J C PENNEY CO INC
Form 10-K/A
May 30, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(Amendment No. 1)
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended February 3, 2018
or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to ________________
Commission File Number: 001-15274

J. C. PENNEY COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware	26-0037077
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6501 Legacy Drive, Plano, Texas 75024-3698
(Address of principal executive offices)
(Zip Code)
(972) 431-1000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock of 50 cents par value	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant’s most recently completed second fiscal quarter (July 29, 2017). $1,716,555,230

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

312,215,072 shares of Common Stock of 50 cents par value, as of March 16, 2018.

DOCUMENTS INCORPORATED BY REFERENCE

Documents from which portions are incorporated by reference	Parts of the Form 10-K into which incorporated
J. C. Penney Company, Inc. 2018 Proxy Statement	Part III

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Explanatory Note

This Amendment No. 1 to Annual Report on Form 10-K/A ("Amendment No. 1") is being filed by J. C. Penney Company, Inc. (the "Company") to amend the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018 filed with the Securities and Exchange Commission on March 19, 2018 (the "Original 10-K").
This Amendment No. 1 is being filed at the request of KPMG LLP ("KPMG") solely to provide a corrected version of KPMG's report contained in Part II, Item 8 of the Original 10-K to include a paragraph that was inadvertently omitted from such report that confirms that KPMG, the Company's independent registered accounting firm, audited the Company's internal control over financial reporting for the fiscal year ended February 3, 2018. This change does not in any way change the conclusions expressed by KPMG in the original report included in the Original 10-K. This change also does not in any way change any other disclosure included in Part II, Item 8 of the Original 10-K, including, but not limited to, the Consolidated Financial Statements and notes thereto of the Company included in the Original 10-K.
In addition, the exhibit list included in Part IV, Item 15 of the Original 10-K has been amended to contain currently-dated certifications from the Company's Principal Executive Officer and Principal Financial Officer, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, as well as a currently-dated consent of KPMG.
For ease of reference, this Amendment No. 1 restates the Original 10-K in its entirety, making only the amendments described above. Except as described above, this Amendment No. 1 does not otherwise amend, update or change any other information or disclosure contained in the Original 10-K. This Amendment No. 1 speaks only as of the date of the Original 10-K and does not reflect any events that may have occurred subsequent to the date of the Original 10-K.

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PART I

Item 1. Business

Business Overview

J. C. Penney Company, Inc. is a holding company whose principal operating subsidiary is J. C. Penney Corporation, Inc. (JCP). JCP was incorporated in Delaware in 1924, and J. C. Penney Company, Inc. was incorporated in Delaware in 2002, when the holding company structure was implemented. The new holding company assumed the name J. C. Penney Company, Inc. (Company). The holding company has no independent assets or operations, and no direct subsidiaries other than JCP. Common stock of the Company is publicly traded under the symbol “JCP” on the New York Stock Exchange. The Company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP’s outstanding debt securities. The guarantee by the Company of certain of JCP’s outstanding debt securities is full and unconditional. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this Annual Report on Form 10-K as “we,” “us,” “our,” “ourselves,” “Company” or “JCPenney.”

Since our founding by James Cash Penney in 1902, we have grown to be a major retailer, operating 872 department stores in 49 states and Puerto Rico as of February 3, 2018. Our fiscal year ends on the Saturday closest to January 31. Unless otherwise stated, references to years in this report relate to fiscal years, rather than to calendar years. Fiscal year 2017 ended on February 3, 2018; fiscal year 2016 ended on January 28, 2017; and fiscal year 2015 ended on January 30, 2016. Fiscal year 2017 consisted of 53 weeks and fiscal years 2016 and 2015 consisted of 52 weeks.

Our business consists of selling merchandise and services to consumers through our department stores and our website at jcpenney.com, which utilizes fully optimized applications for desktop, mobile and tablet devices. Our department stores and website generally serve the same type of customers, our website offers virtually the same mix of merchandise as our store assortment plus other extended categories that are not offered in store, and our department stores generally accept returns from sales made in stores and via our website. We fulfill online customer purchases by direct shipment to the customer from our distribution facilities and stores or from our suppliers' warehouses and by in store customer pick up. We primarily sell family apparel and footwear, accessories, fine and fashion jewelry, beauty products through Sephora inside JCPenney, home furnishings and large appliances. In addition, our department stores provide our customers with services such as styling salon, optical, portrait photography, custom decorating and home services.

Based on how we categorized our divisions in 2017, our merchandise mix of total net sales over the last three years was as follows:

	2017	2016	2015
Women’s apparel	22 %	23 %	25 %
Men’s apparel and accessories	21 %	22 %	22 %
Home	15 %	13 %	12 %
Women’s accessories, including Sephora	13 %	13 %	12 %
Children’s apparel	9 %	10 %	10 %
Footwear and handbags	8 %	8 %	8 %
Jewelry	6 %	6 %	6 %
Services and other	6 %	5 %	5 %
	100%	100%	100%

Operating Strategy

We have developed a strategic framework that focuses on the following three pillars:

•Private brands;
•Omnichannel; and
•Revenue per customer.

We believe these three pillars provide the foundation to increase loyalty with our customers and enable the organization to simplify its focus by ensuring that resources and capital investments are effectively allocated to drive these priorities.

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Our first priority is private brands. To differentiate us with the consumer, we plan to leverage our sourcing and private brand infrastructure to increase our production of private brands with style, quality and value. With an established global network of sourcing offices, along with a team of in-house designers, we plan to grow private brand penetration to enhance our profitability.

Our second priority is to become a world-class omnichannel retailer. We have a rich heritage of being a catalog retailer and have much of our omnichannel infrastructure already in place. We are digitally connected with our customers via a mobile app and the Internet and have three large, strategically located dot-com distribution centers with approximately five million square feet of space for providing expanded assortment and order fulfillment. Additionally, our objective is to create a seamless connection between our digital and brick-and-mortar operations through initiatives such as a mobile app that is designed to be deeply integrated with the store experience and buy-online-pick-up-in-store (BOPIS).

Our final strategic priority is increasing revenue per customer. Within our new brand platform of "Style and value for all," it is our mission to help our customer find what she loves for less time, money and effort. To accomplish this mission, we see an increased opportunity to grow shopping frequency and the amount that customers spend on every transaction. We plan to address this opportunity by enhancing our cross-merchandising appeal with initiatives to continue the roll out of our Sephora inside JCPenney locations and to further promote our appliance and home merchandise categories.

Competition and Seasonality

The business of selling merchandise and services is highly competitive. We are one of the largest department store and e-commerce retailers in the United States, and we have numerous competitors, as further described in Item 1A, Risk Factors. Many factors enter into the competition for the consumer’s patronage, including merchandise assortment, advertising, price, quality, service, location, shipping times and cost, online and mobile user experience, reputation, credit availability, customer loyalty, availability of in-store services such as styling salon, optical, portrait photography and custom decorating, and the ability to offer personalized customer experiences. Our annual earnings depend to a great extent on the results of operations for the last quarter of the fiscal year, which includes the holiday season, when a significant portion of our sales and profits are recorded.

Trademarks

The JCPenney®, JCP®, Liz Claiborne®, Claiborne®, Okie Dokie®, Worthington®, a.n.a®, St. John’s Bay®, The Original Arizona Jean Company®, Ambrielle®, Decree®, Stafford®, J. Ferrar®, Xersion®, Belle + Sky®, Total Girl®, monet®, JCPenney Home®, Studio JCP Home™, Home Collection by JCPenney™, Made for Life™, The Boutique™ Plus Sleep Chic®, Home Expressions® and Cooks JCPenney Home® trademarks, as well as certain other trademarks, have been registered, or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law. We consider our marks and the accompanying name recognition to be valuable to our business.

Website Availability

We maintain an Internet website at www.jcpenney.com and make available free of charge through this website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all related amendments to those reports, as soon as reasonably practicable after the materials are electronically filed with or furnished to the Securities and Exchange Commission. In addition, our website provides press releases, access to webcasts of management presentations and other materials useful in evaluating our Company.

Suppliers

We have a diversified supplier base, both domestic and foreign, and are not dependent to any significant degree on any single supplier. We purchase our merchandise from approximately 3,100 domestic and foreign suppliers, many of whom have done business with us for many years. In addition to our Plano, Texas home office, we, through our purchasing subsidiary, maintained buying and quality assurance offices in 9 foreign countries as of February 3, 2018.

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Employment

The Company and its consolidated subsidiaries employed approximately 98,000 full-time and part-time employees as of February 3, 2018.

Environmental Matters

Environmental protection requirements did not have a material effect upon our operations during 2017. It is possible that compliance with such requirements (including any new requirements) would lengthen lead time in expansion or renovation plans and increase construction costs, and therefore operating costs, due in part to the expense and time required to conduct environmental and ecological studies and any required remediation.

As of February 3, 2018, we estimated our total potential environmental liabilities to be $20 million and recorded our estimate in Other accounts payable and accrued expenses and Other liabilities in the Consolidated Balance Sheet as of that date. This estimate covered potential liabilities primarily related to underground storage tanks, remediation of environmental conditions involving our former drugstore locations and asbestos removal in connection with approved plans to renovate or dispose of our facilities. We continue to assess required remediation and the adequacy of environmental reserves as new information becomes available and known conditions are further delineated. If we were to incur losses at the estimated amount, we do not believe that such losses would have a material effect on our financial condition, results of operations or liquidity.

Executive Officers of the Registrant

The following is a list, as of March 16, 2018, of the names and ages of the executive officers of J. C. Penney Company, Inc. and of the offices and other positions held by each such person with the Company. These officers hold identical positions with JCP. There is no family relationship between any of the named persons.

Name	Offices and Other Positions Held With the Company	Age
Marvin R. Ellison	Chairman of the Board and Chief Executive Officer	53
Jeffrey A. Davis	Executive Vice President and Chief Financial Officer	55
Brynn L. Evanson	Executive Vice President, Human Resources	48
Marci Grebstein	Executive Vice President, Chief Marketing Officer	54
Joseph M. McFarland	Executive Vice President and Chief Customer Officer	48
Therace M. Risch	Executive Vice President and Chief Information/Digital Officer	45
Michael Robbins	Executive Vice President, Supply Chain	52
Andrew S. Drexler	Senior Vice President, Chief Accounting Officer and Controller	47
Brandy L. Treadway	Senior Vice President, General Counsel	43

Mr. Ellison has served as Chairman of the Board since 2016, Chief Executive Officer since 2015, and as a director of the Company and a director of JCP since 2014. He previously served as President of the Company from 2014 to 2015. Prior to joining the Company, he served as Executive Vice President - U.S. Stores of The Home Depot, Inc. (home improvement supplies retailer) from 2008 to 2014. His prior roles with The Home Depot, Inc. included President - Northern Division from 2006 to 2008, Senior Vice President - Logistics from 2005 to 2006, Vice President - Logistics from 2004 to 2005, and Vice President - Loss Prevention from 2002 to 2004. Mr. Ellison began his career with Target Corporation (retailer) where he served in a variety of operational roles. Mr. Ellison currently serves as a director of FedEx Corporation (courier delivery services), the Retail Industry Leaders Association and the National Retail Federation.

Mr. Davis has served as Executive Vice President and Chief Financial Officer, and as a director of JCP, since July 2017. Prior to joining the Company, he served as Senior Vice President and Chief Financial Officer at Darden

Restaurants, Inc. (food service industry) from 2015 to 2016. Mr. Davis also served as Executive Vice President and Chief Financial Officer for the Walmart U.S. segment at Walmart Inc. (retailer) from 2014 to 2015. His prior roles with Walmart Inc. included Treasurer from 2010 to 2014, Senior Vice President, Finance and Strategy for the Walmart U.S. segment from 2009 to 2010, and Vice President, Finance, US Stores Operations/Specialty Division from 2006 to 2009.

Ms. Evanson has served as Executive Vice President, Human Resources since 2013, and as a director of JCP since 2017. She previously served as Vice President, Compensation, Benefits and Talent Operations from 2010 to 2013 and Director of Compensation from 2009 to 2010. Prior to joining the Company, she worked at the Dayton Hudson Corporation (retailer) from

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1991 to 2009 (renamed Target Corporation in 2000). Ms. Evanson began her career with Marshall Field's (department store retailer) where she advanced through positions in stores, finance, human resources and merchandising and moved to the Target stores division in 2000, ultimately serving as Director of Executive Compensation and Retirement Plans.

Ms. Grebstein has served as Executive Vice President, Chief Marketing Officer since June 2017. Prior to joining the Company, she served as Chief Marketing Officer of Lowe's Companies, Inc. (home improvement supplies retailer) from 2015 to 2017. Ms. Grebstein also served as Vice President, Advertising of Lowe's Companies, Inc. from June 2015 to November 2015. Prior to that, she served as Vice President, Marketing and Brand Strategy of Food Lion, LLC (grocery retailer) from 2012 to 2015 and in positions of increasing responsibility with Staples, Inc. (office supply retailer) from 1996 to 2012, including Vice President, Business-to-Business Marketing and eCommerce from 2006 to 2012 and Vice President, Media and Consumer Marketing from 1998 to 2006. From 1992 to 1996, Ms. Grebstein served in positions of increasing responsibility with CVS Health Corporation (retail pharmacy and healthcare), including Director of Advertising and Broadcast Advertising Manager.

Mr. McFarland has served as Executive Vice President and Chief Customer Officer since March 2018. Prior to that, he served as Executive Vice President, Stores from 2016 to March 2018. From 2007 to 2015, Mr. McFarland served as President, Northern and Western Divisions of The Home Depot, Inc. (home improvement supplies retailer), with which he served in positions of increasing responsibility since 1993. Prior to The Home Depot, he spent six years serving in the United States Marine Corps and is a veteran of Operation Desert Storm.

Ms. Risch has served as Executive Vice President and Chief Information/Digital Officer since March 2018. Prior to that, she served as Executive Vice President and Chief Information Officer from 2015 to March 2018. Prior to joining the Company, Ms. Risch served as Executive Vice President and Chief Information Officer of Country Financial (insurance and investment services) from 2014 to 2015. Prior to that, she spent 10 years at Target Corporation (retailer) in a variety of technology roles of increasing responsibility, including Vice President of Technology Delivery Services from 2012 to 2014 and Vice President, Business Technology Team from 2009 to 2012.

Mr. Robbins has served as Executive Vice President, Supply Chain since 2016. Prior to that, he served as Senior Vice President, Supply Chain from 2015 to 2016. From 2012 to 2015, Mr. Robbins served as Senior Vice President, Global Supply Chain at Target Corporation (retailer), with which he served in positions of increasing responsibility since 2001, including Senior Vice President of Distribution Operations from 2010 to 2012, Vice President of Pharmacy from 2008 to 2010 and Regional Vice President of West Coast Distribution from 2006 to 2008.

Mr. Drexler has served as Senior Vice President, Chief Accounting Officer and Controller since 2015. Prior to joining the Company, he served as Senior Vice President and Chief Financial Officer of Giant Eagle, Inc. (grocery retailer) from 2014 to 2015. He also served as Senior Vice President, Finance, and Corporate Controller for GNC Holdings, Inc. (health and nutrition retailer) from 2011 to 2014. Prior to that, Mr. Drexler spent 11 years at Walmart Inc. in roles of increasing responsibility, including Vice President of Finance for the information systems division from 2010 to 2011. Earlier in his career, he held a variety of roles with PricewaterhouseCoopers, LLP (accounting firm). Mr. Drexler is a certified public accountant.

Ms. Treadway has served as Senior Vice President, General Counsel since August 2017. She previously served as Vice President, interim General Counsel from June 2017 to August 2017, Vice President, Associate General Counsel from 2016 to June 2017, Assistant General Counsel from 2014 to 2016, Senior Managing Counsel from 2012 to 2014, and Senior Counsel from 2011 to 2012. Prior to joining the Company, Ms. Treadway was an associate at Weil, Gotshal & Manges, LLP (law firm) from 2002 to 2011.

Item 1A. Risk Factors

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking information contained in this Annual Report on Form 10-K. Any of the following risks could

materially adversely affect our business, operating results, financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

Our ability to sustain profitable growth is subject to both the risks affecting our business generally and the inherent difficulties associated with implementing our strategic plan.

As we position the Company for long-term growth, it may take longer than expected to achieve our objectives, and actual results may be materially less than planned. Our ability to improve our operating results depends upon a significant number of factors, some of which are beyond our control, including:

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- customer response to our marketing and merchandise strategies;
- our ability to achieve profitable sales and to make adjustments in response to changing conditions;
- our ability to respond to competitive pressures in our industry;
- our ability to effectively manage inventory;
- the success of our omnichannel strategy;
- our ability to gather accurate and relevant data and effectively utilize that data in our strategic planning and decision making;
- our ability to benefit from capital improvements made to our store environment;
- our ability to respond to any unanticipated changes in expected cash flows, liquidity and cash needs, including our ability to obtain any additional financing or other liquidity enhancing transactions, if and when needed;
- our ability to achieve positive cash flow;
- our ability to access an adequate and uninterrupted supply of merchandise from suppliers at expected levels and on acceptable terms;
- changes to the regulatory environment in which our business operates; and
- general economic conditions.

There is no assurance that our marketing, merchandising and omnichannel strategies, or any future adjustments to our strategies, will improve our operating results.

We operate in a highly competitive industry, which could adversely impact our sales and profitability.

The retail industry is highly competitive, with few barriers to entry. We compete with many other local, regional and national retailers for customers, employees, locations, merchandise, services and other important aspects of our business. Those competitors include other department stores, discounters, home furnishing stores, large appliance retailers, specialty retailers, wholesale clubs, direct-to-consumer businesses, including those on the Internet, providers of home improvement services and other forms of retail commerce. Some competitors are larger than JCPenney, and/or have greater financial resources available to them, and, as a result, may be able to devote greater resources to sourcing, promoting, selling their products, updating their store environment and updating their technology. Competition is characterized by many factors, including merchandise assortment, advertising, price, quality, service, location, reputation, shipping times and cost, online and mobile user experience, credit availability, customer loyalty, availability of in-store services, such as styling salon, optical, portrait photography and custom decorating, and the ability to offer personalized customer experiences. We have experienced, and anticipate that we will continue to experience for at least the foreseeable future, significant competition from our competitors. The performance of competitors as well as changes in their pricing and promotional policies, marketing activities, customer loyalty programs, availability of in-store services, new store openings, store renovations, launches of Internet websites or mobile platforms, brand launches and other merchandise and operational strategies could cause us to have lower sales, lower merchandise margin and/or higher operating expenses such as marketing costs and other selling, general and

administrative expenses, which in turn could have an adverse impact on our profitability.

Our sales and operating results depend on our ability to develop merchandise offerings that resonate with our existing customers and help to attract new customers.

Our sales and operating results depend in part on our ability to predict and respond to changes in fashion trends and customer preferences in a timely manner by consistently offering stylish, quality merchandise assortments at competitive prices. We continuously assess emerging styles and trends and focus on developing a merchandise assortment to meet customer preferences. There is no assurance that these efforts will be successful or that we will be able to satisfy constantly changing customer demands. To the extent our decisions regarding our merchandise differ from our customers' preferences, we may be

faced with reduced sales and excess inventories for some products and/or missed opportunities for others. Any sustained failure to identify and respond to emerging trends in lifestyle and customer preferences and buying trends could have an adverse impact on our business. In addition, merchandise misjudgments may adversely impact the perception or reputation of our Company, which could result in declines in customer loyalty and vendor relationship issues, and ultimately have a material adverse effect on our business, financial condition and results of operations.

We may also seek to expand into new lines of business from time to time, such as offering large appliances for sale and offering home improvement products and installation services through third-parties. There is no assurance that these efforts will be successful. As we devote time and resources to new lines of business, management's attention and resources may be diverted from existing business activities. Further, if new lines of business are not as successful as we planned, then we risk damaging our overall business results. In addition, we may seek to expand our merchandise offerings into new product categories. Moving into new lines of business and expanding our merchandise offerings may carry new or additional risks beyond those typically associated with our traditional apparel and home furnishings businesses, including potential reputational harm resulting from actions by unaffiliated third-parties that we may use to assist us in providing goods or services. We may not be able to develop new lines of business in a manner that improves our operating results or address or mitigate the risks associated with new product categories and new lines of business, and may therefore be forced to close the new lines of business or reduce our expanded merchandise offerings, which may damage our reputation and negatively impact our operating results.

Our results may be negatively impacted if customers do not maintain their favorable perception of our Company and our private brand merchandise.

Maintaining and continually enhancing the value of our Company and our private brand merchandise is important to the success of our business. The value of our private brands is based in large part on the degree to which customers perceive and react to them. The value of our private brands could diminish significantly due to a number of factors, including customer perception that we have acted in an irresponsible manner in sourcing our private brand merchandise, adverse publicity about our private brand merchandise, our failure to maintain the quality of our private brand products, the failure of our private brand merchandise to deliver consistently good value to the customer, or the failure to protect the image associated with our private brands. The growing use of social and digital media by customers, us, and third parties increases the speed and extent that information or misinformation and opinions can be shared. Negative posts or comments about us, our private brands, or any of our merchandise on social or digital media could seriously damage our reputation. If we do not maintain the favorable perception of our Company and our private brand merchandise or we experience a reduction in the level of private brand sales, our business results could be negatively impacted.

Our ability to increase sales and store productivity is largely dependent upon our ability to increase customer traffic and conversion.

Customer traffic depends upon our ability to successfully market compelling merchandise assortments, present an appealing shopping environment and experience to customers, and attract customers to our stores through omnichannel initiatives such as pickup-in-store programs. Our strategies focus on increasing customer traffic and improving conversion in our stores and online; however, there can be no assurance that our efforts will be successful or will result in increased sales or margins. Further, costs to drive online traffic may be higher than anticipated, which could result in lower margins, and actions to drive online traffic may not deliver anticipated results. In addition, external events outside of our control, including store closings by our competitors, pandemics, terrorist threats, domestic conflicts and civil unrest, may influence customers' decisions to visit malls or might otherwise cause customers to avoid public places. There is no assurance that we will be able to reverse any decline in traffic or that increases in Internet sales will offset any decline in store traffic. We may need to respond to any declines in customer traffic or conversion rates by increasing markdowns or promotions to attract customers, which could adversely impact

our operating results and cash flows from operating activities. In addition, the challenge of declining store traffic along with the growth of digital shopping channels and its diversion of sales from brick-and-mortar stores could lead to store closures and/or asset impairment charges, which could adversely impact our operating results, financial position and cash flows.

If we are unable to manage our inventory effectively, our merchandise margins could be adversely affected.

Our profitability depends upon our ability to manage appropriate inventory levels and respond quickly to shifts in consumer demand patterns. We must properly execute our inventory management strategies by appropriately allocating merchandise among our stores and online, timely and efficiently distributing inventory to stores, maintaining an appropriate mix and level of inventory in stores and online, adjusting our merchandise mix between our private and exclusive brands and national brands, appropriately changing the allocation of floor space of stores among product categories to respond to customer demand and

effectively managing pricing and markdowns. If we overestimate customer demand for our merchandise, we will likely need to record inventory markdowns and sell the excess inventory at clearance prices which would negatively impact our merchandise margins and operating results. If we underestimate customer demand for our merchandise, we may experience inventory shortages which may result in missed sales opportunities and have a negative impact on customer loyalty. In addition, although we have various processes and systems to help protect against loss or theft of our inventory, higher than expected levels of lost or stolen inventory (called "shrinkage") could result in write-offs and lost sales, which could adversely impact our profitability.

We must protect against security breaches or other unauthorized disclosures of confidential data about our customers as well as about our employees and other third parties.

As part of our normal operations, we and third-party service providers with whom we contract receive and maintain information about our customers (including credit/debit card information), our employees and other third parties. Confidential data must at all times be protected against security breaches or other unauthorized disclosure. We have, and require our third-party service providers to have, administrative, physical and technical safeguards and procedures in place to protect the security, confidentiality, integrity and availability of such information and to protect such information against unauthorized access, disclosure or acquisition. Despite our safeguards and security processes and procedures, there is no assurance that all of our systems and processes, or those of our third-party service providers, are free from vulnerability to security breaches, inadvertent data disclosure or acquisition by third parties. Further, because the methods used to obtain unauthorized access change frequently and may not be immediately detected, we may be unable to anticipate these methods or promptly implement safeguards. Any failure to protect confidential data about our business or our customers, employees or other third parties could materially damage our brand and reputation as well as result in significant expenses and disruptions to our operations, and loss of customer confidence, any of which could have a material adverse impact on our business and results of operations. We could also be subject to government enforcement actions and private litigation as a result of any such failure.

The failure to retain, attract and motivate our employees, including employees in key positions, could have an adverse impact on our results of operations.

Our results depend on the contributions of our employees, including our senior management team and other key employees. This depends to a great extent on our ability to retain, attract and motivate talented employees throughout the organization, many of whom, particularly in the stores, are in entry level or part-time positions, which have historically had high rates of turnover. We currently operate with significantly fewer individuals than we have in the past who have assumed additional duties and responsibilities, which could have an adverse impact on our operating performance and efficiency. Negative media reports regarding the Company or the retail industry in general, as well as uncertainty due to announced store closings, could also have an adverse impact on our ability to attract, retain and motivate our employees. If we are unable to retain, attract and motivate talented employees with the appropriate skill sets, we may not achieve our objectives and our results of operations could be adversely impacted. Our ability to meet our changing labor needs while controlling our costs is also subject to external factors such as unemployment levels, competing wages, potential union organizing efforts and government regulation. An inability to provide wages and/or benefits that are competitive within the markets in which we operate could adversely affect our ability to retain and attract employees. In addition, the loss of one or more of our key personnel or the inability to effectively identify a suitable successor to a key role in our senior management could have a material adverse effect on our business.

If we are unable to successfully develop and maintain a relevant and reliable omnichannel experience for our customers, our sales, results of operations and reputation could be adversely affected.

One of the pillars of our strategic framework is to deliver a superior omnichannel shopping experience for our customers through the integration of our store and digital shopping channels. Omnichannel retailing is rapidly

evolving and we must anticipate and meet changing customer expectations. Our omnichannel strategies include our ship-from-store and pickup-in-store programs and expansion of our SKU count online. In addition, we continue to explore ways to enhance our customers’ omnichannel shopping experience, including through investments in IT systems, operational changes and developing a more customer-friendly user experience. Our competitors are also investing in omnichannel initiatives, some of which may be more successful than our initiatives. For example, online and other competitors have placed an emphasis on delivery services, with customers increasingly seeking faster, guaranteed delivery times and low-price or free shipping. There is no assurance that we will be able to maintain an ability to be competitive on delivery times and delivery costs, which is dependent on many factors. If the implementation of our omnichannel strategies is not successful or does not meet customer expectations, or we do not realize a return on our omnichannel investments, our reputation and operating results may be adversely affected.

Disruptions in our Internet website or mobile applications, or our inability to successfully execute our online strategies, could have an adverse impact on our sales and results of operations.

We sell merchandise over the Internet through our website, www.jcpenney.com, and through mobile applications for smart phones and tablets. Our Internet operations are subject to numerous risks, including rapid technological change and the implementation of new systems and platforms; liability for online and mobile content; violations of state or federal laws, including those relating to online and mobile privacy and intellectual property rights; credit card fraud; problems associated with the operation, security and availability of our website, mobile applications and related support systems; computer malware; telecommunications failures; electronic break-ins and similar disruptions; and the allocation of inventory between our online operations and department stores. The failure of our website or mobile applications to perform as expected could result in disruptions and costs to our operations and make it more difficult for customers to purchase merchandise online. In addition, our inability to successfully develop and maintain the necessary technological interfaces for our customers to purchase merchandise through our website and mobile applications, including user friendly software applications for smart phones and tablets, could result in the loss of Internet sales and have an adverse impact on our results of operations.

Our operations are dependent on information technology systems; disruptions in those systems or increased costs relating to their implementation could have an adverse impact on our results of operations.

Our operations are dependent upon the integrity, security and consistent operation of various systems and data centers, including the point-of-sale systems in the stores, our Internet website and mobile applications, data centers that process transactions, communication systems and various software applications used throughout our Company to track inventory flow, process transactions, generate performance and financial reports and administer payroll and benefit plans.

We have implemented several applications and systems from third party vendors, providers and licensors to simplify our processes and reduce our use of customized existing legacy systems and expect to place additional applications and systems into operation in the future. Any continued reliance on existing legacy systems may result in extended system outages due to the difficulty in recovering those systems as well as inefficiencies in our business workflow due to the complexity and high levels of customization inherent in such systems. Implementing new applications and systems carries substantial risk, including implementation delays, cost overruns, disruption of operations, potential loss of data or information, lower customer satisfaction resulting in lost customers or sales, inability to deliver merchandise to our stores or our customers, the potential inability to meet reporting requirements and unintentional security vulnerabilities. There can be no assurances that we will successfully launch the new applications and systems as planned, that the new applications and systems will perform as expected or that the new applications and systems will be implemented without disruptions to our operations, any of which may cause critical information upon which we rely to be delayed, unreliable, corrupted, insufficient or inaccessible.

We also outsource various information technology functions to third party service providers and may outsource other functions in the future. We rely on those third party service providers to provide services on a timely and effective basis and their failure to perform as expected or as required by contract could result in disruptions and costs to our operations.

Our vendors are also highly dependent on the use of information technology systems. Major disruptions in their information technology systems could result in their inability to communicate with us or otherwise to process our transactions or information, their inability to perform required functions, or in the loss or corruption of our information, any and all of which could result in disruptions to our operations. Our vendors are responsible for having safeguards and procedures in place to protect the confidentiality, integrity and security of our information, and to protect our information and systems against unauthorized access, disclosure or acquisition. Any failure in their

systems to operate or in their ability to protect our information or systems could have a material adverse impact on our business and results of operations.

We have insourced, and may continue to insource, certain business functions from third party vendors and may seek to relocate certain business functions to international locations in an attempt to achieve additional efficiencies, both of which subject us to risks, including disruptions in our business.

We have recently insourced certain business functions and may also need to continue to insource other aspects of our business in the future in order to effectively manage our costs and stay competitive. We may also seek from time to time to relocate certain business functions to countries other than the United States to access highly skilled labor markets and further control costs. There is no assurance that these efforts will be successful. In addition, future regulatory developments could hinder our ability to fully realize the anticipated benefits of these actions. These actions may also cause disruptions that negatively impact our business. If we are ultimately unable to perform insourced functions better than, or at least as well as, third party providers, or otherwise fully realize the anticipated benefits of these actions, our operating results could be adversely impacted.

Changes in our credit ratings may limit our access to capital markets and adversely affect our liquidity.

The credit rating agencies periodically review our capital structure and the quality and stability of our earnings. Any downgrades to our long-term credit ratings could result in reduced access to the credit and capital markets and higher interest costs on future financings. The future availability of financing will depend on a variety of factors such as economic and market conditions, the availability of credit and our credit ratings, as well as the possibility that lenders could develop a negative perception of us. There is no assurance that we will be able to obtain additional financing on favorable terms or at all.

Our profitability depends on our ability to source merchandise and deliver it to our customers in a timely and cost-effective manner.

Our merchandise is sourced from a wide variety of suppliers, and our business depends on being able to find qualified suppliers and access products in a timely and efficient manner. Inflationary pressures on commodity prices and other input costs could increase our cost of goods, and an inability to pass such cost increases on to our customers or a change in our merchandise mix as a result of such cost increases could have an adverse impact on our profitability. Additionally, the impact of economic conditions on our suppliers cannot be predicted and our suppliers may be unable to access financing or become insolvent and thus become unable to supply us with products. Developments in tax policy, such as the disallowance of tax deductions for imported merchandise, or the imposition of tariffs on imported merchandise, could further have a material adverse effect on our results of operations and liquidity.

Our arrangements with our suppliers and vendors may be impacted by our financial results or financial position.

Substantially all of our merchandise suppliers and vendors sell to us on open account purchase terms. There is a risk that our key suppliers and vendors could respond to any actual or apparent decrease in or any concern with our financial results or liquidity by requiring or conditioning their sale of merchandise to us on more stringent or more costly payment terms, such as by requiring standby letters of credit, earlier or advance payment of invoices, payment upon delivery or other assurances or credit support or by choosing not to sell merchandise to us on a timely basis or at all. Our arrangements with our suppliers and vendors may also be impacted by media reports regarding our financial position. Our need for additional liquidity could significantly increase and our supply of merchandise could be materially disrupted if a significant portion of our key suppliers and vendors took one or more of the actions described above, which could have a material adverse effect on our sales, customer satisfaction, cash flows, liquidity and financial position.

Our senior secured real estate term loan credit facility and senior secured notes are secured by certain of our real property and substantially all of our personal property, and such property may be subject to foreclosure or other

remedies in the event of our default. In addition, the real estate term loan credit facility and the indenture governing the senior secured notes contain provisions that could restrict our operations and our ability to obtain additional financing.

We are (i) party to a $1.688 billion senior secured term loan credit facility and (ii) the issuer of $500 million aggregate principal amount of senior secured notes that are secured by mortgages on certain real property of the Company, in addition to liens on substantially all personal property of the Company, subject to certain exclusions set forth in the security documents relating to the term loan credit facility and the senior secured notes. The real property subject to mortgages under the term loan credit facility and the indenture governing the senior secured notes includes our distribution centers and certain of our stores.

The credit and guaranty agreement governing the term loan credit facility and the indenture governing the senior secured notes contain operating restrictions which may impact our future alternatives by limiting, without lender consent, our ability to borrow additional funds, execute certain equity financings or enter into dispositions or other liquidity enhancing or strategic

transactions regarding certain of our assets, including our real property. Our ability to obtain additional or other financing or to dispose of certain assets could also be negatively impacted because a substantial portion of our owned assets have been pledged as collateral for repayment of our indebtedness under the term loan credit facility and the senior secured notes.

If an event of default occurs and is continuing, our outstanding obligations under the term loan credit facility and the senior secured notes could be declared immediately due and payable or the lenders could foreclose on or exercise other remedies with respect to the assets securing the term loan credit facility and the senior secured notes, including our distribution centers and certain of our stores. If an event of default occurs, there is no assurance that we would have the cash resources available to repay such accelerated obligations or refinance such indebtedness on commercially reasonable terms, or at all. The occurrence of any one of these events could have a material adverse effect on our business, financial condition, results of operations and liquidity.

Our senior secured asset-based revolving credit facility limits our borrowing capacity to the value of certain of our assets. In addition, our senior secured asset-based revolving credit facility is secured by certain of our personal property, and lenders may exercise remedies against the collateral in the event of our default.

We are party to a $2.35 billion senior secured asset-based revolving credit facility. Our borrowing capacity under our revolving credit facility varies according to the Company’s inventory levels, accounts receivable and credit card receivables, net of certain reserves. In the event of any material decrease in the amount of or appraised value of these assets, our borrowing capacity would similarly decrease, which could adversely impact our business and liquidity.

Our revolving credit facility contains customary affirmative and negative covenants and certain restrictions on operations become applicable if our availability falls below certain thresholds. These covenants could impose significant operating and financial limitations and restrictions on us, including restrictions on our ability to enter into particular transactions and to engage in other actions that we may believe are advisable or necessary for our business.

Our obligations under the revolving credit facility are secured by liens with respect to inventory, accounts receivable, deposit accounts and certain related collateral. In the event of a default that is not cured or waived within any applicable cure periods, the lenders’ commitment to extend further credit under our revolving credit facility could be terminated, our outstanding obligations could become immediately due and payable, outstanding letters of credit may be required to be cash collateralized and remedies may be exercised against the collateral, which generally consists of the Company’s inventory, accounts receivable and deposit accounts and cash credited thereto. If we are unable to borrow under our revolving credit facility, we may not have the necessary cash resources for our operations and, if any event of default occurs, there is no assurance that we would have the cash resources available to repay such accelerated obligations, refinance such indebtedness on commercially reasonable terms, or at all, or cash collateralize our letters of credit, which would have a material adverse effect on our business, financial condition, results of operations and liquidity.

Our level of indebtedness may adversely affect our business and results of operations and may require the use of our available cash resources to meet repayment obligations, which could reduce the cash available for other purposes.

As of February 3, 2018, we have $4.232 billion in total indebtedness and we are highly leveraged. Our level of indebtedness may limit our ability to obtain additional financing, if needed, to fund additional projects, working capital requirements, capital expenditures, debt service, and other general corporate or other obligations, as well as increase the risks to our business associated with general adverse economic and industry conditions. Our level of indebtedness may also place us at a competitive disadvantage to our competitors that are not as highly leveraged. In addition, any future limitations on tax deductions for interest paid on outstanding indebtedness as a result of the Tax Cuts and Jobs Act enacted in December 2017 (the “Tax Act”) could have a material adverse effect on our results of

operations and liquidity.

We are required to make quarterly repayments in a principal amount equal to $10.55 million during the seven-year term of the real estate term loan credit facility, subject to certain reductions for mandatory and optional prepayments. In addition, we are required to make prepayments of the real estate term loan credit facility with the proceeds of certain asset sales, insurance proceeds and excess cash flow, which could reduce the cash available for other purposes, including capital expenditures for store improvements, and could impact our ability to reinvest in other areas of our business.

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There is no assurance that our internal and external sources of liquidity will at all times be sufficient for our cash requirements.

We must have sufficient sources of liquidity to fund our working capital requirements, capital improvement plans, service our outstanding indebtedness and finance investment opportunities. The principal sources of our liquidity are funds generated from operating activities, available cash and cash equivalents, borrowings under our credit facilities, other debt financings, equity financings and sales of non-operating assets. We expect our ability to generate cash through the sale of non-operating assets to diminish as our portfolio of non-operating assets decreases. In addition, our recent operating losses have limited our capital resources. Our ability to achieve our business and cash flow plans is based on a number of assumptions which involve significant judgments and estimates of future performance, borrowing capacity and credit availability, which cannot at all times be assured. Accordingly, there is no assurance that cash flows from operations and other internal and external sources of liquidity will at all times be sufficient for our cash requirements. If necessary, we may need to consider actions and steps to improve our cash position and mitigate any potential liquidity shortfall, such as modifying our business plan, pursuing additional financing to the extent available, reducing capital expenditures, pursuing and evaluating other alternatives and opportunities to obtain additional sources of liquidity and other potential actions to reduce costs. There can be no assurance that any of these actions would be successful, sufficient or available on favorable terms. Any inability to generate or obtain sufficient levels of liquidity to meet our cash requirements at the level and times needed could have a material adverse impact on our business and financial position.

Our ability to obtain any additional financing or any refinancing of our debt, if needed at any time, depends upon many factors, including our existing level of indebtedness and restrictions in our debt facilities, historical business performance, financial projections, prospects and creditworthiness and external economic conditions and general liquidity in the credit and capital markets. Any additional debt, equity or equity-linked financing may require modification of our existing debt agreements, which there is no assurance would be obtainable. Any additional financing or refinancing could also be extended only at higher costs and require us to satisfy more restrictive covenants, which could further limit or restrict our business and results of operations, or be dilutive to our stockholders.

Our use of interest rate hedging transactions could expose us to risks and financial losses that may adversely affect our financial condition, liquidity and results of operations.

To reduce our exposure to interest rate fluctuations, we have entered into, and in the future may enter into, interest rate swaps with various financial counterparties. The interest rate swap agreements effectively convert a portion of our variable rate interest payments to a fixed price. There can be no assurances, however, that our hedging activity will be effective in insulating us from the risks associated with changes in interest rates. In addition, our hedging transactions may expose us to certain risks and financial losses, including, among other things:

- counterparty credit risk;
- the risk that the duration or amount of the hedge may not match the duration or amount of the related liability;
- the hedging transactions may be adjusted from time to time in accordance with accounting rules to reflect changes in fair values, downward adjustments or “mark-to-market losses,” which would affect our stockholders’ equity; and
- the risk that we may not be able to meet the terms and conditions of the hedging instruments, in which case we may be required to settle the instruments prior to maturity with cash payments that could significantly affect our liquidity.

Further, we have designated the swaps as cash flow hedges in accordance with Accounting Standards Codification Topic 815, Derivatives and Hedging. However, in the future, we may fail to qualify for hedge accounting treatment under these standards for a number of reasons, including if we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or if the swaps are not highly effective. If we fail to qualify for hedge accounting treatment, losses on the swaps caused by the change in their fair value will be recognized as part of net income, rather than being recognized as part of other comprehensive income.

Operating results and cash flows may cause us to incur asset impairment charges.

Long-lived assets, primarily property and equipment, are reviewed at the store level at least annually for impairment, or whenever changes in circumstances indicate that a full recovery of net asset values through future cash flows is in question. We also assess the recoverability of indefinite-lived intangible assets at least annually or whenever events or changes in

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circumstances indicate that the carrying amount may not be fully recoverable. Our impairment review requires us to make estimates and projections regarding, but not limited to, sales, operating profit and future cash flows. If our operating performance reflects a sustained decline, we may be exposed to significant asset impairment charges in future periods, which could be material to our results of operations.

Reductions in income and cash flow from our marketing and servicing arrangement related to our private label and co-branded credit cards could adversely affect our operating results and cash flows.

Synchrony Financial (“Synchrony”) owns and services our private label credit card and co-branded MasterCard® programs. Our agreement with Synchrony provides for certain payments to be made by Synchrony to the Company, including a share of revenues from the performance of the credit card portfolios. The income and cash flow that the Company receives from Synchrony is dependent upon a number of factors including the level of sales on private label and co-branded accounts, the percentage of sales on private label and co-branded accounts relative to the Company’s total sales, the level of balances carried on the accounts, payment rates on the accounts, finance charge rates and other fees on the accounts, the level of credit losses for the accounts, Synchrony’s ability to extend credit to our customers as well as the cost of customer rewards programs. All of these factors can vary based on changes in federal and state credit card, banking and consumer protection laws, which could also materially limit the availability of credit to consumers or increase the cost of credit to our cardholders. The factors affecting the income and cash flow that the Company receives from Synchrony can also vary based on a variety of economic, legal, social and other factors that we cannot control. If the income or cash flow that the Company receives from our consumer credit card program agreement with Synchrony decreases, our operating results and cash flows could be adversely affected.

We are subject to risks associated with importing merchandise from foreign countries.

A substantial portion of our merchandise is sourced by our vendors and by us outside of the United States. All of our vendors must comply with our supplier legal compliance program and applicable laws, including consumer and product safety laws. Although we diversify our sourcing and production by country and supplier, the failure of a supplier to produce and deliver our goods on time, to meet our quality standards and adhere to our product safety requirements or to meet the requirements of our supplier compliance program or applicable laws, or our inability to flow merchandise to our stores or through the Internet channel in the right quantities at the right time, could adversely affect our profitability and could result in damage to our reputation.

Although we have implemented policies and procedures designed to facilitate compliance with laws and regulations relating to doing business in foreign markets and importing merchandise from abroad, there can be no assurance that suppliers and other third parties with whom we do business will not violate such laws and regulations or our policies, which could subject us to liability and could adversely affect our results of operations.

We are subject to the various risks of importing merchandise from abroad and purchasing product made in foreign countries, such as:

- potential disruptions in manufacturing, logistics and supply;
- changes in duties, tariffs, quotas and voluntary export restrictions on imported merchandise;
- strikes and other events affecting delivery;
- consumer perceptions of the safety of imported merchandise;
- product compliance with laws and regulations of the destination country;

- product liability claims from customers or penalties from government agencies relating to products that are recalled, defective or otherwise noncompliant or alleged to be harmful;

- concerns about human rights, working conditions and other labor rights and conditions and environmental impact in foreign countries where merchandise is produced and raw materials or components are sourced, and changing labor, environmental and other laws in these countries;

- local business practice and political issues that may result in adverse publicity or threatened or actual adverse consumer actions, including boycotts;

- compliance with laws and regulations concerning ethical business practices, such as the U.S. Foreign Corrupt Practices Act; and

- economic, political or other problems in countries from or through which merchandise is imported.

Political or financial instability, trade restrictions, tariffs, currency exchange rates, labor conditions, congestion and labor issues at major ports, transport capacity and costs, systems issues, problems in third party distribution and warehousing and other interruptions of the supply chain, compliance with U.S. and foreign laws and regulations and other factors relating to international trade and imported merchandise beyond our control could affect the availability and the price of our inventory. These risks and other factors relating to foreign trade could subject us to liability or hinder our ability to access suitable merchandise on acceptable terms, which could adversely impact our results of operations. In addition, developments in tax policy, such as the disallowance of tax deductions for imported merchandise, or the imposition of tariffs on imported merchandise, could have a material adverse effect on our results of operations and liquidity.

Disruptions and congestion at ports through which we import merchandise may increase our costs and/or delay the receipt of goods in our stores, which could adversely impact our profitability, financial position and cash flows.

We ship the majority of our private brand merchandise by ocean to ports in the United States. Our national brand suppliers also ship merchandise by ocean. Disruptions in the operations of ports through which we import our merchandise, including but not limited to labor disputes involving work slowdowns, lockouts or strikes, could require us and/or our vendors to ship merchandise by air freight or to alternative ports in the United States. Shipping by air is significantly more expensive than shipping by ocean which could adversely affect our profitability. Similarly, shipping to alternative ports in the United States could result in increased lead times and transportation costs. Disruptions at ports through which we import our goods could also result in unanticipated inventory shortages, which could adversely impact our reputation and our results of operations.

Our Company’s growth and profitability depend on the levels of consumer confidence and spending.

Our results of operations are sensitive to changes in overall economic and political conditions that impact consumer spending, including discretionary spending. Many economic factors outside of our control, including the housing market, interest rates, recession, inflation and deflation, energy costs and availability, consumer credit availability and terms, consumer debt levels, tax rates and policy, and unemployment trends influence consumer confidence and spending. The domestic and international political situation and actions also affect consumer confidence and spending. Additional events that could impact our performance include pandemics, terrorist threats and activities, worldwide military and domestic disturbances and conflicts, political instability and civil unrest. Declines in the level of consumer spending could adversely affect our growth and profitability.

Our business is seasonal, which impacts our results of operations.

Our annual earnings and cash flows depend to a great extent on the results of operations for the last quarter of our fiscal year, which includes the holiday season. Our fiscal fourth-quarter results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions. This seasonality causes our operating results to vary considerably from quarter to quarter.

Our profitability may be impacted by weather conditions.

Our merchandise assortments reflect assumptions regarding expected weather patterns and our profitability depends on our ability to timely deliver seasonally appropriate inventory. Unseasonable or unexpected weather conditions such as warm temperatures during the winter season or prolonged or extreme periods of warm or cold temperatures could render a portion of our inventory incompatible with consumer needs. Extreme weather or natural disasters could also severely hinder our ability to timely deliver seasonally appropriate merchandise, preclude customers from traveling to our stores, delay capital improvements or cause us to close stores. A reduction in the demand for or supply of our seasonal merchandise could have an adverse effect on our inventory levels and results of operations.

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Changes in federal, state or local laws and regulations could increase our expenses and adversely affect our results of operations.

Our business is subject to a wide array of laws and regulations. Government intervention and activism and/or regulatory reform may result in substantial new regulations and disclosure obligations and/or changes in the interpretation of existing laws and regulations, which may lead to additional compliance costs as well as the diversion of our management's time and attention from strategic initiatives. If we fail to comply with applicable laws and regulations we could be subject to legal risk, including government enforcement action and class action civil litigation that could disrupt our operations and increase our costs of doing business. Changes in the regulatory environment regarding topics such as privacy and information security, tax policy, product safety, environmental protection, including regulations in response to concerns regarding climate change, collective bargaining activities, minimum wage, wage and hour, and health care mandates, among others, as well as changes to applicable accounting rules and regulations, such as changes to lease accounting standards, could also cause our compliance costs to increase and adversely affect our business, financial condition and results of operations.

Legal and regulatory proceedings could have an adverse impact on our results of operations.

Our Company is subject to various legal and regulatory proceedings relating to our business, certain of which may involve jurisdictions with reputations for aggressive application of laws and procedures against corporate defendants. We are impacted by trends in litigation, including class action litigation brought under various consumer protection, employment, and privacy and information security laws. In addition, litigation risks related to claims that technologies we use infringe intellectual property rights of third parties have been amplified by the increase in third parties whose primary business is to assert such claims. Reserves are established based on our best estimates of our potential liability. However, we cannot accurately predict the ultimate outcome of any such proceedings due to the inherent uncertainties of litigation. Regardless of the outcome or whether the claims are meritorious, legal and regulatory proceedings may require that we devote substantial time and expense to defend our Company. Unfavorable rulings could result in a material adverse impact on our business, financial condition or results of operations.

Significant changes in discount rates, actual investment return on pension assets, and other factors could affect our earnings, equity, and pension contributions in future periods.

Our earnings may be positively or negatively impacted by the amount of income or expense recorded for our qualified pension plan. Generally accepted accounting principles in the United States of America (GAAP) require that income or expense for the plan be calculated at the annual measurement date using actuarial assumptions and calculations. The most significant assumptions relate to the capital markets, interest rates and other economic conditions. Changes in key economic indicators can change the assumptions. Two critical assumptions used to estimate pension income or expense for the year are the expected long-term rate of return on plan assets and the discount rate. In addition, at the measurement date, we must also reflect the funded status of the plan (assets and liabilities) on the balance sheet, which may result in a significant change to equity through a reduction or increase to other comprehensive income. We may also experience volatility in the amount of the annual actuarial gains or losses recognized as income or expense because we have elected to recognize pension expense using mark-to-market accounting. Although GAAP expense and pension contributions are not directly related, the key economic factors that affect GAAP expense would also likely affect the amount of cash we could be required to contribute to the pension plan. Potential pension contributions include both mandatory amounts required under federal law and discretionary contributions to improve a plan's funded status.

Our stock price has been and may continue to be volatile.

The market price of our common stock has fluctuated substantially and may continue to fluctuate significantly. Future announcements or disclosures concerning us or any of our competitors, our strategic initiatives, our sales and profitability, our financial condition, any quarterly variations in actual or anticipated operating results or comparable sales, any failure to meet analysts' expectations and sales of large blocks of our common stock, among other factors, could cause the market price of our common stock to fluctuate substantially. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many retail and other stocks that have often been unrelated or disproportionate to the operating performance of these companies. This volatility could affect the price at which you could sell shares of our common stock.

Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. The Company and certain of our former members of the Board of Directors and executives were defendants in a consolidated class action lawsuit and continue to be defendants in two related stockholder derivative actions that were filed following our announcement of an issuance of common stock on September 26, 2013. Such

litigation could result in substantial costs, divert our management's attention and resources and have an adverse effect on our business, results of operations and financial condition.

The Company's ability to use net operating loss carryforwards to offset future taxable income for U.S. federal income tax purposes may be limited.

The Company has a federal net operating loss (NOL) of $2.1 billion as of February 3, 2018. These NOL carryforwards (expiring in 2032 through 2034) arose prior to December 31, 2017 and are available to offset future taxable income. The Company may recognize additional NOLs in the future which, under the Tax Act, would not expire but would only be available to offset up to 80% of the Company's future taxable income.

Section 382 of the Internal Revenue Code of 1986, as amended (the Code), imposes an annual limitation on the amount of taxable income that may be offset by a corporation's NOLs if the corporation experiences an "ownership change" as defined in Section 382 of the Code. An ownership change occurs when the Company's "five-percent shareholders" (as defined in Section 382 of the Code) collectively increase their ownership in the Company by more than 50 percentage points (by value) over a rolling three-year period. Additionally, various states have similar limitations on the use of state NOLs following an ownership change.

If an ownership change occurs, the amount of the taxable income for any post-change year that may be offset by a pre-change loss is subject to an annual limitation that is cumulative to the extent it is not all utilized in a year. This limitation is derived by multiplying the fair market value of the Company stock as of the ownership change by the applicable federal long-term tax-exempt rate, which was 1.97% at February 3, 2018. To the extent that a company has a net unrealized built-in gain at the time of an ownership change, which is realized or deemed recognized during the five-year period following the ownership change, there is an increase in the annual limitation for each of the first five-years that is cumulative to the extent it is not all utilized in a year.

The Company has an ongoing study of the rolling three-year testing periods. Based upon the elections the Company has made and the information that has been filed with the Securities and Exchange Commission through February 3, 2018, the Company has not had a Section 382 ownership change through February 3, 2018.

If an ownership change should occur in the future, the Company's ability to use the NOL to offset future taxable income will be subject to an annual limitation and will depend on the amount of taxable income generated by the Company in future periods. There is no assurance that the Company will be able to fully utilize the NOL and the Company could be required to record an additional valuation allowance related to the amount of the NOL that may not be realized, which could impact the Company's result of operations.

We believe that these NOL carryforwards are a valuable asset for us. Consequently, we have a stockholder rights plan in place, which was approved by the Company's stockholders, to protect our NOLs during the effective period of the rights plan. Although the rights plan is intended to reduce the likelihood of an "ownership change" that could adversely affect us, there is no assurance that the restrictions on transferability in the rights plan will prevent all transfers that could result in such an "ownership change".

The rights plan could make it more difficult for a third party to acquire, or could discourage a third party from acquiring, our Company or a large block of our common stock. A third party that acquires 4.9% or more of our common stock could suffer substantial dilution of its ownership interest under the terms of the rights plan through the issuance of common stock or common stock equivalents to all stockholders other than the acquiring person.

The foregoing provisions may adversely affect the marketability of our common stock by discouraging potential investors from acquiring our stock. In addition, these provisions could delay or frustrate the removal of incumbent

directors and could make more difficult a merger, tender offer or proxy contest involving us, or impede an attempt to acquire a significant or controlling interest in us, even if such events might be beneficial to us and our stockholders.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

At February 3, 2018, we operated 872 department stores throughout the continental United States, Alaska and Puerto Rico, of which 404 were owned, including 113 stores located on ground leases. The following table lists the number of stores operating by state as of February 3, 2018:

Alabama	15	Maine	5	Oklahoma	15
Alaska	1	Maryland	16	Oregon	8
Arizona	21	Massachusetts	9	Pennsylvania	27
Arkansas	14	Michigan	34	Rhode Island	2
California	76	Minnesota	16	South Carolina	14
Colorado	17	Mississippi	10	South Dakota	3
Connecticut	7	Missouri	24	Tennessee	21
Delaware	3	Montana	5	Texas	82
Florida	53	Nebraska	8	Utah	8
Georgia	22	Nevada	6	Vermont	4
Idaho	8	New Hampshire	9	Virginia	22
Illinois	30	New Jersey	13	Washington	21
Indiana	22	New Mexico	10	West Virginia	8
Iowa	11	New York	38	Wisconsin	10
Kansas	14	North Carolina	23	Wyoming	3
Kentucky	22	North Dakota	5	Puerto Rico	6
Louisiana	13	Ohio	38		
Total square feet	95.6 million				

We are party to a $1.688 billion senior secured term loan credit facility and the issuer of $500 million aggregate principal amount of senior secured notes that are secured by mortgages on certain real property of the Company, in addition to liens on substantially all personal property of the Company, subject to certain exclusions set forth in the security documents relating to the term loan credit facility and the senior secured notes. The real property subject to mortgages under the term loan credit facility and the indenture governing the senior secured notes includes our distribution centers and certain of our stores.

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At February 3, 2018, our supply chain network operated 13 facilities with multiple types of distribution activities, including store merchandise distribution centers (stores), regional warehouses (regional) and jcpenney.com fulfillment centers (direct to customers) as indicated in the following table:

Location	Leased/Owned	Primary Function(s)	Square Footage (in thousands)
Manchester, Connecticut	Owned	stores	1,956
Lenexa, Kansas	Owned	stores, direct to customers	1,944
Columbus, Ohio	Owned	stores, direct to customers	1,941
Milwaukee, Wisconsin	Owned	stores	1,921
Atlanta, Georgia	Owned	stores, regional, direct to customers	2,026
Reno, Nevada	Owned	stores, direct to customers	1,660
Alliance, Texas	Owned	regional	920
Statesville, North Carolina	Owned	stores, regional	595
Lathrop, California	Leased	regional	436
Cedar Hill, Texas	Leased	stores	420
Spanish Fork, Utah	Leased	stores	412
Buena Park, California [1]	Leased	stores, regional	1,034
San Bernardino, California [1]	Leased	stores	625
Total supply chain network			15,890

(1) The Company sold the Buena Park location during 2017 and is leasing it back until it transfers certain operations to the San Bernardino location during 2018.

Item 3. Legal Proceedings

The matters under the caption "Litigation" in Note 21 of the Notes to Consolidated Financial Statements included in this Form 10-K are incorporated herein by reference.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for Registrant’s Common Equity

Our common stock is traded principally on the New York Stock Exchange (NYSE) under the symbol “JCP.” The number of stockholders of record at March 16, 2018, was 21,995. In addition to common stock, we have authorized 25 million shares of preferred stock, of which no shares were issued and outstanding at February 3, 2018.

The table below sets forth the quoted high and low intraday sale prices of our common stock on the NYSE for each quarterly period indicated and the quarter-end closing market price of our common stock:

Fiscal Year 2017	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price:				
High	$ 7.42	$ 5.73	$ 5.63	$ 4.24
Low	$ 5.32	$ 4.17	$ 2.76	$ 2.35
Close	$ 5.38	$ 5.56	$ 3.12	$ 3.54
Fiscal Year 2016	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price:				
High	$ 11.99	$ 9.82	$ 11.30	$ 10.74
Low	$ 6.88	$ 7.10	$ 8.25	$ 6.38
Close	$ 9.28	$ 9.66	$ 8.48	$ 6.45

Since May 2012, the Company has not paid a dividend. Under our senior secured term loan credit facility and senior secured asset-based credit facility, we are subject to restrictive covenants regarding our ability to pay cash dividends.

Additional information relating to the common stock and preferred stock is included in this Annual Report on Form 10-K in the Consolidated Statements of Stockholders’ Equity and in Note 13 to the Consolidated Financial Statements.

Issuer Purchases of Securities

No repurchases of common stock were made during the fourth quarter of 2017 and no amounts are authorized for share repurchases as of February 3, 2018.

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Five-Year Total Stockholder Return Comparison

The following presentation compares our cumulative stockholder returns for the past five fiscal years with the returns of the S&P 500 Stock Index and the S&P 500 Retail Index for Department Stores over the same period. A list of these companies follows the graph below. The graph assumes $100 invested at the closing price of our common stock on the NYSE and each index as of the last trading day of our fiscal year 2012 and assumes that all dividends were reinvested on the date paid. The points on the graph represent fiscal year-end amounts based on the last trading day of each fiscal year. The following graph and related information shall not be deemed “soliciting material” or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

S&P Department Stores:
Macy’s, Kohl’s, Nordstrom

	2012	2013	2014	2015	2016	2017
JCPenney	$100	$30	$37	$37	$32	$18
S&P 500	100	120	137	136	165	203
S&P Department Stores	100	116	145	104	84	104

The stockholder returns shown are neither determinative nor indicative of future performance.

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Item 6. Selected Financial Data

Five-Year Financial Summary ($ in millions, except per share data)	2017	2016	2015	2014	2013
Results for the year					
Total net sales	$12,506	$12,547	$12,625	$12,257	$11,859
Sales percent increase/(decrease):					
Total net sales	(0.3)%[1]	(0.6)%	3.0%	3.4%	(8.7)%[1]
Comparable store sales [2]	0.1%	0.0%	4.5%	4.4%	(7.4)%
Operating income/(loss)	116	395	(89)	(254)	(1,242)
As a percent of sales	0.9%	3.1%	(0.7)%	(2.1)%	(10.5)%
Net income/(loss) from continuing operations	(116)	1	(513)	(717)	(1,278)
Adjusted EBITDA (non-GAAP) [3]	972	1,009	715	292	(612)
Adjusted net income/(loss) from continuing operations (non-GAAP) [3]	68	24	(315)	(766)	(1,407)
Per common share					
Earnings/(loss) per share from continuing operations, diluted	$(0.37)	$0.00	$(1.68)	$(2.35)	$(5.13)
Adjusted earnings/(loss) per share from continuing operations, diluted (non-GAAP) [3]	$0.22	$0.08	$(1.03)	$(2.51)	$(5.64)
Financial position and cash flow					
Total assets	$8,413	$9,118	$9,211	$10,137	$11,517
Cash and cash equivalents	458	887	900	1,318	1,515
Total debt [4]	4,232	4,836	4,805	5,321	5,510
Free cash flow (non-GAAP) [3]	213	3	131	57	(2,746)

(1) Includes the effect of the 53rd week in 2017 and 2012. Excluding sales of $147 million and $163 million for the 53rd week in 2017 and 2012, respectively, total net sales decreased 1.5% and 7.5% in 2017 and 2013, respectively.

(2) Comparable store sales are presented on a 52-week basis and include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) See Non-GAAP Financial Measures herein for additional information and reconciliation to the most directly comparable GAAP financial measure.

(4) Total debt includes long-term debt, net of unamortized debt issuance costs, including current maturities, capital leases, financing obligation, note payable and any borrowings under our revolving credit facility.

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Five-Year Operations Summary

	2017	2016	2015	2014	2013
Number of department stores:					
Beginning of year	1,013	1,021	1,062	1,094	1,104
Openings	—	1	—	1	—
Closings	(141)	(9)	(41)	(33)	(10)
End of year	872	1,013	1,021	1,062	1,094
Gross selling space (square feet in millions)	95.6	103.3	104.7	107.9	110.6
Sales per gross square foot [1]	$127	$121	$120	$113	$107
Sales per net selling square foot [1]	$177	$166	$165	$155	$147
Number of the Foundry Big and Tall Supply Co. stores [2]	—	—	—	—	10

(1) Calculation includes the sales, including commission revenue, and square footage of department stores, including selling space allocated to services and licensed departments, that were open for the full fiscal year, as well as Internet sales.

(2) All stores opened during 2011 and closed during 2014. Gross selling space was 51 thousand square feet as of the end of 2013.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion, which presents our results, should be read in conjunction with the accompanying Consolidated Financial Statements and notes thereto, along with the Five-Year Financial and Operations Summaries, the risk factors and the cautionary statement regarding forward-looking information. Unless otherwise indicated, all references in this Management’s Discussion and Analysis (MD&A) related to earnings/(loss) per share (EPS) are on a diluted basis and all references to years relate to fiscal years rather than to calendar years.

Growth Initiatives

Our revenue growth strategy for 2018 will continue to focus on the following four initiatives:

- Beauty;
- Home refresh;
- Women's apparel business; and
- Omnichannel.

First, we will have a continued focus in our beauty categories of Sephora, The Salon by InStyle and Fine Jewelry. In 2017, we opened 70 additional Sephora locations, bringing our total number of locations to 642, and had a successful launch of Fenty Beauty by Rihanna in the fall. We plan to add approximately 30 new Sephora locations and will continue to roll out and launch new brands in 2018. We are also continuing to rebrand our salons to The Salon by InStyle and will modernize and rebrand another 100 salons in 2018. Finally, we will continue to enhance our Fine Jewelry offerings to better provide the customer with a total beauty solution. Magnifying the importance of physical stores, we see Sephora, Salon and Fine Jewelry as differentiators to help drive traffic and increase the frequency of visits to our stores.

Second, we will continue to enhance the strong results of our home refresh initiative. We have established appliance showrooms in over 600 stores and plan to add new brand partners to our showrooms throughout the year. Additionally, we have increased our mattress offering to approximately 500 in-store showrooms, have added televisions to our Home category and continue to develop our home services offering. We see our home refresh initiative as an opportunity for us to increase our revenue per customer.

Third, we will continue to focus on improving our women's apparel offering by strategically adjusting our assortment to better align with customer preferences. We plan to enhance our women's apparel with our strategy to improve speed and offer great fashion at a value across several categories. Along with our partnership with Nike, we continue to expand the breadth of our Adidas assortment by increasing the number of stores that carry the brand and by upgrading the store experience with Adidas shops. In addition, we are taking steps in women's apparel to simplify the floor, better balance our career and casual offerings and create a stronger value statement with pricing.

Lastly, we remain committed to becoming a world-class omnichannel retailer. Our online business remains strong, delivering double-digit growth in 2017. We plan to continue to drive increased online revenue in 2018 by increasing our online SKU assortment, continuing to improve site functionality, enhancing ship-from-store capabilities and developing additional enhancements to our improved mobile app.

We believe these growth initiatives will not only serve the needs of our value-oriented customer, they will differentiate us from our traditional competitors.

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2017 Overview

Sales were $12,506 million, a decrease of 0.3% as compared to 2016, and comparable store sales increased 0.1% for the year. Excluding sales of $147 million for the 53rd week in 2017, total net sales decreased 1.5% in 2017.

Cost of goods sold, which excludes depreciation and amortization, as a percentage of sales was 65.4% compared to 64.3% last year. This increase was primarily driven by the liquidation of both closed store and slow-moving inventory, the continued growth in certain lower margin merchandise categories such as major appliances and higher shrinkage rates.

Selling, general and administrative (SG&A) expenses decreased $70 million, or 2.0%, as compared to 2016. These savings were primarily driven by reductions in store controllable costs and marketing efficiencies, which were partially offset by lower credit income and higher incentive compensation.

Net loss was $116 million, or $0.37 per share, compared to net income of $1 million, or $0.00 per share, in 2016. Results for 2017 included the following amounts that are not directly related to our ongoing core business operations:

$303 million, or $(0.97) per share, of restructuring and management transition charges most of which encompassed the closure of 138 stores and the costs related to a Voluntary Early Retirement Program (VERP) for approximately 2,800 eligible associates;
$11 million, or $0.04 per share, for Primary Pension Plan income;
$25 million, or $(0.08) per share, for the mark-to-market (MTM) adjustment for supplemental retirement plans;
$33 million, or $(0.11) per share, for the loss on extinguishment of debt;
$31 million, or $0.10 per share, for our proportional share of net income from our joint venture formed to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture);
$60 million, or $0.19 per share, for the tax impact resulting from other comprehensive income allocation; and
$75 million, or $0.24 per share, for the impact of tax reform.

Adjusted net income was $68 million, or $0.22 per share, compared to adjusted net income of $24 million, or $0.08 per share, in 2016. See the reconciliation of net income/(loss) and diluted EPS, the most directly comparable GAAP financial measures, to adjusted net income/(loss) and adjusted diluted EPS on page 36.

Adjusted EBITDA was $972 million for 2017 compared to adjusted EBITDA of $1,009 million in 2016. See the reconciliation of net income/(loss), the most directly comparable GAAP financial measure, to adjusted EBITDA on page 35.

We completed the sale of our Buena Park, California distribution facility in March for a net sales price of $131 million
and recorded a net gain of $111 million.

During the second quarter, we amended and restated our $2.35 billion senior secured asset-based revolving credit facility to, among other things, extend the maturity date to June 20, 2022 and to lower the interest rate spread by 75 basis points.

During the year, we reduced our outstanding debt position by approximately $600 million.

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Results of Operations

Three-Year Comparison of Operating Performance

(in millions, except per share data)	2017	2016	2015
Total net sales	$12,506	$12,547	$12,625
Percent increase/(decrease) from prior year	(0.3)% [1]	(0.6)%	3.0%
Comparable store sales increase/(decrease) [2]	0.1%	0.0%	4.5%
Costs and expenses/(income):			
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	8,174	8,071	8,074
Selling, general and administrative	3,468	3,538	3,775
Pension	21	19	162
Depreciation and amortization	570	609	616
Real estate and other, net	(146)	(111)	3
Restructuring and management transition	303	26	84
Total costs and expenses	12,390	12,152	12,714
Operating income/(loss)	116	395	(89)
As a percent of sales	0.9%	3.1%	(0.7)%
Loss on extinguishment of debt	33	30	10
Net interest expense	325	363	405
Income/(loss) before income taxes	(242)	2	(504)
Income tax (benefit)/expense	(126)	1	9
Net income/(loss)	$(116)	$1	$(513)
Adjusted EBITDA [3]	$972	$1,009	$715
Adjusted net income/(loss) (non-GAAP) [3]	$68	$24	$(315)
Diluted EPS	$(0.37)	$0.00	$(1.68)
Adjusted diluted EPS (non-GAAP) [3]	$0.22	$0.08	$(1.03)
Weighted average shares used for diluted EPS	311.1	313.0	305.9

(1) Includes the effect of the 53rd week in 2017. Excluding sales of $147 million for the 53rd week in 2017, total net sales decreased 1.5% in 2017.

(2) Comparable store sales are presented on a 52-week basis and include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) See discussion herein of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure.

2017 Compared to 2016

Total Net Sales

Our year-to-year change in total net sales is comprised of (a) sales from new stores net of closings and relocations, referred to as non-comparable store sales, (b) sales of stores opened in both years as well as Internet sales, referred to as comparable store sales and (c) other revenue adjustments such as sales return estimates and store liquidation sales. We consider comparable store sales to be a key indicator of our current performance measuring the growth in sales and sales productivity of existing stores. Positive comparable store sales contribute to greater leveraging of operating costs, particularly payroll and occupancy costs, while negative comparable store sales contribute to de-leveraging of

costs. Comparable store sales also have a direct impact on our total net sales and the level of cash flow.

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	2017	2016
Total net sales (in millions)	$12,506	$12,547
Sales percent increase/(decrease)		
Total net sales	(0.3)% [1]	(0.6)%
Comparable store sales [2]	0.1%	—%
Sales per gross square foot [3]	$127	$121

(1) Includes the effect of the 53rd week in 2017. Excluding sales of $147 million for the 53rd week in 2017, total net sales decreased 1.5% in 2017.

(2) Comparable store sales are presented on a 52-week basis and include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(3) Calculation includes the sales, including commission revenue, and square footage of department stores, including selling space allocated to services and licensed departments, that were open for the full fiscal year, as well as Internet sales.

Total net sales decreased $41 million in 2017 compared to 2016. The following table provides the components of the net sales decrease:

($ in millions)	2017
Comparable store sales increase/(decrease)	$12
Sales related to new and closed stores, net	(205)
Other revenues and sales adjustments [1]	152
Total net sales increase/(decrease)	$(41)

(1) Includes sales of $147 million for the 53rd week in 2017.

As our omnichannel strategy continues to mature, it is increasingly difficult to distinguish between a store sale and an Internet sale. Because we no longer have a clear distinction between store sales and Internet sales, we do not separately report Internet sales. Below is a list of some of our omnichannel activities:

- Stores increase Internet sales by providing customers opportunities to view, touch and/or try on physical merchandise before ordering online.
- Our website increases store sales as in-store customers have often pre-shopped online before shopping in the store, including verification of which stores have online merchandise in stock.
- Most Internet purchases are easily returned in our stores.
- JCPenney Rewards can be earned and redeemed online or in stores.
- In-store customers can order from our website with the assistance of associates in our stores or they can shop our website from the JCPenney app while inside the store.
- Customers who utilize our mobile application can receive mobile coupons to use when they check out both online or in our stores.
- Internet orders can be shipped from a dedicated jcpenney.com fulfillment center, a store, a store merchandise distribution center, a regional warehouse, directly from vendors or any combination of the above.
- Certain categories of store inventory can be accessed and purchased by jcpenney.com customers and shipped directly to the customer's home from the store.
- Internet orders can be shipped to stores for customer pick up.
- "Buy online and pick up in store" is now available in all of our stores.

For 2017, units per transaction increased and average unit retail increased, while transaction counts decreased as compared to the prior year. On a geographic basis, all regions experienced comparable store sales decreases for 2017 compared to the prior year. During 2017, our Home, Jewelry, Sephora and Footwear and Handbags merchandise divisions experienced sales

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increases. Home, which reflected the addition of 100 new appliance showrooms and 500 mattress showrooms, experienced the highest sales increase.

During 2017, private brand merchandise comprised 46% of total merchandise sales, as compared to 44% in 2016. During 2017 and 2016, exclusive brand merchandise comprised 7% and 8%, respectively, of total merchandise sales.

Cost of Goods Sold
Cost of goods sold, exclusive of depreciation and amortization, increased to 65.4% of sales in 2017, or 110 basis points, compared to 2016. On a dollar basis, cost of goods sold increased $103 million, or 1.3%, to $8,174 million in 2017 compared to $8,071 million in the prior year. The net 110 basis point increase was primarily driven by the liquidation of both closed store and slow-moving inventory, higher shrinkage rates and the continued growth in certain lower margin merchandise categories such as major appliances.

SG&A Expenses
SG&A expenses declined $70 million to $3,468 million in 2017 compared to $3,538 million in 2016, primarily due to the closing of 138 stores. As a percent of sales, SG&A expenses were 27.7% compared to 28.2% in the prior year. The net 50 basis point improvement was primarily driven by reductions in store controllable costs and marketing efficiencies, which were partially offset by lower credit income and higher incentive compensation.

Our private label credit card and co-branded MasterCard® programs are owned and serviced by Synchrony Financial (Synchrony). Under our agreement with Synchrony, we receive cash payments from Synchrony based upon the performance of the credit card portfolio. We participate in the programs by providing marketing promotions designed to increase the use of each card, including enhanced marketing offers for cardholders. Additionally, we accept payments in our stores from cardholders who prefer to pay in person when they are shopping in our locations. The income we earn under our agreement with Synchrony is included as an offset to SG&A expenses. For 2017 and 2016, we recognized income of $319 million and $347 million, respectively, pursuant to our agreement with Synchrony.
Pension

($ in millions)	2017	2016
Primary pension plan expense/(income)	$(11)	$ 1
Supplemental pension plans expense/(income)	32	18
Total pension expense/(income)	$21	$ 19

Total pension expense/(income) increased slightly from 2016. Primary pension plan expense/(income) was income of $11 million in 2017 as a result of the expected return on the plan assets exceeding the service and interest cost components and $13 million in settlement expense. Supplemental pension plans expense/(income) increased primarily due to the increase of the MTM adjustment from $11 million in 2016 to $25 million in 2017.

Depreciation and Amortization Expenses
Depreciation and amortization expense in 2017 decreased $39 million to $570 million, or 6.4%, compared to $609 million in 2016. This decrease is primarily a result of closing 141 store locations in 2017.
Real Estate and Other, Net
Real estate and other consists of ongoing operating income from our real estate subsidiaries. Real estate and other also includes net gains from the sale of facilities and equipment that are no longer used in operations, asset impairments, accruals for certain litigation and other non-operating charges and credits. In addition, during the first quarter of 2014, we entered into the Home Office Land Joint Venture in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas. The joint venture was formed to develop the contributed property and our proportional share of the joint venture's activities is recorded in Real estate and other, net.

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The composition of real estate and other, net was as follows:

($ in millions)	2017	2016
Net gain from sale of non-operating assets	$—	$(5)
Investment income from Home Office Land Joint Venture	(31)	(28)
Net gain from sale of operating assets	(119)	(73)
Other	4	(5)
Total expense/(income)	$(146)	$(111)

In 2016, we sold several non-operating assets for a net gain of $5 million. Investment income from the Home Office Land Joint Venture represents our proportional share of net income of the joint venture.

In 2017, the net gain from the sale of operating assets primarily related to the sale of our Buena Park, California distribution facility for a net sale price of $131 million and a net gain of $111 million and the sale of excess property.

In 2016, the net gain from the sale of operating assets related to the sale of land surrounding our home office and the sale of excess property.

Restructuring and Management Transition

The composition of restructuring and management transition charges was as follows:

($ in millions)	2017	2016
VERP	$122	$ —
Home office and stores	176	8
Management transition	—	3
Other	5	15
Total	$303	$ 26

In February 2017, we announced a Voluntary Early Retirement Program (VERP), which was offered to approximately 6,000 eligible associates. In the first quarter of 2017, we recorded a total charge of $122 million related to the VERP. Charges included $112 million related to enhanced retirement benefits for the approximately 2,800 associates who accepted the VERP, $8 million related to curtailment charges for our Primary Pension Plan and Supplemental Pension Plans as a result of the reduction in the expected years of future service related to these plans and $2 million in other related costs.

In 2017 and 2016, we recorded $176 million and $8 million, respectively, of costs to reduce our store and home office expenses. Costs during 2017, primarily related to the closure of 138 stores, include store closing asset impairments of $77 million, employee termination benefits of $29 million and store related closing costs of $75 million. For 2016, the costs relate to employee termination benefits, lease termination costs and impairment charges associated with the closure of 7 department stores.

We also implemented several changes within our management leadership team during 2016 that resulted in management transition costs of $3 million, for both incoming and outgoing members of management. Other miscellaneous restructuring charges of $15 million, primarily related to contract termination and other costs associated with our previous shops strategy, were recorded during 2016.

Operating Income/(Loss)

For 2017, we reported operating income of $116 million compared to an operating income of $395 million in 2016, which is a decline of $279 million.

(Gain)/Loss on Extinguishment of Debt

During the second quarter of 2017, we settled cash tender offers with respect to portions of our outstanding 5.75% Senior Notes
due 2018 (2018 Notes) and 8.125% Senior Notes due 2019 (2019 Notes), resulting in a loss on extinguishment of debt of $34
million, and amended and restated our $2.35 billion senior secured asset-based revolving credit facility (Revolving Credit Facility), which resulted in a loss on extinguishment of debt of $1 million.

During the fourth quarter of 2017, we repurchased and retired $40 million aggregate principal amount of our outstanding 5.65% Senior Notes due 2020 (2020 Notes) resulting in a gain on extinguishment of debt of $2 million.

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During the first quarter of 2016, we repurchased and retired $60 million aggregate principal amount of our outstanding debt resulting in a gain on extinguishment of debt of $4 million.

During the second quarter of 2016, we completed the refinancing of our 2013 Senior Secured Term Loan Facility and the issuance of the Senior Secured Notes, resulting in a loss on extinguishment of debt of $34 million.

Net Interest Expense

Net interest expense consists principally of interest expense on long-term debt, net of interest income earned on cash and cash equivalents. In 2017, Net interest expense was $325 million, a decrease of $38 million, or 10.5%, from $363 million in 2016. The reduction in net interest expense is due to lower debt levels in 2017 compared to 2016.

Income Taxes

Our deferred tax assets, which include the future tax benefits of our net operating loss carryforwards, are subject to a valuation allowance. At February 3, 2018, the federal and state valuation allowances were $535 million and $232 million, respectively. Our deferred tax assets include the impact of re-measurement on U. S. deferred taxes at the lower enacted corporate tax rate resulting from U. S. tax reform enacted in December 2017. Future book pre-tax losses will require additional valuation allowances to offset the deferred tax assets created. Until such time that we achieve sufficient profitability to allow removal of most of our valuation allowance, utilization of our loss carryforwards will result in a corresponding decrease in the valuation allowance and offset our tax provision dollar for dollar.

Each period we are required to allocate our income tax expense or benefit to continuing operations and other items such as other comprehensive income and stockholder's equity. In accordance with these rules, when we have a loss in continuing operations and a gain in other comprehensive income, as arose in 2013, we are required to recognize a tax benefit in continuing operations up to the amount of tax expense that we are required to report in other comprehensive income. In 2017, we experienced a loss in continuing operations and income in other comprehensive income. Under the allocation rules, we are only required to recognize the valuation allowance allocable to the tax benefit attributable to losses in each component of comprehensive income. Accordingly, there is no valuation allowance offsetting a deferred tax benefit attributable to other comprehensive income included in the total valuation allowance of $767 million noted above.

For 2017, we recorded a net tax benefit of $126 million. The net tax expense included $7 million related to the amortization of certain indefinite-lived intangible assets, $6 million for state and foreign jurisdictions where loss carryforwards are limited or unavailable offset by net tax benefits of $3 million to adjust the valuation allowance, $1 million for state audit settlements and $60 million related to other comprehensive income. The 2017 net tax benefit includes an income tax benefit of $75 million related to the re-measurement of the U. S. net deferred tax liabilities from 35% to 21% tax rate.

For 2016, we recorded a net tax expense of $1 million. The net tax expense included $7 million related to the amortization of certain indefinite-lived intangible assets, $9 million for state and foreign jurisdictions where loss carryforwards are limited or unavailable offset by net tax benefits of $1 million to adjust the valuation allowance, $2 million for state audit settlements and $12 million related to other comprehensive income.

Net Income/(Loss) and Adjusted Net Income/(Loss) (non-GAAP)

In 2017, we reported a loss of $116 million, or $0.37 per share, compared with income of $1 million, or $0.00 per share, last year. Excluding the impact of restructuring and management transition charges, the impact of our Primary Pension Plan expense, the mark-to-market adjustment for supplemental retirement plans, the loss on extinguishment of debt, the net gain on sale of non-operating assets, the proportional share of net income from joint venture, the tax impact resulting from other comprehensive income allocation, and the impact of tax reform, adjusted net

income/(loss) (non-GAAP) was income of $68 million, or $0.22 per share, in 2017 compared to income of $24 million, or $0.08 per share, in 2016.

The reduction in net income/(loss) in 2017 was driven primarily by restructuring charges associated with the 2017 store closures and the VERP.

Adjusted EBITDA (non-GAAP)
In 2017, adjusted EBITDA was $972 million, a decline of $37 million for 2017 compared to adjusted EBITDA of $1,009 million for the prior year.

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2016 Compared to 2015

Total Net Sales

	2016		2015	
Total net sales (in millions)	$12,547		$12,625	
Sales percent increase/(decrease)				
Total net sales[1]	(0.6	)%	3.0	%
Comparable store sales[2]	—	%	4.5	%
Sales per gross square foot[3]	$121		$120	

(1) Comparable store sales are presented on a 52-week basis and include sales from all stores, including sales from services and commissions earned from our in-store licensed departments, that have been open for 12 consecutive full fiscal months and Internet sales. Stores closed for an extended period are not included in comparable store sales calculations, while stores remodeled and minor expansions not requiring store closure remain in the calculations. Certain items, such as sales return estimates and store liquidation sales, are excluded from the Company's calculation. Our definition and calculation of comparable store sales may differ from other companies in the retail industry.

(2) Calculation includes the sales, including commission revenue, and square footage of department stores, including selling space allocated to services and licensed departments, that were open for the full fiscal year, as well as Internet sales.

Total net sales decreased $78 million in 2016 compared to 2015. The following table provides the components of the net sales decrease:

($ in millions)	2016
Comparable store sales increase/(decrease)	$2
Sales related to new and closed stores, net	(76)
Other revenues and sales adjustments	(4)
Total net sales increase/(decrease)	$(78)

For 2016, conversion, units per transaction and average unit retail increased, while transaction counts decreased as compared to the prior year. On a geographic basis, all regions experienced comparable store sales decreases for 2016 compared to the prior year. During 2016, our Sephora, Home and Footwear and Handbags merchandise divisions experienced sales increases. Sephora, which reflected the addition of 60 Sephora inside JCPenney locations, experienced the highest sales increase.

During both 2016 and 2015, private brand merchandise comprised 44% and exclusive brand merchandise comprised 8% of total merchandise sales.

Cost of Goods Sold

Cost of goods sold, exclusive of depreciation and amortization, increased to 64.3% of sales in 2016, or 30 basis points, compared to 2015. On a dollar basis, cost of goods sold decreased $3 million to $8,071 million in 2016 compared to $8,074 million in the prior year. The net 30 basis point decrease resulted primarily from the addition of lower margin appliances to our assortment and increased sales of merchandise in certain lower margin categories.

SG&A Expenses

SG&A expenses declined $237 million to $3,538 million in 2016 compared to $3,775 million in 2015. As a percent of sales, SG&A expenses were 28.2% compared to 29.9% in the prior year. The net 170 basis point decrease was primarily driven by lower incentive compensation, store controllable costs, corporate overhead and more efficient advertising spend.

Our private label credit card and co-branded MasterCard® programs are owned and serviced by Synchrony Financial (Synchrony). Under our agreement with Synchrony, we receive cash payments from Synchrony based upon the performance of the credit card portfolio. We participate in the programs by providing marketing promotions designed to increase the use of each card, including enhanced marketing offers for cardholders. Additionally, we accept payments in our stores from cardholders who prefer to pay in person when they are shopping in our locations. The income we earn under our agreement with Synchrony is included as an offset to SG&A expenses. For 2016 and 2015, we recognized income of $347 million and $367 million, respectively, pursuant to our agreement with Synchrony.

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Pension Expense

($ in millions)	2016	2015
Primary pension plan expense/(income)	$ 1	$ 154
Supplemental pension plans expense/(income)	18	8
Total pension expense/(income)	$ 19	$ 162

Total pension expense, which consists of our Primary Pension Plan expense and our supplemental pension plans expense, decreased primarily due to the $180 million settlement charge of unrecognized actuarial losses that occurred in 2015. The settlement charge related to the total transfer of approximately $1.5 billion in Primary Pension Plan assets to settle a portion of the Primary Pension Plan obligation. Additionally, the MTM adjustment was expense of $11 million and $52 million in 2016 and 2015, respectively.

Depreciation and Amortization Expense

Depreciation and amortization expense in 2016 decreased $7 million to $609 million, or 1.1%, compared to $616 million in 2015. This decrease is primarily a result of closing 50 store locations since the beginning of 2015.

Real Estate and Other, Net

The composition of real estate and other, net was as follows:

($ in millions)	2016	2015
Net gain from sale of non-operating assets	$ (5)	$ (9)
Investment income from Home Office Land Joint Venture	(28)	(41)
Net gain from sale of operating assets	(73)	(9)
Asset impairments	—	20
Other	(5)	42
Total expense/(income)	$ (111)	$ 3

In 2016 and 2015, we sold several non-operating assets for a net gain of $5 million and $9 million, respectively.

In 2016, the net gain from the sale of operating assets related to the sale of land surrounding our home office and the sale of excess property. In 2015, the net gain from the sale of operating assets related to the sale of a former furniture store location, payments received from landlords to terminate two leases prior to the original expiration date and the sale of excess property.

In 2015, we incurred an impairment charge related to the write-down of internal use software products.

Included in the other category in 2015 is a $50 million accrual for the proposed settlement related to a pricing class action lawsuit. Pursuant to the settlement, the Company paid $25 million in cash to certain class members and issued $25 million of store credit to the remainder of the class members.

See "Restructuring and Management Transition" below for additional impairments related to stores closed in 2015.

Restructuring and Management Transition

The composition of restructuring and management transition charges was as follows:

($ in millions)	2016	2015
Home office and stores	$ 8	$ 42
Management transition	3	28
Other	15	14
Total	$ 26	$ 84

In 2016 and 2015, we recorded $8 million and $42 million, respectively, of costs to reduce our store and home office expenses. The costs relate to employee termination benefits, lease termination costs and impairment charges associated with the closure of 7 underperforming department stores in 2016. Additionally, the costs include employee termination benefits in connection with the elimination of approximately 300 positions in our home office in 2015.

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We also implemented several changes within our management leadership team during 2016 and 2015 that resulted in management transition costs of $3 million and $28 million, respectively, for both incoming and outgoing members of management. Other miscellaneous restructuring charges of $15 million and $14 million, primarily related to contract termination and other costs associated with our previous shops strategy, were recorded during 2016 and 2015, respectively.

Operating Income/(Loss)

For 2016, we reported an operating income of $395 million compared to an operating loss of $89 million in 2015, which was an improvement of $484 million.

(Gain)/Loss on Extinguishment of Debt

During the first quarter of 2016, we repurchased and retired $60 million aggregate principal amount of our outstanding debt resulting in a gain on extinguishment of debt of $4 million.

During the second quarter of 2016, we completed the refinancing of the 2013 Term Loan Facility and the issuance of the Senior Secured Notes, resulting in a loss on extinguishment of debt of $34 million.

In December 2015, we prepaid and retired the outstanding $494 million principal amount of the term loan under our $2,350 million asset-based senior credit facility (2014 Credit Facility) and recognized a loss on extinguishment of debt of $10 million for the write off of the related unamortized debt issuance costs.

Net Interest Expense

In 2016, Net interest expense was $363 million, a decrease of $42 million, or 10.4%, from $405 million in 2015. The reduction in net interest expense is primarily due to refinancing the 2013 Term Loan Facility.

Income Taxes

Our net deferred tax assets, which include the future tax benefits of our net operating loss carryforwards, are subject to a valuation allowance. At January 28, 2017, the federal and state valuation allowances were $765 million and $228 million, respectively. Future book pre-tax losses will require additional valuation allowances to offset the deferred tax assets created. Until such time that we achieve sufficient profitability to allow removal of most of our valuation allowance, utilization of our loss carryforwards will result in a corresponding decrease in the valuation allowance and offset our tax provision dollar for dollar.

Each period we are required to allocate our income tax expense or benefit to continuing operations and other items such as other comprehensive income and stockholder's equity. In accordance with these rules when we have a loss in continuing operations and a gain in other comprehensive income, as arose in 2013, we are required to recognize a tax benefit in continuing operations up to the amount of tax expense that we are required to report in other comprehensive income. In 2016, we experienced income in both continuing operations and other comprehensive income. Under the allocation rules we are required to recognize the valuation allowance allocable to the tax benefit attributable to these losses in each component of comprehensive income. Accordingly, there is no valuation allowance offsetting a deferred tax benefit attributable to other comprehensive income included in the total valuation allowance of $993 million noted above.

For 2016, we recorded a net tax expense of $1 million. The net tax expense included $7 million related to the amortization of certain indefinite-lived intangible assets, $9 million for state and foreign jurisdictions where loss carryforwards are limited or unavailable offset by net tax benefits of $1 million to adjust the valuation allowance, $2 million for state audit settlements and $12 million related to other comprehensive income.

For 2015, we recorded a net tax expense of $9 million. The net tax expense included $7 million related to the amortization of certain indefinite-lived intangible assets, $12 million for state and foreign jurisdictions where loss carryforwards are limited or unavailable offset by net tax benefits of $2 million for state audit settlements and $8 million to adjust the valuation allowance.

Net Income/(Loss) and Adjusted Net Income/(Loss)
In 2016, we reported income of $1 million, or $0.00 per share, compared with a loss of $513 million, or $1.68 per share, in 2015. Excluding the impact of restructuring and management transition charges, the impact of our Primary Pension Plan expense, the mark-to-market adjustment for supplemental retirement plans, the loss on extinguishment of debt, the net gain on sale of non-operating assets, the proportional share of net income from joint venture and the tax impact resulting from other comprehensive income allocation, adjusted net income/(loss) (non-GAAP) went from a loss of $315 million, or $1.03 per share, in 2015 to income of $24 million, or $0.08, in 2016.

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Overall, net income/(loss) and adjusted net income/(loss) improved significantly in 2016 as compared to the corresponding prior year periods as we were able to reduce our operating costs.

Adjusted EBITDA (non-GAAP)
In 2016, adjusted EBITDA was $1,009 million, improving $294 million for 2016 compared to adjusted EBITDA of $715 million for the prior year corresponding period.

Non-GAAP Financial Measures

We report our financial information in accordance with generally accepted accounting principles in the United States (GAAP). However, we present certain financial measures and ratios identified as non-GAAP under the rules of the Securities and Exchange Commission (SEC) to assess our results. We believe the presentation of these non-GAAP financial measures and ratios is useful in order to better understand our financial performance as well as to facilitate the comparison of our results to the results of our peer companies. In addition, management uses these non-GAAP financial measures and ratios to assess the results of our operations. It is important to view non-GAAP financial measures in addition to, rather than as a substitute for, those measures and ratios prepared in accordance with GAAP. We have provided reconciliations of the most directly comparable GAAP measures to our non-GAAP financial measures presented.

The following non-GAAP financial measures are adjusted to exclude the impact of restructuring and management transition charges, the impact of our qualified defined benefit pension plan (Primary Pension Plan), the mark-to-market (MTM) adjustment for supplemental retirement plans, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from our joint venture formed to develop the excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture), the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps and the impact of tax reform. Unlike other operating expenses, the impact of restructuring and management transition charges, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from the Home Office Land Joint Venture, the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps and the impact of tax reform are not directly related to our ongoing core business operations. Primary Pension Plan expense/(income) and the mark-to-market adjustment for supplemental retirement plans are determined using numerous complex assumptions about changes in pension assets and liabilities that are subject to factors beyond our control, such as market volatility. Accordingly, we eliminate our Primary Pension Plan expense/(income) in its entirety as we view all components of net periodic benefit expense/(income) as a single, net amount, consistent with its presentation in our Consolidated Financial Statements. We believe it is useful for investors to understand the impact of restructuring and management transition charges, Primary Pension Plan expense/(income), the mark-to-market adjustment for supplemental retirement plans, the loss on extinguishment of debt, the net gain on the sale of non-operating assets, certain net gains, the proportional share of net income from the Home Office Land Joint Venture, the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps and the impact of tax reform on our financial results and therefore are presenting the following non-GAAP financial measures: (1) adjusted EBITDA; (2) adjusted net income/(loss); and (3) adjusted earnings/(loss) per share-diluted.

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Adjusted EBITDA. The following table reconciles net income/(loss), the most directly comparable GAAP measure, to adjusted EBITDA, which are non-GAAP financial measures:

($ in millions)	2017	2016	2015	2014	2013
Net income/(loss) from continuing operations	$(116)	$1	$(513)	$(717)	$(1,278)
Add: Net interest expense	325	363	405	406	352
Add: Loss on extinguishment of debt	33	30	10	34	114
Add: Income tax expense/(benefit)	(126)	1	9	23	(430)
Add: Depreciation and amortization	570	609	616	631	601
Add: Restructuring and management transition charges	303	26	84	87	215
Add: Primary pension plan expense/(income)	(11)	1	154 [(1)]	(18)	(52)
Add: Mark-to-market adjustment for supplemental retirement plans	25	11	—	12	(2)
Less: Net gain on the sale of non-operating assets	—	(5)	(9)	(25)	(132)
Less: Proportional share of net income from home office land joint venture	(31)	(28)	(41)	(53)	—
Less: Certain net gains	—	—	—	(88) [(2)]	—
Adjusted EBITDA (non-GAAP)	$972	$1,009	$715	$292	$(612)

(1) Includes $52 million mark-to-market adjustment.

(2) Represents the net gain on the sale of one department store location and the net gain recognized on a payment received from a landlord to terminate an existing lease prior to its original expiration date.

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Adjusted Net Income/(Loss) and Adjusted Diluted EPS from Continuing Operations. The following table reconciles net income/(loss) and diluted EPS from continuing operations, the most directly comparable GAAP financial measures, to adjusted net income/(loss) and adjusted diluted EPS from continuing operations, non-GAAP financial measures:

($ in millions, except per share data)	2017	2016	2015	2014	2013
Net income/(loss) (GAAP) from continuing operations	$(116)	$1	$(513)	$(717)	$(1,278)
Diluted EPS (GAAP) from continuing operations	$(0.37)	$—	$(1.68)	$(2.35)	$(5.13)
Add: restructuring and management transition charges	303	26	84	87	215
Add/(deduct): primary pension plan expense/(income)	(11)	1	154 (1)	(18)	(52)
Add: Mark-to-market adjustment for supplemental retirement plans	25	11	—	12	(2)
Add: Loss on extinguishment of debt	33	30	10	34	114
Less: Net gain on sale or redemption of non-operating assets	—	(5)	(9)	(25)	(132)
Less: Proportional share of net income from home office land joint venture	(31)	(28)	(41)	(53)	—
Less: Certain net gains	—	—	—	(88) (2)	—
Less: Aggregate tax impact related to the above adjustments	— (3)	— (3)	— (3)	2 (4)	(22) (5)
Less: Tax impact resulting from other comprehensive income allocation	(60) (6)	(12) (6)	—	—	(250) (6)
Less: Impact of tax reform	(75)	—	—	—	—
Adjusted net income/(loss) (non-GAAP) from continuing operations	$68	$24	$(315)	$(766)	$(1,407)
Adjusted diluted EPS (non-GAAP) from continuing operations	$0.22	$0.08	$(1.03)	$(2.51)	$(5.64)

(1) Includes $52 million mark-to-market adjustment.
(2) Represents the net gain on the sale of one department store location and the net gain recognized on a payment received from a landlord to terminate an existing lease prior to its original expiration date.
(3) Reflects no tax effect due to the impact of the Company's tax valuation allowance.
(4) Tax effect represents state taxes payable in separately filing states related to the sale of assets.
(5) Tax effect for the three months ended May 4, 2013 was calculated using the Company's statutory rate of 38.82% and includes state taxes payable in separately filing states related to the sale of assets. The last nine months of 2013 reflects no tax effect due to the impact of the Company's tax valuation allowance.
(6) Represents the tax benefits related to the allocation of tax expense to other comprehensive income items, including the amortization of actuarial losses and prior service costs related to the Primary Pension Plan and the results of our annual remeasurement of our pension plans.

Financial Condition and Liquidity

Overview

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our revolving credit facility. During 2017, we executed the following transactions:

- Sold our Buena Park, California distribution facility for a net sale price of $131 million and recorded a net gain of $111 million.
- We paid $334 million to settle cash tender offers with respect to portions of our outstanding 5.75% Senior Notes due 2018 (2018 Notes) and 8.125% Senior Notes due 2019 (2019 Notes) and amended and restated our $2.35 billion senior secured asset-based revolving credit facility (Revolving Credit Facility) to extend the maturity date to June 20, 2022 and to lower the interest rate spread by 75 basis points.

We ended the year with $458 million of cash and cash equivalents, a decrease of $429 million from the prior year. As of the end of 2017, based on our borrowing base and amounts reserved for outstanding standby and import letters of credit, we had $1,884 million available for future borrowings under the Revolving Facility, providing a total available liquidity of approximately $2.3 billion.

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The following table provides a summary of our key components and ratios of financial condition and liquidity:

($ in millions)	2017	2016	2015
Cash and cash equivalents	$458	$887	$900
Merchandise inventory	2,762	2,854	2,721
Property and equipment, net	4,281	4,599	4,816
Total debt and other financing obligations (1)	4,232	4,836	4,805
Stockholders' equity	1,379	1,354	1,309
Total capital	5,611	6,190	6,114
Maximum capacity under our Revolving Credit Facility	2,350	2,350	2,350
Cash flow from operating activities	454	334	440
Free cash flow (non-GAAP) (2)	213	3	131
Capital expenditures	395	427	320
Ratios:			
Debt-to-total capital (3)	75.4 %	78.1 %	78.6 %
Cash-to-debt (4)	10.8 %	18.3 %	18.7 %

(1) Includes long-term debt, net of unamortized debt issuance costs, including current maturities, capital leases, financing obligation, note payable and any borrowings under our revolving credit facility.
(2) See below for a discussion of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure.
(3) Total debt and other financing obligations divided by total capital.
(4) Cash and cash equivalents divided by total debt.

Free Cash Flow (Non-GAAP)

Free cash flow is a key financial measure of our ability to generate additional cash from operating our business. We define free cash flow as cash flow from operating activities, less capital expenditures and dividends paid, plus the proceeds from the sale of operating assets. Free cash flow is a relevant indicator of our ability to repay maturing debt, revise our dividend policy or fund other uses of capital that we believe will enhance stockholder value. Free cash flow is considered a non-GAAP financial measure under the rules of the SEC. Free cash flow is limited and does not represent remaining cash flow available for discretionary expenditures due to the fact that the measure does not deduct payments required for debt maturities, payments made for business acquisitions or required pension contributions, if any. Therefore, it is important to view free cash flow in addition to, rather than as a substitute for, our entire statement of cash flows and those measures prepared in accordance with GAAP.

The following table reconciles net cash provided by/(used in) operating activities, the most directly comparable GAAP measure, to free cash flow, a non-GAAP financial measure, as well as information regarding net cash provided by/(used in) investing activities and net cash provided by/(used in) financing activities.

($ in millions)	2017	2016	2015	2014	2013
Net cash provided by/(used in) operating activities (GAAP)	$454	$334	$440	$239	$(1,814)
Less:					
Capital expenditures	(395)	(427)	(320)	(252)	(951)
Plus:					
Proceeds from sale of operating assets	154	96	11	70	19
Free cash flow (non-GAAP)	$213	$3	$131	$57	$(2,746)
Net cash provided by/(used in) investing activities (1)	$(229)	$(316)	$(296)	$(142)	$(789)
Net cash provided by/(used in) financing activities	$(654)	$(31)	$(562)	$(294)	$3,188

(1)

Net cash provided by/(used in) investing activities includes capital expenditures and proceeds from sale of operating assets, which are also included in our computation of free cash flow.

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During 2017, free cash flow increased $210 million to an inflow of $213 million compared to an inflow of $3 million in 2016. Free cash flow improved due to increased cash from operations, lower capital expenditures and higher proceeds from the sale of operating assets in 2017 when compared to 2016.

Operating Activities

While a significant portion of our sales, profit and operating cash flows have historically been realized in the fourth quarter, our quarterly results of operations may fluctuate significantly as a result of many factors, including seasonal fluctuations in customer demand, product offerings, inventory levels and the impact of our strategy to return to profitable growth.

In 2017, cash flow from operating activities was an inflow of $454 million, an increase of $120 million compared to an inflow of $334 million during the same period last year. Our net loss as of the end of 2017 of $116 million included significant charges and credits that did not impact operating cash flow, including depreciation and amortization, certain restructuring charges, loss on extinguishment of debt, benefit plans, the sale of operating and non-operating assets and stock-based compensation. Overall, the increase in cash from operations was driven primarily by our improved inventory position. In addition, during 2017 we received an aggregate cash distribution of $40 million from the Home Office Land Joint Venture of which $31 million was included in operating activities and $9 million was classified as investing activities as it was considered a return of investment as the aggregate cash distribution exceeded our proportional share of the cumulative earnings of the joint venture by this amount. Cash flows from operating activities also included construction allowances from landlords of $20 million, which provided additional cash that was used to fund a portion of our capital expenditures in investing activities.

Merchandise inventory decreased $92 million to $2,762 million, or 3.2%, as of the end of 2017 compared to $2,854 million as of the end of last year. Inventory turns for 2017, 2016 and 2015 were 2.76, 2.59 and 2.65 respectively. Merchandise accounts payable decreased $4 million at the end of 2017 compared to 2016.

In 2016, cash flow from operating activities was an inflow of $334 million, a decrease of $106 million compared to an inflow of $440 million during the prior year. Our net income as of the end of 2016 of $1 million included significant charges and credits that did not impact operating cash flow, including depreciation and amortization, certain restructuring and management transition charges, loss on extinguishment of debt, benefit plans, the sale of operating and non-operating assets and stock-based compensation. Overall, the decrease in cash from operations was driven primarily by the payment of incentive compensation and other expenses in 2016 where such incurred expenses did not accrue at the sames levels as had occurred in 2015. In addition, during 2016 we received an aggregate cash distribution of $44 million from the Home Office Land Joint Venture. Cash flows from operating activities also included construction allowances from landlords of $43 million, which provided additional cash that was used to fund a portion of our capital expenditures in investing activities.

Investing Activities

In 2017, investing activities was a cash outflow of $229 million compared to an outflow of $316 million for 2016. The decrease in the cash outflow from investing activities was primarily a result lower capital expenditures and the increase in proceeds from the sale of operating assets.

For 2017, capital expenditures were $395 million. At the end of the year, we also had an additional $58 million of accrued capital expenditures, which will be paid in subsequent periods. The capital expenditures for 2017 related primarily to investments in our store environment and store facility improvements, including investments in 70 new and 32 expanded Sephora inside JCPenney stores, the roll out of 100 new appliance showrooms and investments in information technology in both our home office and stores. We received construction allowances from landlords of $20 million in 2017, which are classified as operating activities, to fund a portion of the capital expenditures related to store leasehold improvements. These funds have been recorded as deferred rent credits in the Consolidated Balance Sheets and are amortized as an offset to rent expense. Additionally, we received net cash proceeds of $131 million for the sale of our Buena Park, California distribution facility.

In 2016, investing activities was a cash outflow of $316 million compared to an outflow of $296 million for 2015. The increase in the cash outflow from investing activities was primarily a result of an increase in capital expenditures offset by the increase in proceeds from the sale of operating assets.

For 2016, capital expenditures were $427 million. At the end of the year, we also had an additional $33 million of accrued capital expenditures, which were paid in 2017. The capital expenditures for 2016 related primarily to the roll out of over 500 appliance showrooms, the roll out of our center core concept in 350 locations, the opening of 60 Sephora inside JCPenney stores, other investments in our store environment and store facility improvements and investments in information technology

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in both our home office and stores. We also received construction allowances from landlords of $43 million in 2016. Additionally, we received $80 million in cash proceeds for the sale of land near our home office.

The following provides a breakdown of capital expenditures:

($ in millions)	2017	2016	2015
Store renewals and updates	$178	$240	$170
Capitalized software	123	100	93
New and relocated stores	5	17	—
Technology and other	89	70	57
Total	$395	$427	$320

We expect our investment in capital expenditures for 2018 to be approximately $375 million, net of construction allowances from landlords, which will relate primarily to our store environment, investments in information technology and the continued roll-out of approximately 30 new Sephora inside JCPenney locations and the conversion of approximately 100 of our salons to The Salon by InStyle format. Our plan is to fund these expenditures with cash flow from operations and existing cash and cash equivalents.

Financing Activities

In 2017, cash flows from financing activities were an outflow of $654 million compared to an outflow of $31 million for the same period last year.

During 2017, we paid $334 million to settle cash tender offers with respect to portions of our outstanding 2018 Notes and 2019 Notes. Additionally, we repurchased and retired $40 million aggregate principal amount of our 2020 Notes, repaid $220 million of debt at maturity and repaid $16 million on our capital leases and note payable.

During 2016, we completed the refinancing of our Senior Secured Term Loan Facility with our amended and restated $1.688 billion 2016 Term Loan Facility and the issuance of $500 million aggregate principal amount of 5.875% Senior Secured Notes due 2023. We also received net cash proceeds of $216 million for the sale-leaseback of our home office. Additionally, we repurchased and retired $60 million aggregate principal amount of our debt, repaid $78 million of debt at maturity and repaid $29 million on our capital leases and note payable.

Cash Flow and Financing Outlook

Our primary sources of liquidity are cash generated from operations, available cash and cash equivalents and access to our Revolving Credit Facility. Our cash flows may be impacted by many factors including the economic environment, consumer confidence, competitive conditions in the retail industry and the success of our strategies. For 2018, we believe that our existing liquidity will be adequate to fund our capital expenditures and working capital needs; however, in accordance with our long-term financing strategy, we may access the capital markets opportunistically.

2017 Credit Facility

The Company has a $2,350 million senior secured asset-based revolving credit facility . As of the end of 2017, we had no borrowings outstanding under the Revolving Credit Facility. In addition, as of the end of 2017, based on our borrowing base, we had $2,019 million available for borrowing under the facility, of which $135 million was reserved for outstanding standby and import letters of credit, none of which have been drawn on, leaving $1,884 million for future borrowings. The applicable rate for standby and import letters of credit were 2.50% and 1.25%, respectively, while the commitment fee was 0.375% for the unused portion of the Revolving Credit Facility.

Credit Ratings

Our credit ratings and outlook as of March 16, 2018 were as follows:

	Corporate	Outlook

Fitch Ratings	B+	Stable
Moody’s Investors Service, Inc.	B1	Stable
Standard & Poor’s Ratings Services	B+	Negative

Credit rating agencies periodically review our capital structure and the quality and stability of our earnings. Rating agencies consider, among other things, changes in operating performance, comparable store sales, the economic environment, conditions

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in the retail industry, financial leverage and changes in our business strategy in their rating decisions. Downgrades to our long-term credit ratings could result in reduced access to the credit and capital markets and higher interest costs on future financings.

Contractual Obligations and Commitments

Aggregated information about our obligations and commitments to make future contractual payments, such as debt and lease agreements, and contingent commitments as of February 3, 2018 is presented in the following table.

($ in millions)	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Recorded contractual obligations:					
Total debt, excluding unamortized debt issuance costs, capital leases, financing obligation and note payable	$4,063	$232	$619	$84	$3,128
Capital leases, financing obligation and note payable	285	21	40	38	186
Unrecognized tax benefits (1)	35	2	—	—	33
Contributions to non-qualified supplemental retirement plans (2)	156	29	54	29	44
	$4,539	$284	$713	$151	$3,391
Unrecorded contractual obligations:					
Interest payments on long-term debt (3)	$4,653	$242 (4)	$442	$389	$3,580
Operating leases (5)	2,535	211	356	282	1,686
Standby and import letters of credit (6)	135	135	—	—	—
Surety bonds (7)	68	68	—	—	—
Contractual obligations (8)	114	74	39	1	—
Purchase orders (9)	1,847	1,847	—	—	—
	$9,352	$2,577	$837	$672	$5,266
Total	$13,891	$2,861	$1,550	$823	$8,657

(1) Represents management's best estimate of the payments related to tax reserves for uncertain income tax positions. Based on the nature of these liabilities, the actual payments in any given year could vary significantly from these amounts. See Note 19 to the Consolidated Financial Statements.

(2) Represents expected cash payments through 2027.

(3) Includes interest expense related to our 2016 Term Loan Facility of $450 million that was calculated using its interest rate as of February 3, 2018 for the anticipated amount outstanding each period, which assumes the required principal payments for the loan remain the same each quarter.

(4) Includes $67 million of accrued interest that is included in our Consolidated Balance Sheet at February 3, 2018.

(5) Represents future minimum lease payments for non-cancelable operating leases, including renewals determined to be reasonably assured. Future minimum lease payments have not been reduced for sublease income.

(6) Standby letters of credit, which totaled $135 million, are issued as collateral to a third-party administrator for self-insured workers' compensation and general liability claims and to support our merchandise initiatives. There were no outstanding import letters of credit at February 3, 2018.

(7) Surety bonds are primarily for previously incurred and expensed obligations related to workers' compensation and general liability claims.

(8) Consists primarily of (a) minimum purchase requirements for exclusive merchandise and fixtures; (b) royalty obligations; and (c) minimum obligations for professional services, energy services, software maintenance and network services.

(9) Amounts committed under open purchase orders for merchandise inventory of which a significant portion are cancelable without penalty prior to a date that precedes the vendor's scheduled shipment date.

Off-Balance Sheet Arrangements

Management considers all on- and off-balance sheet debt in evaluating our overall liquidity position and capital structure. Other than operating leases, which are included in the Contractual Obligations and Commitments table, we do not have any material off-balance sheet financing. See detailed disclosure regarding operating leases in Note 15 to the Consolidated Financial Statements.

We do not have any additional arrangements or relationships with entities that are not consolidated into the financial statements.

Impact of Inflation, Deflation and Changing Prices

We have experienced inflation and deflation related to our purchase of certain commodity products. We do not believe that changing prices for commodities have had a material effect on our Net Sales or results of operations. Although we cannot precisely determine the overall effect of inflation and deflation on operations, we do not believe inflation and deflation have had
a material effect on our financial condition or results of operations.

Critical Accounting Policies

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires that we make estimates and use assumptions that in some instances may materially affect amounts reported in the accompanying Consolidated Financial Statements. In preparing these financial statements, we have made our best estimates and judgments based on history and current trends, as well as other factors that we believe are relevant at the time of the preparation of our Consolidated Financial Statements. Historically, actual results have not differed materially from estimates; however, future events and their effects cannot be determined with certainty and as a result, actual results could differ from our assumptions and estimates.

See Note 2 to the Consolidated Financial Statements for a description of our significant accounting policies.

Inventory Valuation under the Retail Method

Inventories are valued at the lower of cost (using the first-in, first-out or "FIFO" method) or market, determined under the Retail Inventory Method (RIM). Under RIM, retail values of merchandise groups are converted to a cost basis by applying the specific average cost-to-retail ratio related to each merchandise grouping. RIM inherently requires management judgment and certain estimates that may significantly impact the ending inventory valuation at cost, as well as our Cost of goods sold. The most significant estimates are permanent reductions to retail prices (markdowns) and permanent devaluation of inventory (markdown accruals) used primarily to clear seasonal merchandise or otherwise slow-moving inventory and inventory shortage (shrinkage).

Permanent markdowns and markdown accruals are designated for clearance activity and are recorded at the point of decision, when the utility of inventory has diminished, versus the point of sale. Factors considered in the determination of permanent markdowns and markdown accruals include current and anticipated demand, customer preferences, age of the merchandise and style trends. Under RIM, permanent markdowns and markdown accruals result in the devaluation of inventory and the corresponding increase to cost of goods sold is recognized in the period the decision to execute the markdown is made. Shrinkage accruals are estimated as a percent of sales for a given period based on physical inventories or cycle count activities. Physical inventory counts for stores are are taken at least annually and cycle count activities for distribution centers and regional warehouses are executed on a daily basis. Inventory records and shrinkage accruals are adjusted appropriately based on the actual results from physical inventories and cycle counts. The shrinkage rate from the most recent physical inventory and cycle count activity, in combination with current events and historical experience, is used as the standard for the shrinkage accrual rate for the next inventory cycle or cycle count activity. Historically, our actual physical inventory and cycle counts results have shown our estimates to be reliable. Based on prior experience, we do not believe that the actual results will differ significantly from the assumptions used in these estimates.

Valuation of Long-Lived and Indefinite-Lived Assets

Long-Lived Assets

We evaluate recoverability of long-lived assets, such as property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable, such as historical operating losses or plans to close stores and dispose of or sell long-lived assets before the end of their previously estimated useful lives. Additionally, annual operating performance of individual stores are periodically analyzed to identify potential underperforming stores which may require further evaluation of the recoverability of the carrying amounts. If our

further evaluations of underperforming stores, performed on an undiscounted cash flow basis, indicate that the carrying amount of the asset may not be recoverable, the potential impairment is measured as the excess of carrying value over the fair value of the impaired asset. The impairment calculation requires us to apply estimates for future cash flows and use judgments for qualitative factors such as local market conditions, operating environment, mall performance and other trends. We estimate fair value based on either a projected discounted cash flow method using a discount rate that is considered commensurate with the risk inherent in our current business model or a appraised value method, as appropriate.

We recognize impairment losses in the earliest period that it is determined a loss has occurred. The carrying value is adjusted to the new carrying value and any subsequent increases in fair value are not recorded. If it is determined that the estimated remaining useful life of the asset should be decreased, the periodic depreciation expense is adjusted based on the new carrying

value of the asset. Impairment losses totaling $77 million in 2017 that related to Company's closure of 138 stores were recorded in the Consolidated Statement of Operations in the line item Restructuring and management transition.

While we do not believe there is a reasonable likelihood that there will be a material change in our estimates or assumptions used to calculate long-lived asset impairments, if actual results are not consistent with our current estimates and assumptions, we may be exposed to additional impairment charges, which could be material to our results of operations.

Indefinite-Lived Assets
We assess the recoverability of indefinite-lived intangible assets at least annually during the fourth quarter of our fiscal year or whenever events or changes in circumstances indicate that the carrying amount of the indefinite-lived intangible asset may not be fully recoverable. Examples of a change in events or circumstances include, but are not limited to, a decrease in the market price of the asset, a history of cash flow losses related to the use of the asset or a significant adverse change in the extent or manner in which an asset is being used. For our 2017 annual impairment test, we tested our indefinite-lived intangible assets utilizing the relief from royalty method to determine the estimated fair value for each indefinite-lived intangible asset. The relief from royalty method estimates our theoretical royalty savings from ownership of the intangible asset. Key assumptions used in this model include discount rates, royalty rates, growth rates, sales projections and terminal value rates. Discount rates, royalty rates, growth rates and sales projections are the assumptions most sensitive and susceptible to change as they require significant management judgment. Discount rates used are similar to the rates estimated by the weighted average cost of capital considering any differences in company-specific risk factors. Royalty rates are established by management based on comparable trademark licensing agreements in the market. Operational management, considering industry and company-specific historical and projected data, develops growth rates and sales projections associated with each indefinite-lived intangible asset. Terminal value rate determination follows common methodology of capturing the present value of perpetual sales estimates beyond the last projected period assuming a constant weighted average cost of capital and long-term growth rates.

While we do not believe there is a reasonable likelihood that there will be a material change in our estimates or assumptions used to calculate indefinite-lived asset impairments, if actual results are not consistent with our current estimates and assumptions, we may be exposed to additional impairment charges, which could be material to our results of operations.

Valuation of Deferred Tax Assets
We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of the realization of the deferred tax assets based on future events. Our accounting for deferred tax consequences represents our best estimate of those future events. If based on the weight of available evidence, it is more likely than not (defined as a likelihood of more than 50%) the deferred tax assets will not be realized, we record a valuation allowance. The weight given to both positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, to outweigh objective negative

evidence of recent losses. Cumulative losses in recent years are a significant piece of negative evidence that is difficult to overcome in determining that a valuation allowance is not needed against deferred tax assets.

This assessment is completed on a taxing jurisdiction basis and takes into account several types of evidence, including the following:

- Nature, frequency, and severity of current and cumulative financial reporting losses. A pattern of recent losses is heavily weighted as a source of negative evidence. In certain circumstances, historical information may not be as relevant due to a change in circumstances.

- Sources of future taxable income. Future reversals of existing temporary differences are heavily weighted sources of objectively verifiable positive evidence. Projections of future taxable income, exclusive of reversing temporary differences, are a source of positive evidence only when the projections are combined with a history of recent profits

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and can be reasonably estimated. Otherwise, these projections are considered inherently subjective and generally will not be sufficient to overcome negative evidence that includes cumulative losses in recent years, particularly if the projected future taxable income is dependent on an anticipated turnaround to profitability that has not yet been achieved. In such cases, we generally give these projections of future taxable income no weight for the purposes of our valuation allowance assessment.

- Tax planning strategies. If necessary and available, tax-planning strategies would be implemented to accelerate taxable amounts to utilize expiring net operating loss carryforwards. These strategies would be a source of additional positive evidence and, depending on their nature, could be heavily weighted.

In the second quarter of 2013, our net deferred tax position, exclusive of any valuation allowance, changed from a net deferred tax liability to a net deferred tax asset. In our assessment of the need for a valuation allowance, we heavily weighted the negative evidence of cumulative losses in recent periods and the positive evidence of future reversals of existing temporary differences. Although a sizable portion of our losses in recent years were the result of charges incurred for restructuring and other special items, even without these charges we still would have incurred significant losses. Accordingly, we considered our pattern of recent losses to be relevant to our analysis. Considering this pattern of recent losses and the uncertainties associated with projected future taxable income exclusive of reversing temporary differences, we gave no weight to projections showing future U.S. taxable income for purposes of assessing the need for a valuation allowance. As a result of our assessment, we concluded that, beginning in the second quarter of 2013, our estimate of the realization of deferred tax assets would be based solely on future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring carryforwards.

Future book pre-tax losses will require additional valuation allowances to offset the deferred tax assets created. A sustained period of profitability is required before we would change our need for a valuation allowance against our net deferred tax assets. Additionally, under the U.S. Tax Cuts and Jobs Act, additional NOLs that the Company may recognize in the future would not expire but would only be available to offset up to 80% of the Company’s future taxable income.

See Note 19 to the Consolidated Financial Statements for more information regarding income taxes and also Risk Factors, Item 1A.

Pension

Pension Accounting

We maintain a qualified funded defined benefit pension plan (Primary Pension Plan) and smaller non-qualified unfunded supplemental defined benefit plans. The determination of pension expense is the result of actuarial calculations that are based on important assumptions about pension assets and liabilities. The most important of these are the expected rate of return on assets and the discount rate assumptions. These assumptions require significant judgment and a change in any one of them could have a material impact on pension expense reported in our Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income/(Loss), as well as in the assets, liability and equity sections of the Consolidated Balance Sheets.

The following table reflects our expected rate of return and discount rate assumptions:

	2017	2016	2015
Expected return on plan assets	6.50%	6.75%	6.75%
Discount rate for pension expense	4.40%	4.73%	3.87%
Discount rate for pension obligation	3.98%	4.40%	4.73%

Return on Plan Assets and Impact on Earnings

For the Primary Pension Plan, we apply our expected return on plan assets using fair market value as of the annual measurement date. The fair market value method results in greater volatility to our pension expense than the more

commonly used calculated value method (referred to as smoothing of assets). Our Primary Pension Plan asset base consists of a mix of equities (U.S., non-U.S. and private), fixed income (investment-grade and high-yield), real estate (private and public) and alternative asset classes.

The expected return on plan assets is based on the plan's long-term asset allocation policy, historical returns for plan assets and overall capital market returns, taking into account current and expected market conditions. The expected return assumption for 2017 at 6.50% is slightly lower than 2016 given our current asset allocation targets and updated expected capital market return assumptions.

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Discount Rate
The discount rate used to measure pension expense each year is the rate as of the beginning of the year (i.e., the prior measurement date). The discount rate, as determined by the plan actuary, is based on a hypothetical AA yield curve represented by a series of bonds maturing over the next 30 years, designed to match the corresponding pension benefit cash payments to retirees.

For 2017, the discount rate to measure pension expense was 4.40% compared to 4.73% in 2016. The discount rate to measure the pension obligations decreased to 3.98% as of February 3, 2018 from 4.40% as of January 28, 2017.

Sensitivity
The sensitivity of pension expense to a plus or minus one-half of one percent of expected return on assets is a decrease or increase in pension expense of approximately $17 million. An increase in the discount rate of one-half of one percent would increase the 2018 pension expense by approximately $5 million and a decrease in the discount rate of one-half of one percent would decrease pension expense by approximately $6 million.

Pension Funding
Funding requirements for our Primary Pension Plan are determined under Employee Retirement Income Security Act of 1974 (ERISA) rules, as amended by the Pension Protection Act of 2006. As a result of the funded status of the Primary Pension Plan, we are not required to make cash contributions in 2018.
Recent Accounting Pronouncements

In fiscal 2018, we will adopt ASC Topic 606 (ASC 606), Revenue from Contracts with Customers, a replacement of Revenue Recognition (Topic 605) using the full retrospective approach. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle of the guidance is that a Company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Based on the new standard our revenue recognition policies related to gift card breakage, customer loyalty programs, credit card income and principal versus agent considerations will change.

We currently recognize gift card breakage (net of required escheatment) 60 months after the gift card is issued.In the future we will recognize gift card breakage (net of required escheatment) over the redemption pattern of gift cards. The change in policy will require us to record new gift card breakage amounts in a given period and to present such amounts in Net sales as opposed to our current reduction of SG&A classification.

Whereas we utilize the incremental cost method to account for our customer loyalty programs with a charge to Cost of goods sold, we will in the future account for our customer loyalty programs as Net sales which will require us to defer a portion of our Net sales to loyalty rewards to be earned by reward members for a future discount on a future sale.

We will also change the classification of profit sharing income earned in connection with our private label credit card and co-branded MasterCard® programs owned and serviced by Synchrony Financial (Synchrony). Under our agreement with Synchrony, we receive cash payments from Synchrony based upon the performance of the credit card portfolios. Currently the income we earn under our agreement with Synchrony is included as an offset to SG&A expenses. In connection with the adoption of the new standard, we plan to change our presentation to include such income in a separate line item described as Credit card income and other.

Whereas we currently consider ourselves to be the principal (report gross sales) or the agent (report net sales) based on our risk and rewards in a sales transaction, we will in the future assess principal versus agent considerations depending on our control of the good or service before it is transferred to the customer. The changes required by our new principal versus agent considerations will require us to reclassify the cost components of such transactions from a

reduction of Net sales to a charge of Cost of goods sold.

In fiscal 2018, we will also adopt ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost on a retrospective basis. This new standard will require us to change the presentation of the service cost component and the other components of net periodic pension cost in the Consolidated Statement of Operations. The service cost component will be presented in SG&A along with other compensation costs and all the other pension cost components will be included in a new separate line item described as Other components of net periodic pension cost/(income).

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Upon our retrospective adoption of ASC 606 and ASU 2017-07 on February 4, 2018, our Consolidated Statement of Operations for fiscal 2017 and 2016 will be impacted as shown in the table below:

(Unaudited)	2017			2016		
($ in millions, except per share data)	As Reported	Adjustment	As Adjusted	As Reported	Adjustment	As Adjusted
Total net sales	$12,506	$ 48	$12,554	$12,547	$ 24	$12,571
Credit income and other	—	319	319	—	347	347
Total revenues	$12,506	$ 367	$12,873	$12,547	$ 371	$12,918
Costs and expenses/(income):						
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	8,174	34	8,208	8,071	26	8,097
Selling, general and administrative (SG&A)	3,468	377	3,845	3,538	418	3,956
Pension	21	(21)	—	19	(19)	—
Depreciation and amortization	570	—	570	609	—	609
Real estate and other, net	(146)	—	(146)	(111)	—	(111)
Restructuring and management transition	303	(119)	184	26	—	26
Total costs and expenses	12,390	271	12,661	12,152	425	12,577
Operating income/(loss)	116	96	212	395	(54)	341
Other components of net periodic pension cost/(income)	—	98	98	—	(36)	(36)
Loss on extinguishment of debt	33	—	33	30	—	30
Net interest expense	325	—	325	363	—	363
Income/(loss) before income taxes	(242)	(2)	(244)	2	(18)	(16)
Income tax expense/(benefit)	(126)	—	(126)	1	—	1
Net income/(loss)	$(116)	$ (2)	$(118)	$1	$ (18)	