Think Big

May 16, 2012



Pershing Square Capital Management, L.P.

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Agenda



- **✓** Business Overview
- √ History of JCP
- **✓ Transformation Under New Management**
 - √ Sales opportunity
 - ✓ Cost opportunity
- ✓ Valuation
- √ Think Big

Business Overview

J.C. Penney



Ticker: JCP

Stock Price: \$26

Market Cap: ~\$5.7bn

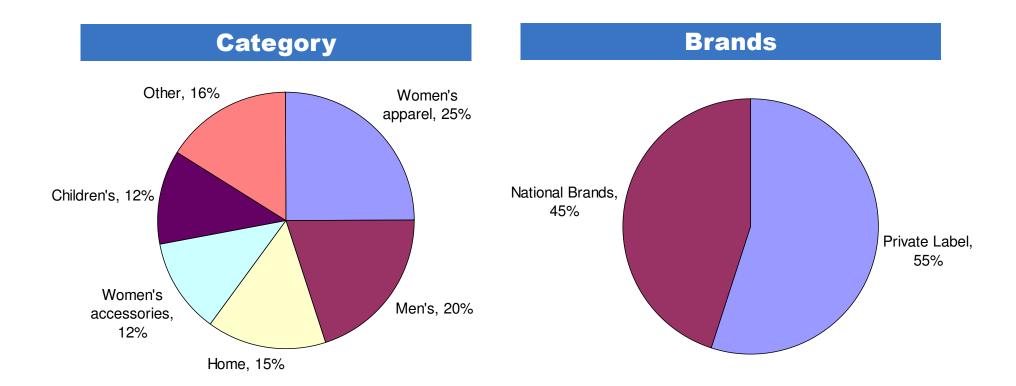
EV: ~\$8bn

► Founded in 1902, JCP has grown into one of the largest retailers in America

- \$17.3bn of sales in 2011
- 1,103 stores nationwide, 2/3^{rds} of sqft is "on-mall"
- \$1.5bn revenue internet business
- Wide-assortment of apparel, accessory, and home merchandise
- Affordable price points, average price per item is ~\$14
- Undergoing complete transformation under new management

Products

JCP sells a wide assortment of both exclusive and national brand merchandise



JCP Real Estate

Nationwide store base is split across three types of formats:

	On-Mall	Off-Mall	"Legacy"	Total
Units	544	135	424	1,103
Sq ft/Box	145k	101k	45k	101k
Total Sq ft	79mm	14mm	19mm	112mm

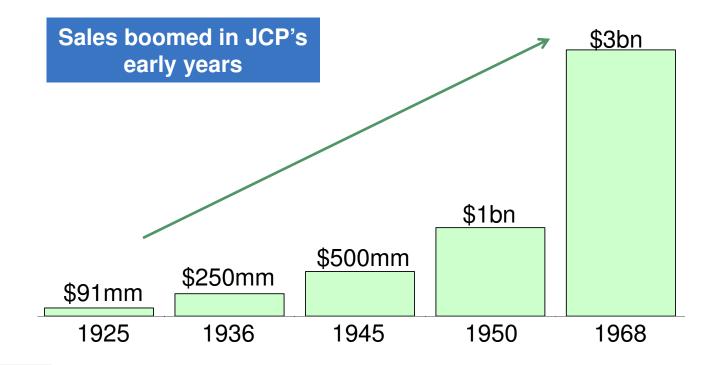
~80% of Penney's on-mall stores are in shopping centers with sales >\$300 per sf. For Macy's, this figure is roughly ~75%

Source: Company data

History of JCP

Origins of Initial Success

- JCP's early success was largely due to its founder's innovations:
 - Fair Prices "Golden Rule", no haggling
 - Aligned Management Incentives Store managers were allowed to buy a 1/3rd stake in their store
 - Great Products Imported popular East Coast product to the West



Source: Company Data

Successful Transition to a Department Store

- In the 1980s, in response to competition from emerging mass discounters like Wal-Mart, CEO W. R. Howell transitioned JCP from being a mass-merchant to an apparel-focused department store
- While the shift to apparel was initially successful, it created complexity that eventually overwhelmed JCP's outdated infrastructure

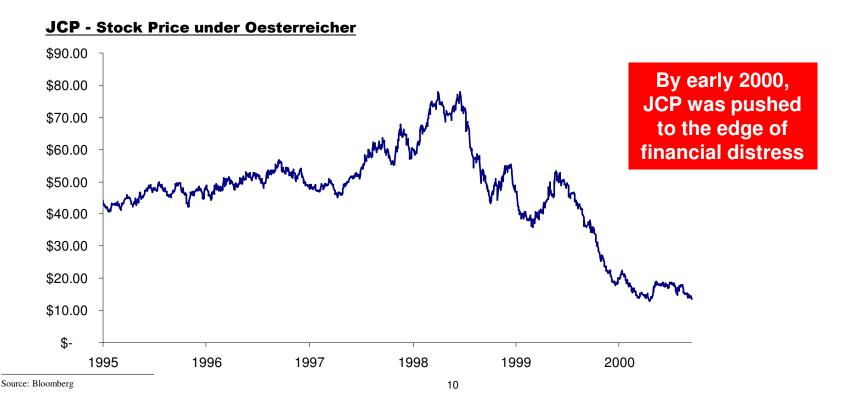
JCP - Stock Price under Howell



Source: Bloomberg

Late 1990s: JCP Begins to Decline

- Under Oesterreicher (1995-2000), the difficulty of running a fashion retailer without modern planning and allocation systems caught up with JCP
- Between 1997 and 2000, weak sales and lower gross margins pushed EBIT in the core retail business down ~80%
- The company also suffered from too much leverage and a poorly planned expansion of its drug store business (bought Eckerd in 1996 for ~\$3.3bn)



Early 2000s: Saved from Financial Distress

- Oesterreicher was forced out; Allen Questrom was hired in 2001
- Performance improved under his strategy of shedding non-core businesses, centralizing planning and allocation, and modernizing systems, but many core problems remained

JCP - Stock Price under Questrom



Source: Bloomberg

Late 2000s: Core Problems Remain

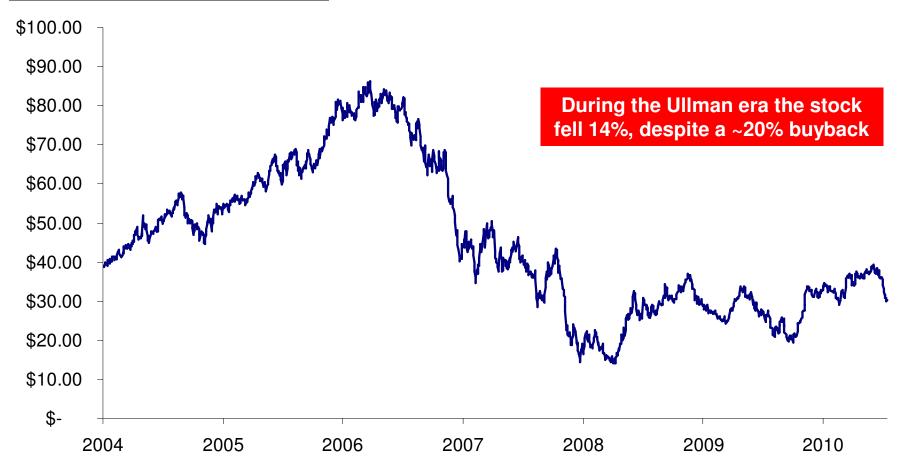
Mike Ullman replaced Questrom as CEO in 2005

- Under Ullman, JCP failed to right size its uncompetitive cost structure despite a severe consumer recession
- Invested >\$1bn to expand the off-mall store base with inadequate return on capital
- Sales track record of new products was mixed:



Late 2000s: Progress Stalls

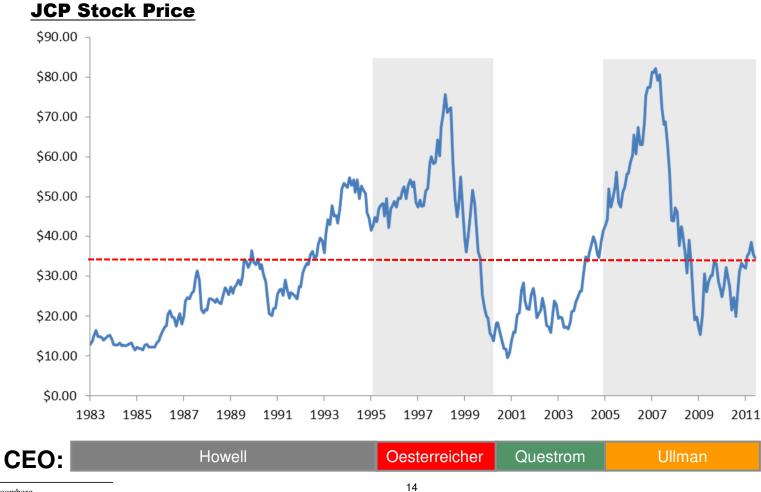
JCP - Stock Price under Ullman



Source: Bloomberg

JCP Has Been Chronically Mismanaged

Over the past twenty years, JCP has failed to create value for shareholders



Source: Bloomberg

The Competitors Have Been Winning

While the consumer environment has been challenging, JCP has vastly underperformed

		2007 - 2011		
	% Total Shareholder Return	% Revenue Growth	% EBIT Growth	2011 EBITDAR Margin (%)
★ Macy [‡]	-18%	0%	15%	14%
KOHĽS	-22%	14%	12%	17%
T-J-MODX	98%	26%	68%	17%
NORDSTROM	5%	19%	-3%	16%
jcp	-54%	-13%	-56%	9%
JCP Rank	Last	Last	Last	Last

Source: Company Data

Nordstrom: Excludes credit card business; JCP: EBIT and EBITDAR exclude restructuring charges, markdowns related to new pricing strategy, and qualified pension expense Shareholder returns are through 6/13/2011 – the day before Ron Johnson's hiring was announced

Why Have The Competitors Been Winning?

The company has made a lot of mistakes:

- × Commodity product
- × No price integrity
- × Tired brand image
- Cluttered stores bulging with inventory
- × Bloated cost structure
- **×** Culture of complacency

Underperformance Despite Competitive Advantages

JCP is not fundamentally broken. In fact, the company has many competitive advantages, but has suffered from years of mismanagement

Real Estate: 49% of retail sf is owned, balance is leased at avg. of ~\$4/sf

- "On-Mall": 80% of malls have average sales of >\$300/sf
- "Legacy Off-Mall": High free cash flow, limited competition
- "Prototype Off-Mall": All built in the last 10 years

Scale: ~\$17bn of sales in 2011

- Advertising: Historically >\$1bn in annual spend
- Sourcing: Large enough to directly source from factories in Asia
- National Brands: Bargaining power to get best product at the lowest cost

Early mover: Brand legacy, direct marketing capability, dominant in many small town markets

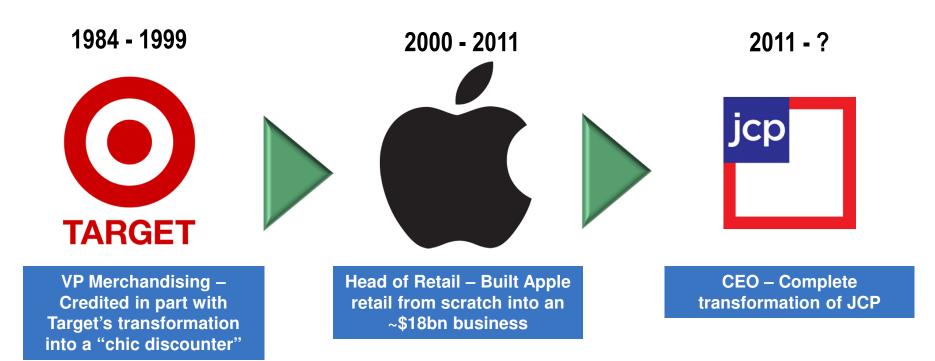
Transformation Under New Management

New CEO: Ron Johnson (Nov. 2011)



Ron Johnson's record of retailing success makes him the ideal leader to fix JCP

Retail is an industry where the right leader can make a big impact: Drexler, Ulrich, Walton, Wexner, etc...



New Management is Motivated to Win

Ron Johnson has personally invested a material portion of his net worth in JCP warrants purchased at market value

Ron Johnson's Warrant Terms

Price: \$50mm

Amount: 7.3mm shares

Strike: \$29.92

Maturity: 7.5 years, may not hedge or sell for 6 years

Assembling a Dream Team

Since joining JCP in November, Ron Johnson has assembled a dream team of 41 managers to help him turnaround the company

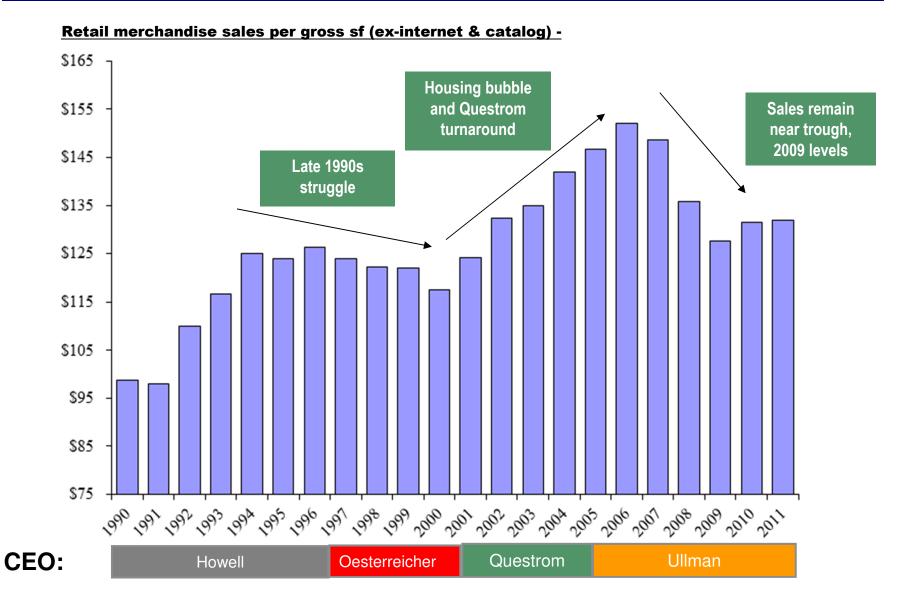
- Michael Francis, President, 22-year veteran of Target and most recently head of marketing
- Michael Kramer, COO, previously CEO of Kellwood and CFO of Abercrombie & Fitch and Apple Stores
- Ken Hannah, CFO, brings operational and finance expertise from MEMC, Home Depot, Boeing, and GE
- Daniel Walker, Chief Talent Officer, former senior HR executive at Apple and Gap
- Kristen Blum, Chief Technology Officer, a former senior executive at Pepsico, Abercrombie & Fitch, and Apple

What's wrong?

- Sales are too low
- **×** Expenses are too high

The Sales Opportunity

Sales per SF Near Mid-1990s Levels



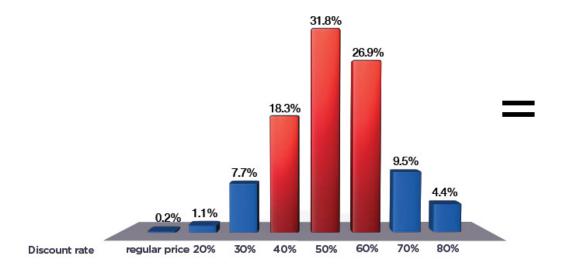
Why?

- **×** Excessive promotions
- Commodity product
- **×** Poor store-experience
- **×** Limited customer universe

Promotional Pricing Strategy

The old model was excessively promotional, which hurt the JCP brand and complicated the company

2011 JCP Sales Discount Distribution



Observations

Initial mark-ups were too high:

>72% of revenue at 50% off or more

She knows the right price:

>75%
of revenue is in a 20% price band

JCP Struggled to Attract Good Product

JCP had difficulty attracting high quality brands into its store

Why good brands would not come to JCP:

- No price integrity; Excessively promotional
- JCP's image had become outdated
- Cluttered stores made product look cheap

Old Strategy – Summary

Because good brands would not come to JCP, the company sold lower quality commodity product and competed on price

On-line merchants are the low-cost providers, making competing on price a losing strategy for the company





Extreme Makeover

Changes across all aspects JCP's retail model

- ✓ Pricing & Promotion
- ✓ Personality
- ✓ Presentation & Place
- **✓** Product

Pricing & Promotion -

Old Model

- High initial price
- Final sales price at an average ~60% discount
- Highly promotional, 590 events a year



- "Everyday" initial price close to where she normally buys
- One, month-long, seasonal promotion each month
- Friday clearance; corresponds with payday
- Dynamic implementation; continuous improvement

Pricing & Promotion -

Advantages of the New Model

- ✓ Strengthens JCP's brand equity
- ✓ Frees merchants to focus on product, not promotional cadence
- ✓ Eliminates unproductive advertising expense
- ✓ Reduces store labor hours

Personality -

JCP's outdated image needed to be refreshed

New Logo:







New Advertising:

Monthly "Book"



Television



Spokesperson



Presentation & Place -

New Model

- Reduce clutter; more product on walls, less on the floor
- Build 100 brand focused "shops within a shop"
- Introduce 10 shops in 2012, starting in August
- 2 to 3 shops/month through end of 2015

Replicate Success of Existing Shops



Advantages of the New Model

- Improved shopping experience
- Brands are competing to have their own shop – vendors will help fund construction
- Monthly build-out cadence creates constant "newness"

Cost Effective Engineering – Return on Capital is a Priority



First Shops Recently Announced





























Product Initiatives

Getting the right product in the store is a critical factor in driving higher sales and better gross margin

Changes to the model will attract the best product to the store:

- Pricing & Promotion:
 - Improved price integrity strengthens the brands sold at JCP
- Personality:
 - An updated look improves JCP and associated brands
- Presentation & Place:
 - Branded shops and less clutter will help vendors build their brands
- Vendor Economics:
 - Bringing vendors into partnership with the store will ensure that they send their best product to JCP

Recent Product Announcements

New brands:















Revamping existing brands:















JCP had to fix the brand, price, promotion, place, and presentation before it could get the new product

The consequence is an initial sales decline

How We Expect Sales To Develop

Sequence of the sales model transformation

Sales Impact





- Implement every day low pricing, fewer promotions
- Change personality (logo, advertising)
- Improve presentation by reducing clutter



August 2012:

- Major brand announcements and introduction of the first shops
- 50% of product will be new or revamped brands



Year-end 2012:

First 10 shops complete



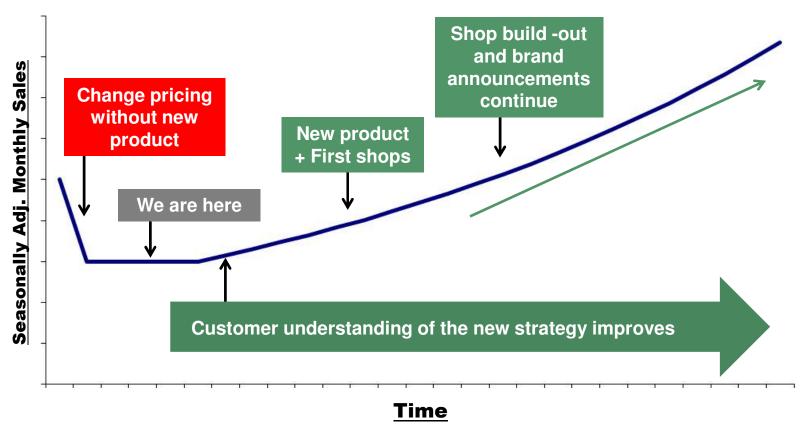
Year-end 2015

- Build out of all 100 shops completed at a pace of 2 to 3 per month
- Increase national brands from 45% of sales to 75% 80%

How We Expect Sales To Develop

Sales are under pressure today, but we believe better product from existing new brands and the shop build-out will lead to meaningful sales growth

Forecasted Sales Progression (illustrative)

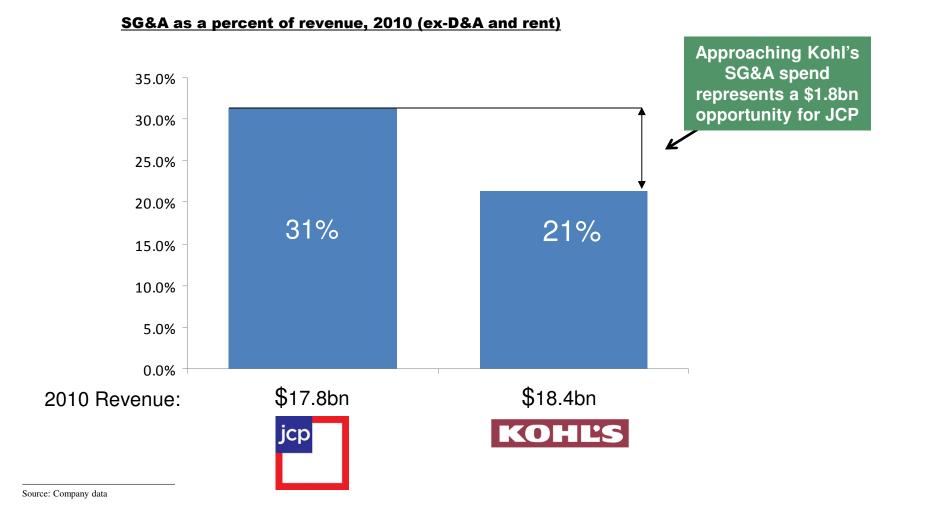


Note: This illustration is not intended to communicate specific rates of sales growth but rather only to illustrate Pershing Square's expectations based on its estimates and anticipated trends

The Cost Opportunity

Eliminating Waste

JCP has an extremely inefficient cost structure. Management is quickly and effectively addressing the issue



Eliminating Waste

At its core, JCP is a simple business – it has one segment and no international sales. Unfortunately, years of mismanagement bloated the cost structure

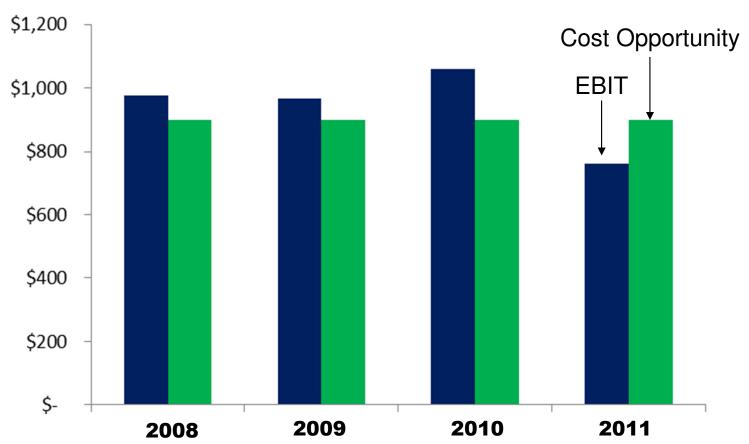
Management has identified at least \$900mm/yr of net savings by 2012

- √ Home Office (management target = \$200+mm)
- √ Stores (\$400+mm)
- ✓ Advertising (\$300+mm)

The Magnitude of the Cost Opportunity is Large

The \$900mm cost opportunity is ~120% of 2011 EBIT

Adj. EBIT vs. Cost Opportunity



Home Office (management target = \$200+mm)

Historic dysfunction at JCP's home office in Plano is symptomatic of an organization which was not focused on cost control

Cost Structure Issues

- Out of ~5,900 home office employees (pre-layoffs), ~700 were assistants
- JCP spends 2x benchmarks on IT
- Merchandise, Planning & Allocation teams were staffed ~35% above competition
- The average "manager" had only 4 direct reports

Work or Play? – Cultural Issues

- Netflix, consumed 20% of corporate internet bandwidth during work hours
- The average employee made 1,000 clicks on youtube per month

Illustrative Initiatives:

- Executing planned layoffs on-schedule
- Within six weeks, the new vice president of IT was able to reduce her run-rate budget (ex-special projects) by 25% for 2012

Stores (management target = \$400+mm)

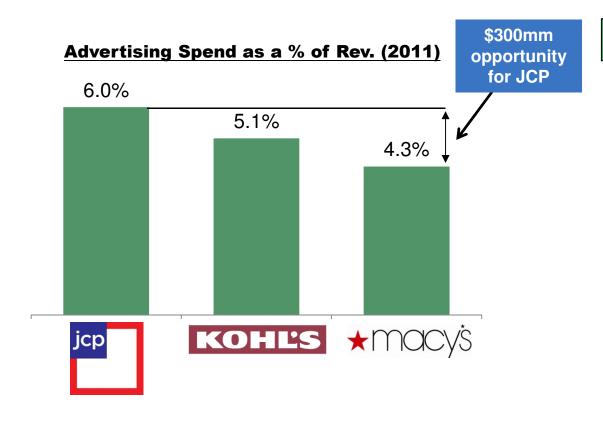
JCP's stores require ~25% more labor hours than Kohl's. Management will use technology to narrow this gap

Illustrative Initiatives:

- Headcount -
 - 40% more supervisors per store than competitors
 - 15% more employees per store than competitors
- Reducing clerical tasks -
 - New pricing strategy requires fewer price changes, reducing store labor hours
 - Simplifying stocking and merchandise receiving processes
 - Eliminating layers of management to bring staff closer to the customer
 - Shrinking the number of cash registers and using technology on the floor to assist with checkout

Advertising (management target = \$300+mm)

The former promotional strategy and corporate inefficiency led to overspending in advertising



Correcting Inefficiency

 Fewer, better promotions will make advertising more efficient

Other Operational Opportunities

Management's \$900mm target is only half the gap with Kohl's. Given opportunities uncovered so far, we expect more progress to come

Assorted potential sources of additional value creation:

Inventory

- JCP carries too much inventory
- In 2012 alone, JCP expects to eliminate \$500+mm of unproductive inventory

Supply Chain

- Zero base budgeting the supply chain and distribution center rationalization
- Goal to reduce store truck deliveries from 3-5x per week to 1-2x

Capital Allocation

Historically, store capex spend based on sf not productivity

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Turnaround Summary

All of the Requirements for a Turnaround are in Place

- √ Solid core business with natural competitive advantages
- ✓ New, high-quality management team
- ✓ Management incentives are aligned with shareholder returns
- ✓ High potential new sales strategy
- ✓ Abundant "low-hanging fruit" in the cost structure to fund sales opportunity

JCP Reminds us of Another Retail Turnaround...

	Mid-1980s	Today
	GAP	jcp
Broken model	Expensive real estate; commodity product	Excessively promotional, weak product selection
Talented new management with equity incentives	Drexler's leadership attracted top talent	Johnson's leadership has attracted top talent
	Drexler made ~\$350mmon Gap stock¹	Johnson's net worth is levered to JCP stock
Decisive strategy change	Eliminated national brands and focused on the "GAP" label	Fairer pricing, better product, improved store environment
The first year was difficult	■ Net income fell 43%²	Sales will be challenged in 2012
Results	■ Under Drexler, Gap stock rose ~60x	?

Source: 1WSJ magazine, June 2010

²The GAP – Company history, Fundinguniverse.com

Thoughts on the First Quarter

Costs

- Identified and executing on \$650mm of opportunity
- Management pulled their \$900mm cost target forward to year-end 2012

Sales

- Disappointing SSS (-19%) and gross margin (-120bps)
- Management is responding; expect sales progress in the second half
- Many new and revamped brands announced
- Vendors are enthusiastic and have submitted 110 shop applications
- Long-term, we believe JCP will grow sales and achieve ~40% gross margins

Dividend cut has caused forced selling by yield investors

Ron has been CEO for 106 days

Valuation

What Sales Could the New JCP Generate?

Within several years we believe JCP's sales per square foot will recover to the 2007 peak of \$177, with potential for substantial upside

Sales Build:		2011	2015		
Sales per foot	\$	154	\$	177	
Gross Square Ft. (mm)		112		112	
Sales	\$	17,260	\$	19,824	
% increase vs. 2011				15%	

Sales Per Gross SF Comparison:

Store	Sales/Ft	vs. JCP 2011	vs. JCP Peak
JCP ('07 Peak)	\$177	15%	
Macy's	174	13%	
Kohl's	194	26%	10%
TJ Maxx	285	85%	61%
Nordstrom	431	180%	144%

Meaningful opportunity to grow sales versus 2011 levels <u>and</u> peak

What Could the New JCP Earn?

We believe JCP could earn ~\$6.00 per share in 2015

Illustrative P&L

Sales	\$ 19,824	<sales '07="" peak<="" sqft="\$177," th=""></sales>			
Gross Profit	7,930				
% Margin	40%	<mgmt's guidance<="" long-term="" td=""></mgmt's>			
SG&A	4,850	<\$900mm of cost saves, less inflation and volume adj.			
% of Sales	24%				
D&A	700	<40% above Itm reflects higher capex			
% of Sales	4%				
EBIT	2,379				
% Margin	12%	< 100bps below mgmt's long-term guidance			
2015 EPS	\$ 6.00				

Assumptions:

Conservatively assumes inflation does not benefit revenue
- (New Sales - 2011 Sales)*.10 = SG&A impact of higher sales
Implies that ~40% of SG&A is variable

All EPS dilution assumes \$50/share

EPS excludes: Real estate and other, and qualified pension expense

\$230mm of interest expense and 37% tax rate

Management's long-term guidance: 1/25/2012 analyst day presentation

⁻ SG&A Inflation: (\$5,144-900)*(1.02^4-1)

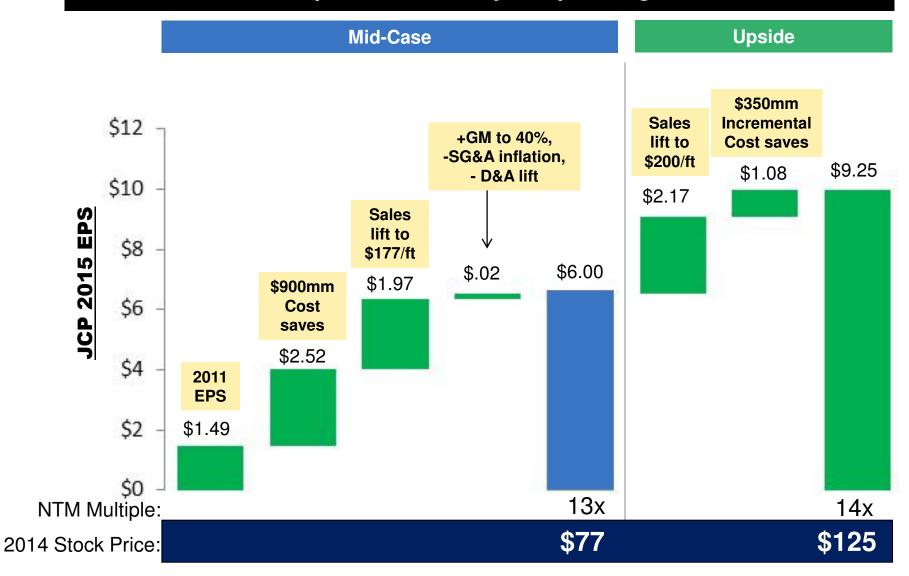
What Could the New JCP Earn?

Leverage to additional improvement

- Every 5% increase in sales adds ~80c of EPS
- Every \$100mm of SG&A reduction adds ~30c to EPS

Mid-Case			Upside		
Sales/sf	\$	177		\$	200
Cost Saves		900			1,250
2015 EPS	\$	6.00		\$	9.25

We think JCP is cheap under a variety of operating outcomes:



All EPS dilution assumes \$50/share; all stock prices adj. for option and warrant dilution; earnings adj. for restructuring charges, qualified pension expense, real estate and other, and markdowns related to new pricing strategy Stock price includes \$1/share for REIT interests and other non-core real estate

Good Downside Protection

Cost Opportunity:

The \$900mm cost opportunity alone generates ~\$2.50 of EPS or \$30 per share of value at 12x EPS

Real Estate:

JCP controls 112mm sf of high quality real estate through long-dated, low-cost leases at ~\$4/sf (51%), as well as outright ownership (49%)

\$11+bn replacement cost

Think Big

What Will the New JCP Look Like?

JCP will become a mall within a mall, with 100 high-quality, branded tenants:















The model works: JCP's Sephora shops generate \$600+ of sales per square foot

What Will the New JCP Look Like?

What's the sales potential?

- Specialty stores in 80% of JCP's malls earn an average of \$300+ in sales per square foot
- If JCP becomes a collection of specialty stores, why can't its sales approach specialty store levels?



What is the Potential Upside?

JCP has high sales potential plus a major cost advantage



Other advantages:

- JCP will have a flexible, diversified portfolio of 100 brands, reducing fashion risk
- Even at its current sales level, JCP has greater scale than nearly all other specialty stores

Think Big

How much would JCP be worth if it had sales per square foot approaching that of a specialty store?

In-Store Merchandise Sales/sf	\$250	\$300	\$350
Total Sales	\$ 31,000	\$ 36,600	\$ 42,200
Gross Profit	12,400	14,640	16,880
Gross Margin	40%	40%	40%
SG&A	5,968	6,528	7,088
% of Revenue	19%	18%	17%
D&A	1,000	1,000	1,000
EBIT	\$ 5,432	\$ 7,112	\$ 8,792
% of Revenue	18%	19%	21%
EPS	\$14	\$18	\$22
Multiple	14.0x	14.0x	14.0x

Share Price	\$191	\$253	\$315
Multiple of today's share price (\$26)	7x	10x	12x

Additional upside: Store growth, buybacks, dividends