J C PENNEY CO INC
Form 10-Q
August 30, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 29, 2017
or
¨ 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: 1-15274

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)
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 by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an 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 ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
Emerging growth company ¨	

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. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 310,741,236 shares of Common Stock of 50 cents par value, as of August 25, 2017.

J. C. PENNEY COMPANY, INC.
FORM 10-Q
For the Quarterly Period Ended July 29, 2017
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Part I. Financial Information
Item 1. Unaudited Interim Consolidated Financial Statements

J. C. PENNEY COMPANY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In millions, except per share data)	Three Months Ended July 29, 2017	Three Months Ended July 30, 2016	Six Months Ended July 29, 2017	Six Months Ended July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Costs and expenses/(income):				
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	1,923	1,834	3,646	3,627
Selling, general and administrative (SG&A)	842	853	1,685	1,725
Pension	(4)	2	(6)	4
Depreciation and amortization	144	153	289	307
Real estate and other, net	(19)	(9)	(137)	(47)
Restructuring and management transition	23	9	243	15
Total costs and expenses	2,909	2,842	5,720	5,631
Operating income/(loss)	53	76	(52)	98
(Gain)/loss on extinguishment of debt	35	34	35	30
Net interest expense	79	93	166	188
Income/(loss) before income taxes	(61)	(51)	(253)	(120)
Income tax expense/(benefit)	1	5	(11)	4
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Earnings/(loss) per share:				
Basic	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Diluted	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Weighted average shares – basic	310.8	308.0	310.2	307.6
Weighted average shares – diluted	310.8	308.0	310.2	307.6

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
(Unaudited)

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$(62)	$ (56)	$(242)	$(124)
Other comprehensive income/(loss), net of tax:				
Retirement benefit plans				
Net actuarial gain/(loss) arising during the period [(1)]	—	—	5	—
Prior service credit/(cost) arising during the period [(2)]	—	—	—	5
Reclassification for net actuarial (gain)/loss [(3)]	—	(1)	—	(2)
Reclassification for amortization of prior service (credit)/cost [(4)]	1	—	2	—
Net curtailment gain [(5)]	—	—	20	—
Cash flow hedges				
Gain/(loss) on interest rate swaps [(6)]	(3)	(6)	(6)	(9)
Reclassification for periodic settlements [(7)]	2	2	4	4
Foreign currency translation				
Unrealized (gain)/loss	2	—	2	—
Deferred tax valuation allowance	—	(1)	—	(1)
Total other comprehensive income/(loss), net of tax	2	(6)	27	(3)
Total comprehensive income/(loss), net of tax	$(60)	$ (62)	$(215)	$(127)

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

(1) Net of $(4) million in tax in the six months ended July 29, 2017.
(2) Net of $(3) million in tax in the six months ended July 30, 2016.
(3) Net of $1 million and $2 million in tax in the three and six months ended July 30, 2016, respectively. Pre-tax amounts of $(2) million and $(4) million in the three and six months ended July 30, 2016, respectively, were recognized in SG&A in the Consolidated Statements of Operations.
(4) Net of $(1) million and $(2) million in tax in the three and six months ended July 29, 2017, respectively. Pre-tax amounts of $2 million and $4 million in the three and six months ended both July 29, 2017 and July 30, 2016, respectively, were recognized in Pension in the Consolidated Statements of Operations. Pre-tax amounts of $(2) million and $(4) million in the three and six months ended July 30, 2016, respectively, were recognized in SG&A in the Consolidated Statements of Operations.
(5) Net of $(11) million in tax in the six months ended July 29, 2017. Pre-tax prior service cost of $5 million related to the curtailment is included in Restructuring and management transition in the Consolidated Statements of Operations in the six months ended July 29, 2017.
(6) Net of $2 million and $3 million of tax in the three and six months ended July 29, 2017, respectively. Net of $3 million and $4 million of tax in the three and six months ended July 30, 2016, respectively.
(7) Net of $(1) million and $(2) million of tax in each of the three and six months ended July 29, 2017 and July 30, 2016, respectively, and $3 million and $6 million in pre-tax amounts for each of the three and six months ended July 29, 2017 and July 30, 2016, respectively, were recognized in Net interest expense in the Consolidated Statements of Operations.

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J. C. PENNEY COMPANY, INC.
CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	July 29, 2017 (Unaudited)	July 30, 2016 (Unaudited)	January 28, 2017
Assets			
Current assets:			
Cash in banks and in transit	$ 186	$ 171	$ 125
Cash short-term investments	128	258	762
Cash and cash equivalents	314	429	887
Merchandise inventory	2,777	2,981	2,854
Prepaid expenses and other	223	235	160
Total current assets	3,314	3,645	3,901
Property and equipment (net of accumulated depreciation of $3,610, $3,742 and $3,842)	4,390	4,686	4,599
Other assets	622	604	618
Total Assets	$ 8,326	$ 8,935	$ 9,118
Liabilities and Stockholders' Equity			
Current liabilities:			
Merchandise accounts payable	$ 950	$ 1,094	$ 977
Other accounts payable and accrued expenses	1,091	1,121	1,164
Current portion of capital leases, financing obligation and note payable	9	18	15
Current maturities of long-term debt	232	341	263
Total current liabilities	2,282	2,574	2,419
Long-term capital leases, financing obligation and note payable	216	10	219
Long-term debt	3,836	4,356	4,339
Deferred taxes	202	194	204
Other liabilities	635	604	583
Total Liabilities	7,171	7,738	7,764
Stockholders' Equity			
Common stock[(1)]	155	154	154
Additional paid-in capital	4,694	4,668	4,679
Reinvested earnings/(accumulated deficit)	(3,248)	(3,131)	(3,006)
Accumulated other comprehensive income/(loss)	(446)	(494)	(473)
Total Stockholders' Equity	1,155	1,197	1,354
Total Liabilities and Stockholders' Equity	$ 8,326	$ 8,935	$ 9,118

(1) 1,250 million shares of common stock are authorized with a par value of $0.50 per share. The total shares issued and outstanding were 310.3 million, 307.6 million and 308.3 million as of July 29, 2017, July 30, 2016 and January 28, 2017, respectively.

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Cash flows from operating activities				
Net income/(loss)	$ (62)	$ (56)	$(242)	$(124)
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:				
Restructuring and management transition	(4)	—	73	(1)
Asset impairments and other charges	2	1	3	2
Net gain on sale of non-operating assets	—	—	—	(5)
Net gain on sale of operating assets	(1)	(2)	(118)	(10)
(Gain)/loss on extinguishment of debt	35	34	35	30
Depreciation and amortization	144	153	289	307
Benefit plans	(15)	(15)	96	(27)
Stock-based compensation	9	10	16	20
Deferred taxes	(1)	3	(19)	—
Change in cash from:				
Inventory	172	(56)	77	(260)
Prepaid expenses and other	7	(9)	(64)	(68)
Merchandise accounts payable	57	99	(27)	169
Current income taxes	(2)	(3)	3	(4)
Accrued expenses and other	61	27	(66)	(237)
Net cash provided by/(used in) operating activities	402	186	56	(208)
Cash flows from investing activities				
Capital expenditures	(109)	(121)	(192)	(160)
Net proceeds from sale of non-operating assets	—	—	—	2
Net proceeds from sale of operating assets	10	4	146	16
Joint venture return of investment	1	1	9	15
Net cash provided by/(used in) investing activities	(98)	(116)	(37)	(127)
Cash flows from financing activities				
Proceeds from issuance of long-term debt	—	2,188	—	2,188
Proceeds from borrowings under the credit facility	272	—	272	—
Payments of borrowings under the credit facility	(272)	—	(272)	—
Premium on early retirement of debt	(30)	—	(30)	—
Payments of capital leases, financing obligation and note payable	(6)	(5)	(12)	(19)
Payments of long-term debt	(311)	(2,188)	(541)	(2,250)
Financing costs	(9)	(49)	(9)	(49)
Proceeds from stock issued under stock plans	3	—	3	1
Tax withholding payments for vested restricted stock	—	(2)	(3)	(7)
Net cash provided by/(used in) financing activities	(353)	(56)	(592)	(136)
Net increase/(decrease) in cash and cash equivalents	(49)	14	(573)	(471)
Cash and cash equivalents at beginning of period	363	415	887	900
Cash and cash equivalents at end of period	$ 314	$ 429	$314	$429

Supplemental cash flow information

Income taxes received/(paid), net	$ (4)	$ (5)	$ (5)	$ (8)
Interest received/(paid), net	(59)	(62)	(163)	(184)
Supplemental non-cash investing and financing activity				
Increase/(decrease) in other accounts payable related to purchases of property and equipment and software	1	(9)	6	32

See the accompanying notes to the unaudited Interim Consolidated Financial Statements.

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J. C. PENNEY COMPANY, INC.
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Consolidation

Basis of Presentation

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 holding company has no independent assets or operations, and no direct subsidiaries other than JCP. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this quarterly report as "we," "us," "our," "ourselves" or the "Company," unless otherwise indicated.

J. C. Penney Company, Inc. is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP's outstanding debt securities. The guarantee of certain of JCP's outstanding debt securities by J. C. Penney Company, Inc. is full and unconditional.

These unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The accompanying unaudited Interim Consolidated Financial Statements, in our opinion, include all material adjustments necessary for a fair presentation and should be read in conjunction with the audited Consolidated Financial Statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended January 28, 2017 (2016 Form 10-K). We follow substantially the same accounting policies to prepare quarterly financial statements as are followed in preparing annual financial statements. A description of such significant accounting policies is included in the 2016 Form 10-K. The January 28, 2017 financial information was derived from the audited Consolidated Financial Statements, with related footnotes, included in the 2016 Form 10-K. Because of the seasonal nature of the retail business, operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

Fiscal Year

Our fiscal year ends on the Saturday closest to January 31. As used herein, "three months ended July 29, 2017" and "three months ended July 30, 2016" refer to the 13-week periods ended July 29, 2017 and July 30, 2016, respectively. "Six months ended July 29, 2017" and "six months ended July 30, 2016" refer to the 26-week periods ended July 29, 2017 and July 30, 2016, respectively. Fiscal year 2017 contains 53 weeks, and fiscal year 2016 contains 52 weeks.

Basis of Consolidation

All significant inter-company transactions and balances have been eliminated in consolidation. Certain reclassifications were made to prior period amounts to conform to the current period presentation. None of the reclassifications affected our net income/(loss) in any period.

2. Effect of New Accounting Standards

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes, which requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The new standard no longer requires allocating valuation allowances between current and noncurrent deferred tax assets because those allowances are classified as noncurrent. The Company adopted ASU 2015-17 retrospectively in its first quarter ended April 29, 2017. As a result of the retrospective adoption, the Company reclassified deferred tax assets of $231 million and $196 million as of July 30, 2016, and January 28, 2017, respectively, from Deferred taxes (a component of current assets) to a reduction in Deferred taxes (a component of long-term liabilities) on the unaudited Interim Consolidated Balance Sheets.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330), Simplifying the Measurement of Inventory, which simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. Under previous guidance, net realizable value is one of several calculations an entity needs to make to measure inventory at the lower of cost or market. However, companies will continue to apply their existing

impairment models to inventories that are accounted for using last-in first-out (LIFO) and the retail inventory method (RIM). The Company adopted ASU 2015-11 in its first quarter ended April 29, 2017. The adoption of this standard did not have a material impact on our financial condition, results of operations or cash flows as substantially all of our inventory is measured by the RIM impairment model which is considered a continued acceptable method under the new standard.

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In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 changes how companies account for certain aspects of share-based payments to employees. Entities are required to recognize the income tax effects of awards (windfalls or shortfalls) in the income statement when the awards vest or are settled (i.e., additional paid-in capital or APIC pools will be eliminated). The guidance on employers' accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and for forfeitures also changed. The ASU also provides a practical expedient for public companies that allows the use of a simplified method to estimate the expected term for certain awards. The Company adopted ASU 2016-09 in its first quarter ended April 29, 2017.

As a result of ASU 2016-09 requiring all windfalls and shortfalls to be recognized when they arise, excess tax benefits that were not previously recognized because the related tax deduction had not reduced current taxes payable have been recorded on a modified retrospective basis through a cumulative effect adjustment to retained earnings as of January 29, 2017. Additionally, the deferred tax assets recognized as a result of this transition guidance have been assessed for realizability and any valuation allowance has been recognized as part of the cumulative effect adjustment to retained earnings also as a result of this transition guidance. Considering these aspects of transitioning to the new guidance, there was no impact to retained earnings as a result of a valuation allowance being recorded against the related deferred tax asset recorded as the cumulative adjustment.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the FASB Emerging Issues Task Force) (ASU 2016-05). Under the ASU, the novation of a derivative contract (i.e., a change in the counterparty) in a hedge accounting relationship does not, in and of itself, require dedesignation of that hedge accounting relationship. The hedge accounting relationship could continue uninterrupted if all of the other hedge accounting criteria are met, including the expectation that the hedge will be highly effective when the creditworthiness of the new counterparty to the derivative contract is considered. The Company adopted ASU 2016-05 in the first quarter ended April 29, 2017 and the new guidance had no impact as the Company had no transactions involving the novation of a derivative.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. Companies will present all other components of net benefit cost outside of operating income, if this subtotal is presented. This guidance is effective for fiscal years beginning after December 15, 2017, and interim periods therein. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Entities should apply this guidance retrospectively for the presentation of the service cost component and the other components of net periodic pension cost in the income statement and prospectively, on and after the effective date, for any capitalization of the service cost component of net periodic pension cost in assets. We are currently evaluating the effect that adopting this new accounting guidance will have on our financial condition, results of operations, or cash flows.

In May 2014, the FASB issued ASC Topic 606, Revenue from Contracts with Customers, a replacement of Revenue Recognition (Topic 605). 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. This standard is effective for us beginning in fiscal 2018 and we plan to adopt the new standard using the full retrospective approach. We are analyzing the impact of the new standard on our current accounting policies and internal controls and the software changes required to implement the new standard. Although we have not completed all of the required due diligence, we have identified the certain impacts to our revenue recognition policies related to gift card breakage and our customer loyalty programs. Whereas we currently recognize gift card breakage, net of required escheatment, 60

months after the gift card is issued, the new standard will require us to recognize gift card breakage, net of required escheatment, over the redemption pattern of gift cards. Additionally, whereas under current standards we utilize the incremental cost method to account for our customer loyalty programs, the new standard will require us to account for our customer loyalty program as revenue which will require us to defer a portion of our incremental sales to loyalty rewards to be earned by reward members.

We are also evaluating 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 portfolio. Currently the income we earn under our agreement with Synchrony is included as an offset to SG&A expenses and along with the adoption of the new standard, we plan to change our presentation to include such income in Real estate and other, net.

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3. Earnings/(Loss) per Share

Net income/(loss) and shares used to compute basic and diluted earnings/(loss) per share (EPS) are reconciled below:

	Three Months Ended		Six Months Ended	
(in millions, except per share data)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Earnings/(loss)				
Net income/(loss)	$ (62)	$ (56)	$ (242)	$ (124)
Shares				
Weighted average common shares outstanding (basic shares)	310.8	308.0	310.2	307.6
Adjustment for assumed dilution:				
Stock options, restricted stock awards and warrant	—	—	—	—
Weighted average shares assuming dilution (diluted shares)	310.8	308.0	310.2	307.6
EPS				
Basic	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)
Diluted	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)

The following average potential shares of common stock were excluded from the diluted EPS calculation because their effect would have been anti-dilutive:

	Three Months Ended		Six Months Ended	
(Shares in millions)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Stock options, restricted stock awards and warrant	33.5	34.8	33.3	35.0

4. Long-Term Debt

($ in millions)	July 29, 2017	July 30, 2016	January 28, 2017
Issue:			
7.65% Debentures Due 2016	$—	$78	$ —
7.95% Debentures Due 2017	—	220	220
5.75% Senior Notes Due 2018 [1]	190	265	265
8.125% Senior Notes Due 2019 [1]	175	400	400
5.65% Senior Notes Due 2020 [1]	400	400	400
2016 Term Loan Facility (Matures in 2023)	1,646	1,688	1,667
5.875% Senior Secured Notes Due 2023 [1]	500	500	500
7.125% Debentures Due 2023	10	10	10
6.9% Notes Due 2026	2	2	2
6.375% Senior Notes Due 2036 [1]	388	388	388
7.4% Debentures Due 2037	313	313	313
7.625% Notes Due 2097	500	500	500
Total debt, excluding unamortized debt issuance costs, capital leases, financing obligation and note payable	4,124	4,764	4,665
Unamortized debt issuance costs	(56)	(67)	(63)
Total debt, excluding capital leases, financing obligation and note payable	4,068	4,697	4,602
Less: current maturities	232	341	263
Total long-term debt, excluding capital leases, financing obligation and note payable	$3,836	$4,356	$ 4,339

(1) These debt issuances contain a change of control provision that would obligate us, at the holders' option, to repurchase the debt at a price of 101%.

On May 22, 2017, we paid approximately $334 million aggregate consideration to settle cash tender offers with respect to portions of our outstanding 5.75% Senior Notes due 2018 and 8.125% Senior Notes due 2019 (collectively, the Securities). In doing so, we recognized a loss on extinguishment of debt of $34 million which includes the premium paid over the face value of the accepted Securities of $30 million, reacquisition costs of $1 million and the write off of unamortized debt issuance costs of $3 million.

During the second quarter of 2017, we amended our $2.35 billion senior secured asset-based revolving credit facility (2017 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. All borrowings under the 2017 Credit Facility accrue interest at a rate equal to, at the Company's option, a base rate or an adjusted LIBOR rate plus a spread. As of July 29, 2017, there were no outstanding borrowings under the 2017 Credit Facility.

5. Derivative Financial Instruments

We use derivative financial instruments for hedging and non-trading purposes to manage our exposure to changes in interest rates. Use of derivative financial instruments in hedging programs subjects us to certain risks, such as market and credit risks. Market risk represents the possibility that the value of the derivative instrument will change. In an effective hedging relationship, the change in the value of the derivative is offset to a great extent by the change in the value of the underlying hedged item. Credit risk related to derivatives represents the possibility that the counterparty will not fulfill the terms of the contract. The notional, or contractual, amount of our derivative financial instruments is used to measure interest to be paid or received and does not represent our exposure due to credit risk. Credit risk is monitored through established approval procedures, including setting concentration limits by counterparty, reviewing credit ratings and requiring collateral (generally cash) from the counterparty when appropriate.

When we use derivative financial instruments for the purpose of hedging our exposure to interest rates, the contract terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria are recorded using hedge accounting. If a derivative instrument qualifies for hedge accounting, depending on the nature of the hedge, changes in the fair value of the instrument will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or be recognized in accumulated other comprehensive income/(loss) until the hedged item is recognized in earnings. The ineffective portion of an instrument's change in fair value will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which we have not elected to apply hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of change.

We have entered into interest rate swap agreements with notional amounts totaling $1,250 million to fix a portion of our variable LIBOR-based interest payments. The interest rate swap agreements have a weighted-average fixed rate of 2.04%, mature on May 7, 2020 and have been designated as cash flow hedges.

The fair value of our interest rate swaps are recorded on the unaudited Interim Consolidated Balance Sheets as an asset or a liability (see Note 7). The effective portion of the interest rate swaps' changes in fair values is reported in Accumulated other comprehensive income/(loss) (see Note 8), and the ineffective portion is reported in Net income/(loss). Amounts in Accumulated other comprehensive income/(loss) are reclassified into net income/(loss) when the related interest payments affect earnings. For the periods presented, all of the interest rate swaps were 100% effective.

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Information regarding the gross amounts of our derivative instruments in the unaudited Interim Consolidated Balance Sheets is as follows:

($ in millions)	Asset Derivatives at Fair Value				Liability Derivatives at Fair Value			
	Balance Sheet Location	July 29, 2017	July 30, 2016	January 28, 2017	Balance Sheet Location	July 29, 2017	July 30, 2016	January 28, 2017
Derivatives designated as hedging instruments:								
Interest rate swaps	N/A	$ —	$ —	$ —	Other accounts payable and accrued expenses	$ 2	$ 2	$ 2
Interest rate swaps	N/A	—	—	—	Other liabilities	13	35	10
Total derivatives designated as hedging instruments		$ —	$ —	$ —		$ 15	$ 37	$ 12

6. Restructuring and Management Transition

On March 17, 2017, the Company finalized its plans to close 138 stores to help align the Company's brick-and-mortar presence with its omnichannel network, thereby redirecting capital resources to invest in locations and initiatives that offer the greatest revenue potential. The expected store closures resulted in a $77 million asset impairment charge for store assets with limited future use and a $14 million severance charge for the expected displacement of store associates. Other store related closing costs such as certain lease obligations will be recorded as incurred when each respective store ceases operations.

The Company also initiated a Voluntary Early Retirement Program (VERP) for approximately 6,000 eligible associates. Eligibility for the VERP included home office, stores and supply chain personnel who met certain criteria related to age and years of service as of January 31, 2017. The consideration period for eligible associates to accept the VERP ended on March 31, 2017. Based on the approximately 2,800 associates who elected to accept the VERP, we incurred a total charge of $112 million for enhanced retirement benefits. The enhanced retirement benefits increased the projected benefit obligation (PBO) of the Primary Pension Plan and the Supplemental Pension Plans by $88 million and $24 million, respectively. In addition, we incurred curtailment charges of $6 million related to our Primary Pension Plan and $2 million related to Supplemental Pension Plans as a result of the reduction in the expected years of future service related to these plans. As a result of these curtailments, the assets and the liabilities for our Primary Pension Plan and the liabilities of certain Supplemental Pension Plans were remeasured as of March 31, 2017. The discount rate used for the March 31 remeasurements was 4.34% compared to the year-end 2016 discount rate of 4.40%. These events resulted in the PBO of our Primary Pension Plan decreasing by $3 million and the related assets increasing by $34 million and the PBO of our Supplemental Pension Plans increasing by $3 million. The funded status of the Primary Pension Plan was 98% as of the remeasurement date.

The components of restructuring and management transition include:

- VERP — charges for enhanced retirement benefits, curtailment and other expenses related to the VERP;
- Home office and stores — charges for actions to reduce our store and home office expenses including employee termination benefits, store lease termination and impairment charges;
- Management transition — charges related to implementing changes within our management leadership team for both incoming and outgoing members of management; and
- Other — charges related primarily to contract termination costs and other costs associated with our previous shops strategy and costs related to the closure of certain supply chain locations.

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

($ in millions)	Three Months Ended		Six Months Ended		Cumulative Amount From Program Inception Through July 29, 2017
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016	
VERP	$ —	$ —	$ 122	$ —	$ 122
Home office and stores	23	—	121	4	418
Management transition	—	1	—	3	255
Other	—	8	—	8	178
Total	$ 23	$ 9	$ 243	$ 15	$ 973

Activity for the restructuring and management transition liability for the six months ended July 29, 2017 was as follows:

($ in millions)	Home Office and Stores	Other	Total
January 28, 2017	$ 4	$ 27	$ 31
Charges	48	—	48
Cash payments	(25)	(21)	(46)
July 29, 2017	$ 27	$ 6	$ 33

7. Fair Value Disclosures

In determining fair value, the accounting standards establish a three level hierarchy for inputs used in measuring fair value, as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Significant observable inputs other than quoted prices in active markets for similar assets and liabilities, such as quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Significant unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants.

Cash Flow Hedges Measured on a Recurring Basis

As of July 29, 2017, July 30, 2016 and January 28, 2017, the $15 million, $37 million and $12 million fair value of our cash flow hedges, respectively, are valued in the market using discounted cash flow techniques which use quoted market interest rates in discounted cash flow calculations which consider the instrument's term, notional amount, discount rate and credit risk. Significant inputs to the derivative valuation for interest rate swaps are observable in the active markets and are classified as Level 2 in the fair value measurement hierarchy.

Other Non-Financial Assets Measured on a Non-Recurring Basis

In connection with the Company announcing its plan to close underperforming department stores, long-lived assets held and used with a carrying value of $86 million were written down to their fair value of $9 million, resulting in asset impairment charges of $77 million in the six months ended July 29, 2017. The fair value was determined based on comparable market values of similar properties or on a rental income approach and the significant inputs related to valuing the store related assets are classified as Level 2 in the fair value measurement hierarchy.

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Other Financial Instruments

Carrying values and fair values of financial instruments that are not carried at fair value in the unaudited Interim Consolidated Balance Sheets are as follows:

($ in millions)	July 29, 2017		July 30, 2016		January 28, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Total debt, excluding unamortized debt issuance costs, capital leases, financing obligation and note payable	$4,124	$3,817	$4,764	$4,530	$4,665	$4,495

The fair value of long-term debt was estimated by obtaining quotes from brokers or was based on current rates offered for similar debt. As of July 29, 2017, July 30, 2016 and January 28, 2017, the fair values of cash and cash equivalents and accounts payable approximated their carrying values due to the short-term nature of these instruments.

Concentrations of Credit Risk

We have no significant concentrations of credit risk.

8. Stockholders' Equity

The following table shows the change in the components of stockholders' equity for the six months ended July 29, 2017:

(in millions)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Reinvested Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
January 28, 2017	308.3	$ 154	$ 4,679	$ (3,006)	$ (473)	$ 1,354
Net income/(loss)	—	—	—	(242)	—	(242)
Other comprehensive income/(loss)	—	—	—	—	27	27
Stock-based compensation and other	2.0	1	15	—	—	16
July 29, 2017	310.3	$ 155	$ 4,694	$ (3,248)	$ (446)	$ 1,155

Accumulated Other Comprehensive Income/(Loss)

The following table shows the changes in accumulated other comprehensive income/(loss) balances for the six months ended July 29, 2017:

($ in millions)	Net Actuarial Gain/(Loss)	Prior Service Credit/(Cost)	Foreign Currency Translation	Gain/(Loss) on Cash Flow Hedges	Accumulated Other Comprehensive Income/(Loss)
January 28, 2017	$ (421)	$ (33)	$ (2)	$ (17)	$ (473)
Other comprehensive income/(loss) before reclassifications	22	—	2	(6)	18
Amounts reclassified from accumulated other comprehensive income	—	5	—	4	9
July 29, 2017	$ (399)	$ (28)	$ —	$ (19)	$ (446)

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9. Retirement Benefit Plans

The components of net periodic benefit expense/(income) for our non-contributory qualified defined benefit pension plan (Primary Pension Plan) and non-contributory supplemental pension plans were as follows:

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Primary Pension Plan				
Service cost	$ 10	$ 14	$21	$ 28
Interest cost	36	38	73	76
Expected return on plan assets	(53)	(54)	(107)	(108)
Amortization of prior service cost/(credit)	2	2	4	4
Net periodic benefit expense/(income)	$ (5)	$ —	$(9)	$ —
Supplemental Pension Plans				
Service cost	$ —	$ —	$—	$ —
Interest cost	1	2	3	4
Net periodic benefit expense/(income)	$ 1	$ 2	$3	$ 4
Primary and Supplemental Pension Plans Total				
Service cost	$ 10	$ 14	$21	$ 28
Interest cost	37	40	76	80
Expected return on plan assets	(53)	(54)	(107)	(108)
Amortization of prior service cost/(credit)	2	2	4	4
Net periodic benefit expense/(income)	$ (4)	$ 2	$(6)	$ 4

Additionally, the Company had net periodic postretirement income of $4 million and $8 million, respectively, in the three and six months ended July 30, 2016 related to the Company's noncontributory postretirement medical and dental plan which was included in SG&A expense in the unaudited Interim Consolidated Statements of Operations. The postretirement medical and dental plan was terminated effective December 31, 2016.

10. 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 a joint venture in which we contributed approximately 220 acres of excess property adjacent to our home office facility in Plano, Texas (Home Office Land Joint Venture). 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.

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net gain from sale of non-operating assets	$—	$ —	$—	$ (5)
Investment income from Home Office Land Joint Venture	(19)	(5)	(20)	(29)
Net gain from sale of operating assets	(1)	(2)	(118)	(10)
Other	1	(2)	1	(3)
Total expense/(income)	$(19)	$ (9)	$(137)	$ (47)

Investment Income from Joint Ventures

During the second quarter and first six months of 2017, the Company had income of $19 million and $20 million, respectively, related to its proportional share of the net income in the Home Office Land Joint Venture and received aggregate cash distributions of $20 million and $28 million, respectively. During the second quarter and first six months of 2016, the

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Company had income of $5 million and $29 million, respectively, related to its proportional share of the net income in the Home Office Land Joint Venture and received aggregate cash distributions of $6 million and $44 million, respectively.

Net Gain from Sale of Operating Assets

During the first quarter of 2017, we completed the sale of our Buena Park, California distribution facility for a net sale price of
$131 million and recorded a net gain of $111 million.

11. Income Taxes

The net tax expense of $1 million for the three months ended July 29, 2017 consisted of state and foreign tax expenses of $4 million and $2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a net tax benefit of $4 million to adjust the valuation allowance and $1 million resulting from state audit settlements.

The net tax benefit of $11 million for the six months ended July 29, 2017 consisted of state and foreign tax expenses of $7 million and $4 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a $16 million benefit relating to other comprehensive income and a net tax benefit of $4 million to adjust the valuation allowance and $2 million resulting from state audit settlements.

As of July 29, 2017, we have approximately $2.2 billion of net operating losses (NOLs) available for U.S. federal income tax purposes, which expire in 2032 through 2034 and $62 million of tax credit carryforwards that expire at various dates through 2035. A valuation allowance of $826 million fully offsets the federal deferred tax assets resulting from the NOL and tax credit carryforwards that expire at various dates through 2034. A valuation allowance of $247 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034. In assessing the need for the valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our periodic assessment, our estimate of the realization of deferred tax assets is solely based on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring NOL and tax credit carryforwards. Accordingly, in the second quarter and first six months of 2017, the valuation allowance was increased by $16 million and $80 million, respectively, to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards.

12. Litigation and Other Contingencies

Litigation

Class Action Securities Litigation

The Company, Myron E. Ullman, III and Kenneth H. Hannah are parties to the Marcus consolidated purported class action lawsuit in the U.S. District Court, Eastern District of Texas, Tyler Division. The Marcus consolidated complaint is purportedly brought on behalf of persons who acquired our common stock during the period from August 20, 2013 through September 26, 2013, and alleges claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiff claims that the defendants made false and misleading statements and/or omissions regarding the Company's financial condition and business prospects that caused our common stock to trade at artificially inflated prices. The consolidated complaint seeks class certification, unspecified compensatory damages, including interest, reasonable costs and expenses, and other relief as the court may deem just and proper. Defendants filed a motion to dismiss the consolidated complaint which was denied by the court on September 29, 2015. Defendants filed an answer to the consolidated complaint on November 12, 2015. Plaintiff filed a motion for class certification on January 25, 2016, and on August 29, 2016, a magistrate judge issued a report and recommendation that the motion for class certification be granted. The district court adopted this report and recommendation granting class certification on March 8, 2017.

Also, on August 26, 2014, plaintiff Nathan Johnson filed a purported class action lawsuit against the Company, Myron E. Ullman, III and Kenneth H. Hannah in the U.S. District Court, Eastern District of Texas, Tyler Division. The suit is

purportedly brought on behalf of persons who acquired our securities other than common stock during the period from August 20, 2013 through September 26, 2013, generally mirrors the allegations contained in the Marcus lawsuit discussed above, and seeks similar relief. On June 8, 2015, plaintiff in the Marcus lawsuit amended the consolidated complaint to include the members of the purported class in the Johnson lawsuit, and on June 10, 2015, the Johnson lawsuit was consolidated into the Marcus lawsuit.

The parties have reached an agreement in principle, subject to final court approval, to settle the consolidated securities class action for $97.5 million, which will be funded by insurance. The court granted preliminary approval of the settlement on June 24, 2017. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of

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these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Shareholder Derivative Litigation
In October, 2013, two purported shareholder derivative actions were filed against certain present and former members of the Company’s Board of Directors and executives by the following parties in the U.S. District Court, Eastern District of Texas, Sherman Division: Weitzman (filed October 2, 2013) and Zauderer (filed October 3, 2013). The Company is named as a nominal defendant in both suits. The lawsuits assert claims for breaches of fiduciary duties and unjust enrichment based upon alleged false and misleading statements and/or omissions regarding the Company’s financial condition. The lawsuits seek unspecified compensatory damages, restitution, disgorgement by the defendants of all profits, benefits and other compensation, equitable relief to reform the Company’s corporate governance and internal procedures, reasonable costs and expenses, and other relief as the court may deem just and proper. On October 28, 2013, the Court consolidated the two cases into the Weitzman lawsuit. On January 15, 2014, the Court entered an order staying the derivative suits pending certain events in the class action securities litigation described above.

Also, in March 2016, plaintiff Frank Lipsius filed a purported shareholder derivative action against certain present and former members of the Company's Board of Directors and executives in the District Court of Collin County in the State of Texas. The Company is named as a nominal defendant in the suit. The suit generally mirrors the allegations contained in the Weitzman and Zauderer suits discussed above, and seeks similar relief. On May 18, 2017, plaintiff in the Lipsius suit voluntarily dismissed the Collin County action, and on May 19, 2017, refiled the action in the District Court of Dallas County, Texas.

On June 8, 2017, the Company’s Board of Directors received a demand from a purported shareholder of the Company, Douglas Carlson, to conduct an investigation regarding potential claims that certain present and former members of the Board of Directors and executives violated federal securities law and/or breached their fiduciary duties to the Company based upon allegations similar to those in the Marcus class action securities litigation and the related shareholder derivative litigation. An initial response to the demand has been sent.

While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

ERISA Class Action Litigation
JCP and certain present and former members of JCP's Board of Directors have been sued in a purported class action complaint by plaintiffs Roberto Ramirez and Thomas Ihle, individually and on behalf of all others similarly situated, which was filed on July 8, 2014 in the U.S. District Court, Eastern District of Texas, Tyler Division. The suit alleges that the defendants violated Section 502 of the Employee Retirement Income Security Act (ERISA) by breaching fiduciary duties relating to the J. C. Penney Corporation, Inc. Savings, Profit-Sharing and Stock Ownership Plan (the Plan). The class period is alleged to be between November 1, 2011 and September 27, 2013. Plaintiffs allege that they and others who invested in or held Company stock in the Plan during this period were injured because defendants allegedly made false and misleading statements and/or omissions regarding the Company’s financial condition and business prospects that caused the Company’s common stock to trade at artificially inflated prices. The complaint seeks class certification, declaratory relief, a constructive trust, reimbursement of alleged losses to the Plan, actual damages, attorneys’ fees and costs, and other relief. Defendants filed a motion to dismiss the complaint which was granted in part and denied in part by the court on September 29, 2015. The parties reached a settlement agreement, subject to final court approval, pursuant to which JCP would make available $4.5 million to settle class members’ claims, and the court granted preliminary approval of the settlement on January 3, 2017. While no assurance can be given as to the ultimate outcome of this matter, we believe that the final resolution of this action will not have a

material adverse effect on our results of operations, financial position, liquidity or capital resources.

Employment Class Action Litigation

JCP is a defendant in a class action proceeding entitled Tschudy v. JCPenney Corporation filed on April 15, 2011 in the U.S.
District Court, Southern District of California. The lawsuit alleges that JCP violated the California Labor Code in connection with the alleged forfeiture of accrued and vested vacation time under its “My Time Off” policy. The class consists of all JCP employees who worked in California from April 5, 2007 to the present. Plaintiffs amended the complaint to assert additional claims under the Illinois Wage Payment and Collection Act on behalf of all JCP employees who worked in Illinois from January 1, 2004 to the present. After the court granted JCP’s motion to transfer the Illinois claims, those claims are now pending in a separate action in the U.S. District Court, Northern District of Illinois, entitled Garcia v. JCPenney Corporation. The lawsuits seek compensatory damages, penalties, interest, disgorgement, declaratory and injunctive relief, and attorney’s fees and costs. Plaintiffs in both lawsuits filed motions, which the Company opposed, to certify these actions on behalf of all employees in California and Illinois based on the specific claims at issue. On December 17, 2014, the California court granted plaintiffs’ motion for class certification. Pursuant to a motion by the Company, the California court decertified the

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class on December 9, 2015. On March 30, 2016, the California court granted JCP’s motion for summary judgment. On April 26, 2016, the California plaintiffs filed a notice of appeal. On May 4, 2016, the California court entered judgment for JCP on all plaintiffs’ claims. The Illinois court denied without prejudice plaintiffs' motion for class certification pending the filing of an amended complaint. Plaintiffs filed their amended complaint in the Illinois lawsuit on April 14, 2015 and the Company answered. On July 2, 2015, the Illinois plaintiffs renewed their motion for class certification, which the Illinois court granted on March 8, 2016. The parties have reached a settlement agreement, subject to final court approval, to resolve the California action for $1.75 million. The California court granted preliminary approval of the settlement on June 7, 2017. The parties have also reached a settlement agreement to resolve the Illinois action for $5 million. The Illinois court granted final approval of the settlement on August 9, 2017. While no assurance can be given as to the ultimate outcome of these matters, we believe that the final resolution of these actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Other Legal Proceedings

We are subject to various other legal and governmental proceedings involving routine litigation incidental to our business. Accruals have been established based on our best estimates of our potential liability in certain of these matters, including certain matters discussed above, all of which we believe aggregate to an amount that is not material to the Consolidated Financial Statements. These estimates were developed in consultation with in-house and outside counsel. While no assurance can be given as to the ultimate outcome of these matters, we currently believe that the final resolution of these actions, individually or in the aggregate, will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Contingencies

As of July 29, 2017, we estimated our total potential environmental liabilities to range from $20 million to $25 million and recorded our best estimate of $24 million in Other accounts payable and accrued expenses and Other liabilities in the unaudited Interim 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 upper end of the estimated range, we do not believe that such losses would have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

General

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 holding company has no independent assets or operations and no direct subsidiaries other than JCP. The holding company and its consolidated subsidiaries, including JCP, are collectively referred to in this quarterly report as “we,” “us,” “our,” “ourselves” or the “Company,” unless otherwise indicated.

The holding company is a co-obligor (or guarantor, as appropriate) regarding the payment of principal and interest on JCP’s outstanding debt securities. The guarantee of certain of JCP’s outstanding debt securities by the holding company is full and unconditional.

This discussion is intended to provide information that will assist the reader in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, how operating results affect the financial condition and results of operations of our Company as a whole, as well as how certain accounting principles affect the financial statements. It should be read in conjunction with our consolidated financial statements as of January 28, 2017, and for the year then ended, and related Notes, and Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), all contained in the Annual Report on Form 10-K for the fiscal year ended January 28, 2017 (2016 Form 10-K). Unless

otherwise indicated, all references 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.

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Growth Initiatives

Our growth strategy for 2017 focuses on the following five initiatives:

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

First, we will continue to focus on our beauty categories of Sephora and The Salon by InStyle. In 2016, we opened 60 additional Sephora locations, bringing our total number of locations to 577, and we launched several new brands in our Sephora shops. We plan to add approximately 70 new Sephora locations and expand 32 existing locations in 2017. During the second quarter, 32 new Sephora locations and 31 expansions were completed. We also plan to continue to roll out and launch new beauty merchandise brands in 2017. With these plans every Sephora location we operate will be enhanced in 2017 either through an expansion or an updated assortment of brands. We are rebranding our salons to The Salon by InStyle and also recently added new functionality to jcpenney.com and our mobile app, allowing customers to book salon services appointments easily and more conveniently. Magnifying the importance of physical stores, we see Sephora and Salon as differentiators to help drive traffic and increase the frequency of visits to our stores.

Second, we plan to increase our revenue per customer with 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 plan to expand our mattress showrooms to 500 stores and to add new toy shops to the merchandise assortment of all stores. Lastly, we are conducting several tests within our Home Store focusing on home installed services including an HVAC install program through our partnership with Trane, bathroom remodeling with Re-Bath, and quick ship and installed window blinds.

Third, we remain committed to becoming a world-class omnichannel retailer. Our online business remains strong, having delivered double-digit growth in 2016. We plan to continue to drive increased online revenue in 2017 by increasing our online SKU assortment, continuing to improve site functionality and our mobile app. During the second quarter of 2017, we expanded our ship-from-store capabilities from approximately 250 stores to 100% of our store network.

Pricing strategy is our fourth initiative. In 2017, we have restructured the internal pricing process so that all of our pricing and promotional decisions will be made using a more data-driven approach. Once fully implemented, we expect our pricing initiatives to enhance our merchandise margin performance in 2017 and beyond.

Last, we are focused on improving our women's apparel merchandise assortment. We are enhancing our partnership with Nike to create inspiring brand shops and offering an improved assortment of apparel, accessories and footwear across all divisions. In the women's area we will have Nike in all stores, an increase of over 400 stores from 2016. We are also converting all women's shoe areas to open sale fixtures this year and are introducing new styles and comfort features to attempt to seize available market share in footwear. In addition, we are taking steps in women's apparel to simplify the floor, better balance our career and casual offerings and creating a stronger value statement with pricing. We also plan to expand our use of customer and trend data more effectively to ensure we better understand the desires of the customer in advance of the season. Finally, we see an opportunity with the plus size community that remains underserved, and we want to become the destination for providing style, value and an appealing shopping environment. Our women's plus boutique shop Boutique+™ continues to resonate with our plus size customers and we plan to enhance this strategy for 2017 by launching swimwear and other accessories.

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

Second Quarter Overview

- Sales were $2,962 million with a total sales increase of 1.5% compared to the second quarter of 2016 and a comparable store sales decrease of 1.3%.

Cost of goods sold as a percentage of sales increased to 64.9% compared to 62.9% in the same period last year primarily driven by the liquidation of inventory in closing stores, higher penetration of Internet and appliance sales and increased shrinkage.

Selling, general and administrative (SG&A) expenses decreased $11 million, or 1.3%, for the second quarter of 2017 as compared to the same period last year. These savings were primarily driven by reductions in store controllable costs and corporate overhead and an increase in private label credit card income. SG&A as a percentage of sales decreased to 28.4% compared to 29.2% in the same period last year.

Our net loss was $62 million, or ($0.20) per share, compared to a net loss of $56 million, or ($0.18) per share, for the corresponding prior year quarter. Results for this quarter included the following amounts that are not directly related to our ongoing core business operations:

$23 million, or ($0.07) per share, of restructuring and management transition charges;
$5 million, or $0.02 per share, of Primary Pension income;
$35 million, or ($0.11) per share, for loss on extinguishment of debt; and
$19 million, or $0.06 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).

Adjusted net loss was $28 million, or $(0.09) per share, compared to an adjusted net loss of $16 million, or $(0.05) per share, in last year's first quarter. 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 pages 24 and 25.

Adjusted earnings before interest expense, income tax (benefit)/expense and depreciation and amortization (Adjusted EBITDA) (non-GAAP) was $196 million, a $37 million decline from the same period last year.

On May 22, 2017, we paid approximately $334 million aggregate consideration 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).

On June 20, 2017, we amended our $2.35 billion senior secured asset-based revolving credit facility (Revolving Credit Facility). Among other things, the amended and restated facility provides improved pricing terms and extends the maturity from 2019 to 2022.

Effective July 24, 2017, the Board of Directors elected Jeffrey Davis as Executive Vice President and Chief Financial Officer of the Company.

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Results of Operations

($ in millions, except EPS)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Percent increase/(decrease) from prior year	1.5 %	1.5 %	(1.1)%	(0.1)%
Comparable store sales increase/(decrease)[1]	(1.3)%	2.2 %	(2.4)%	0.9 %
Costs and expenses/(income):				
Cost of goods sold (exclusive of depreciation and amortization shown separately below)	1,923	1,834	3,646	3,627
Selling, general and administrative	842	853	1,685	1,725
Primary pension plan	(5)	—	(9)	—
Supplemental pension plans	1	2	3	4
Total pension	(4)	2	(6)	4
Depreciation and amortization	144	153	289	307
Real estate and other, net	(19)	(9)	(137)	(47)
Restructuring and management transition	23	9	243	15
Total costs and expenses	2,909	2,842	5,720	5,631
Operating income/(loss)	53	76	(52)	98
(Gain)/loss on extinguishment of debt	35	34	35	30
Net interest expense	79	93	166	188
Income/(loss) before income taxes	(61)	(51)	(253)	(120)
Income tax expense/(benefit)	1	5	(11)	4
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Adjusted EBITDA (non-GAAP) [2]	$196	$233	$451	$386
Adjusted net income/(loss) (non-GAAP) [2]	$(28)	$(16)	$(9)	$(113)
Diluted EPS	$(0.20)	$(0.18)	$(0.78)	$(0.40)
Adjusted diluted EPS (non-GAAP) [2]	$(0.09)	$(0.05)	$(0.03)	$(0.37)
Ratios as a percent of sales:				
Cost of goods sold	64.9 %	62.9 %	64.3 %	63.3 %
SG&A	28.4 %	29.2 %	29.7 %	30.1 %
Operating income/(loss)	1.8 %	2.6 %	(0.9)%	1.7 %

(1) Comparable store sales 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) See “Non-GAAP Financial Measures” for a discussion of this non-GAAP measure and reconciliation to its most directly comparable GAAP financial measure and further information on its uses and limitations.

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Total Net Sales

($ in millions)	Three Months Ended July 29, 2017	Three Months Ended July 30, 2016	Six Months Ended July 29, 2017	Six Months Ended July 30, 2016
Total net sales	$2,962	$2,918	$5,668	$5,729
Sales percent increase/(decrease):				
Total net sales	1.5 %	1.5 %	(1.1)%	(0.1)%
Comparable store sales	(1.3)%	2.2 %	(2.4)%	0.9 %

Total net sales increased $44 million in the second quarter of 2017 compared to the second quarter of 2016. For the first six months of 2017, total net sales decreased $61 million from the same period last year.

The following table provides the components of the net sales increase/(decrease):

($ in millions)	Three Months Ended July 29, 2017	Six Months Ended July 29, 2017
Comparable store sales increase/(decrease)	$ (35)	$ (133)
Closed stores, net	79	69
Other revenues and sales adjustments	—	3
Total net sales increase/(decrease)	$ 44	$ (61)

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 same day" is available in all of our stores.

For the second quarter and first six months of 2017, average unit retail and units per transaction increased, while transaction counts decreased as compared to the prior year.

For the second quarter of 2017, Home, Fine Jewelry, Footwear and Handbags and Sephora were our top-performing merchandise divisions. For the first half of 2017, our top-performing merchandise divisions were Home, Sephora and Fine Jewelry, with all experiencing sales gains on a comparable store basis. Geographically, the Southwest and Southeast were the best performing regions of the country during the second quarter and first half of 2017.

During the second quarters of both 2017 and 2016, private brand merchandise comprised 46% of total merchandise sales. During the second quarters of 2017 and 2016, exclusive brand merchandise comprised 7% and 8% of total merchandise sales,

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respectively. For the first halves of both 2017 and 2016, private brand merchandise comprised 45% of total merchandise sales. For the first halves of 2017 and 2016, exclusive brand merchandise comprised 8% and 9%, respectively, of total merchandise sales.

Store Count

The following table compares the number of stores for the three and six months ended July 29, 2017 and July 30, 2016:

	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
JCPenney department stores				
Beginning of period	1,013	1,014	1,013	1,021
Closed stores	(2)	—	(2)	(7)
End of period [1]	1,011 [2]	1,014	1,011 [2]	1,014

(1) Gross selling space, including selling space allocated to services and licensed departments, was 103 million square feet as of July 29, 2017 and 104 million square feet as of July 30, 2016.

(2) During August 2017, 125 stores ceased operations and were closed.

Cost of Good Sold

Cost of goods sold, exclusive of depreciation and amortization, for the three months ended July 29, 2017 was $1,923 million, an increase of $89 million compared to $1,834 million for the three months ended July 30, 2016. Cost of goods sold as a percentage of sales was 64.9% for the three months ended July 29, 2017 compared to 62.9% for the three months ended July 30, 2016, an increase of 200 basis points. Cost of goods sold, exclusive of depreciation and amortization, for the six months ended July 29, 2017 was $3,646 million, an increase of $19 million compared to $3,627 million for the six months ended July 30, 2016. Cost of goods sold as a percentage of sales was 64.3% for the six months ended July 29, 2017 compared to 63.3% for the six months ended July 30, 2016, an increase of 100 basis points. The increase for the second quarter and the first six months was primarily driven by the liquidation of inventory in closing stores, higher penetration of Internet and appliance sales and increased shrinkage.

SG&A Expenses

For the three months ended July 29, 2017, SG&A expenses were $11 million lower than the corresponding period of 2016. As a percent of sales, SG&A expenses decreased to 28.4% compared to 29.2% in the second quarter of 2016. Through the first six months of 2017, SG&A expenses were $40 million lower than the corresponding period of 2016. Through the first six months of 2017, as a percent of sales, SG&A expenses decreased to 29.7% compared to 30.1% in the corresponding period of 2016. The net decrease in SG&A expenses for the three month period was primarily driven by reductions in store controllable costs and corporate overhead and an increase in private label credit card income. The net decrease in SG&A expenses for the six month period was primarily driven by lower marketing, store controllable costs, and incentive compensation and an increase in private label credit card income.

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 the second quarters of 2017 and 2016, we recognized income of $83 million and $75 million, respectively, pursuant to our private label credit card programs. Through the first halves of 2017 and 2016, we recognized income of $166 million and $154 million, respectively.

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Pension Expense/(Income)

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Primary Pension Plan	$ (5)	$ —	$ (9)	$ —
Supplemental pension plans	1	2	3	4
Total pension expense/(income)	$ (4)	$ 2	$ (6)	$ 4

Depreciation and Amortization Expense

Depreciation and amortization expense was $144 million and $153 million for the three months ended July 29, 2017 and July 30, 2016, respectively, and $289 million and $307 million for the six months ended July 29, 2017 and July 30, 2016, respectively. The decrease is primarily a result of closing store locations since the beginning of 2015.

Restructuring and Management Transition

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Voluntary early retirement program (VERP)	$ —	$ —	$ 122	$ —
Home office and stores	23	—	121	4
Management transition	—	1	—	3
Other	—	8	—	8
Total	$ 23	$ 9	$ 243	$ 15

In February 2017, we announced a 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.

During the six months ended July 29, 2017 and July 30, 2016, we recorded $121 million and $4 million, respectively, of costs to reduce our store and home office expenses. Costs during the first half of 2017 include store closing asset impairments of $77 million, employee termination benefits of $20 million and store closing costs of $24 million. Costs during the first half of 2016 primarily include employee termination benefits in connection with the elimination of positions in our home office.

We also implemented changes within our management leadership team during the six months ended July 30, 2016 that resulted in management transition costs of $3 million for both incoming and outgoing members of management.

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)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net gain from sale of non-operating assets	$—	$ —	$—	$ (5)
Investment income from Home Office Land Joint Venture	(19)	(5)	(20)	(29)
Net gain from sale of operating assets	(1)	(2)	(118)	(10)
Other	1	(2)	1	(3)
Total expense/(income)	$(19)	$ (9)	$(137)	$ (47)

During the first half of 2016, we sold 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 from the joint venture.

During the first half of 2017, the net gain from the sale of operating assets includes a $111 million net gain on the sale of our Buena Park, California distribution facility and $7 million in net gains on the sale of excess land. During the first half of 2016, the net gain from the sale of operating assets related primarily to the sale of land adjacent to our home office not contributed to the Home Office Land Joint Venture.

Operating Income/(Loss)

For the second quarter of 2017, we reported operating income of $53 million compared to operating income of $76 million in the second quarter of 2016. For the first six months of 2017, we reported an operating loss of $52 million compared to operating income of $98 million in the prior year corresponding period.

(Gain)/Loss on Extinguishment of Debt

During the second quarter of 2017, we settled cash tender offers with respect to portions of our outstanding 2018 Notes and 2019 Notes, resulting in a loss on extinguishment of debt of $34 million, and amended our Revolving Credit Facility, which resulted in a loss on extinguishment of debt of $1 million.

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 $2.25 billion five-year senior secured term loan facility entered into in 2013 with an amended and restated $1.688 billion seven-year senior secured term loan facility and the issuance of $500 million of 5.875% Senior Secured Notes due 2023, resulting in a loss on extinguishment of debt of $34 million.

Net Interest Expense

Net interest expense for the second quarters of 2017 and 2016 was $79 million and $93 million, respectively, a year-over-year decrease of $14 million, or 15.1%. For the first six months of 2017, net interest expense was $166 million, a decrease of $22 million, or 11.7%, from $188 million in 2016. The reduction in net interest expense is due to lower debt levels in 2017 compared to 2016.

Income Taxes

The net tax expense of $1 million for the three months ended July 29, 2017 consisted of state and foreign tax expenses of $4 million and $2 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a net tax benefit of $4 million to adjust the valuation allowance and $1 million resulting from state audit settlements.

The net tax benefit of $11 million for the six months ended July 29, 2017 consisted of state and foreign tax expenses of $7 million and $4 million of expense related to the deferred tax asset change arising from the tax amortization of indefinite-lived intangible assets, offset by a $16 million benefit relating to other comprehensive income and a net tax benefit of $4 million to adjust the valuation allowance and $2 million resulting from state audit settlements.
As of July 29, 2017, we have approximately $2.2 billion of net operating losses (NOLs) available for U.S. federal income tax purposes, which expire in 2032 through 2034 and $62 million of tax credit carryforwards that expire at various dates through 2035. A valuation allowance of $826 million fully offsets the federal deferred tax assets resulting from the NOL and tax credit carryforwards that expire at various dates through 2034. A valuation allowance of $247 million fully offsets the deferred tax assets resulting from the state NOL carryforwards that expire at various dates through 2034. In assessing the need for the

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valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. As a result of our periodic assessment, our estimate of the realization of deferred tax assets is solely based on the future reversals of existing taxable temporary differences and tax planning strategies that we would make use of to accelerate taxable income to utilize expiring NOL and tax credit carryforwards. Accordingly, in the second quarter and first six months of 2017, the valuation allowance was increased by $16 million and $80 million, respectively, to offset the net deferred tax assets created in the quarter relating primarily to the increase in NOL carryforwards.

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 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 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 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 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 restructuring and management transition charges, the impact of our Primary Pension Plan, the (gain)/loss on extinguishment of debt, the net gain on the sale of non-operating assets, the proportional share of net income from our Home Office Land Joint Venture and the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps. Unlike other operating expenses, restructuring and management transition charges, the (gain)/loss on extinguishment of debt, the net gain on the sale of non-operating assets, the proportional share of net income from our Home Office Land Joint Venture and the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps are not directly related to our ongoing core business operations. Primary Pension Plan expense/(income) is 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 (gain)/loss on extinguishment of debt, the net gain on the sale of non-operating assets, the proportional share of net income from the Home Office Land Joint Venture and the tax impact for the allocation of income taxes to other comprehensive income items related to our Primary Pension Plan and interest rate swaps 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.

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

($ in millions)	Three Months Ended		Six Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$(62)	$(56)	$(242)	$(124)
Add: Net interest expense	79	93	166	188
Add: (Gain)/loss on extinguishment of debt	35	34	35	30
Add: Income tax expense/(benefit)	1	5	(11)	4
Add: Depreciation and amortization	144	153	289	307
Add: Restructuring and management transition charges	23	9	243	15

Add: Primary Pension Plan expense/(income)	(5)	—	(9)	—
Less: Net gain on the sale of non-operating assets	—	—	—	(5)
Less: Proportional share of net income from joint venture	(19)	(5)	(20)	(29)
Adjusted EBITDA (non-GAAP)	$196	$ 233	$451	$386

For the three months ended July 29, 2017, adjusted EBITDA was $196 million, a reduction of $37 million compared to $233 million in the prior year corresponding period. For the six months ended July 29, 2017, adjusted EBITDA was $451 million, an improvement of $65 million compared to $386 million in the prior year corresponding period.

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Adjusted EBITDA for the second quarter of 2017 declined as compared to the corresponding prior year period due to the liquidation of inventory in the closing stores, partially offset by reductions in our controllable expenses.

Adjusted EBITDA for the first half of 2017 improved as compared to the corresponding prior year period as we recorded a significant net gain on the sale of operating assets and effectively managed our controllable expenses, partially offset by the liquidation of inventory in the closing stores.
Adjusted Net Income/(Loss) and Adjusted Diluted EPS. The following table reconciles net income/(loss) and diluted EPS, the most directly comparable GAAP financial measures, to adjusted net income/(loss) and adjusted diluted EPS, which are non-GAAP financial measures:

	Three Months Ended		Six Months Ended	
($ in millions, except per share data)	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income/(loss)	$ (62)	$ (56)	$ (242)	$ (124)
Diluted EPS	$ (0.20)	$ (0.18)	$ (0.78)	$ (0.40)
Add: Restructuring and management transition charges [1]	23	9	243	15
Add: Primary Pension Plan expense/(income) [1]	(5)	—	(9)	—
Add: (Gain)/loss on extinguishment of debt [1]	35	34	35	30
Less: Net gain on sale of non-operating assets [1]	—	—	—	(5)
Less: Proportional share of net income from joint venture [1]	(19)	(5)	(20)	(29)
Less: Tax impact resulting from other comprehensive income allocation [2]	—	2	(16)	—
Adjusted net income/(loss) (non-GAAP)	$ (28)	$ (16)	$ (9)	$ (113)
Adjusted diluted EPS (non-GAAP)	$ (0.09)	$ (0.05)	$ (0.03)	$ (0.37)

(1) Reflects no tax effect due to the impact of the Company's tax valuation allowance.
(2) Represents the net tax benefit that resulted from our other comprehensive income allocation between our Operating loss and Accumulated other comprehensive income.

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Liquidity and Capital Resources

Overview

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. We ended the second quarter of 2017 with $314 million of cash and cash equivalents. As of the end of the second quarter of 2017, based on our borrowing base and amounts reserved for outstanding letters of credit, we had $1,968 million available for future borrowings under our revolving credit facility, providing total available liquidity of $2,282 million.