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JCP - Q4 2019 J C Penney Company Inc Earnings Call

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OVERVIEW:

Co. reported 4Q19 adjusted net income of $43m or $0.13 per share.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q4 2019 JCPenney's Earnings Conference Call. (Operator Instructions). Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Kelley Buchhorn, Director of Investor Relations. Thank you. Please go ahead, madam.

Kelley Buchhorn *- J. C. Penney Company, Inc. - Head of IR*

Thank you, Justin, and good morning, everyone. Joining us on the call today is Chief Executive Officer, Jill Soltau; and Chief Financial Officer, Bill Wafford.

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

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Following our prepared remarks this morning, we look forward to taking your questions.

With that, I'll now turn the call over to Jill.

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

Thank you, Kelley, and good morning. Before we get started, I want to briefly update you on a couple of items. First, the impact of the coronavirus; and second, our New York Stock Exchange listing status.

The coronavirus continues to be a fluid situation that we are, of course, watching closely. As you know, we have a diversified supply chain and we have no stores in China or in other impacted countries. We do have associates in our international buying offices, including in Shanghai and Hong Kong, and we are in constant contact with them to ensure we are meeting their needs. For now, it remains too early to quantify any financial impact of the virus.

Next, the New York Stock Exchange. Our 30-day average closing share price fell below $1 as of January 30. We intend to increase our share price to above $1 through improvements in our operating performance as we did this past December. We will go into detail about those improvements and walk you through the 3-year financial outlook during our upcoming Analyst Day.

Now let's move on to our Q4 and fiscal year 2019 performance. As a reminder, we set our expectations for the year knowing that it would take time to restore discipline and return growth in a profitable and sustainable manner. I am pleased to say that we are seeing results. As I've shared with you, for more than a year, we are returning JCPenney to sustainable, profitable growth by reestablishing the fundamentals of our business. We are making strategic decisions based on data that is fueling our actions to develop an emotional connection with our customers.

To rebuild the fundamentals of our business, we are making improvements, ranging from our core store processes to our integrated digital strategy. We are now consistently reducing inventory, improving shrink, re-envisioning our merchandise and rolling out innovations, including curbside pickup, which I will tell you more about in just a moment.

Our deep research and data informed us as we developed our plan for renewal. We acted on our insights and stood up experiential, physical initiatives to test capital-light concepts that enhance the shopping experience, while gathering customer feedback to validate our hypothesis.

Overall, in my experience, there are no quick fixes when you are turning around a major retailer. We are methodically rebuilding the company's foundation, and I continue to be encouraged by the progress we are making. As you saw in our release earlier this morning, we met or exceeded all 5 financial guidance metrics for the year. We also delivered our third consecutive quarter of meaningful gross margin improvement, up 200 basis points versus Q4 of last year. This is a result of the intensely focused work we are doing to rebuild the business across the key tenets of strategic, purposeful and effective retailing. While our plan is beginning to take hold, turnarounds take time and significant action.

Let's take a closer look at the key areas where we acted in 2019 to improve our operations and our connection to the customer. First, we increased inventory productivity. We lowered inventory levels by over 11% compared to the end of last year, reflecting our continued discipline and commitment to inventory management and productivity. When compared to the end of fiscal 2017, inventory was down nearly 23%. We expect that inventory levels will continue to be a source of working capital in 2020, actually improving our ability to meet customer needs.

We also reallocated inventory to areas where we are seeing the most growth, including athletic apparel and denim. Customers are noticing and they are telling us that they like our shoppable racks and the look and feel of our stores with reduced inventory.

Second, we improved gross margin by executing our markdown cadence differently, refining our pricing and promotion strategy and improving shrink. Shrink is being addressed on several fronts, including technology updates, reconfigured store layouts and staffing adjustments. Over the previous year, reductions in shrink contributed 20 basis points to our gross margin results.

Next, we eliminated inefficient spending in certain areas and corrected overspending in others, positioning the company to invest in driving growth in sales and earnings. We also expect to see positive results from zero-based budgeting implemented for 2020.

Additionally, we defined our customer-focus segment through our extensive quantitative and qualitative research, the all-in shopping enthusiast, serious shoppers who want a retailer that understands the occasions in their lives. We took those deep insights about our customers and are improving our offerings. We're building clear brand architectures within every division to make our customer's shopping experience easier, establishing differentiation for JCPenney.

And finally, we designed an engaging, inspiring customer experience. We introduced occasion merchandising to better connect with how customers live every day; move, chill, all day, on point and shine. In addition, we reimplemented visual merchandising to bring our products to life and inspire our customers. These efforts require no capital.

Our experiential physical initiatives, which I will tell you more about in a few minutes, and our occasion merchandising and visual merchandising improvements are generating favorable response from customers. They are telling us that this is how they want to shop.

Now let's summarize 2019. Overall, we delivered on our business objectives and on our financial guidance, including both comparable sales metrics, reported on adjusted comps, gross margin rate, adjusted EBITDA and free cash flow, exceeding guidance on gross margin and adjusted EBITDA. During the second half of the year, 6 of our 8 merchandise divisions showed an improvement in comparable store sales over the first half of the year. The biggest improvements were in women's apparel, women's accessories, footwear and home within continuing categories.

We still have work to do on our top line. As I have said before, we're not just running a business, we're rebuilding a business. We strongly believe that growing sales in an unprofitable way is simply not an option. Instead, we are guided by our plan for renewal and will continue to be measured and methodical in our approach.

Before I walk you through our Q4 progress with our plan for renewal, I want to remind you of the 5 components: Offer compelling merchandise, deliver an engaging experience, drive traffic, fuel growth and build a results-minded culture.

Let's start with an update on offering compelling merchandise. Improving our apparel business is critical to our success. Chief Merchant, Michelle Wlazlo, first focused on women's apparel, and we are beginning to see results. Women's apparel had a sequential improvement from the third to fourth quarter, continuing the trend we saw in Q3. This was driven by positive comps in dresses and our broad assortment in sportswear. We also saw positive gains in our denim business, including our private brand, a.n.a., as well as our national brand partner, Levi's. Other private label brands that performed well include Liz Claiborne and St. John's Bay.

Performance-active businesses drove a double-digit comp in women's, men's and kids apparel. We saw positive comps overall in athletic apparel in both our private and national brands. All of our national brand athletic partners had strong sales results, including our newest brand, Champion.

In men's apparel, our dominant big and tall business continued its strong performance, gaining market share as we offered more choices in key areas such as active and core essentials. Many brands are comping positively, and our customers are responding favorably to our inclusivity initiative.

Our kids business had dramatic sequential improvement from Q3 to Q4. Our toddler business delivered a positive comp this quarter as we aggressively went after growth in elevated separates. Our boys and girls dress category and our new stretch denim, which landed in Q3, also continued to fuel improvements. Overall, all 3 of our major apparel categories, women's, men's and kids, have shown considerable sequential comp sales improvement since Q2.

Now let's turn to home, where we have made significant enhancements and are receiving great customer response. For the holidays, we expanded key brands, including Keurig and Instant Pot, which helped drive national brand market share gains in kitchen electrics. Because of our strong results, we continue to add national brands, including Greenpan, which we launched in January.

Textile saw positive comps in decorative bedding, cozy flannels and in towels, where we launched our new Liz Claiborne Egyptian cotton towel program in Q4. Another enhancement we made this quarter was our improved brand balance between Sealy and Serta helping to drive positive comps in our mattress category. And although small, home decor also comped up, led by expansion in candles, diffusers and new decor, demonstrating our commitment to returning fashion to our home store.

Most recently, we were excited to relaunch our women's private brand, a.n.a., just 3 weeks ago, establishing ourselves as a destination for casual women's apparel and an authority in denim. Our expanded collection is designed for inclusivity with 15 fits in more than 80 washes, sizes 2 through 24, and is available in stores and on the JCPenney flagship store, jcp.com. The full online assortment carrying sizes 2 through 30 and tall sizing is available March 1. a.n.a. is our anchor brand for all day, and it is showing strong preliminary results.

We are also thrilled about the new Sephora partnership with Selena Gomez, who is bringing her beauty line, Rare Beauty, to Sephora inside JCPenney. We will see this authentic beauty brand in our stores beginning this summer. These are just 2 examples of how we are leveraging our new brand architecture, and it's the start of additional brand introductions and relaunches to come.

Next, deliver an engaging experience. Our customers want a great experience, both for themselves and to share with family and friends. To create that experience, we put our customer insights to work. As a reminder, we tested 4 distinct concepts; all bold, low capital and quickly implemented. Next, we took our learnings and implemented them in a single store, where we featured our new occasion merchandising, improved visual merchandising and a redesigned shopping experience. From there, we tested customer receptivity and gathered feedback, taking our scalable earnings and quickly rolling them out to more than 90 stores.

Then in November, we opened our brand-defining store. It is the fullest articulation of our customer commitment and the manifestation of the research, planning and hard work that characterized 2019. We're measuring over 100 touch points in this lab store to inform our future actions as we put the customer at the heart of everything we do. One of those touch points that is making our stores even more convenient is JCPenney Style on the Go curbside pickup. We tested it at our brand defining store, and our customers responded so positively that we are quickly expanding this service. JCPenney Style on the Go will be available in 50 additional stores starting next week as we help customers live lives their way through this convenient service.

Now on to drive traffic. We think about our physical stores and our flagship store, jcp.com, holistically in terms of how customers shop us. Our goal is to connect with them emotionally at every touch point of the customer shopping experience from exploration to discovery, to purchase. Whether it's in-store, online or through our app. We've strengthened our execution on fulfillment, including ship from store, and buy online and pick up in store, where we saw accelerated demand over the holidays. Through the hard work of our associates, we met our increasing fulfillment demands.

More than 80% of our sales are generated in our physical stores, yet nearly 90% of our customers actually start their path to purchase online. As part of our transformative journey, we have 3 distinct work streams; personalization, our affinity programs and improvements to our e-commerce site, which we consider our flagship store. Supporting this work is Carl Walsh, our new Chief Digital Officer, who is leading these strategic advancements. Carl was most recently with Pandora Jewelry, where he grew the global e-commerce business, and he brings 18 years of digital expertise to JCPenney.

We are working with speed to enhance our in-house capabilities to adjust how we go to market and adapt to customer needs so that they can shop when and where they want. We are energized by the work underway to drive traffic across all channels.

Next, fuel growth. Fueling growth is about developing a more efficient operating model, reinvesting in value-creating activities and establishing a capital structure that supports the long-term needs of the company. We must work differently, and we are. Bill will go into more detail. Yet simply put, overall, in Q4, gross margin rate was up and SG&A expenses were down. The entire organization is focused on process improvement and eliminating inefficient spend. Through these efforts, we delivered $100 million in expense savings in controllable costs in 2019.

And finally, build a results-minded culture. To reestablish the fundamentals of retail, we are ensuring that our associates are well supported with a deliberate, structured and consistent go-to-market philosophy and clear guidelines. We developed a comprehensive framework and we are training all of our business-driving associates on it, including an end-to-end process for delivering merchandise to our customer from concept to shelf and site.

In addition, our strong leadership team remains focused on the customer and is consistently mobilizing all associates around our plan for renewal. Together, we are building a results-minded culture that is based on accountability, urgency and innovative problem solving at all levels of the organization. That includes ensuring every associate understands where we are going as a company, how their role contributes to our success and how their work connects to our plan for renewal.

In November, we hosted our private and national brand partners at our partner summit, sharing our plan for renewal. It was a great dialogue, and we are continuing with consistent growth meetings and robust conversations.

The journey to restore our company to health is an ongoing process, and it takes time. I am pleased with our progress and confident that we are on the right track. We still have a lot of work to do and are energized by the effort.

Now I'll turn it over to Bill, who will take you through our financial results.

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

Thank you, Jill, and good morning, everyone. As we reported this morning, and as Jill discussed, we delivered on each of our annual guidance metrics in 2019. We knew the most effective way to fuel growth, as we worked through our plan for renewal, was quite simply to improve operating efficiencies and reduce our overall cost structure. As a result, our efforts to improve gross margin and minimize or eliminate unnecessary expenses over the course of the year translated into growth in full year adjusted EBITDA and free cash flow, both of which far exceeded our financial guidance.

While we are pleased with these results, we know there's more work to be done. This morning, I will first go through the detailed results of our fourth quarter, followed by our full year results as well as our balance sheet, concluding with a review of the financial guidance for fiscal 2020 that was reported earlier this morning.

For the fourth quarter, total net sales decreased 7.7% and comparable sales decreased 7%. The exit of major appliance and in-store furniture categories had a negative impact to comp sales this quarter of 230 basis points. As such, when you exclude this impact, adjusted comp sales decreased 4.7%. The incremental improvement in comp sales decline from last quarter reflects increases we saw in average transaction value along with a deceleration of traffic declines.

As expected, our top line sales this quarter were affected by the pressure from aggressive promotions in the fourth quarter last year to drive the liquidation of slow-moving and aged inventory. As Jill just shared, we saw several areas of meaningful sales growth in our merchandise divisions. Those that outperformed our adjusted sales comp this quarter included women's apparel, women's accessories, men's apparel and footwear. The efforts of our teams are beginning to show improved financial results.

Credit income for the fourth quarter was $109 million this year compared to $121 million in the fourth quarter last year. The decline was in line with our expectations as we discussed on our last earnings call.

Cost of goods sold for the fourth quarter was 66.7% of net sales, an improvement of approximately 200 basis points compared to the same period last year. This improvement was primarily related to increased enterprise clearance selling margins from lower permanent markdowns, improved shrink results and the exit of major appliance and in-store furniture categories earlier this year.

Moving to expenses. SG&A expenses were $1.005 billion in the fourth quarter this year, and were slightly below last year's levels. We achieved meaningful savings in controllable expenses, which helped offset higher incentive compensation and the home office lease expense, which is now recorded in SG&A. Net interest expense this quarter was $73 million.

Adjusted net income was $43 million, or $0.13 per share for the fourth quarter this year compared to adjusted net income of $57 million or $0.18 per share last year. We were pleased with our progress in the fourth quarter.

Now let me summarize our full year financial results. For the year, total net sales were $10.7 billion, a decrease of 8.1% compared to last year. Comparable store sales decreased 7.7% and adjusted comparable sales decreased 5.6%, both well in line with our guided expectations.

Credit income this year was $451 million compared to $355 million last year. The nearly $100 million increase this year is primarily due to higher gain share, resulting from the improved loss performance of the underlying credit portfolio and reserve changes. The improved loss performance and favorable reserve adjustments taken this year are not expected to repeat. And as such, we anticipate credit income for fiscal 2020 to be more in line with fiscal 2018.

Cost of goods sold for the year was 65.4% of net sales, a 210 basis point improvement compared to 67.5% of net sales last year. As we've discussed throughout the year, the improvement was primarily driven by an increase in both store and online selling margins, improved shrink results and the exit of major appliance and in-store furniture categories. For the full year, nonclearance and clearance selling margins were up year-over-year, both in-store and online. Additionally, total enterprise selling margins improved in the majority of our divisions in fiscal 2019.

Before I move to expenses, I want to remind you that at the start of fiscal 2019, we had an approximate $90 million headwind to SG&A expenses. Last year, SG&A expenses included an approximate $70 million benefit, which was primarily related to the buyout of a lease hold interest in 2 stores. Additionally, we adopted the new lease accounting standard, and starting in fiscal 2019, our home office lease expense of approximately $20 million was recorded in SG&A expense. Last year, the home office lease was recorded in depreciation and amortization and interest expense.

With that, full year SG&A expenses were $3.59 billion, a decrease of $11 million compared to last year. The decrease in SG&A dollars was primarily due to lower controllable expenses that were partially offset by both higher incentive compensation and the headwinds just mentioned. When you take last year's headwinds into account, we delivered total SG&A expense savings of approximately $100 million in 2019. Interest expense was $293 million, down $20 million compared to last year.

Adjusted EBITDA was $583 million this year compared to $568 million last year. We are pleased that we are -- that we meaningfully exceeded our adjusted EBITDA guidance, which was primarily driven by improvements in gross margin rate, lower SG&A expenses and higher credit income. For the year, our adjusted net loss was $257 million, or $0.80 per share, an improvement of $39 million, or $0.14 per share versus last year.

Next, let's move to the balance sheet. As expected, we fully repaid the outstanding balance under our ABL credit facility during the quarter and ended the year with no outstanding borrowings under this facility. At the end of fiscal 2019, our liquidity position remained strong at approximately $1.8 billion. For fiscal 2019, our debt repayments totaled $97 million, which included $50 million of unsecured notes paid at maturity in the third quarter earlier in the year. We have very manageable near-term debt maturities with $105 million of unsecured notes maturing in June of 2020.

Cash and cash equivalents at the end of the year were $386 million. Capital expenditures were $309 million for the year, which consisted primarily of investments in technology, store environment, supply chain and logistics and general maintenance. For the year, free cash flow was $145 million, an increase of $34 million when compared to last year. As you know, our reported free cash flow includes proceeds from the sale of operating assets. When you exclude these proceeds from both years, the improvement we delivered in fiscal 2019 was greater than $150 million when compared to fiscal 2018.

Inventory at the end of the year was $2.17 billion, a decrease of $271 million or 11.1% compared to the end of last year. The decline was primarily -- the decline primarily resulted from our commitment to inventory management. Additionally, the full liquidation of our appliance and furniture floor model inventory accounted for $73 million or approximately 3% of our full year's inventory reduction. When compared to the end of fiscal 2017, inventory was down $637 million or 23%. We remain focused on increasing inventory productivity. As a result, we expect our inventory improvements will continue to be a source of working capital in 2020. Merchandise accounts payable was $786 million, down $61 million or 7.2% compared to last year. The decrease was primarily due to our reduced inventory position.

Before moving to our financial guidance, let me touch on our store closures for 2020. We ended fiscal 2019 with 846 stores in our fleet. Of these, approximately 72% are mall-based and the remaining 28% are off-mall locations. For the full year 2019, the vast majority of our stores delivered positive operating profit results. As we reported this morning, we expect to close at least 6 stores in 2020. Including these stores, we will have closed 173 stores since the start of 2017. We continuously review and assess our real estate portfolio, and we look forward to sharing more details of our future real estate plans with you at our Analyst Day in a few weeks.

Now our financial guidance for full year 2020. I want to note that our financial guidance does include the impact from any currently imposed China tariff enactments, yet it does not include any potential impact from the current coronavirus situation.

Comparable sales are expected to be in a range of down 3.5% to down 4.5%. Cost of goods sold as a percent of net sales is expected to improve 100 to 130 basis points compared to last year, resulting in an increase in gross margin rate of the same amount. Adjusted EBITDA dollars are expected to be 5% to 10% higher than fiscal 2019. Additionally, free cash flow is expected to be positive.

To support this guidance, let me provide you with some additional key directions. As a reminder, we fully exited our appliance and in-store furniture categories by the end of the first quarter last year, and we liquidated our floor model inventory in these categories, which together generated approximately $70 million in net sales in Q1 last year. Additionally, we closed 18 full-line stores in 2019, 3 of which were closed in the first quarter last year.

As I mentioned earlier, we anticipate credit income for fiscal 2020 to be more in line with fiscal 2018, as the improved loss performance and favorable reserve adjustments taken in 2019 are not expected to repeat in 2020. With that, we do expect to achieve the 5% to 10% increase in our adjusted EBITDA guidance given this approximate $100 million headwind in credit income.

Depreciation and amortization is expected to be approximately $515 million for the full year. Other components of net periodic pension for the full year is expected to be a benefit of approximately $80 million. Net interest expense is expected to be approximately $290 million for the full year. And finally, capital expenditures for the full year are expected to be approximately $300 million.

And now I'll turn the call back over to Jill.

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

Thank you, Bill. As we conclude, I want to remind you that we take a do-then-say approach, providing updates as we make meaningful progress. As I mentioned, we are on the right track and we are encouraged, yet we still have more work to do. We look forward to providing more updates on our plan for renewal during our Analyst Day on Tuesday, April 7, in New York.

I'd like to close by thanking our shareholders and vendor partners for their support. I would also like to thank our nearly 90,000 associates for their hard, purposeful work over the last year and the millions of customers who shop us annually. Their feedback is helping transform JCPenney and they are rooting for us on our journey of fundamental change.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Oliver Chen from Cowen and Company.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

You've made some nice progress with your product assortment. Looking ahead, where do you see the most opportunity for improvement in the product? And also, as we think about merchandise margins and your guidance, what are your thoughts on clearance levels going forward and the ability to reduce markdowns?

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

Thanks, Oliver. In terms of product assortment, we are very focused on our women's apparel, which I shared some of the areas that we've made improvements to date on that. Corresponding with that, of course, is accessories and footwear to enable our female all-in shopping enthusiast to complete her look. And then the home store, as I've talked about consistently, we see additional opportunity in reestablishing our national brand dominance as well as reintroducing and strengthening key categories and key classifications.

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

Oliver, and on the gross margin piece, and you talk about clearance markdowns, we see that getting back to a more traditional level for us. When you look at -- we're talking about 100 to 130 basis point improvement in gross margin rate this year, and there's a little bit of that, that comes from the annualization of the remaining discontinued merchandise. But also, a big element of that is, as we get back to a more rightsized inventory level, getting to a consistent cadence on clearance, we do think and really -- and fiscal 2020 will be a bit of a tailwind for us on a gross margin rate.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay. A follow-up is speaking to your digital priorities, what would you say are the top ones that are important to you in the year ahead and balancing capital needs there? And also, as you look at your consumer research, I would love your thoughts on making sure that you embrace and engage the younger customer as well and what the younger customer is looking for in terms of the store experience as well as assortment.

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

In terms of digital priorities, we are focused on the 3 paths of personalization and our affinity programs as well as the e-commerce, and they're all interrelated. We have foundation there, but our complete focus is to connect more, mostly with the customer, and be providing to them what they most want from us in the way in which they want it.

As it relates to our product offerings and our consumer research and keeping our all-in shopping enthusiasts at the heart of everything we do, I have believed all my career that fashion is an attitude, it's not an age. And we are very focused on the all-in shopping enthusiasts. These are customers who love to shop. They live life to the fullest. They are the most interested in their personal style. We like to think that they have a growth mindset. They're very confident, yet they are interested in input and to be inspired. They're the most connected with their family and friends. They see part of their job as an all-in shopping enthusiast to bring life and excitement into the lives of their friends and family. So all of our efforts are around the all-in shopping enthusiasts, and getting it right for those customers will halo onto other psychographic segments. Again, that cross all ages and demographics.

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

Yes, Oliver, and the thing I would add to that is I think when you look at kind of our progression and our fulfillment capabilities and being more convenient for customers, we think that's going to extend the halo to all customer segments, not just younger customers as you referenced.

Operator

And our next question comes from Chuck Grom with Gordon Haskett.

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

Just wondering if you guys could unpack for us the decline in the comp in the fourth quarter, that's down 7% between traffic and ticket. And I guess, Jill, if you could just amplify on your comments that traffic improved relative to the fourth quarter, I guess, where you saw that by category?

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

Yes, Chuck. We don't give the exact delineation between traffic and ticket in terms of the fourth quarter. The thing I will tell you is when you look, when we released our kind of holiday sales results and where we were at the midpoint of the quarter, we were down 7.5% and then ended up down 7%, right? So you can see the progression in the quarter and how it took through. And as I kind of stated earlier in the remarks, it was basically an improvement in our average transaction value and a bit of a deceleration in the traffic decline that we've seen coming into the quarter.

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

Okay. Great. And then, I guess, one more for you, Bill. Just -- I missed it exactly why you guys are expecting credit revenue in 2020 to be more like 2018 as opposed to 2019. Again, could you just go through that again one more time for me?

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

Yes. No problem, Chuck. I think when you look at where we were in 2018, then to get to -- flashforward to 2020, sales decline with our kind of receivable balance it's at now, which is at a steady state level, you see kind of lower pull-through on the fulfillment there or the gain share associated with the percent of the revolving balance. In addition, we saw an improvement in the loss reserves associated with our credit portfolio, and so there was a release of those reserves. We anticipate kind of loss rates which were not meaningfully different but to normalize at a more consistent level of what we've seen historically. And so we had a little bit of a -- calling it almost a one-time benefit in 2019, that we just don't expect that to annualize on a go-forward basis.

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

Okay. Great. And then just one more last one from me. On the gross margin, it looks like you're projecting getting back close to, say, roughly 36%. Do you feel like that's a good run rate for the business going forward once you recapture some of these one-time items as you guys improve those clearance margins and get shrink backed up? Or do you think over time you can get closer back to the 37%, 38% range where you were in the beginning part of the last decade?

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

Well, I think everybody is having trouble getting back to where they were 10 years ago on a gross margin rate when you think about fulfillment capabilities, right? So I do think we've got, to your point, a little bit of the tailwind as we normalize on our clearance margins and kind of our level of clearance in the organization, balancing out our pricing and promotion. Over time, do we see potential headwind pressure as fulfillment potentially skews to more direct fulfillment and things like that? Yes, there's probably a potential headwind there, but that's our work to try to offset that over time. We're -- I mean 130 basis points is a lot of work to get to on a 1-year basis this year, and we feel comfortable in that range right now.

Operator

And our next question is from Matthew Boss from JPMorgan.

Elliott Marshall Simon - *JP Morgan Chase & Co, Research Division - Analyst*

This is Elliott, on for Matt. Thanks for all the color. Could you just talk on SG&A for a second. The guidance implies further expense reductions this year. Bill, can you just help bucket the efficiencies you see in 2020 and the magnitude of expense opportunity multiyear?

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

Yes. I mean, Elliott, it's -- like I said, we've got an Analyst Day coming up in April. So I think we can get into a little more detail for you. I'm kind of forward-looking with that. But you're right, if you look at kind of the sales decline forecasted the gross margin rate expansion, but then still, and I'm also losing a little bit on credit income there, the -- where you're squeezing the bucket out there becomes SG&A, right? We feel like we've got the opportunity not only on the controllable expense side that's purely variable but just underlying cost structure to improve the efficiency of the organization to get to a lower operating model rate. It takes time. You don't flip the switch in 1 year on that, so we can kind of walk you through that in April. But we do feel like there's ample opportunity there to get meaningful improvements on a multiyear basis.

Elliott Marshall Simon - *JP Morgan Chase & Co, Research Division - Analyst*

Great. And then a quick follow-up. Just -- you'll probably address this at the Analyst Day as well, but we recently visited the store in Hurst, Texas, which looks great. What have been your kind of primary takeaways from this concept and any opportunities to roll out the format across the chain?

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

Yes. Well, thanks for visiting. The brand-defining store in Hurst is our -- full articulation of our customer commitment, and it is a lab store for us. And as mentioned, we are monitoring and measuring over 100 touch points in that store based on customer feedback and response. And we've been learning since the first day that it opened back on November 1. I shared today that one of the first things that popped out very strong right away was the curbside pickup. So JCPenney Style on the Go is expanding to 50 stores starting next week. And we want to ensure that we're methodical. And that, as we scale, that we're also implementing and operating with excellence.

We have had great response to our occasion merchandising through our occasion -- the occasions that our customer lives every day of move, chill, all day, on point and shine. The customers have responded that this is how they live their life, this is how they want to shop. Visual merchandising continues to inspire our customer. That's been something that they've commented on that they really feel connected, they find themselves within the store and within our merchandise. As you know, we have a styling room there. We've talked a lot about our women's styling room, which was one of our test and learns that we first stood up last March to improve the fitting room experience and understand how a customer felt about that. And that continues to do very well. And in Hurst, we introduced our first-ever men's styling room, and it has had very favorable response as well. And those are just some of the key takeaways. But we're very excited as we continue to monitor and react and take action against what we're learning there.

Operator

And the next question comes from Paul Trussell from Deutsche Bank.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Congrats on meeting or exceeding your fiscal '19 goals. Just looking at the 2020 guidance, you've outlined free cash flow to be positive. Just any additional color on to what extent are you thinking as much as '19 or not necessarily just given all the inventory and working capital improvement already made this year? And maybe bigger picture, while liquidity is certainly sufficient currently, just any comments on how you're thinking about the capital structure and debt levels longer term?

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

Sure, Paul. I mean I give you -- forward-looking to the extent I can. When you think about free cash flow this year, we came in -- our guidance was positive, which was the same guidance we had last year. We don't anticipate as much as an improvement from inventory pickup as we've had over the last couple of years, right, as we get to more efficient inventory levels. But obviously, the balance there, as you see, we're growing earnings at the 5% to 10% clip, right? So we've got a little bit of an offset there, which makes us feel comfortable. We're not giving -- we're not putting a targeted number on it. We feel comfortable in being positive free cash flow range, but don't anticipate huge swings relative to what we delivered this year.

On the forward-looking in capital structure basis, I mean everything we're doing now, we feel incredibly comfortable with where our capital structure sits, the relationship we have with our creditors, which has been very strong and very supportive and how we think about kind of maintaining liquidity position and capital structure for many years to come. So -- I mean not much more that I can share with you on that, but we feel really comfortable in the position we're at right now.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

And certainly, coronavirus is obviously a pretty fluid situation. I know it's tough to think about quantifying right now the impact, but just what can you tell us today in terms of what you see as it relates to the supply chain impacts, any potential disruption on deliveries or manufacturing of private label goods that you can gauge currently?

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

As you mentioned, Paul, it is a very fluid situation, and it really is too early to quantify. We are watching it every hour of every day to understand more about this very unfortunate situation. As you know, we have a diversified supply chain. And as we worked through the tariff situation, we found ourselves in a pretty good place there because our sourcing organization has worked over the last decade to diversify away from China. So that's been a little bit of comfort as we just watched the news unfold like everyone else has. But we are very connected to our suppliers. We're very connected to our associates and our international buying offices, and we are watching it as closely as we can. But I don't have any forecast to share with you today.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Understood. And lastly from me, and I know you'll give more color on this in April. It's just, as you talk to your customer, what are they telling you in terms of how they utilize JCPenney and what they like in terms of what they see in the stores today, what advice they're giving you on what could be better?

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

Well, we serve millions and millions of customers every single year, and they are very loyal to the brand, and we are so appreciative of them, and the fact that they are championing us as we move through this turnaround and implement our plan for renewal. As you know, we did extensive, extensive, qualitative and quantitative research to understand what's on their mind, and every action that we've taken has been based on what they told us.

I believe that the most direct feedback, it comes through our results. And I am pleased with the progress that we're making. I am pleased with the improvements that we've already seen in our women's apparel and women's accessories, footwear businesses as well as our home. They are responding to our improved shopping experiences, both in-store and online, certainly, our in-store with the -- almost 23% reduction in inventory since 2017. They are responding and letting us know that they feel the difference, and we're creating a much easier shopping experience for them. And we're getting some additional comments of the same nature as we are beginning to make improvements to our flagship store as well.

Operator

And our next question comes from Paul Lejuez from Citigroup.

Tracy Jill Kogan - *Citigroup Inc, Research Division - VP*

It's Tracy Kogan, filling in for Paul. I was wondering if you could comment a little more on the women's apparel category? And how you see the mix of private versus national brands trending as you look to the future? I'm not sure what the mix ended at this past year, but I was just wondering on how -- what your view is on that in the future?

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

Thanks, Tracy. Well, as I mentioned, women's apparel had sequential improvement from third to fourth quarter, which was continuing the trend we saw in Q3. We saw positive comps in dresses as well as our broad assortment in sportswear. And sportswear is, obviously, the biggest part of women's apparel, everything, pants, blouses, sweaters, skirts, the whole gamut. And in addition, we were really pleased with the gains that we had in our denim businesses.

And as I mentioned, just as an example, in denim, both our a.n.a. -- our private brand, a.n.a., as well as our national brand partner, Levi's, both performed very well. And I'm a strong believer in the complementary relationship between private brands and national brands that our customer wants both. They each serve a purpose. And as we have been working diligently on our assortments, we are developing and have developed very detailed and specific brand architectures for each category that we sell so as we make a very clear and understandable presentation to the customer through our assortment. And so you will continue to see that complementary relationship between our beloved private brands as well as our very distinguished national brands.

Operator

And our final question comes from Lorraine Hutchinson from Bank of America.

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

This is Heather Balsky, on for Lorraine. Just a follow-up on the coronavirus impact in your supply chain. Just without having to quantify because I realize it's early, but just are you starting to see signs of delays? And can you put that into just some time frame? Like are you -- are there worries right now about back to school? And you talked about your diversified sourcing, are you seeing any signs that sourcing outside of China is being impacted just due to challenges getting materials from China?

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

Thanks, Heather. It's changing. As we've all been talking, it's very fluid and it's so early to try and quantify because it's changing daily in terms of factories opened, factories closed, workforces returning, roads opened, roads closed. Just the sheer number of touch points that we're monitoring and the fact that it's just continuing to evolve and change. So we don't have a financial impact or forecast to share with you today. We're just really focused on understanding what our associates need in our international buying offices as well as we're very close to our vendors and supporting them through this. And we're kind of all in it together, and we're just staying on top of it.

Operator

And ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
