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EARNINGS

Jump in Shoplifting Hurt Penney

Lack of Security Tags Meant Open Season for Thefts



J.C. Penney's stock was up 8.4%. *GETTY IMAGES*

By **SUZANNE KAPNER**

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Shoppers are buying more at J.C. Penney Co. They're also stealing more.

The retailer said Wednesday that theft spiked in the third quarter after it removed sensor security tags from merchandise while it shifted to a new inventory-tracking system that uses radio tags.

Shoplifting took a full percentage point off the department store chain's profit margins during the quarter, Chief Executive Myron "Mike" Ullman said. That was just one more weight that dragged the 1,100-store chain down to a loss of nearly half a billion dollars even as it showed some improvement getting long disaffected customers to spend again.

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Penney is struggling to right itself after a disastrous overhaul under former Apple Inc. executive Ron Johnson, who drove customers away when he did away with promotions and eliminated in-house brands in an effort to simplify and modernize the chain's offerings.

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That bad bet pushed Penney into a loss of \$1 billion last year and continues to plague the company. The need to liquidate old inventory did further damage to profits in the last quarter and will continue through the end of the year. Penney also wrote down the value of

some tax offsets by \$184 million.

In all, Penney reported a loss of \$489 million for the three months ended Nov. 2, compared with a year-earlier loss of \$123 million. Sales fell 5.1% to \$2.78 billion, compared with a drop of 27% a year earlier.

Sales excluding newly opened or long closed stores fell 4.8% in the third quarter, but ticked up in October for the first time since December 2011. Mr. Ullman stuck to his forecast that they would be positive in the crucial holiday quarter as well, finally stopping a long slide.

Store traffic was up in November, and the company said it is doing a better job of getting browsers to buy.

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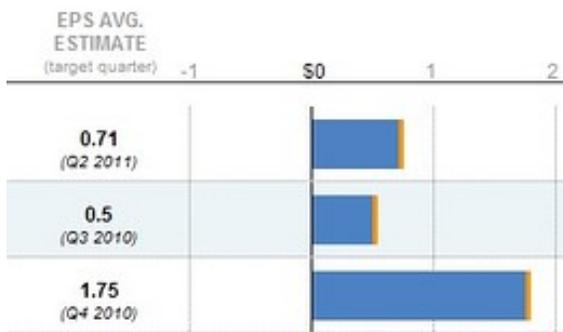
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Then there is the shoplifting. Penney unveiled plans in early 2012 to add radio frequency identification, or RFID, tags to every item in its stores.

The tags are more expensive than traditional bar codes, but they promise to make it easier to manage inventory. Sensor tags designed to prevent theft were removed from merchandise, because they would have interfered with the radio frequency, a person familiar with the situation said.

At the same time, Penney had switched to a friendlier return policy that did not require customers to present a receipt. The combination gave people the opportunity to grab armloads of merchandise off store shelves, walk over to a cash register and return the goods on the spot, the person said.

Mr. Ullman indicated on a conference call with analysts Wednesday that the move away from sensors actually encouraged thieves to come to Penney. Competitors were still using the devices, so "most of the theft comes to our place," he said.

Penney, which scaled back its storewide RFID ambitions in January, said that rising store traffic had made thefts a big enough problem in the August to October period to disclose to investors.

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The company is now retagging items on the sales floors with sensors, as well as tagging those that it is bringing in. It also recently tightened its return policy by giving store credit, rather than a refund, to customers who return goods without a receipt and are unable to produce the credit card used for purchase.

Mr. Ullman also said the bulk of the effort to clear old inventory should be completed in the first quarter of the new year.

"As we come out of the third quarter and go into the fourth, obviously we're seeing traction, and we're seeing things move in the right direction," Kenneth Hannah, Penney's chief financial officer, said on the conference call to discuss earnings.

Nevertheless, executives declined to give a time frame for when Penney's earnings before interest, taxes, depreciation and amortization—a measure of its ability to generate cash—would turn positive.

Mr. Hannah said he and Mr. Ullman would be in a better position to get "a little more specific around 2014 and Ebitda" when the company reports fourth-quarter earnings. But for now, he said, "we're not ready to provide that level of detail."

Analysts are closely watching Penney's earnings for clues as to whether it will be able to get through this year without raising more money. Penney said it would end the year with more than \$2 billion in cash and borrowing ability, unchanged from its previous forecasts.

Penney's shares closed up 8.4% on the day at \$9.44, as investors latched on to Mr. Ullman's comments about the all-important year-end shopping season. The stock remains down more than 52% on the year.

"Our margins are not yet improving as much as sales, but we are making progress," Mr. Ullman said.

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