Retail

JCP Beats the Street, Lowers Guidance

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In what is clearly an unexpected reaction, **JCPenney** (JCP) is rising after the company beat consensus estimates for the fourth quarter but guided lower for the upcoming quarter and year. Certainly, the better results deserve applause, but the guidance is disappointing.

What may be giving market participants some reason for optimism could be the ability of the company to move inventory out the door and manage its cost in the process to offset margin declines. Perhaps, it is just an opportunity to cover some shorts or take a flier that the worst in retail may be already priced into the stock.

JCPenney has taken an aggressive expansion plan, opening a slew of new stores in the last five quarters. This is a big bet that -- if it pays off -- will handsomely reward buyers at these levels. If it fails, however, then the company will have to dig deeper to manage its debt and additional SG&A.

JCPenney reported EPS from continuing operations of $1.93 for fourth quarter 2007 and $4.90 for the full year. Net sales for the quarter were $6.39 billion vs. $6.66 billion in the year-ago quarter. Fourth quarter 2006 was a 14-week period, however, while fourth quarter 2007 was a 13-week period. For the 52-week full year 2007, net sales were $19.86 billion vs. $19.9 billion in the 53-week year of 2006.

Management kicked off the call with the obligatory verbalization of how challenging the environment is and how the company is preparing itself to be better-positioned for competition in 2008. Inventories are "well-balanced" as JCPenney moved merchandise on clearance. The company reported strong sales for the Thanksgiving weekend, and January was better than that of its competition.

Same-store comps declined 2.3%, while Internet sales continue to grow fast. The best performance came out of the Northeast, and the softest region was the Southeast. Women's and children's apparel were the strongest categories, while jewelry and home were the weakest. The Sephora store concept had a strong holiday season and continues to perform above expectations.

Gross margins declined 180 basis points and were negatively impacted by promotional sales pricing. Inventories now stand at 7.1% above last year's level, including the 50 new stores opened in 2007 and the 11 new stores to be opened in first quarter 2008. Total square footage is expected to increase by 3.5% for the new 2007 stores and 2.5% for the new 2008 stores.

SG&A improved by 180 basis points. Operating profits increased by 10 basis points. The income tax rate was 37.2%.

JCPenney ended the quarter with $2.5 billion of cash and investments vs. $3.7 billion of long-term debt. The debt-to-leverage ratio rose to 1.6-to-1 from 1.5-to-1 at the same time last year.

Management guided first-quarter 208 EPS to a range of 75 cents to 80 cents vs. consensus at 80 cents and full-year 2008 EPS $3.75 to $4.00 vs. consensus at $4.02. Sales are expected to increase slightly in the first quarter and low single digits for the full year.

JCP Preview: Looking Ahead

JCPenney
(JCP) is expected to report fourth-quarter and full-year 2007 results (ended Jan. 31, 2008) and conduct its quarterly conference call before the market opens on Thursday morning.

Analysts expect JCPenney to earn $1.77 per share on net sales of $6.39 billion in the quarter, and for the full year, the company is expected to earn $4.60 per share on net sales of $19.86 billion. In the prior year's fourth quarter, JCPenney earned $2.00 per share on net sales of $6.66 billion, and for 2006, the company posted EPS of $4.91 on net sales of $19.90 billion.

Clearly, JCPenney is expected to bear some burden from the slowing consumer and the relatively weak holiday shopping season. Please note that the quarter will also include post-holiday sales, including those related to gift card redemptions and the Martin Luther King Day holiday weekend.

In 2006, JCPenney was a sweetheart comeback story, but 2007 was a totally different picture for the company. It appears that this retailer was able to restructure and reform its business with a great deal of short-term success but those benefits did not extend into 2007. This has not distracted Chairman Mike Ullman from launching new brands and concepts, hoping to capture consumers with better offerings once they return to the stores.

The conference call will focus more on looking ahead, both in terms of the near-term Presidents' Day weekend results and the rest of the year as retailers greatly anticipate the benefit of tax rebates to consumers.

At the time of publication, Rothbort had no positions in the stocks mentioned, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

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