time. They, along with our valuable veteran senior leaders, are working tirelessly to restore health back into our business; and together we are finalizing our strategy. I am passionate about this team. And I am energized by their infectious drive, commitment, vision and most importantly their ability to deliver.

We recently added 2 more keys leaders to our team. First, Jim DePaul is our Executive Vice President of Stores and is just completing his second week with us, reporting directly to me. He is a highly accomplished field executive with nearly 25 years of retail experience. In this role, Jim will be responsible for improving our in-store and omnichannel operations as part of our continued focus on transforming the customer experience to grow traffic, engagement and customer retention. Jim joins us from Shopko stores, where he spent over 20 years, recently serving as Chief Operations Officer; and most importantly, leading stores, store operations, store development and loss prevention. While there, he made key improvements to customer service scores, reducing operating expenses; and improved shrink and overall productivity. During his tenure at Shopko, Jim also oversaw supply chain, inventory management, planning and procurement. Second, Stacey Shively is joining us as Senior Vice President, General Merchandise Manager of Home responsible for all the -- for overseeing the company's merchandise strategies that span all the product categories in the home store, including bedding and bath, window coverings, small electrics, home electronics, luggage, seasonal and home decor. Stacey is an accomplished merchant who has spent her nearly 25-year retail career curating products and experiences that appeal to a value-oriented customer based on lifestyle needs. Stacey joins us from Bluestem Brands, where she most recently served as Senior Vice President of Merchandising overseeing a broad selection of name brand and private label general merchandise for a portfolio of national multichannel retail brands, including Gettington and Fingerhut. While there, she is credited with enhancing revenue and sales, optimizing assortments and vendor partnerships as well as implementing new pricing strategies and cost efficiencies and driving gross margin improvement.

I am delighted to welcome Jim and Stacey to JCPenney. They will further expand our strong team of highly accomplished leaders. Our entire leadership team are all customer obsessed, believe in the JCPenney brand and are here to drive our company to its rightful place.

Now let's move back to our objectives. We are laser focused on 2 parallel paths. One is building a framework to reestablish the practices needed to strengthen the day-to-day operations of our business. Concurrently, we are developing differentiating, transformational initiatives. We are working with speed, urgency and a relentless focus aimed to reconnect with our customers on their terms, with a deep understanding of how they live, shop and interact with JCPenney. And with that comes the rigor surrounding our efforts to date and those that we will continue to do.

I want to be clear in what we're doing. We are not simply running a business. We are rebuilding a business. And while this will take time, we have made solid progress, and I am confident we will continue to do so. We know there is a lot of questions about what we've been up to. The short answer is, a lot. The long answer is much more complicated. Take a step back for a moment and think about the amount of change this organization has gone through over the last decade. In doing so, you can appreciate the magnitude of erosion there has been in our foundational retail operating and -- practices. The journey we are on will restore health back into our company. It is an ongoing process, and the proposition we are implementing is for the long term. Our practice has been and will continue to be to take a deliberate do than say approach. We've taken this approach because we know we need to earn it: earn the interest, consideration and business of our customers; earn deeper, better, more innovative relationships with our vendors. We must also earn the confidence of our investors and other key stakeholders so that they know we are riding the business and generating returns. With that, let me update you on the progress we have made in executing against our immediate actions, which continue to prove valuable as we begin our journey to sustainable, profitable growth.

First, our continued efforts to reduce and enhance our inventory position. As I stated earlier, our inventory levels were down 12.5% this quarter. Both our enterprise sell-through rates and selling margins increased in Q2. Additionally, we are improving the management of our markdown and clearance cadence. Our actions led to a -- lower permanent markdowns, contributing to nearly half of our cost of goods sold improvement this quarter. Second, we are strengthening our integrated omnichannel strategy as we focus on returning to growth in e-commerce. As we shared last quarter, we've removed unproductive and unprofitable factory-shipped SKUs from our website. We continued to reap the benefits from our efforts, as our online gross profit improved in Q2, which has helped driving improvement in our total gross margin results. We are improving navigation and presentation while curating the assortment to provide an easier shopping experience across all platforms, desktop, mobile and our app. This has resulted in improved conversion and customer service scores year-over-year.

Third, we are improving and redesigning core store processes that will benefit our customers directly. Last quarter, we launched a new checkout process that streamlines tasks and provides an enhanced customer experience. We have received positive customer feedback and we've seen significant improvement in key customer service scores. As I discussed last quarter, we've tested a new centralized pickup and returns area that improves not only the in-store experience but is also a step towards a better omnichannel customer experience. As we committed to last quarter, we have now rolled this out to nearly 500 stores. And lastly, we remain focused on improving our shrink results. For the second quarter, we delivered an improvement in gross margin. Our investments in technology and improved staffing around high-shrink stores and categories have enabled us to reduce our level of shrink.

I also want to highlight the strong relationships we have with our valued vendors and key partners. Delivering on our customers' expectations relies heavily on our vendors and the portfolio of brands we offer at JCPenney. The ongoing dialogues and interactions we are having with our vendors are strong and positive. They're equally excited about our direction and are bringing new ideas and innovating with us. They continue to demonstrate their belief in JCPenney.

With that, our new Chief Merchant, Michelle Wlazlo, who joined us in March; and Shawn Gensch, our Chief Customer Officer, who joined us in June, have been quickly unpacking and aligning merchandise and marketing strategies for the back half of 2019. We know we haven't been relevant in all of our merchandise categories, and for the past 5 months, Michelle and her teams have been aligning our merchandise assortment and choice counts with the trends, quality and styles for our customers. Given our lead time, the teams made adjustment where possible to influence the assortment and relevance of trends for the back half of the year. Shawn and his team have been focused on reviewing all areas of marketing and media strategy and are taking action to become more intentional in both our brand voice and customer engagement. Together, Michelle and Shawn are effectively influencing change and aligning our creative with our merchandising strategy for fall and holiday.

As an example, in back-to-school we were able to strengthen top looks in the most-wanted merchandise categories, along with driving a more dominant positioning of our national brand denim. This is being supported by fresh creative storytelling across all marketing channels and touch points. For fall, we are amplifying and coordinating key trend statements across all women's brands as well as expanding national brands in our active portfolio. You will see a shift in the look and feel of how our merchandise comes to life in this key fashion season. For holidays, JCPenney will deliver an experience our customers have not had in years. Our products will come to life through cohesive and coordinated storytelling online, in stores and through every customer touch point. We are excited to introduce market share leading national brands into our home store this holiday. As you know, we have incredibly strong and relevant national and private brands in our portfolio. Much of Michelle's efforts to date have been focused on further defining, expanding and improving our brand positions. She is also influencing, enhancing our visual merchandising effort. The teams are improving the standards of how we display and showcase our product through the store, starting first in women's apparel through better utilization of fixturing and mannequin displays. This will come to life in key locations, starting in fall.

I share all of this with you to illustrate the magnitude of effort required to [re-port] the foundation of our business. With that said, there is much left to do, as we've only impacted a small percentage.

Turning our attention to transformation. We are at a point in our journey where I can now share specifics on our customer insights work and how this is shaping the transformation of the JCPenney brand and helping to rebuild the business.

My entire career has been in retail, with a keen focus on the customer. I know the importance of building a relationship with the customer that is foundational; and demonstrating that we understand them, value them and make their life easy. Since I arrived last October, everything we have been doing has been centered around more deeply understanding our customer. We have gone through a very rigorous, data-driven process conducting both deep quantitative and qualitative research with our customers. We've sought feedback from thousands of JCPenney customers as well as non-JCPenney customers to fully understand what is in their hearts and on their minds, both for us and the industry as a whole. Today's customers engage in a way we've never seen before. Their expectations are higher than ever, and we must rebuild our business around meeting their expectations. Every functional area of this company is committed to focusing on the customer first. We know that to renew the JCPenney brand we must reconnect with our customers and build experiences to support their lifestyles. Consumers today are not influenced by what they hear individually from any brand. They are influenced by everything that they absorb in their life.

The work we did in understanding our customer was a deep and lengthy process, and the importance of the insights gained cannot be undersold. We are using this information every day and executing against our learnings. Michelle and her teams are developing brand architectures that are aligned with how shoppers live, supported by a strong position of both private and national brands, each with a unique place in our portfolio. At the same time, Shawn and his teams are using these insights to adapt to the shifting expectations of consumers and the way that they are consuming media and buying products. Leveraging this connection with our customer will create a deeper emotional relationship with them and guide each of our interactions. It will be through innovation, personalization and clear differentiation that will enable us to ultimately drive traffic and capture share of wallet. We will fully respond to what they want from us, what they need from us and just as importantly what they are giving us permission to be.

Our new partnership with thredUP, the world's largest online consignment store featuring like-new styles from leading designers and brands is a great example. With the exponential growth in resale, there's no doubt that demand for affordable luxury is at an all-time high. There is an emotional thrill that comes with finding a high-quality secondhand product for much less. While there are more secondhand shoppers than ever before, we'll continue to test and evaluate how this resonates with our customers. We're excited about the prospects of creating a new in-store experience that makes high-end brands attainable, as well as catering to eco-minded consumers who want more sustainable options in their wardrobe. Offering a seasonal array of resale handbags and women's fashion, the thredUP assortment will be uniquely branded in 30 stores with a 500- to 1,000-square-foot presentation. We are in select markets, starting this week. JCPenney shoppers will discover quality brand names and designer merchandise at compelling price points.

Switching gears to online customer behavior. No one can argue with how easy it is to shop online and drive growth in this channel. And while sales have slowed over time in stores, over 80% of our sales today are generated in a physical JCPenney store. We know we need to look beyond how we have always used our physical retail space and turn it into a competitive advantage. We've taken the learnings from our customer research and created store design and merchandising ideas that are at work in a test store environment reflective of the JCPenney brand. We have the benefit of a large footprint in the U.S., allowing us to leverage our physical space, which gives us the capacity to test customer insight-driven ideas directly. These tests have been designed to be bold, swiftly executed concepts driven by improvement in customer experience and enhanced customer engagement. As such, we can quickly tell what is resonating with our customers and what can be rolled out more broadly. Given these tests are capital-light projects, we have the capacity and are positioned to build scale and impact a broader range of stores. While we are still testing these concepts, we are very pleased with the early results.

Today, I'm excited to share one compelling concept that improves the fitting rooms and the adjacent area in our women's apparel department. We are calling this test concept the styling room. We enhanced the fitting room to create an inviting space where our customers try on clothes in a bright, fun and welcoming atmosphere. Digital billboards and mannequins are positioned outside the fitting room area that display new, fresh and trend-right merchandise, bringing these styles to life. Wall displays and fixtures showcase complementary accessories, including jewelry, handbags, shoes and Sephora beauty, that complete the look. Importantly, we added a stylist to this area to provide customers with personalized one-on-one service. We selected some of our most highly talented, passionate and customer-centric associates from within our stores. The response by customers interacting with the styling room have been extremely positive. In fact, over 90% of these customers stated the styling room made them feel that shopping at JCPenney is a fun experience. Almost 80% said the stylist made them feel more confident in their decisions. Of note, the basket size was significantly larger for the customers shopping in this area. We are also excited about broader in-store design concepts that have been developed to create inviting and engaging experiences for our customers. We look forward to providing the results of these design concepts and our customers' responses soon. These details give you an idea of the focus being placed on analytics to reconnect with our customers on their terms, with a deep understanding of how they live, shop and interact with JCPenney.

We are taking action and getting results. Again, we are laser focused on 2 parallel paths. One is building a framework to reestablish the practices needed to strengthen the day-to-day operations of our business. Concurrently, we are developing differentiating transformational initiatives.

Now I'm going to turn the call over to Bill to give us a detailed update on our Q2 financial results. I'll rejoin the call shortly to provide a few closing remarks before opening the lines for questions.

Bill?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Thank you, Jill. And good morning, everyone. It's a pleasure to join you on the call this morning.

As Jill mentioned, we have a sharp focus on returning JCPenney to sustainable and profitable growth. You will see early signs of our efforts in our Q2 results with a significant improvement in cost of goods sold and an increase in adjusted EBITDA dollars while reducing our year-over-year inventory by 12.5%. In addition, we continue to maintain a very strong liquidity position and are focused on further enhancing our capital structure while we restore this iconic retailer. With that, let's move on to discuss the details of our Q2 financial results.

Earlier this morning, we reported a total net sales decrease of 9.2% for the quarter. Comparable sales decreased 9%. The exit of major appliances and in-store furniture categories had a negative impact to comp sales this quarter of 300 basis points. As such, when you exclude this impact, comp sales decreased 6%. Comp sales -- the comp sales decline was primarily driven by a decrease in transactions, partially offset by a slight increase in average transaction size.

Divisions that outperformed the go-forward business comp for the quarter were fine jewelry, women's apparel, footwear and men's apparel, while we had softer sales across home, women's accessories and boys' and girls' apparel. Our fine jewelry business continued to deliver strong sales results, comping positive in Q2. We saw strength in categories such as modern bride, gold, diamonds and fashion gems. Our teams have been working closely with our vendors, bringing in newness in diamonds and fashion gems. Additionally, our Red Bow Deals and key promotional price points continue to resonate and drive value for our customers.

Women's apparel outperformed our go-forward business comp this quarter. We delivered positive comps in both our active and career categories, while dresses and national brand denim also performed well this quarter. Our best-performing brands in women's apparel included Liz Claiborne, a.n.a. and Xersion. Our family footwear business also performed well in the quarter. Women's footwear, particularly sandals, and family athletic footwear were our top-performing categories. Men's apparel also outperformed the underlying company comp, with particular strengths in active apparel and licensed categories as well as our men's big and tall apparel.

Credit income for the second quarter was $110 million compared to $67 million in Q2 last year. The improvement to last year is primarily due to an increase in our income share due to the performance of our credit portfolio. Of note, we don't expect the current trend that we saw in credit income for the first half of 2019 to continue into the back half of the year.

Cost of goods sold for the second quarter was 63.2% of net sales, a decrease of 310 basis points compared to the same period last year. Approximately half of the year-over-year decrease was due to an improved management of our markdown and clearance cadence, which led to lower permanent markdowns taken in the quarter. The remaining half of the decrease was driven by an improvement in our shrink results, an increase in both store and online selling margins and the exit of major appliance and in-store furniture categories earlier this year.

During the second quarter, both nonclearance and clearance selling margins were up year-over-year. We delivered a significant improvement in both stores and online clearance selling margins, with an -- which on an enterprise level were positive in the mid-single-digit range. Additionally, total selling margins improved in nearly every division in Q2, helping to reinforce our expectations for improved underlying gross margin performance in 2019. We are executing on our fundamental approach to inventory management and SKU rationalization, which allows us to have a sharper focus on both quality and quantity. We are improving inventory productivity while also more effectively managing receipts and optimizing our working capital.

Now moving to expenses. SG&A expenses were $870 million in Q2 this year compared to $880 million last year. The decrease in SG&A dollars was primarily due to lower store controllable expenses and advertising, which were offset slightly by higher incentive compensation. Last year, SG&A expenses included a $7 million benefit resulting from the sale of the leasehold interest in our Laguna Hills, California store. As a reminder, we adopted the new lease accounting standard this fiscal year. Our home office lease expense is now included in SG&A expenses. As such, we recorded approximately $5 million in expense related to the home office lease in Q2 this year. Last year, the home office lease was recorded as depreciation and amortization and interest expense.

Net interest expense this quarter was $74 million.

Our adjusted net loss was $56 million or $0.18 per share for the second quarter this year compared to an adjusted net loss of $120 million or $0.38 per share for the second quarter last year.

With that, let's turn to our capital structure, liquidity and balance sheet.

First, our capital structure. Since my arrival to JCPenney, we have been very focused on reviewing the overall dynamics of our capital structure. We have outlined key tenets that we will abide by when evaluating our capital structure. First, we will continue to maintain more-than-adequate liquidity to fund the operations of our business. Second, we will proactively manage our existing outstanding debt maturities. And third, we will maintain flexibility in how we fund the business and options we have to ensure sustainable and profitable growth. With that, we are taking positive and proactive measures to improve our capital structure and the long-term health of our balance sheet.

Moving now to our liquidity and balance sheet. We ended the second quarter with liquidity of approximately $1.7 billion and no outstanding borrowings under our revolving credit facility. We continue to expect liquidity to be at least $1.5 billion throughout the year. As Jill mentioned earlier, without question, our relationships with our vendors and partners have always been and continue to remain very strong. We highly value and appreciate the relationships we have with our vendors and partners, who continue to demonstrate their belief in JCPenney.

Cash and cash equivalents at the end of the second quarter were $175 million. Capital expenditures, net of landlord allowances, were $142 million for the first 6 months of 2019. Free cash flow was a use of $133 million for the first 6 months of the year, an improvement of $102 million compared to the same period last year. We continue to expect free cash flow to be positive for full year 2019.

During the second quarter, we purchased and retired $5 million of our outstanding unsecured notes due in 2020 in open-market transactions. We have very manageable near-term debt maturities, with $50 million of unsecured debt maturing in October this year and now $105 million of unsecured debt maturing in June of 2020.

Inventory at the end of the second quarter was $2.47 billion, a decrease of $353 million or 12.5% compared to the end of Q2 last year. Both our seasonal and basic inventory levels were significantly down at the end of Q2 this year compared to the same period last year. As a reminder, we have fully liquidated all of our appliance and furniture floor model inventory following the decision to eliminate these categories in Q1 earlier this year. As such, our total inventory level was down approximately $80 million or 2.8% at the end of Q2 as a result of liquidating this inventory earlier in the year. We remain very focused on our ongoing efforts to reduce and enhance inventory position and believe our inventory levels will continue to improve as we continue into the back half of 2019. Having said that, we expect inventory to be a source of working capital in 2019.

Merchandise accounts payable was $878 million, down $32 million or 3.5% versus the end of Q2 last year. The reduction was primarily due to our reduced inventory position.

We closed 15 full-line stores during the second quarter, completing the 18 announced closures for fiscal 2019. In addition, the 9 previously announced ancillary home and furniture stores have all been closed as of the end of Q2.

Moving now to our outlook and financial guidance for the year. As you saw earlier this morning, we are reaffirming our expectation of positive free cash flow for full year 2019. We also provided additional financial guidance for full year 2019 as follows.

Comparable sales are expected to be in a range of down 7% to down 8%. Comparable sales excluding the impact of our exit for major appliances and in-store furniture categories are expected to be in a range of down 5% to down 6%. Cost of goods sold as a rate of net sales is expected to decrease 150 to 200 basis points compared to last year. And adjusted EBITDA is expected to be in a range of $440 million to $475 million.

As a reminder, our 2018 adjusted EBITDA included $70 million in benefit primarily related to the buyout of a leasehold interest in 2 stores last year. In addition, we'll record approximately $20 million in home office lease expense in SG&A this year, which last year was recorded in depreciation and amortization and interest expense. When combined, these items account for an approximate $90 million headwind to last year's adjusted EBITDA. And finally, our full year financial guidance does not contemplate any impact from the impending fourth tranche of tariffs coming out of China.

In closing. We are reestablishing the fundamentals of retail operations at JCPenney and are taking positive and proactive measures to improve our capital structure to support the long-term health and needs of our company.

With that, I will now turn the call back over to Jill for a few closing remarks before we open the lines for questions.

Jill?

Jill Ann Soltau - *J. C. Penney Company, Inc. - CEO & Director*

Thank you, Bill.

Redefining the JCPenney brand is about knowing what is in the hearts and on the minds of our customers. We will stay true to our DNA yet innovate and differentiate based on the customer insights we've captured and what they are giving us permission to be for them. We have moved from our analytics and research stage to implementing against these insights. We are making progress, and I am confident we will continue to do so. The sound strategic decisions we make will be backed by data and always rooted in delivering on our customers' wants and expectations. Reestablishing the fundamentals of our business while being innovative and transformational will be an ongoing process. Again, we are not simply running a business. We are rebuilding a business.

While there is significant amount of work ahead of us around our customer-facing initiatives, we are making a difference. And today, I feel more confident than ever that we will reinvigorate and rejuvenate this great company to sustainable, profitable growth. We are taking a deliberate do-than-say approach and will continue providing updates as we move through our business plan and finalize a more comprehensive long-term strategy for JCPenney.

JCPenney is an American retail icon that is very important to our customers, vendors and hundreds of communities throughout the country. We have assembled a highly talented team representing all functional areas of a retailer. These leaders have brought expertise, passion, commitment and drive to implement our plan for renewal to commercial success.

In closing. I would like to thank our shareholders, vendor partners and customers for their support. I would also like to thank our over 90,000 dedicated and passionate associates, each and every one across our entire company, for their hard work, dedication and commitment to our customer. They are the centerpiece of our brand.

On that note, we'll be happy to take your questions. Operator, we are ready to open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Oliver Chen with Cowen and Company.

Ross A. Collins - *Cowen and Company, LLC, Research Division - Associate*

This is Ross on for Oliver. Just in terms of understanding the selling margin on a like-for-like basis, can you just speak a bit more to how that trended in the quarter just excluding the appliance and furniture category exits that were mentioned?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Yes. And when you look at it, we had and you talked about kind of [that piece], but we still had kind of not only the appliance and category exits but we had improved selling margin not only in in-store and online from the work we've done there, as well as just better cadence this year with lower permanent markdowns than we took last year, right? And so -- and that was about half of the improvement you saw in year-over-year but just really the -- as we were clearing inventory in prior quarter, the improvement in that business there.

Ross A. Collins - *Cowen and Company, LLC, Research Division - Associate*

Got it. And then secondly, just regarding this exit and the repurposing of store space moving forward. How are you thinking about that? I mean the thredUP partnership is -- sounds pretty exciting. Is that kind of our partnerships to the future there? Or how are you thinking about the repurposing of space in your stores moving forward?

Jill Ann Soltau - *J. C. Penney Company, Inc. - CEO & Director*

Well, as we mentioned, our customer is engaged in ways we've never seen before. And we have to reconnect with our customers and build experiences that support their lifestyles, and thredUP is just one example of what we're doing. So partnerships certainly are part of the mix, but we also talked in detail about our new initiative, the styling room, that is showing up for our customers based on pain points they have of feeling confident in their style. And so it'll be a combination of what we innovate and the types of partnerships we bring in.

Operator

Our next question comes from Lorraine Hutchinson with Bank of America.

Heather Nicole Balsky - *BofA Merrill Lynch, Research Division - VP*

This is Heather Balsky on for Lorraine. I had a question with regards to your approach to cutting inventory. As you go through and take out inventory levels, how are you ensuring you have the right products and enough products for things that are in demand?

Jill Ann Soltau - *J. C. Penney Company, Inc. - CEO & Director*

Thanks, Heather. We remain focused on reducing and enhancing our inventory position. As we said, we're down 12.5%. And we're testing different strategies around optimal inventory levels and assortment, customer choice counts. I mean that's really the focus of it is that we have to ensure our inventory is healthy and that the quality is very strong. So it's not just we're trying to hit any sort of number. It's all about building it from the bottoms up to ensure that we have the right customer choice counts, we have the right fixture feels, that the density in our stores is balanced so that the customer has a very welcoming and inviting shopping experience. Some of our test stores where we've done some of this, we just have never seen our women's pads look so inviting. And just you just want to go in and browse because it's so easy to see what we stand for.

Operator

Our next question comes from Chuck Grom with Gordon Haskett.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

On the gross margin improvement, I was wondering if you guys can unpack for us each of the factors that you've called out, the lower marks, the better shrinks, improved selling margins and obviously the exit of appliances. And then looking ahead, it appears that your guidance implies about 200 basis points of improvement in the back half of the year, which would be obviously a little bit of a deceleration from what you did here in the second quarter, so I'm just wondering which of those factors you would not expect to continue.

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Chuck, this is -- when you look at kind of -- and we're not going to kind of break down the basis point impact, but [we are saying here the] lower permanent markdowns where roughly half of the 310 basis point improvement in the breakdown. And then the other elements that we talked about kind of comprise the second half. Not so much of a deceleration in gross margin improvement, but I think when you look at the cadence of our business and the promotion intensity of where we would be in Q4 versus where we would be in Q2, it's more the balance of this than really anything that we do from a deceleration standpoint on improving gross margin. I think you'll see, continue to see the good work that we've done carry throughout the year. And that's why the guidance was an improvement of 150 to 200 basis points on a year-over-year basis.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Okay. Great. And then just my follow-up will be just on tariffs. It appears your guidance excludes any potential change from list 4. Macy's called out about $0.05 of a potential headwind. Just wondering if you could kind of handicap what you think the risk could be; and I guess, when you think about the price increases that are going to happen, what the elasticity would look like, if you'd look to take prices up. Would you look to absorb it? I guess just maybe just pull the handle a little bit on that front.

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Yes. [And that's fair]. I mean I'll say they called, I mean -- and I can't speak to their business, but we're still evaluating this. Our teams are doing -- always had very minimal impact from the list 3 tariffs that came through. And that's because of the fact that we are lower penetrated in China compared to some of the -- the rest of the industry, which we've seen that. We do know that there will be an impact associated with Q4. Our teams are working to mitigate that now and evaluate potential risks. Our -- we're not calling out a dollar number on that yet because we're still working through, and to be fair, some of these things aren't even completely finalized yet, on the full impact of it. So I mean more to come on that, but our teams are working through it. And as you saw, we've worked through it really well thus far, and I think we'll continue to do so.

Operator

(Operator Instructions) Our next question comes from Jeff Van Sinderen with B. Riley FBR.

Richard Frederick Magnusen - *B. Riley FBR, Inc., Research Division - Associate Analyst*

This is Richard Magnusen in for Jeff Van Sinderen. What can you tell us regarding plans for restructuring, including store sale and leasebacks and other ways, to take advantage of the real estate? And we know that your real estate is in -- covered, but at this point, would it make sense to find creative ways to restructure the store fleet, including the sale and leasebacks of owned stores? And then further, would it make sense to get all concerned parties to sit down and figure out ways to go forward in a stronger position?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Yes. And we're obviously evaluating our -- not -- our entire capital structure, and part of that is the assets that we have with that. We'll -- we're not going to kind of comment on how would you think about store leasebacks or anything like that, all right? We're going to do the best thing to improve our balance sheet and ensure adequately liquidity for the business going forward, right? And so we're not going to address any of those things on the call right now.

Richard Frederick Magnusen - *B. Riley FBR, Inc., Research Division - Associate Analyst*

All right. And just is there any more insight you can give us into what you plan for store closures or the rationalization of the store fleet perhaps in the second half of this year and then throughout 2020 as well?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

We don't give any guidance or kind of forward looking on 2020. We have closed the number of stores that we committed to closing in 2019 through Q2 already.

Operator

Our last question comes from Paul Trussell with Deutsche Bank.

Damon Joseph Polistina - *Deutsche Bank AG, Research Division - Research Associate*

This is Damon Polistina on for Paul. Just one question on the comp. Can you just provide some color on the cadence that you saw throughout the quarter and the trends you're seeing quarter-do-date?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

On the cadence we saw throughout the quarter...

Damon Joseph Polistina - *Deutsche Bank AG, Research Division - Research Associate*

Yes.

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

I think the quarter did -- we don't -- and we don't give the monthly breakdown of comps, but what we will share with you is that we did get off to a slow start in the quarter. And we don't -- we never like to use weather as a cause on that, but we did see an impact of weather in May earlier this quarter. That was a headwind leading into it, all right? We don't give any kind of breakdown on the -- sequential quarter breakdown, but we did start slow.

Jill Ann Soltau - *J. C. Penney Company, Inc. - CEO & Director*

And then it continued to improve as we moved through June and July.

Damon Joseph Polistina - *Deutsche Bank AG, Research Division - Research Associate*

Okay. And then on the SG&A line, kind of what opportunities do you see this year? And any headwinds to cutting costs?

Bill Wafford - *J. C. Penney Company, Inc. - Executive VP & CFO*

Yes. I mean that's part of kind of normally operating the business, right? Just as we work through inventory and everything else, we're obviously always looking at opportunities to be more efficient in the business. We're not calling out anything from a target perspective. We gave our guidance on EBITDA for the full year. That's inclusive of all the line items of the P&L.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. Thanks for joining us, and everyone have a wonderful day.