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# EDITED TRANSCRIPT

JCP - Q4 2018 J C Penney Company Inc Earnings Call

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## OVERVIEW:

JCP reported 4Q18 adjusted net income of \$57m or \$0.18 per share.



FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

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## PRESENTATION

### Operator

Good day, ladies and gentlemen. Welcome to the Q4 2018 JCPenney Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded. I would now like to introduce your host for this conference call, Mr. Trent Kruse. You may begin sir.

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**Trent Kruse** - *J. C. Penney Company, Inc. - SVP of Finance*

All right. Thank you, Kevin, 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 similar expressions identify forward-looking statements. Any such forward-looking statements are subject to risks and uncertainties, and the company's future results of operations could differ materially from historical results or current expectations. For more details on these risks, please refer to the company's form 10-Q and other SEC filings.

Please note that no portion of this presentation may be rebroadcast in any form without the prior written consent of JCPenney. For those listening after February 28, 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. 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 me on today's call is Jill Soltau, Chief Executive Officer of JCPenney. And following our prepared remarks, we look forward to taking your questions.

And with that, I would now like to turn the call over to CEO, Jill Soltau.

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

Thank you, Trent, and good morning, everyone. I have been looking forward to speaking with you about the company and how we are progressing on the journey to reestablish our fundamentals and drive towards growth and improved profitability. In a moment, Trent will cover our results for



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

the fourth quarter and full year 2018, but I wanted to start the call by providing you insights to the work we have been focused on in my early days as CEO here at JCPenney.

For the past few months, I have talked to and listened to JCPenney associates throughout the organization, in the field and in the home office. I've also spent time with our vendors, customers and other partners to gain their candid perspectives on our company, both good and bad. I am very pleased with the level of support from our current vendors as well as potential new partners we are meeting with who are excited to do business with us and are proposing new ideas, brands and initiatives to JCPenney for consideration. Based on everything I have seen and heard, I'm even more convinced that we can establish a path to sustainable profitable growth.

As I have visited stores across the U.S. and worked with our team, I've been continually impressed with the level of our talent and passion to serve our customers. As we have begun our work to develop JCPenney's longer-term goals, we've aligned on a few objectives. First, we are providing strategic clarity to the team that we will always be about serving the customer and growing in a sustainable and profitable manner. Next, we are thoughtfully prioritizing what we do and applying discipline to ensure we're focused on work that adds the most long-term value. Also, we are building capabilities to support our priorities so the team is equipped to deliver on these goals. And finally, we are developing a culture of accountability and urgency at all levels of the organization.

This foundational work, along with the extensive research on our existing operations, enables us to have a renewed perspective on our strength and opportunities based upon data that will serve as a foundation for 2019 and beyond.

While our work to define JCPenney's longer-term vision is not yet complete, we've made significant progress in designing priorities for our business. I'm impressed with the progress the team has made recently, including our decisions to eliminate noncore and low-growth margin product categories, meaningfully reduce excess inventory and the ongoing revitalization of our Women's Apparel business.

Yet we need to continue to move faster. We need to reestablish the fundamentals of retail at JCPenney and build capabilities focused on satisfying the wants and expectations of our customers. This work will put us on a path to ensure that our digital and store operations operate seamlessly to provide an experience that exceeds our customers' expectations.

I look forward to continuing to work with the team to harness their passion and develop the appropriate strategies that position JCPenney for success, both today and over time.

Now before I get into some of the early actions we are taking, I wanted to briefly discuss the announcement we made earlier this morning of our new Chief Merchant, Michelle Wlazlo. Michelle is a talented merchant and seasoned retail executive who brings with her over 30 years of retail experience, primarily in merchandising. Michelle most recently served as Senior Vice President of Merchandising over a multi-billion dollar apparel and accessories business for Target Corporation, where she was responsible for all aspects of strategy and implementation of the apparel and accessories remodel program in 2018. Michelle was instrumental in launching more than a dozen brands while driving significant comp and market share growth during her tenure. Michelle also previously served at GAP, Inc. as the Senior Vice President of Global Merchandising across all brands divisions, including women's, men's, kids, baby, body and fit. Over the course of nearly 2 decades, she held multiple merchandising roles for GAP, GAP Outlet and Old Navy. I'm very excited to have Michelle join our team. Her skill set and expertise will be instrumental as we progress on our journey to drive improvement in key businesses.

I would also like to welcome John Welling who joined our team today as Senior Vice President of Planning and Allocation. John brings to us over 25 years of experience in retail and consulting, primarily in merchandise and store operations. John most recently served as Senior Vice President of Merchandise Operations at The Michaels Companies where he was responsible for planning, pricing, inventory management and merchandise finance functions. John also spent a little over 10 years at Walmart where he held positions in store operations and replenishment and innovation.

Additionally, I'd like to welcome Mark Stinde who will join our team on Monday as Senior Vice President of Asset Protection. Mark brings over 23 years of experience to us in loss prevention and store operations, specializing in asset protection, safety and security. He has a proven track record of significantly reducing shrink levels at leading national retailers, most recently serving as Vice President of Asset Protection for 7-Eleven. Mark has previously held key leadership positions of increasing responsibility at Toys "R" Us and The Home Depot.



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

I'm very excited to have John and Mark join our team in these mission-critical roles as we continue to work on our inventory management and strength improvement efforts.

I couldn't be prouder or more excited to have 3 highly accomplished and esteemed retail experts join our organization. These executive appointments demonstrate our ability to attract great talent who believe in JCPenney and who will play a meaningful role in delivering a compelling and rewarding shopping experience for our customers.

With that, let me turn now and share some of the immediate actions we are taking and initiatives we are implementing as we begin our journey to attain sustainable, profitable growth. First, we are continuing our efforts to reduce and enhance our inventory position. This is evident by the over 13% reduction we delivered in 2018, but also continues into 2019. We will continue to clear unproductive inventory swiftly and thoughtfully and implement new processes and training across our organization to ensure we prevent future buildup of excess inventory.

Second, we are strengthening our integrated omnichannel strategy to ensure we return to growth in our digital channels, but in a sustainable and profitable way.

Third, we are redesigning and improving core store processes while implementing enhanced technology tools to better equip our store associates to deliver on our customers' expectations. It is critical that we improve the productivity of our labor hours by delivering service where and when it matters most.

Fourth, we are taking immediate actions to improve our shrink results. We must continue to take advantage of recent technology investments and staffing adjustments to improve what have been very poor results in this area. Of note, we have seen better shrink results in our test initiatives over the last several months and expect to deliver improved results beginning in 2019.

Lastly, we are hard at work revamping and rethinking our merchandise assortments and strategies. As previously announced, we made the decision to discontinue selling major appliances in an effort to improve financial performance and refocus on our legacy strengths in apparel and soft home as well as profitable growth opportunities. Also, we will continue to leverage our best-in-class global sourcing and design organization across our product spectrum to enhance the style and quality we deliver, but also to improve profitability within our assortment.

As pleased as I am with the immediate and significant actions we have taken, this will be an ongoing process. Again, my commitment is that we will make sound, strategic decisions backed by data and will always be rooted in delivering on our customers' wants and expectations. We are acting swiftly, but thoughtfully as we move the business forward.

Now I'm going to turn the call over to Trent to give us a more detailed financial update on our Q4 and full year results. I'll rejoin the call shortly to provide a few closing remarks before opening up the lines for questions. Trent?

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### **Trent Kruse** - J. C. Penney Company, Inc. - SVP of Finance

All right. Thank you, Jill, and good morning, everyone. As we reported earlier this morning, total net sales for the quarter decreased 9.5% while comp sales on a shifted basis decreased 4% for the 13 weeks ended February 2, 2019, compared to the 13 weeks ended February 3, 2018, of last fiscal year. Notably, our fourth quarter comp sales accelerated 140 basis point sequentially on a 2-year stack versus the third quarter with brick-and-mortar showing the strongest improvement.

Gross margin decreased 220 basis points, primarily the result of permanent markdowns directly related to our decision to further liquidate slow-moving and aged inventory during the quarter. Throughout 2018, we clearly took significant action around our inventory levels as we worked to strike the right balance between an enhanced assortment and her shopping experience to deliver better top line and profitability results. We believe these actions will provide a solid foundation that we can continue to build upon.

But let me be clear that while the entire organization is focused and aligned on absolute inventory levels, we will not restrict receipts and product flow in growing brands and businesses. In fact, our actions will better support the brands and categories that are demonstrating profitable sales



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

growth. They will minimize our investment and exposure across less profitable lines of our business, and they will eliminate tasks currently associated with managing through high levels of inventory.

Going forward, our renewed discipline and fundamental approach to inventory management and SKU rationalization will allow us to have a sharper focus on both quality and quantity. We will not only have the ability to drive improved inventory productivity, but also more effectively manage planned receipts and optimize our working capital.

Of note, for full year 2018, both store and online nonclearance selling margins were up year-over-year. We are making significant progress on our assortments, an indication that as we continue to get our inventory better aligned with our customers' wants and expectations, we are positioned to deliver improved profitability.

Let's turn now to a more detailed review of our Q4 and full year performance. As I mentioned earlier, our fourth quarter comp sales were down 4% on a shifted basis. This decline was primarily driven by a decrease in transactions, offset partially by an increase in average unit retail.

For the full year, total net sales were down 7.1% and comps were down 3.1%.

Divisions and categories that outperformed the total company comp for the quarter were Jewelry, Women's Apparel, Children's Apparel and Men's Apparel. Additionally, we saw strong category performance for the quarter in areas such as athletic and active apparel, special-sized apparel, baby apparel and gear, outerwear apparel and toys. Conversely, categories that underperformed the company comp in Q4 include big-ticket areas in home such as major appliances and furniture as well as women's accessories and handbags.

With that said, let me briefly touch on our decision to discontinue selling major appliances and have furniture available only online at jcp.com and in select Puerto Rico stores. Ultimately, this decision will allow us to better meet customer expectations and improve financial performance moving forward. These businesses represented 2.7% of sales in 2018, but were significantly negative in operating profit. While configurations will vary by store, we are finalizing new layout options, including the possible reduction of store space previously dedicated to appliance and furniture showrooms to maximize efficiencies, reduce inventory and create an enhanced experience that inspires repeat shopping trips and customer loyalty. Optimizing the allocation of store space will enable us to prioritize and focus on our strengths in apparel and soft home furnishings, which represent higher-margin opportunities.

Now let's get back to our Q4 sales performance. Geographically, the Midwest and Southwest were our better-performing regions while the South East and Gold Coast were our most challenged regions.

In looking at our Q4 top line performance and monthly sales cadence, we experienced similar results across November and December with our best results coming over Black Friday and Cyber Monday weeks in November as well as the last 2 weeks of December. January was our toughest month of the quarter.

Expanding further on the categories that outperformed, we remain very pleased with the performance in our Women's Apparel business with comps up 2% in Q4. Categories and brands in Women's Apparel comped positive for the quarter included outerwear; active; dresses; traditional; our brand, Liz Claiborne and Worthington; as well as our modern assortment.

In fact, if you look at Slide 9 in our accompanying earnings deck, you can clearly see the progress we are making in our Women's Apparel business not only in terms of sales trend, but the improved inventory management as well. If you look at quarterly performance within 2018, we saw an over 1,000 basis point acceleration on the 2-year stack comp in Women's Apparel from Q1 to Q4 while simultaneously driving inventory down 17%. Of note, gross profit for our Women's Apparel business was up 30 basis points in Q4 versus last year. And we remain optimistic with both sales and gross profit improvements in our Women's Apparel business and we expect they will have a positive impact in our business moving forward.



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

To expand on that thought a bit further, we believe our Women's Apparel business has historically been a leading indicator of our overall business. Data shows that a significant number of our customers shop Women's Apparel and the vast majority of these customers cross-shop our store. We believe our continued efforts and focus on Women's Apparel provide a great opportunity for the overall enterprise.

Next, our Fine Jewelry business continues to meaningfully outperform the rest of the business, comping up low double digits in Q4. Our merchandising and store teams continued to offer great merchandise and customer service to deliver an enhanced assortment and drive customer engagement in this key category.

Also, our Children's Apparel business outperformed the company comp and was flat for the quarter. We saw strong performance in both our toys and baby apparel and gear businesses, a clear indication that our efforts to enhance these categories and capture market share from competitor closings are working.

And finally, and Men's Apparel outpaced the company comp with particular strength in our active apparel and big and tall apparel categories. Special-sized apparel continued to show strong results with our Men's big and tall apparel business up double digits this quarter.

Similar to last quarter, we, again, saw strong results in our stores that were previously co-tenant with Bon-Ton and continued to see these stores meaningfully outpace the balance of the chain, again, demonstrating our ability to win share from closing competitors.

Additionally, we were co-tenant with just over 90 Sears store locations that were closing and liquidating inventory during the fourth quarter. These liquidations did present a slight sales headwind during the quarter in those markets where there was store overlap, but we believe there is market share opportunity moving forward.

Credit income for the fourth quarter was \$121 million compared to \$84 million in Q4 last year. For the full year, credit income was \$355 million compared to \$319 million last year. Credit income this year has clearly improved relative to our expectations at the beginning of the fiscal year, which was largely a function of an improved credit customer portfolio.

Cost of goods sold for the fourth quarter was 68.7% of net sales, an increase of 220 basis points compared to the same period last year. The increase is primarily attributable to the clearance markdowns during the quarter related to our continued efforts to clean up our inventory positions.

For the full year, cost of goods sold was 67.5% of net sales, an increase of 210 basis points.

As you just heard from Jill, we have several key initiatives we are focused on at JCPenney, and certainly, gross margin improvement remains a major focus for us. As we mentioned on our last call, we know that with the right action and rigor around surrounding inventory management, we have opportunities to improve our current productivity and turns, and ultimately, our gross margin performance. A direct benefit resulting from more efficiently managed inventory is our ability to generate significant gross margin upside through the restoration of clearance selling margins back to historical levels.

As you can see from the chart on Slide 8 of our accompanying slide deck, we were in a similar situation at the end of fiscal 2013 and we were back to positive levels within 2 years. We know our reality today provides a significant opportunity for us to drive meaningful improvements in gross margin as we move forward.

As we discussed last quarter, we believe there are other areas of opportunity that can also provide meaningful benefits to gross margins moving forward. These include, first, our recent decision to eliminate noncore and low gross margin product categories such as major appliances and furniture will allow us to refocus on driving higher sales and gross margin in areas including apparel and soft home.

Second, improving our shrink results. As you know, we are significantly underperforming relative to normalized levels in shrink. We have taken immediate action to improve our shrink results and are beginning to see some traction on recent technology investments and staffing adjustments. Having said that, simply by better managing our inventory and shrink, areas which are completely within our control, we can deliver gross margin and EBITDA upside.



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

Next, we will continue to leverage our capabilities within our private brand network and better utilize our best-in-class global sourcing operations.

And finally, we will further expand and emphasize our pricing analytics efforts.

Moving now to expenses. SG&A expenses in Q4 this year were down \$45 million to \$1.01 billion or 27% of net sales compared to \$1.05 billion or 26% of sales in Q4 last year. The dollar reduction in Q4 this year was primarily attributable to the approximately \$30 million in additional SG&A expenses last year related to the 53rd week. In addition, other SG&A expense reductions included lower incentive compensation.

For the full year, SG&A expenses were down \$249 million to \$3.6 billion compared to \$3.85 billion last year. As a reminder, we now include the current service cost component of pension expense and income in SG&A. All other components of net periodic pension costs and income are now recorded in a separate line item below operating income. Service cost does not impact our operating cash flow and is funded through our pension trust. The pension plan currently remains in an overfunded status. And as a reminder, no cash contributions are expected for the foreseeable future.

Net interest expense this quarter was \$78 million and \$313 million for the full year.

Adjusted net income was \$57 million or \$0.18 per share for the fourth quarter this year compared to adjusted net income of \$160 million or \$0.51 per share for the fourth quarter last year. Fourth quarter adjusted net income for 2018 and 2017 included the following items: \$14 million or \$0.04 per share benefit this year related to other components of net periodic pension income compared to an \$8 million cost or \$0.03 per share last year; \$2 million or \$0.01 per share charge this year related to restructuring and management transition charges compared to \$9 million or \$0.03 a share charge last year; \$6 million, \$0.02 per share benefit this year related to the tax impact, resulting from other comprehensive income allocation compared to \$14 million or \$0.04 per share benefit last year; \$8 million or \$0.03 per share benefit last year related to the proportional share of net income from the Home Office Land Joint Venture; and \$75 million or \$0.24 per share benefit last year related to the impact of tax reform.

For the full year, adjusted net loss was \$296 million or \$0.94 a share compared to adjusted net income of \$31 million or \$0.10 per share last year.

Now let's turn to our capital structure, liquidity position and balance sheet. As expected, we continued to draw down against our ABL facility early in the fourth quarter to fund a portion of our seasonal working capital needs. At our November peak, we had a total of \$576 million outstanding under this facility, and by the first week of fiscal December, the entire outstanding balance was repaid in full. And we ended the fiscal year with a 0 outstanding balance under the ABL facility.

We ended the fiscal year with a liquidity position of approximately \$1.9 billion, driven by a change in timing of receipts. Importantly, as these goods were processed and we calculated an updated position for end of February, our liquidity is over \$2 billion today. As a reminder, we have very manageable near-term debt maturities with \$50 million of unsecured debt maturing in October later this year and \$110 million of unsecured debt maturing in June of 2020.

Cash and cash equivalents at the end of the year were \$333 million. And during the year, we utilized approximately \$230 million in available cash to reduce outstanding debt levels. In addition, capital expenditures, net of landlord allowances, for fiscal 2018 were \$369 million.

For fiscal 2018, we generated positive free cash flow of \$111 million.

Inventory at the end of the year was approximately \$2.4 billion, down \$366 million or approximately 13% versus the end of last year.

Both our fall and seasonal inventory levels as well as our basic inventory levels were down significantly at the end of this year compared to the end of last year. Additionally, our current spring seasonal buys are also down as the teams continue to exit unproductive and unprofitable categories and review and edit existing ones.

That said, our inventory content is vastly improved with a balanced penetration of newness in our assortment. We believe our inventory levels are well positioned as we head into 2019, however, we know we have more work ahead of us. Our teams remain focused as they continued to





## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

thoughtfully and swiftly work to clear unwanted inventory, reestablish processes and disciplines and implement training to ensure we prevent the future buildup of unprotected inventory.

Having said that, we expect inventory to be a source of working capital in 2019 as we further work to appropriately reduce our inventory levels.

Merchandise accounts payable was \$847 million, down 13% or \$126 million versus the end of last year. The reduction was primarily due to our reduced inventory position.

Now let me touch on our store closing process. As we announced this morning, we will close 18 full-line stores and 9 ancillary home and furniture stores in 2019. The stores identified for closure either require significant capital or are minimally cash flow positive today relative to the company's overall consolidated average. Comparable sales performance for the closing stores was significantly below the remaining store base and these stores operate at a much higher expense rate -- expense rate given the lack of productivity.

During the first half of 2019, the company expects to record an estimated pretax charge of approximately \$15 million, primarily relating to noncash asset impairments and transition costs in connection with this action.

Now let me briefly touch on 2019 expectations. Given our recent leadership transition and the need to further assess current and go-forward execution of the business, we believe it is appropriate to withhold providing 2019 full year earnings guidance at this time. We are continuing our work and look forward to sharing more details on our plans and strategies in the near future.

With that said, we did want to provide some thoughts on key financial metrics and expectations in 2019. As mentioned, free cash flow for full year 2019 is expected to be positive. Depreciation and amortization for the full year is expected to be approximately \$535 million. Pension expense for full year is expected to be a credit of approximately \$50 million. Net interest expense for full year is expected to be approximately \$300 million. Income tax expense for full year is expected to be approximately \$15 million. Capital expenditures for full year is expected to be in a range of \$300 million to \$325 million. We are expecting asset sale cash proceeds of approximately \$20 million. And lastly, the spread between comps and total sales is expected to be approximately 60 basis points for the year.

In closing, and as you just heard from Jill, the teams have been diligently working towards reestablishing the fundamentals of retail at JCPenney, building capabilities focused on satisfying the wants and expectations of our customers and working to ensure that our digital and store operations operate seamlessly to provide experience that exceeds our customers' expectations. While our work to define JCPenney's longer-term vision is not yet complete, we've made significant progress in defining priorities for our business. With that, I will turn the call back to Jill for a few closing remarks before we open the lines for questions. Jill?

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

Thank you, Trent. Before we open the call for questions, I would like to take a moment to share how much I believe in the potential of this company, which becomes more evident each day that I am immersed in the customer data and the business. As I mentioned earlier, amid all the behind-the-scenes work to formulate our go-forward plans, we are doing what we need to do now to be better. This includes reestablishing and repairing the fundamental practices that strengthen our day-to-day business and positions us for sustainable profitable growth.

Today, we hired key executives that will serve in critical roles as we swiftly and thoughtfully move our business forward. And as I work to complete my leadership team, we will continue to map out a comprehensive long-term strategy for JCPenney, which we look forward to sharing in the coming months.

In the meantime, you have my assurance that we are not accepting the status quo. This is not business-as-usual. Our current reality is clear: JCPenney has been and continues to be in transition. While it doesn't matter how or why we got here, we are taking deliberate actions to improve our operations so we can build the kind of momentum that drives change.





## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

This is a critical time in our company's evolution and our approach needs to be different, balancing the need to act with immediacy while taking the appropriate amount of time to get our strategy right.

Therefore, we have been moving fast to substantially address the areas where we can make a difference as we methodically lay the groundwork for a long-term growth plan.

We have much work to scale our business to position JCPenney for success and create long-term value for our shareholders. However, our unwavering focus and discipline is already enabling meaningful progress. I am confident in the steps we're taking to realize the potential that lies ahead. And on that note, we will be happy to take your questions. Operator, we are ready to open the line for questions.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Our first question comes from Mark Altschwager with Baird.

#### **Mark R. Altschwager** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Jill, Women's Apparel, clearly a big opportunity and a top priority. Can you talk a bit about JCPenney's current supply chain capabilities on this front? What needs to be done or what can be done to increase speed in some of the fashion categories? And then, separately, you did a great job driving a positive comp in Q4 with significantly lower inventory in Women's Apparel. Curious how much of that was onetime liquidation of some aged inventory and how we should be thinking about the balance of inventory and comps, specifically to the apparel category moving forward?

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

All right. Mark, thanks for dialing in. And in terms of Women's Apparel and the supply chain, I feel good about our supply chain and our ability to be able to source what we need to, as well as I alluded to, that our vendor community and the initiatives, the ideas, the new brands, the propositions that the vendor community is bringing to us that's really inspiring us and aiding us in our work as we develop our long-term strategy so that as we get closer to our customer, we can select which of those propositions make the most sense for us to continue to connect with our customer and improve our results. As it relates to Q4 and our results, there was very little of the aged goods that we cleared that impacted that Q4. It was a lot of natural organic increase in our Apparel business.

#### **Mark R. Altschwager** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And then, Trent, appreciate the guidance metrics you provided earlier. Any further clarity you can provide just on that comp gross margin outlook for the year and kind of the cadence through the year given some of the initiatives that are going on? Any additional help would be great.

#### **Trent Kruse** - *J. C. Penney Company, Inc. - SVP of Finance*

Sure, Mark. Listen, obviously, as we mentioned on the call, we're not prepared to give any sort of fundamental guidance this year. Although having said that and to your point, I think as it relates to gross margin in particular, certainly expect that to be a benefit this year. Would expect that to be improved in 2019. As you can imagine, you're probably going to see that develop a little -- frankly, later in the year, if you will. I would say similar from a comp perspective. So while I unfortunately can't probably give you as much clarity as you'd like, I think if you're thinking about it in terms of kind of progression through the year, I would say that's the best way to look at those 2 metrics as we go into 2019. And obviously, that said, we look forward to sharing more details on the thoughts for '19 on a full year and quarterly basis in the near future.



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**FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call**


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**Operator**

Our next question comes from Oliver Chen with Cowen and Company.

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**Maksim Rakhlenko** - *Cowen and Company, LLC, Research Division - Associate*

This is Max on for Oliver. So first, you laid out a number of initiatives for the year. But could you just touch on the ones that you think will have the most impact on comps? And then also, you did not call out Sephora. So can you just discuss the trends you're seeing there?

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

All right. Thanks for the questions. And as you heard, we have a lot going on here at JCPenney. We're not sitting still and we took some near-term actions like reducing some of our noncore and low gross margin categories so that we can better focus what's core to our DNA and what our customer really looks for -- looks to us for with our apparel categories and also our soft home categories. I would say, in addition to that, just our continued focus on reducing inventory and clearing unproductive inventory, that also will create a better shopping experience where our customer can really find the great products that we have. As I have walked the stores with the teams, by myself, with our store associates, we have incredible products in our stores. We just have the opportunity to do a better job of highlighting that and that will be helped and aided by reducing this inventory levels. As it relates to Sephora, we didn't mention it, but our relationship is very strong and very exciting. In fact, I just met with the new CEO of Sephora just a couple of days ago. We had a very exciting conversation. We're both on the same page. We see great things for Sephora inside JCPenney as we move forward and we look forward to getting that going. And like we demonstrated in our total prepared remarks, we're moving with speed. We're being very thoughtful, but we're moving swiftly.

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**Trent Kruse** - *J. C. Penney Company, Inc. - SVP of Finance*

And Max, if I could just add just a little bit on the Sephora piece. I will tell you obviously skin care continues to trend very well in that space. We've seen some great success in the new and trending space within skin care and particularly -- and obviously, continuing, to Jill's point, our partnership with Sephora on exclusive and new trending brands that, I think, will really deliver some freshness, newness and see that business improve from a color perspective, including the launch of IT Cosmetics in 2019 and kind of a continued rollout, if you will, on some of the new brands that we've put in place such as Fresh or Junk Elephant. So I think we're excited obviously to keep moving that business forward in 2019, and to Jill's point, her recent conversations with their team have been very productive.

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**Maksim Rakhlenko** - *Cowen and Company, LLC, Research Division - Associate*

Got it. And just one last one. Can you update us on your top digital priorities? Just some insights there.

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

Well, as I mentioned in the script that strengthening our omnichannel capabilities is a top priority. And we're taking actions in the near term here as with many of our problems that we need to solve to improve our positioning. And we're spending a lot of time on our site from an assortment standpoint and experience standpoint and assuring that the technology platform that supports it is top-notch. And a lot of effort is being done around that as we either look to becoming a stronger omnichannel retailer so that we can be where and when our customers want us to be. So we're taking a lot of action. I am in search for a leader for e-commerce in order that we can make more progress faster. And in my experience, what we're doing right now is mission-critical to get the foundation reestablished so that when that new leader comes in, he or she can hit the ground running and I've seen it done before. And the good thing about digital capabilities is it is real-time and we can move quickly.

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## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

### Operator

Our next question comes from Paul Trussell with Deutsche Bank.

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

I wanted to maybe, first, just ask about the impact of the appliance and furniture exit. I know you're not giving broader guidance, but if we could maybe just isolate this one decision. Is there any color you can provide specific to the impacts to comp, to gross margin, to EBITDA that you expect from the exit of appliance and furniture?

### Trent Kruse - J. C. Penney Company, Inc. - SVP of Finance

Sure, Paul. This is Trent, I'll take that one. As I mentioned in the prepared remarks, it was 2.7% of sales last year. So I think safe to assume the headwind, if you will, on the top line will be somewhere in that territory. Obviously, during the year and as we alluded to, we'll be working to fill that space with more desirable products and categories to hopefully offset some of that potential headwind that we see. But I think if you're thinking about it in that 2.7%-like territory, I think that's fair. Yes, I did mention these are negative businesses on an operating profit, EBITDA line. So I think as you consider that, what I would tell you for the year is it's probably more neutral to a slight benefit potentially in '19. And the reason for that is, to your point, as we are liquidating some of the floor models that we do own in terms of the inventory, particularly in appliances, we will see a little bit of pressure here early in the year as we're winding that business down in the first quarter. But then would expect to see the improvements beyond that. And would tell you from an EBITDA perspective in '19, it's probably a more neutral situation based on the liquidation. But then hope for some benefits obviously as we move forward beyond those negative results.

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

And then as we think about the SG&A expense line you all have done a lot to keep that under control, just curious as you take a look out over the next 12 months, how are you thinking about that balance between making additional investments into the team, into the infrastructures, supply chain, digital initiatives versus being able to find additional ways to maybe have savings and actually have that contribute to growth in EBITDA?

### Trent Kruse - J. C. Penney Company, Inc. - SVP of Finance

Right. Look, I think you nailed it, Paul. I mean, there will be some investments that we make to enhance customer experience, enhance the team, et cetera. But I think as you also know, we will continue -- have shown, as you alluded to, and will continue to, I think, demonstrate our ability to find opportunities within SG&A. Be in areas such as corporate overhead, I think, is still an area where we can be focused and potentially find some additional savings. But I think, clearly, the priority really switches here to moving the top line and margin profile of the business forward, right. I mean, SG&A results have been strong as you alluded to. We know that we're not going to cut ourselves to prosperity or to the ultimate goal that we have. But I do believe there are some ongoing opportunities, certainly in '19 and probably beyond. But I think there will be some additional areas that we do invest in to enhance that customer experience. I don't know, Jill, if you'd to add anything?

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

I concur with what Trent has said. It is an area that we are focused on and we'll ramp up that effort as we move forward. It's been 4 months since I've been here and our teams have done a lot and now continue to build on the number of initiatives we already have to be able to improve our SG&A, but also determine where we need to reinvest.

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

Lastly, and very quickly, Jill, just quick comments on your view early on of Penney's current position and mix between national and private brands?



FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

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

Well, I've spent a lot of time with the merchandise organization in the stores looking at our mix. Certainly, I'm looking at our competition. And what I feel is that we have very strong, high-equity, storied private brands that are very, very important to us and important to our customer. We also have some of the best national brands within our stores that we hold in very high regard. And as we continue to develop our long-term strategy of where JCPenney can win within the industry in total, a complementary relationship between strong national brands that the customer knows and loves along with focused and highly segmented and fashion and high-quality and value private brands is critical. So that is a very strong focus of our consideration set as we move forward. And then, as I mentioned, we're getting a lot of great input from vendors in the marketplace on new opportunities and brands and ideas and initiatives that we have in our consideration set. So I'm very excited about the potential we have to create that strong brand proposition with the combination of national and private brands.

**Operator**

Our next question comes from Chuck Grom with Gordon Haskett.

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

When we look back to 2013, the company underwent a tough stretch, but the gross margins recovered pretty quickly. I think they were up over 500 basis points from '13 to '14. So when you think about all the moving parts and the leverage you guys can pull, can you handicap first that opportunity and maybe rank where you see the easiest wins near term versus ones that you think will take a little bit longer?

**Trent Kruse** - *J. C. Penney Company, Inc. - SVP of Finance*

Sure, Chuck, I'll take that one just from a gross margin perspective. Well, look, I think as we alluded to in the remarks and have been really discussing over the last couple of calls, I think clearance margin restoration is probably right at the top of that list, right, from an immediacy and impact perspective. We're ending the year with inventory down 13%, continuing to work through inventory opportunities as you alluded to and saw in that chart. That was certainly an area in the clearance margin that we saw some pretty speedy recovery. So I would certainly put that at the top of the list. Secondly, I would probably point us to shrink. That is clearly an area where we have been underperforming, have some real opportunity and have started to see some benefits and some improvements as we've taken audits and spot checks in the back half of the year. And obviously, with the recent announcement this morning of some new leadership in that area with a very proven track record, we think that will only enhance what we're doing there. So I would certainly put those two pieces at the top of the list. And then I think Jill has something to add to that.

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

Yes, I'd chime in here that although I can't completely comment on what happened exactly in 2013, but in addition to what Trent said with improving our clearance levels and the mix that it represents within our assortments and also shrink, just our focus on our merchandise strategies and assortment and how we bring that to life with the customer, making it easier for her to find the value in the great products that we offer, I would also say that balancing those labor hours that relate to shrink but also we're looking at further testing on what enhanced labor hours at certain times of the shopping week that can actually drive top line and gross margin. So it's also -- it's related to shrink but also how we deliver a better customer experience. We have a best-in-class global sourcing and design group and we're really focused on improving our quality as well as making sure our style is relevant to what your customer wants. And then, finally, I would just say that although I didn't touch on it in prepared remarks, but we are stepping off on a very strong focus on the depth and breadth of our pricing and promotion and ensuring that we are instilling confidence within our customer that she can get a great value every day at JCPenney and that will also contribute to an improved gross margin.



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

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

Okay, that's helpful. And then just, Jill, in your prepared remarks, you talked about some talks with the vendor community and new brands, potentially new initiatives, potentially -- but also balancing that with profitable growth. Maybe if you could just -- maybe just share with us what maybe you could be thinking in terms of new opportunities to reestablish the image of JCPenney?

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

Well, I appreciate the question, Chuck, and it has been just super inspiring to me with all our vendor partners. Most of them I've known just my entire career, and to reengage with them now as being part of the team here at JCPenney has just been super rewarding and inspiring. Although I can't comment on some of those brands and opportunities and partnerships that have been offered to us, I will tell you that they have been plentiful. I've been very appreciative of the support that the vendor community has displayed to date and we are moving as quickly as we can to get through the last couple of segments of our long-term strategy development so that we make the right decisions that we're very thoughtful and the partnerships that we take on are the new brands that we launch. And I'm looking forward to getting back to them as well because they have just showed great support to us.

**Operator**

Our next question comes from Jeff Van Sinderen with B. Riley FBR.

**Jeffrey Wallin Van Sinderen** - *B. Riley FBR, Inc., Research Division - Senior Analyst*

Jill, I realize you're still completing your vision work, but now that you've been there for a holiday season, can you share maybe a little bit more about what stands out most to you in terms of what you learned over holiday about JCPenney and how the customer relates to JCPenney, the concept? And I know you see to business going forward without appliances, but what do you do with the space that was occupied by appliances? What do you put in there? And aside from improving the Apparel overall, which I have no doubt you could do, what can you share with us about your vision to more substantially evolve the JCPenney business to become more relevant? I guess what are the key points of differentiation that you see JCPenney standing for?

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

Okay. I'm just taking a couple of notes, Jeff, to make sure I answer all your questions. Okay, so what did I learn over holiday? A lot, and I think we covered it pretty holistically in the comments that we've shared. And that is that there is a lot of actions we need to take to reestablish and repair the fundamentals of retail. There are very key parts of this business that all of us in retail have to have established and have working well on a daily basis in order to just do good retail. And then it's the ability to be very refined and buttoned up, almost a well-oiled machine to do great retail. And so many of the things we talked about in terms of reducing and enhancing our inventory and clearing unproductive inventory, which is great for cash flow and it's great for gross margin, but it's also critically important to the customer's experience. And so I won't repeat everything that was in the script. But as I move on to how does the customer relate to us, what I've heard from our customers is that they are in our corner. JCPenney is a storied brand that has been part of the American consumer consideration set for a very long time. And as I've engaged with customers, as I've gotten data from the over thousands of surveys we did and focus groups and shop-alongs and things like that, our customer wants us to be restored to greatness, if you will, because they have great memories. They still find great stuff. We're still doing a lot of business. We just have to be better and improve how we're showing up for her shopping experience and what we're selling. The other piece is how we're promoting. I think that's one of the key initiatives that we'll be working on here in the coming months because we're not being as strategic in how we speak to the customer and engage with the customer through our pricing and promotion. And I would frankly say it might be a little bit confusing, and you might not know exactly when you can get the best value at JCPenney, which, in fact, everyday you should be able to get a great value at JCPenney. This is something that I learned long ago in my career. And I know what good looks like here. And the good thing is that our team understands what good looks like. Because it wasn't too many years ago that they were running a strong pricing and promotion effort and strategy. Regarding moving forward, thank you for your confidence that we will improve Apparel, I appreciate that. As mentioned, we're not quite ready to share our vision



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

go-forward. Frankly, I would say we're about 2/3 of the way through it. I feel good about the direction it's taking. But it would be premature for me to discuss just high-level ideas on what we're thinking. But here's what I will give you assurance on is that I place -- first, I place a high value on the fundamentals of retail. In my experience and with the last 15 years or so that I've been in situations where retail companies have lost their way, first and foremost, the fundamentals of retail have to be in place. But at the same time, you have to innovate and you have to grow and you have to run parallel paths so that you are creating innovation and becoming more relevant to the customer. And so that's what we're working on right now. So I appreciate your interest, Jeff, and I look forward to sharing more about that in the coming months.

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### Operator

Our next question comes from Matthew Boss with JPMorgan.

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### Matthew Robert Boss - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

So on inventory, 13% reduction to exit the year, but I think still flat versus 2016 on a per-square foot basis. Jill, I guess how much opportunity do you see remaining? And to your comments, Trent, would positive gross margin would be an unreasonable assumption in the front half of the year?

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

Thanks, Matthew. We have quantified what we feel is an opportunity to reduce our inventory levels. It is a very long process and not that it's not doable, but we have to be methodical about it. Because where I see the excess inventory, it sits in still a bit in fashion, maybe what I would call fashion basics and basics. And so we have to be thoughtful in how we plan to reduce this knowing that, in some cases, it just may be excess of great go-forward merchandise that we want to continue with. And so although I'm not prepared to quantify that for you, what I would say is that this is a long-term effort that through my experience and I've -- where I've seen retailers being -- they find themselves in an overstaffed position, it does take some time. The other really, really critical piece though is that we are training and we're being very thoughtful on how we're buying go forward, how we're planning, how our replenishment is set, how our allocation is being done so that we don't continue to create situation. And I will say, spending a lot of time with our planning and allocation folks and our merchants, coupled with the fact that we now have a Chief Merchant and a new Senior Vice President of Planning and Allocation, I feel very good about our ability to manage this go forward. And I honestly think our go-forward efforts to buy correctly is part of our DNA. When I think about JCPenney, they were always the best operators in the business. And I have confidence there. Our work is going to be in how we continue to move through some of these excess inventory.

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### Trent Kruse - J. C. Penney Company, Inc. - SVP of Finance

And Matt, just to your second question, GM first half of the year, no, I would not say that as an unrealistic expectation. I think probably as you can imagine, it does probably tilt towards Q2 relative to Q1 as we work through some of these category exits. But no, I don't think that's unrealistic. And I think you're point on inventory is well taken. We've made a lot of progress, and as Jill alluded to, we still have a little bit more to do and that's similar to your comments, it's because as we look at it on a per-store basis, there is still some opportunity.

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### Matthew Robert Boss - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

Great. And then just one follow-up. Near term, I think the math was negative high single-digit shifted comps in January. Maybe have you seen any improvement in February? Or just any direction you can provide for the first quarter same-store sales, I think, would be helpful.

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### Trent Kruse - J. C. Penney Company, Inc. - SVP of Finance

Matt, yes, look, I think we don't want to get into obviously quarter-to-date results or anything like that. So I apologize to not be helpful on that front. But we obviously look forward to sharing more as we go.



## FEBRUARY 28, 2019 / 1:30PM, JCP - Q4 2018 J C Penney Company Inc Earnings Call

### Operator

The last question comes from Dana Telsey with Telsey Advisory.

### Dana Lauren Telsey - Telsey Advisory Group LLC - CEO & Chief Research Officer

As you think about store closures, can you talk about the expectation for closures going forward? And also, when you close a store, what's the profile of the stores that you are closing? And then just lastly, CapEx budgets in 2019. How do you look at the framework of what priorities are for allocation of CapEx?

### Trent Kruse - J. C. Penney Company, Inc. - SVP of Finance

Dana, sure. So look, on the store closings, I think as we go forward, as we mentioned, we're closing 18 this year. I think it's safe to assume that as you roll into '20 and future years, it's likely to see some continuation of that effort. Hard to say now, but I think that's a fair read. I think the team does a really nice job across real estate, stores and finance to really kind of fine-tune that approach. And the characteristics of these stores candidly are they're underperforming, right? They're in tough locations, the demographics probably aren't as favorable to us. Maybe there's not as much of a reason to believe that there can be a recovery there. So they're comping below average. They're less productive, meaning the SG&A rates are higher. And so that's the general profile of these stores. You can't say they're all rural or all mall or all off-mall or big or small. It is a combination of those things. But I'd say the key function there is the market is probably not a place where we see sustainable long-term opportunities and the current reality of the stores from a sales and productivity perspective is tough. From a CapEx perspective in '19, I think it'll be well balanced. Yes, we've been, I would say, roughly half and half kind of store-based and then technology or out-of-store spend. And I would say that's probably looking similar in '19, maybe tilting a little more towards digital initiatives this year. I think that's probably the best way to think about the CapEx spend.

### Operator

Ladies and gentlemen, this does conclude today's conference call. You may now disconnect, and have a wonderful day.

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