PENNEY J C CO INC
Form 10-Q
December 07, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
20549

# FORM 10-Q

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

For the 13 and 39 week periods ended October 27, 2001

Commission file number 1-777

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

| Delaware | 13-5583779 |
|---|---|
| (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) |

Registrant's telephone number, including area code (972) 431-1000

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 _______.

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

263,812,265 shares of Common Stock of 50 cents par value, as of November 30, 2001.

PART I - FINANCIAL INFORMATION

Item 1 - Unaudited Financial Statements

Statements of Operations
(Amounts in millions, except per share data)

| | 13 weeks ended | |
|---|---|---|
| | Oct. 27, 2001 | Oct. 28, 2000 |
| Retail sales | $ 7,729 | $ 7,538 |
| Costs and expenses | | |
| Cost of goods sold | 5,446 | 5,369 |
| Selling, general and administrative expenses | 2,105 | 2,151 |
| Other unallocated | 15 | 4 |
| Net interest expense | 93 | 110 |
| Acquisition amortization | 17 | 18 |
| Restructuring and other charges, net | 2 | (3) |
| Total costs and expenses | 7,678 | 7,649 |
| Income/(loss) from continuing operations before income taxes | 51 | (111) |
| Income taxes | 20 | (41) |
| Income/(loss) from continuing operations | 31 | (70) |
| Income from discontinued operations, net of income tax | - | 40 |
| (Loss) on sale of discontinued operations, net of income tax | - | - |
| Net income/(loss) | $ 31 | $ (30) |
| Earnings/(loss) per common share: | | |
| Income/(loss) from continuing operations | $ 31 | $ (70) |
| Less: preferred stock dividends, net of tax | (7) | (8) |
| Earnings/(loss) from continuing operations for EPS calculation | 24 | (78) |
| Income from discontinued operations | - | 40 |
| (Loss) on sale of discontinued operations | - | - |
| Earnings/(loss) for EPS calculation | $ 24 | $ (38) |
| Shares: | | |
| Average shares outstanding (used for basic EPS) | 264 | 262 |
| Dilutive common stock equivalents | 4 | - |
| Average dilutive shares outstanding | 268 | 262 |
| Earnings/(loss) per share from continuing operations: | | |
| Basic and diluted | $ 0.09 | $ (0.30) |
| Earnings/(loss) per share: | | |
| Basic and diluted | $ 0.09 | $ (0.15) |

See Notes to the Unaudited Interim Consolidated Financial Statements.



Balance Sheets
(Amounts in millions)

| | Oct. 27, 2001 | Oct 2 |
|---|---|---|
| ASSETS | | |
| Current assets | | |
| Cash (including short-term investments of $1,786, $119 and $935) | $ 1,791 | $ |
| Receivables, net | 824 | |
| Merchandise inventory | 6,273 | 6 |
| Prepaid expenses | 173 | |
| Total current assets | 9,061 | 8 |
| Properties, net of accumulated depreciation of $3,224, $3,184 and $2,948 | 4,949 | 5 |
| Goodwill and other intangible assets, net of accumulated amortization of $525, $406 and $452 | 2,782 | 2 |
| Other assets | 1,549 | 1 |
| Assets of discontinued operations (including cash and short-term investments of $0, $58 and $156) | - | 2 |
| Total assets | $ 18,341 | $ 20 |

See Notes to the Unaudited Interim Consolidated Financial Statements.



Balance Sheets
(Amounts in millions)

| | Oct. 27, 2001 | Oct 2 |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable and accrued expenses | $ 3,944 | $ |

| | | |
|---|---|---|
| Short-term debt | 19 | |
| Current maturities of long-term debt | 907 | |
| Deferred taxes | 129 | |
| Total current liabilities | 4,999 | |
| Long-term debt | 5,193 | |
| Deferred taxes | 1,132 | |
| Other liabilities | 954 | |
| Liabilities of discontinued operations | - | |
| Total liabilities | 12,278 | |
| Stockholders' equity | | |
| Capital stock | | |
| Preferred stock, without par value: Authorized, 25 million shares - issued and outstanding, 0.6, 0.7 and 0.6 million shares of Series B ESOP convertible preferred | 371 | |
| Common stock, par value $0.50: Authorized, 1,250 million shares - issued, 263, 262 and 263 million shares | 3,321 | |
| Total capital stock | 3,692 | |
| Reinvested earnings | | |
| at beginning of year | 2,636 | |
| Net income/(loss) | 3 | |
| Common stock dividends declared | (99) | |
| Preferred stock dividends | (15) | |
| Reinvested earnings at end of period | 2,525 | |
| Accumulated other comprehensive (loss) | (154) | |
| Total stockholders' equity | 6,063 | |
| Total liabilities and stockholders' equity | $ 18,341 | $ |

See Notes to the Unaudited Interim Consolidated Financial Statements.



Statements of Cash Flows
(Amounts in millions)

| | 39 weeks Oct. 27, 2001 |
|---|---|
| **Cash flows from operating activities** | |
| Income/(loss) from continuing operations | $ 19 |
| Restructuring and other charges, net | 14 |
| Depreciation and amortization, including intangible assets | 522 |
| Non-cash real estate gain | (26) |
| Deferred taxes | 17 |
| Change in cash from: | |
| Receivables | (131) |
| Sale of receivables-Eckerd | 200 |
| Merchandise inventory, net of trade payables | (556) |
| Current income taxes payable | (48) |
| Other assets and liabilities, net | (269) |
| | (258) |
| **Cash flows from investing activities** | |
| Capital expenditures | (493) |
| Proceeds from sale of discontinued operations | 1,306 |
| Proceeds from sale of assets | - |
| Proceeds from the sale of investment securities | - |
| | 813 |
| **Cash flows from financing activities** | |
| Change in short-term debt | 19 |
| Proceeds from the issuance of long-term debt | 630 |
| Payment of long-term debt | (255) |
| Common stock issued, net | 27 |
| Preferred stock redemption | (28) |
| Dividends paid, preferred and common | (114) |
| | 279 |
| Cash received from discontinued operations | 13 |
| Net increase/(decrease) in cash and short-term investments | 847 |
| Cash and short-term investments at beginning of year | 944 |
| Cash and short-term investments at end of third quarter | $ 1,791 |
| Supplemental disclosures | |
| Interest paid | $ 371 |
| Interest received | 35 |
| Income taxes paid | 27 |

See Notes to the Unaudited Interim Consolidated Financial Statements.



Notes to the Unaudited Interim Consolidated Financial Statements

1) Summary of Significant Accounting Policies

A description of the Company's significant accounting policies is included in the Company's Annual Report on Form 10-K for the fiscal year ended January 27, 2001 (the "2000 10-K"). The accompanying unaudited interim consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and notes thereto in the 2000 10-K.

The accompanying interim consolidated financial statements are unaudited but, in the opinion of management, include all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. Because of the seasonal nature of the retail business, operating results for the 13-week and 39-week periods are not necessarily indicative of the results that may be expected for the entire year.

As disclosed in the 2000 10-K, prior year amounts in the accompanying unaudited consolidated financial statements have been presented to reflect J. C. Penney Direct Marketing Services, Inc. (DMS) as a discontinued operation, the reclassification of shipping and handling fees billed to customers from selling, general and administrative (SG&A) to retail sales and related costs to cost of goods sold, and rent and occupancy costs from cost of goods sold to SG&A expenses. Certain other amounts have been reclassified to conform to the current period presentation.

2) Effect of Accounting Standards Not Yet Adopted

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. SFAS No. 144 excludes goodwill and other intangible assets that are not amortized.

For long-lived assets to be held and used, this statement retains the provisions of SFAS No. 121 to test an asset for recoverability based on undiscounted cash flows and measure any potential impairment loss as the difference between the carrying amount and the fair value of the asset. For long-lived assets to be disposed of other than by sale, this statement requires that the assets be classified as held and used until disposed of. For assets to be disposed of by abandonment, depreciation estimates should be revised to reflect the use of the asset over its shortened useful life. This statement establishes specific criteria to classify a long-lived asset or group as held for sale and contemplates that the sale will occur within one year. It retains the requirement of SFAS No. 121 to measure a long-lived asset held for sale at the lower of its carrying amount or fair value and to cease depreciation. Discontinued operations, which is broadened to include a component of an entity, are no longer measured on a net realizable value basis, and future operating

losses are no longer recognized before they occur. This statement is effective at the beginning of the Company's fiscal 2002 year. The Company does not expect the implementation of this statement to have a material effect on its financial position or results of operations.



In July 2001, the FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets with indefinite useful lives will no longer be amortized but will be subject to annual impairment tests using a fair-value based approach, as set forth in the new standard. Other intangible assets with estimable useful lives will continue to be amortized over their useful lives. Under SFAS No. 142, the Eckerd trade name qualifies as an intangible asset with an indefinite useful life; therefore amortization will cease upon adoption of the new rules.

The Company will apply these new rules beginning in the first quarter of fiscal 2002. The Company has approximately $2,667 million of unamortized goodwill, including the Eckerd trade name, as of October 27, 2001. Application of the non-amortization provisions of the Statement is expected to result in an increase to per share earnings of approximately $0.25 per year. During the first half of fiscal 2002, the Company will perform the first of the required impairment tests as of January 27, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

3) Discontinued Operations

On June 18, 2001, the Company closed on the sale of its J.C. Penney Direct Marketing Services, Inc. (DMS) assets, including its J.C. Penney Life Insurance subsidiaries and related businesses, to Commonwealth General Corporation (Commonwealth), a U.S. subsidiary of AEGON, N. V.(AEGON). The Company received cash at closing of approximately $1.3 billion ($1.1 billion after-tax).

DMS was reflected as a discontinued operation in the 2000 10-K, with an estimated net loss on the sale of $296 million. Upon completion of the transaction, the loss was adjusted to $312 million. The additional net loss of approximately $16 million is reflected in 39-week period ended October 27, 2001 as a loss on the sale of discontinued operations.

4) Restructuring and Other Charges, Net

During the third quarter of 2001, the Company recorded a net pretax charge of $2 million related to adjustments of previously established restructuring reserves.

The year-to-date amount of $14 million also includes charges related to JCPenney unit closings ($15 million), severance benefits for certain members of senior management ($3 million), Eckerd asset impairments ($1 million), and downward adjustments ($7 million) of Eckerd reserves.

5) Restructuring Reserves

In the past, the Company established reserves for the closing of underperforming department stores and drugstores, related exit costs and workforce adjustment programs. The majority of the remaining reserves represent the present value of future lease obligations for both department stores and drugstores that have

closed or were identified for closing. The table below provides a rollforward of the reserves that were established for each of these charges and the status of the reserves at October 27, 2001. Costs are being charged against the reserves as incurred. Reserves are reviewed for adequacy on a periodic basis and are adjusted as appropriate based on those reviews. Cash payments related to these reserves are expected to be approximately $90 million in 2001 and the remaining cash payments are expected to be made by the end of 2005.



| | 2000 | 3rd Qtr 2001 YTD | | |
|---|---|---|---|---|
| | Year End Reserve | 2001 Charges | Cash Payments | Oth Chan |
| ($ in millions) | | | | |
| 1996 and 1997 charges | | | | |
| Department stores and catalog | | | | |
| Future lease obligations | $ 4 | $ - | $ (1) | $ ( |
| Eckerd drugstores | | | | |
| Future lease obligations | 68 | - | (4) | |
| Total 1996 and 1997 | 72 | - | (5) | ( |
| 2000 charges | | | | |
| Department stores and catalog | | | | |
| Future lease obligations | 68 | - | (20) | |
| Severance | 6 | - | (6) | |
| Contract cancellations | 11 | - | (3) | |
| Headcount reductions | 9 | - | (8) | |
| Eckerd drugstores | | | | |
| Future lease obligations | 63 | - | (9) | |
| Other exit costs | 2 | - | (1) | ( |
| Contract cancellations | 24 | - | (14) | ( |
| Headcount reductions | 3 | - | (3) | |
| Total 2000 | 186 | - | (64) | |
| 2001 charges | | | | |
| Department stores and catalog | | | | |
| Future lease obligations | - | 2 | - | |
| Severance | - | 2 | (1) | |
| Total 2001 | - | 4 | (1) | |
| Total | $ 258 | $ 4 | $ (70) | $ |

Department stores and catalog
-----------------------------

Future lease obligations and severance related to store closings - During the first and fourth quarters of 2000, the Company approved plans to close a total

of 92 underperforming JCPenney stores. Reserves were established for future lease obligations for these stores. Severance reserves were established for all those stores that had been announced. Approximately 3,400 associates (1,800 in 2000 and 1,600 in 2001) from the 87 stores that have closed were paid severance benefits. Five stores, which were included in the 2000 plan, are expected to close in the fourth quarter of 2001. In 2001, a $1 million reserve was established for the severance costs of three stores included in the 2000 plan but announced in 2001. Also in 2001, the restructuring plan was modified to include two additional units and a $3 million reserve. Severance benefits have been paid to about 300 out of 800 associates included in the 2001 reserves.



Headcount reductions - During the fourth quarter of 2000, the Company approved a plan to eliminate 300 JCPenney Home Office and field positions. This program is expected to be completed by the end of the year.

Eckerd drugstores

By the end of the second quarter of 2001, Eckerd had closed all 279 underperforming drugstores identified in fiscal 2000 for closing.

6) Earnings/(Loss) per Share (EPS)

The following potential common shares were excluded from the EPS calculations due to an anti-dilutive effect:

- Subordinated notes convertible into 22.8 million common shares were issued on October 15, 2001. The $650 million of notes are convertible at any time prior to maturity, unless previously redeemed, at the option of the holders into shares of common stock at a conversion price of $28.50 per share, subject to certain adjustments.
- Preferred stock totaling 618 and 679 thousand shares, convertible into 12.4 million and 13.6 million common shares were issued and outstanding at October 27, 2001 and October 28, 2000, respectively.
- Options to purchase 9 million and 11 million shares of stock, with exercise prices ranging from $24 to $71 and $13 to $71, were excluded from the computation of diluted earnings per share for the 13 and 39 weeks ended October 27, 2001 and October 28, 2000, respectively, because their exercise prices were greater than the average market price.
- For the 39 weeks ended October 27, 2001 as well as the 13 and 39 weeks ended October 28, 2000, all common stock equivalents were anti-dilutive. In addition to the items listed above, restricted stock units and stock options equivalent to 3 million shares of stock were excluded for the 39 weeks ended October 27, 2001. For the 13 and 39 weeks ended October 28, 2000, restricted stock units convertible into 1 million shares of stock were excluded from the EPS calculation.



7) Comprehensive Income / (Loss) and Accumulated Other Comprehensive (Loss)

Comprehensive Income / (Loss)
(Amounts in millions)

| | 13 weeks ended | | 39 weeks ende |
|---|---|---|---|
| | Oct. 27, 2001 | Oct. 28, 2000 | Oct. 27, 2001 |
| Net income / (loss) | $ 31 | $ (30) | $ 3 |
| Other comprehensive income/(loss) | | | |
| Foreign currency translation adjustments | (19) | (7) | (48) |
| Minimum pension liability | - | - | (41) |
| Net unrealized changes in investment securities | (4) | (9) | 5 |
| Other comprehensive income from discontinued operations | - | 8 | - |
| | (23) | (8) | (84) |
| Total comprehensive income / (loss) | $ 8 | $ (38) | $ (81) |

Accumulated Other Comprehensive (Loss)
(Amounts in millions)

| | Oct. 27, 2001 | Oct. 28, 2000 | Jan. 200 |
|---|---|---|---|
| Foreign currency translation adjustments | $ (121) | $ (68) | |
| Minimum SRP liability | (41) | - | |
| Net unrealized changes in investment securities | 8 | (4) | |
| Other comprehensive (loss) from discontinued operations | - | (14) | |
| Accumulated other comprehensive (loss) | $ (154) | $ (86) | |

Net unrealized changes in investment securities are shown net of deferred taxes of $4, $(2), and $2 million as of October 27, 2001, October 28, 2000 and January 27, 2001, respectively. Minimum pension liability is shown net of deferred tax of $(27) million as of October 27, 2001. A deferred tax asset has not been established for currency translation adjustments.

8) Segment Reporting

The Company operates in two business segments: Department Stores and Catalog (including the Company's Internet web site, jcpenney.com), and Eckerd Drugstores. The results of Department Stores and Catalog are combined because they generally serve the same customer and have virtually the same mix of merchandise. Other items are shown in the following table for purposes of reconciling to total Company amounts.

Segment Reporting
(Amounts in millions)

| | Dept. Stores & Catalog | Eckerd Drugstores | Other Unallocat |
|---|---|---|---|
| 3rd Quarter - 2001 | | | |
| Retail sales, net | $ 4,360 | $ 3,369 | $ - |
| Segment operating profit | 148 | 30 | - |
| Net interest expense | | | (93) |
| Other unallocated | | | (15) |
| Acquisition amortization | | | (17) |
| Restructuring and other charges, net | | | (2) |
| Pretax income from continuing operations | | | |
| Depreciation and amortization expense | 86 | 57 | 17 |
| 3rd Quarter YTD - 2001 | | | |
| Retail sales, net | 12,277 | 10,185 | - |
| Segment operating profit | 292 | 122 | - |
| Net interest expense | | | (285) |
| Other unallocated | | | (9) |
| Acquisition amortization | | | (73) |
| Restructuring and other charges, net | | | (14) |
| Pretax loss from continuing operations | | | |
| Depreciation and amortization expense | 282 | 167 | 73 |
| Total assets | $ 11,334 | $ 6,870 | $ 137 |
| 3rd Quarter - 2000 | | | |
| Retail sales, net | $ 4,402 | $ 3,136 | $ - |
| Segment operating profit | 81 | (63) | - |
| Net interest expense | | | (110) |
| Other unallocated | | | (4) |
| Acquisition amortization | | | (18) |
| Restructuring and other charges, net | | | 3 |
| Pretax loss from continuing operations | | | |
| Depreciation and amortization expense | 85 | 51 | 18 |
| 3rd Quarter YTD - 2000 | | | |
| Retail sales, net | 12,671 | 9,602 | - |
| Segment operating profit | 322 | (86) | - |
| Net interest expense | | | (325) |

| | | | |
|---|---|---|---|
| Other unallocated | | | (22) |
| Acquisition amortization | | | (76) |
| Restructuring and other charges, net | | | (204) |
| Pretax loss from continuing operations | | | |
| Depreciation and amortization expense | 275 | 154 | 76 |
| Total assets | $ 10,234 | $ 7,178 | $ 3,001 |

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9) Benefit Plan Changes

Included in the Eckerd segment results for the 39 weeks ended October 27, 2001 is a curtailment gain of approximately $11 million resulting from the freezing of pension benefits for drugstore associates effective July 31, 2001. These benefits will be replaced with a new 401(k) plan. Benefit costs were also slightly lower in the third quarter as a result of recognizing changes to the retiree benefit plans, approved in the second quarter, which will reduce and cap Company contributions.

10) Issuance of Convertible Debt

The Company issued $650 million of 5% convertible subordinated notes in private placements in October 2001. The notes will mature in October 2008. Interest is payable on April 15 and October 15 of each year. These notes are convertible at any time prior to maturity, unless previously redeemed, at the option of the holders into shares of the Company's common stock at a conversion price of $28.50 per share, subject to certain adjustments. The notes are subordinated to the Company's senior indebtedness and structurally subordinated to all indebtedness and other liabilities of the Company and its subsidiaries. The Company may redeem the notes on or after October 20, 2004. The net proceeds will be used primarily to repay upcoming debt maturities but also, to the extent available, for general corporate purposes, including investments in working capital and capital expenditures.

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Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Discontinued Operations

For the 39 weeks ended October 27, 2001, an additional loss of $16 million has been reflected as a result of the completion of the sale of J. C. Penney Direct Marketing Services, Inc. (DMS). DMS was reflected as a discontinued operation in the Company's 2000 10-K with an estimated $296 million net loss on the sale of DMS assets included in the results of operations for the year. The Company's financial statements, footnotes and other information provided in this Form 10-Q accordingly reflect DMS as a discontinued operation for all periods presented.

## Results of Operations

Consolidated operating results

| $ in millions | 13 weeks ended Oct. 27, 2001 | 13 weeks ended Oct. 28, 2000 | 39 weeks ended Oct. 27, 2001 | 39 weeks ended Oct. 28, 2000 |
|---|---|---|---|---|
| Segment operating profit/(loss) | | | | |
| Department stores and catalog | $ 148 | $ 81 | $ 292 | $ 322 |
| Eckerd drugstores | 30 | (63) | 122 | (86) |
| Total segments | 178 | 18 | 414 | 236 |
| Other unallocated | (15) | (4) | (9) | (22) |
| Net interest expense | (93) | (110) | (285) | (325) |
| Acquisition amortization | (17) | (18) | (73) | (76) |
| Restructuring and other charges, net | (2) | 3 | (14) | (204) |
| Income/(loss) from continuing operations before income taxes | 51 | (111) | 33 | (391) |
| Income taxes | 20 | (41) | 14 | (146) |
| Income/(loss) from continuing operations | $ 31 | $ (70) | $ 19 | $ (245) |

For the third quarter ended October 27, 2001, the Company had earnings from continuing operations of $31 million, or $0.09 per share, as compared to a loss of $70 million, or $0.30 per share, for the comparable 2000 period. For the 39 weeks ended October 27, 2001, income from continuing operations was $19 million, or a loss of $0.01 per share (due to preferred stock dividends, net of tax), compared to a loss of $245 million, or $1.03 per share, for the comparable 2000 period. Results for these periods were affected by non-comparable items, consisting mainly of expenses related to the centralized merchandise process (ACT) and real estate gains and asset impairments, net. The effects on operations of the non-comparable items are summarized in the following table.



2001

| $ in millions, except EPS | 13 weeks ended October 27, 2001 Pre-tax $ | 13 weeks ended October 27, 2001 EPS | 39 weeks ende October 27, 20 Pre-tax $ | |
|---|---|---|---|---|
| Income from continuing operations before the effects of non-comparable items | $ 68 | $ 0.13 | $ 53 | $ |
| Restructuring and other charges, net | (2) | | (14) | |

| | | | | |
|---|---|---|---|---|
| Other non-comparable items: | | | | |
| Eckerd pension curtailment gain included in Eckerd segment results | | | 11 | |
| Information technology transition costs included in Eckerd segment results | | | (5) | |
| Centralized merchandising process costs (ACT) | (7) | | (32) | |
| Real estate gains and asset impairments, net | (8) | | 20 | |
| Total restructuring and other non-comparable items | (17) | (0.04) | (20) | |
| Income/(loss) from continuing operations | 51 | $ 0.09 | $ 33 | $ |

2000

| $ in millions, except EPS | 13 weeks ended October 28, 2000 | | 39 weeks ende October 28, 20 | |
|---|---|---|---|---|
| | Pre-tax $ | EPS | Pre-tax $ | |
| (Loss) from continuing operations before the effects of non-comparable items | $ (99) | $ (0.24) | $ (74) | $ |
| Restructuring and other charges, net | 3 | | (204) | |
| Other non-comparable items: | | | | |
| Store closing activities in Eckerd segment results | | | (73) | |
| Centralized merchandising process costs (ACT) | (15) | | (40) | |
| Total restructuring and other non-comparable items | (12) | (0.06) | (317) | |
| (Loss) from continuing operations | $ (111) | $ (0.30) | $ (391) | $ |

Income from continuing operations before the effects of all non-comparable items for the third quarter of 2001 was $68 million, or $0.13 per share, compared to a loss of $99 million, or $0.24 per share, for the comparable 2000 period. Income from continuing operations before the effects of all non-comparable items for the 39 weeks ending October 27, 2001, was $53 million, or $0.04 per share, compared to a loss of $74 million, or $0.26 per share, for the comparable 2000 period. The increases from prior year results reflect strong comparable store sales gains for both department stores and Eckerd. Operating profits also improved for both segments due to higher gross margin ratios and expense management initiatives.

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Non-comparable items totaling $17 million or $0.04 per share in third quarter 2001 included $2 million of restructuring and other charges, net (see Note 4 to the Unaudited Interim Consolidated Financial Statements for additional discussion) and $15 million of expenses reported as other unallocated ($7

million of ACT initiative expenses and $8 million of real estate gains and asset impairments, net). Non-comparable items totaling $12 million or $0.06 per share in third quarter 2000 included $15 million of Act initiative expenses reported as other unallocated and a net credit of $3 million related to restructuring charges and previously established restructuring reserves.

Segment Operating Results

Department Stores and Catalog

| | 13 weeks ended | | 39 weeks ended | |
|---|---|---|---|---|
| | Oct. 27, 2001 | Oct. 28, 2000 | Oct. 27, 2001 | Oct. 28, 2000 |
| $ in millions | | | | |
| Retail sales | $ 4,360 | $ 4,402 | $ 12,277 | $ 12,671 |
| Cost of goods sold | (2,821) | (2,909) | (7,998) | (8,250) |
| SG&A expenses | (1,391) | (1,412) | (3,987) | (4,099) |
| Segment operating profit | $ 148 | $ 81 | $ 292 | $ 322 |
| Sales percent increase/ (decrease) | | | | |
| Comparable stores | 5.1% | -3.7% | 2.9% | -2.9% |
| Total department stores | 3.9% | -4.5% | 1.1% | -3.3% |
| Catalog | -17.7% | -6.1% | -17.5% | -1.6% |
| Department stores and catalog | -1.0% | -4.9% | -3.1% | -2.9% |
| Ratios as a percent of sales | | | | |
| Gross margin | 35.3% | 33.9% | 34.9% | 34.9% |
| SG&A expense | 31.9% | 32.1% | 32.5% | 32.4% |
| Segment operating profit | 3.4% | 1.8% | 2.4% | 2.5% |
| EBITDA (1) | 5.4% | 3.8% | 4.7% | 4.7% |

(1) EBITDA includes LIFO segment operating profit before depreciation and amortization. EBITDA is provided as an alternative assessment of operating performance and is not intended to be a substitute for GAAP measurements. Calculations may vary for other companies.

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Segment operating profit for department stores and catalog was $148 million in the third quarter compared with $81 million last year. The increase from last year was attributable to improved gross margin and lower expenses. Sales in department stores improved by 5.1% for comparable stores, those stores open at least twelve months. Continued improvements in merchandise assortments coupled with enhancements to marketing events contributed to the positive sales gains in department stores. Sales were strongest in women's apparel, children's, and home furnishings. Catalog sales decreased 17.7 % compared to last year. Catalog sales declines were primarily the result of soft demand for the general catalogs,

which is reflected in the decline of both the number of catalog customers shopping and the average order value. E-commerce sales, which are included as a component of catalog sales, increased by $8 million in the third quarter 2001 or 11% over last year. While Catalog sales have declined, inventory management and expense initiatives had a positive impact on results. Management is continuing a review of the Company's catalog operations and developing and implementing strategies intended to improve catalog performance. In the third quarter, four additional units were approved for closing in 2002.

Gross margin for the segment totaled $1,539 million in the third quarter compared with $1,493 million last year. Gross margin as a percent of sales improved by 140 basis points as a result of good customer response to back-to-school and fall merchandise combined with improved inventory productivity.

Selling, general and administrative (SG&A) expenses improved $21 million compared to last year, or 20 basis points as a percent of sales. Payroll costs were down which offset higher planned advertising costs. Catalog expenses decreased compared to last year but were not leveraged with the decline in sales.

Segment operating profit for the 39 weeks ended October 27, 2001 was $292 million compared to $322 million last year. Sales for comparable department stores increased by 2.9% while catalog sales declined by 17.5% compared with last year's levels. Gross margin for the 39 weeks as a percent of sales were flat with last year. SG&A expense decreased by 2.7% from last year but were not leveraged as a percent of sales primarily due to catalog sales declines.



Eckerd Drugstores

| | 13 weeks ended | | 39 weeks ended | |
|---|---|---|---|---|
| | Oct. 27, 2001 | Oct. 28, 2000 | Oct. 27, 2001 | Oct. 28, 2000 |
| $ in millions | | | | |
| Retail sales | $ 3,369 | $ 3,136 | $ 10,185 | $ 9,602 |
| Cost of goods sold | (2,625) | (2,460) | (7,910) | (7,525) |
| SG&A expenses | (714) | (739) | (2,153) | (2,163) |
| Segment operating profit/ (loss) | $ 30 | $ (63) | $ 122 | $ (86) |
| Gross margin impact from non-comparable items | $ - | $ - | $ - | $ 61 |
| SG&A impact from non-comparable items | - | - | (6) | 12 |
| Sales percent increase | | | | |
| Comparable stores | 8.4% | 9.1% | 8.6% | 8.6% |
| Total sales | 7.4% | 4.2% | 6.1% | 6.3% |
| Ratios as a percent of sales | | | | |
| FIFO gross margin | 22.4% | 22.0% | 22.7% | 22.0% |
| LIFO gross margin | 22.1% | 21.6% | 22.3% | 21.6% |

| | | | | |
|---|---|---|---|---|
| SG&A expense | 21.2% | 23.6% | 21.1% | 22.5% |
| Segment operating profit | 0.9% | -2.0% | 1.2% | -0.9% |
| EBITDA (1) | 2.6% | -0.4% | 2.8% | 0.7% |
| Ratios as a percent of sales before the effects of non-comparable items | | | | |
| FIFO gross margin | 22.4% | 22.0% | 22.7% | 22.7% |
| LIFO gross margin | 22.1% | 21.6% | 22.3% | 22.3% |
| SG&A expense | 21.2% | 23.6% | 21.2% | 22.4% |
| Segment operating profit | 0.9% | -2.0% | 1.1% | -0.1% |
| EBITDA (1) | 2.6% | -0.4% | 2.8% | 1.5% |

(1) EBITDA includes LIFO segment operating profit before depreciation and amortization. EBITDA is provided as an alternative assessment of operating performance and is not intended to be a substitute for GAAP measurements. Calculations may vary for other companies.

LIFO segment operating profit for Eckerd improved to $30 million in the third quarter compared with a loss of $63 million last year. The increase in segment operating profit was a result of a continued generation of strong comparable store sales increases, with improving front-end sales combined with improvements in both gross margin and SG&A expenses. Comparable store sales increased by 8.4% for the quarter, with pharmacy sales increasing 11.2% and front-end sales increasing 3.1%. Sales results reflect continued increases in transaction volumes and unit sales from reduced pricing, improved promotional marketing and store reconfiguration initiatives. The strongest front-end merchandise categories were cosmetics and skin care, baby and hygiene products, seasonal merchandise and candy, food and snacks, including beverages. As of the end of the third quarter, Eckerd reduced prices on 5,000 items by approximately 5% and implemented temporary low pricing on 1,000 items. Additionally, through the end of the third quarter, approximately 350 newer freestanding locations have been reconfigured and these drugstores have experienced a 12% increase in front-end sales and increased pharmacy sales. Gross margin ratios increased 50 basis points as a percent of sales, despite implementation of more competitive pricing, reflecting a better product mix, higher generic dispensing rates in pharmacy and better control over shrinkage rates.

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Third quarter gross margin includes a LIFO charge of $12 million this year compared with $13 million last year.

SG&A expenses improved by 240 basis points as a percent of sales over last year as a result of better leveraging from the strong sales combined with decreased payroll costs and savings on information technology costs from bringing this function in-house. In addition, pension costs were down due to the curtailment of Eckerd's participation in the JCPenney pension plan.

Eckerd had an operating profit before the effects of non-comparable items of $116 million for the 39 weeks ended October 27, 2001 versus a loss of $13 million in last year's comparable period. Sales increased on a comparable store basis by 8.6%, led by pharmacy sales of 12.6%. Gross margin continued to be flat, even with implementation of a more competitive pricing structure. SG&A improved by 120 basis points as a percent of sales, primarily from an emphasis on cost management and the leverage of increased sales. Eckerd recorded LIFO charges of $41 million this year compared with $38 million last year.

Other Unallocated
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Other unallocated consists of real estate activities, investment transactions, and other items that are related to corporate initiatives or activities, which are not allocated to an operating segment. Third quarter 2001 results include non-comparable costs of $7 million of ACT initiative expenses, $36 million of department store and catalog asset impairments and $28 million of real estate gains. Also included was a $3 million loss from third party fulfillment activities.

Third quarter 2000 results included $15 million of ACT initiative expenses.

Net Interest Expense

Interest charges for the third quarter and for the year have decreased 15.5% and 12.3%, respectively, as a result of improved cash balances and the declines in average debt outstanding. The issuance of convertible debt in October 2001 did not have a material impact on interest charges for the third quarter 2001.

Restructuring and Other Charges, Net

During the third quarter of 2001, the Company recorded a pretax charge of $2 million related to restructuring charges and adjustments to previously established restructuring reserves.

Income Taxes

The Company's overall effective income tax rate was 38.3% for the third quarter of 2001 compared with 37.2% for the same period last year. The overall effective income tax rates for 39 weeks ended October 27, 2001 and October 28, 2000, were 40.5% and 37.3%, respectively.

Dividends

Dividends paid in the 39 weeks ended October 27, 2001 were $114 million compared with $245 million for the same period last year. This reflects the reduction of quarterly common stock dividends from $0.2875 to $0.125 in the fourth quarter of last year. The Company's Board of Directors considered the overall performance of the Company's businesses and the need to reinvest earnings in those businesses in the determination to reduce the quarterly dividend rate.

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Benefit Plan Changes

Benefit costs in Department Stores and Catalog were slightly lower in the third quarter as a result of recognizing costs under amended retiree benefit plans. The amendments reduce and cap Company contributions and were approved in the second quarter. Additionally, included in the Eckerd segment results for the 39 weeks ended October 27, 2001 is a curtailment gain of approximately $11 million resulting from an amendment to the Company's pension plan to freeze benefits for all drugstore associates effective July 31, 2001. The Company will be replacing the pension plan benefits with a more competitive 401(k) savings program for drugstore associates.

Effect of Accounting Standards Not Yet Adopted

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In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement retains the provisions of SFAS No. 121 to test an asset to be held and used for recoverability based on undiscounted cash flows. It sets forth more stringent criteria for an asset to be classified as held for sale. Discontinued operations, which is broadened to include a component of an entity, are no longer measured on a net realizable value basis, and future operating losses are no longer recognized before they occur. This statement is effective at the beginning of fiscal 2002. The Company does not expect the implementation of this statement to have a material effect on its financial statements going forward.

The FASB issued two new statements, SFAS Nos. 141 and 142, "Business Combinations" and "Goodwill and Other Intangible Assets", respectively. SFAS No.141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS No.142 goodwill and intangible assets with indefinite lives will cease being amortized, and will instead be subject to an impairment review, to be done at least annually. The Company is required to adopt these new statements at the beginning of fiscal 2002. The Company estimates that the impact of ceasing amortization of goodwill and the Eckerd trade name should have a positive impact on earnings of approximately 25 cents per share. The Company is currently evaluating the impairment test provisions under the new rules and has not determined what effect, if any, they might have on the consolidated financial position and results of operations. See Note 2 to the Unaudited Interim Consolidated Financial Statements for further discussion.

## Financial Condition

Merchandise inventories on a FIFO basis totaled $6,653 million at the end of the third quarter compared with $7,150 million last year. Inventories for department stores and catalog totaled $4,215 million at October 27, 2001, compared with $4,667 million at October 28, 2000, a decline of 9.7%. The decline was due to lower warehouse and catalog inventories, offset by a slight increase in stores inventory. The decline in catalog and warehouse inventory levels is the result of continued emphasis on reducing the number of weeks of inventory on hand and improving inventory productivity. On a comparable store basis, inventories increased 2.4% from last year's levels, with better in-stock position in basics and fashion merchandise and improved assortments of seasonal gift merchandise. Eckerd drugstore inventories totaled $2,438 million compared with $2,483 million last year. The current cost of inventories exceeded the LIFO basis amount carried on the balance sheet by approximately $380 million at October 27, 2001, $339 million at January 27, 2001, and $308 million at October 28, 2000.

At October 27, 2001, the consolidated balance sheet included reserves related to restructuring activities totaling $192 million. These reserves were established in connection with store closing programs and other restructuring activities recorded in the first and second quarters of 2001, first and fourth quarters of 2000, as well as in 1997 and 1996. The reserves are related primarily to future lease



obligations, employee benefits, and other exit costs associated with store closings. Reserves were increased by $4 million for new charges and reduced by $70 million for cash payments made in the 39-weeks ended October 27, 2001. See additional discussion in Notes 4 and 5 to the Unaudited Interim Consolidated

Financial Statements.

## Liquidity and Capital Resources

In 2001, approximately $2 billion has been raised which will enhance the Company's financial flexibility. This consisted of approximately $1.3 billion ($1.1 billion after-tax)from the sale of DMS in June 2001, a $650 million private placement of convertible subordinated notes completed in October 2001(net proceeds of approximately $630 million) and approximately $200 million received in May 2001 from the sale of certain Eckerd managed care receivables. The Company anticipates that this additional liquidity combined with cash generated from operations will be sufficient to fund continuing operations and growth. In addition, the Company has a committed revolving bank credit line in the amount of $1.5 billion available which expires November 21, 2002. No borrowings have been made under this facility.

Net cash used for operating activities through the third quarter of 2001 was $258 million compared to $40 million of cash provided from operations in the comparable period of 2000. The change is due to an increased spending on inventory net of trade payables over the comparable nine month period last year.

The Company had capital expenditures of $493 million through the third quarter of 2001 compared with $450 million for the comparable 2000 period. These were primarily for costs associated with constructing new stores for both JCPenney Department Stores and Eckerd, making improvements to existing JCPenney Department Stores and reconfiguring approximately 350 Eckerd drugstores. Eckerd anticipates reconfiguring approximately 460 drugstores by year-end and remodeling 157 other drugstores.

$250 million of debt matured and was paid in the 39 weeks ended October 27, 2001. The Company had no commercial paper outstanding as of October 27, 2001.

Long-term debt is rated Ba2 by Moody's Investors Service ("Moody's"), BBB- by Standard and Poor's Corporation ("S&P") and BB+ by Fitch Investors Services, Inc ("Fitch") as of the end of the third quarter.

A quarterly dividend of $0.125 per share on the Company's outstanding common stock was paid on November 1, 2001 to stockholders of record on October 10, 2001.

## Seasonality

The Company's business depends to a great extent on the last quarter of the year. Historically, sales for that period have averaged approximately one-third of annual sales. Accordingly, the results of operations for the 13 and 39 weeks ended October 27, 2001 are not necessarily indicative of the results for the entire year.

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## Item 3 - Quantitative and Qualitative Disclosure About Market Risk.

The Company is exposed to market risks in the normal course of business due to changes in interest rates and changes in currency exchange rates. The Company's market risks related to interest rates at October 27, 2001 are similar to those disclosed in the Company's Form 10-K for the year ended January 27, 2001. For the 39 weeks ended October 27, 2001 the accumulated other comprehensive loss on

foreign currency translation was approximately $48 million as disclosed in Note 7 to the Unaudited Interim Consolidated Financial Statements. Due to the size of foreign operations, management believes that its exposure to market risk associated with foreign currencies would not have a material impact on its financial condition or results of operations.

This report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, which reflect the Company's current views of future events and financial performance, involve known and unknown risks and uncertainties that may cause the Company's actual results to be materially different from planned or expected results. Those risks and uncertainties include, but are not limited to, competition, consumer demand, seasonality, economic conditions, and government activity. Investors should take such risks into account when making investment decisions.

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PART II - OTHER INFORMATION

Item 1 - Legal Proceedings.

The Company has no material legal proceedings pending against it.

Item 6 - Exhibits and Reports on Form 8-K.

(a) Exhibits

The following document is filed as an exhibit to this report:

10(a) October 10, 2001 Amendments to the J.C. Penny Company, Inc. Mirror Savings Plans I, II and III.

(b) Reports on Form 8-K

The Company filed the following reports on Form 8-K during the period covered in this report:

Current Report on Form 8-K dated September 10, 2001
(Item 5 - Other Events and Regulation FD Disclosure,
Item 7 - Financial Statements and Exhibits).
Current Report on Form 8-K dated September 21, 2001
(Item 5 - Other Events and Regulation FD Disclosure,
Item 7 - Financial Statements and Exhibits)
Current Report on Form 8-K dated October 9, 2001
(Item 5 - Other Events and Regulation FD Disclosure,
Item 7 - Financial Statements and Exhibits)

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

J. C. PENNEY COMPANY, INC.

By /S/ W. J. Alcorn

W. J. Alcorn
Senior Vice President, Controller, and
Chief Purchasing Officer
(Principal Accounting Officer)

Date: December 7, 2001