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J.C. Penney's Survival: What Are the Odds?

Bankrupt J.C. Penney has a fighting chance to recover in the eyes of some but not all retail experts.

By David Moin and Sindhu Sundar on May 18, 2020

A J.C. Penney mall store.
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For J.C. Penney, ensuring survival is an awesome task.

Extinguishing debt, fresh financing, closing weak stores — all of that is enabled through the bankruptcy, yet that doesn't guarantee a lasting turnaround of the lumbering retail giant.

What's got to happen? The image must be widened to appeal to Millennials — many have never stepped into a Penney's store. At the same time, the $11 billion retailer must not lose its grip on its traditional blue-collar clientele. That happened in the past during the infamous Ron Johnson regime, and it was disastrous.

Furthermore, the value proposition must be strengthened to win back customers who have defected to the likes of Kohl's, Walmart, Amazon, T.J. Maxx, Primark and Macy's. And J.C. Penney needs to drive business on its long lagging web site.

There's no question the company seems dated, lacks flair and has been losing market share and relevance.

But under the leadership of Jill Soltau, the retailer's chief executive officer and first true merchant at the helm in 15 years, there's been an effort to declutter and reorganize the selling floors into lifestyle departments for easier shopping and some style. There's also been cost cutting and some margin growth, and Soltau has rebuilt the management team with talented, experienced executives — no small feat considering Penney's sinking fortunes.

On top of all that, there's finally a resolve to pare way down the fleet of about 850 stores by at least 25 percent. Many of the stores now temporarily closed due to the pandemic will never again see the light of day. And thousands of employees — Penney's has 85,000 — will lose their jobs.

On Friday, it filed for Chapter 11 bankruptcy, sparking an emotional industry debate on whether the 118-year-old company can survive and thrive in the new retail era. While bankruptcy provides a lifeline, it's a painful process that distracts management from day-to-day operations and delays much of the repair work that's needed.

"Bankruptcy is an extraordinarily time-consuming and expensive process," observed Allan Ellinger, senior managing partner of MMG Advisors. "The retailer has to strengthen its legal and accounting representation and so do the creditors that the company pays for. The retailer is forced to engage all of these professionals and ultimately it reduces the amount of money that is available."

On the other hand, "Bankruptcy allows the retailer to nullify all of its employment contracts and leases and start with a clean slate," Ellinger added.

Further complicating matters is that Penney's is exploring different scenarios for its future. While striving to revive its own business, it also will be considering a possible sale of the company. Malls owners in particular don't want Penney's to disappear. There are already too many vacancies in shopping centers and the absence of a big anchor would trigger other retail departures due to co-tenancy clauses enabling specialty stores to get out of leases if an anchor permanently closes.

Yet troubled retailers such as J.C. Penney have an innate ability to generate cash and hang on for years, even if quarter after quarter they fall short on the top and bottom lines. Just look at its longtime rival and equally iconic retailer, Sears, which under the ownership of Edward Lampert, has been more a tool for financial engineering than retailing but still occupies many mall anchor sites.

That J.C. Penney was able to enter the proceedings on Friday with a restructuring plan supported by 70 percent of its first lien lenders demonstrates its staying power and its lenders' faith in its survival through the coronavirus pandemic, Joshua Sussberg of Kirkland & Ellis LLP, an attorney for J.C. Penney, told U.S. Bankruptcy Judge David Jones at a remote hearing Saturday that had more than 300 listeners call in.

The plan would facilitate a reorganization that would separate J.C Penney's operating assets and its real estate assets and form a public real estate investment trust that would own properties. Sussberg pointed out that J.C. Penney has "significant unencumbered real property" worth up to $1.4 billion.

The restructuring agreement also envisions the possibility of a sale, for which there is "robust interest" from third parties, said Sussberg, though he didn't name any potential buyers. "There are third parties interested in investing, and in buying this business," he said.

The company's existing first lien lenders also support its proposed debtor-in-possession financing package, which Sussberg described as a $900 million facility, of which he said half would be used to pay off the retailer's pre-petition secured debt, while the other half would be new money that would go into the business.

The first $225 million of that new money financing would become available when the court grants its initial approval, after a hearing on the DIP that is scheduled to take place in early June, he said, while the other $225 million would become available in two months. But in the meantime, the company has also already paid a 10 percent commitment fee, Sussberg said.

Some industry experts aren't so optimistic about J.C. Penney. JUSTIN LANE/EPA-EFE/REX/Shutterstock

"I really wish Penney's is successful — absolutely. Just think about the thousands of employees there," said Michael Gould, the former chairman and ceo of Bloomingdale's. "But I don't think Penney's has a viable future in retail. I have felt this way about Penney's for three years, since way before the terrible coronavirus. They don't have the capital to drive the redo of stores, to compete online. The business would go to Kohl's, Macy's, T.J. Maxx and places like that. It's very dismal for them, and I don't think they are integral to the vast majority of malls around the U.S.

"Sephora inside Penney's does a good percentage of their business," and if Penney's disappears, "Sephora will take that business elsewhere.

"It's also about the merchandising," Gould added. "What is their direction? What are they trying to do? If they disappear in a mall, what does that mean? Half the malls they are in are going to disappear anyway, regardless of Penney's. I don't see where their path is, how they are differentiating. You can't play catch up. It's a matter of either being ahead of the game or not in the game."

Prof. Erik Gordon of the Ross School of Business at the University of Michigan said Penney's immediate problem "was to avoid having to shovel cash to creditors when cash wasn't coming in the door. Bankruptcy gives the company relief from that, but it doesn't solve the fundamental problem that one ceo after another has failed to solve. It won't lure back former customers who were disappointed by merchandising surprises and stockout failures and were turned off by stores that should have been remodeled ten years ago."

But Ellinger thinks J.C. Penney can survive. “There’s a real merchant running the business, Jill Soltau. Her three predecessors were not. You need a merchant to run the company. She has assembled a good team. J.C. Penney has been the victim of poor management.

“It will restructure and reboot. It has a reason to exist. It fulfills a need in the mid-tier market. J.C. Penney has a very recognizable and respected name, and there is still a consumer that puts trust in the name, and a lot of malls are clearly dependent on J.C. Penney as an anchor store. The industry would like to see it survive. It has to prune itself, shed all those unproductive stores, at least 20 to 25 percent,” Ellinger said.

“Jill Soltau has an opportunity to similarly reinvent the business. I think vendors are going to rally behind her and help her. J.C. Penney accounts for a lot of mid-tier vendor distribution and business. With shoppers, once they see a reincarnation of the business, word can spread pretty fast. That’s where marketing comes in. Soltau and her team will have to be very creative. This reincarnation requires decisiveness, speed. The stores have to be less cluttered, aspirational in their appeal, and cool enough to attract a Millennial customer. When they walk into the store or shop online, they have to see there’s good value, and Penney’s will have to instill as much service as they can.…I really believe there is an opportunity,” he added.

With the Simon Property Group establishing a $6 billion line of credit, “they will still be able to meet their mortgage payments, and I believe it will also be used to buy a piece of some retailers and keep them in the mall. They want to avoid having a lot dark space in the mall,” said Craig Johnson, president of Customer Growth Partners.

“There is a revival path. It’s not easy. Penney’s is a nice, white bread, middle American brand, but the concept of the department store is much changed now. It’s not relevant to Millennials. Penney’s was always a point of destination for younger new households, a good place for good value. But they will have to drop hundreds of stores to be economically viable and that will be a huge issue for some mall operators. It may be a bridge too far, this isn’t going to be cost free. They do have a decent house brand, Arizona, but some of the other brands are frankly aging. Penney’s never really fixed their brand portfolio the way Target has. Target has GoodFellow & Co, and got rid of Merona and Massimo.

“I’d like to see them make it, but you got to say it’s a long shot,” Johnson said. “How do you do it without getting your traffic up? To quote Yogi Berra, ‘If people don’t want to go to the ballpark, you are not going to stop them.'”

“Mid-tier retailing, it is a crowded space, but regardless of how we examine the industry, people are still buying $11 billion or so worth of stuff at J.C. Penney,” observed Kirk Palmer, of Kirk Palmer Associates, the executive search firm. “So if you take out the debt, restructure it down to only 30 percent of what it was, they should be able to make a profit off that kind of volume. If anyone can do it, it’s Jill Soltau. She knows the customer based on her background at Kohl’s, Sears, Shopko and Joann Stores. She knows the space well and she has brought in a good team. It looked to me as if Penney’s was gaining traction,” prior to the spread of the coronavirus.

One headache Penney’s is already encountering is from some opposition to the DIP proposal. On Saturday, an attorney for another lender group, Kris Hansen of Stroock & Stroock & Lavan LLP, argued that his clients had been “disenfranchised” in the discussions. Hansen said also that in the week leading up to the bankruptcy, the company had spent about $72 million, including $10 million in payments to the retailer’s senior executives, as well as $45 million in commitment fees on the DIP.

“It’s been an unfair process to those lenders who are not on the inside of the other group, and candidly, when we get to the DIP in June, you will see more closely that it is an exclusionary DIP,” Hansen said at the hearing.

Nonetheless, Penney’s advisers have sought to reinforce the company’s status as an American retail mainstay, describing it as an irreplaceable institution that survived more than a century that saw the Great Depression and World War II. It once had more than 2,000 stores but is now down to 846 and the store count will certainly shrink further.

But that narrative of endurance clashes with the reality of a company whose stock has plummeted, leaving its shareholders, including its former associates, questioning what they will be left with. J.C. Penney’s stock drops have led to the prospect of being de-listed on the New York Stock Exchange, which requires companies to have an average closing share price of at least $1 over 30 days. Its stock price is about 24 cents a share.

At Saturday’s hearing, Sussberg said the company is “in constant communication” with the stock exchange and the U.S. Securities and Exchange Commission, and that the company will make an announcement when it learns whether it will be de-listed.

“Whether or not the company is ultimately de-listed is a decision that is out of our hands,” he said at the hearing on Saturday.

In the company’s telling of the events leading to its bankruptcy, the retailer was in resurgence mode until it was derailed by the pandemic. Government-mandated store closures since March to rein in the spread of COVID-19 all but obliterated store sales, the company said in court filings, and caused the retailer to draw down its revolver of $1.2 billion, delay payments to vendors and furlough 77,000 employees, roughly 92 percent of its staff of about 85,000.

“This is absolutely about the coronavirus, this is about a governmental shutdown, and it’s about us all being on video chat for this hearing,” Sussberg told the court on Saturday. “There is no question that life as we know it came to a pause, and as a result, this company’s liability management efforts, and all the discussions we had, were no longer fruitful even considering.

“That revolver draw, which we have been using to fund operations, is resulting in an excessive cash burn, and the company simply cannot afford to live without a formal restructuring,” he said.

At the same time, in the hearing as well as in court filings, its advisers also alluded to the effect of its leverage and “burdensome capital structure.” As of its bankruptcy filing, the company had roughly $4.9 billion in debt, including about $1.2 billion on its ABL facility as well as $1.5 billion in term loans, and $500 million on its first lien notes.

On Saturday, the retailer’s attorneys sought approval for the company to access its roughly $475 million in cash collateral, which they argued it needs to fund operations during the bankruptcy and pay its employees. Jones granted interim approval to that motion, and also signed off on a number of other customary first day bankruptcy motions by the retailer, including to pay taxes and wages.

Access to the cash will be especially important in light of the ongoing stores closures and decline in sales, and “tightening trade credit” by its vendors, according to a declaration filed on Friday by James Mesterharm, a managing director at AlixPartners LLP, and restructuring adviser to J.C. Penney since March.

There is also the question of the impact of the pandemic on inventory values, the subject of much consternation among retailers trying to fund their bankruptcies while their products languish on store shelves. So far, J.C. Penney said that a “recent appraisal” of its inventory had led to a $71 million cut in its borrowing based by its ABL lenders.

“Based on my experience generally and my experience with the debtors in particular, approval of the use of cash collateral during the interim period is critical to the debtors’ ability to continue operating and restructure successfully,” Mesterharm said in his declaration.

“Without it, the debtors may have to pursue a liquidation in short order, to the detriment of their creditors and estates,” he wrote.

Jill Soltau’s revival plan for J.C. Penney got cut off by COVID-19. Courtesy Photo