



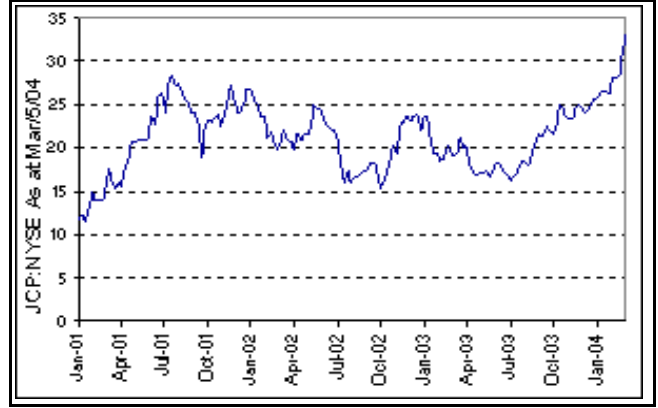
THE COMPANY

The JC Penney Company, Inc. operates two distinct divisions: the department stores/catalog division and Eckerd Corporation. The department stores/catalog division comprises over 1000 moderately priced department store chains located nationwide that offer family apparel, jewelry, shoes, accessories, and home furnishings. The Eckerd drugstore chain operates close to 2700 drugstores located through the Southeast, Sunbelt, and Northeast regions of the U.S.

FINANCIAL DATA

	2000	2001	2002
Earnings per Share (\$)	(2.81)	0.26	1.37
Price to Earnings (times)	N/A	65.4	12.4
Dividend (\$)	0.82	0.50	0.50
Dividend Yield (%)	4.80	2.90	2.90
Book Value (\$)	22.28	21.84	22.44
Price to Book (times)	0.76	0.78	0.76

HISTORICAL SHARE PRICES



WHY ABC FUNDS BOUGHT JC PENNEY

The JC Penney Company Inc. began when James Cash Penney opened his first retail store, called the Golden Rule Store in 1902 in the small mining town of Kemmerer, Wyoming. Since that time, JC Penney has grown to become a familiar household name in the United States offering a wide assortment of goods at reasonable prices. JC Penney entered the drugstore business in 1969 when it acquired the Thrift Drug. Between 1995 and 1997 it acquired several drugstore chains including the Fay, Kerr and Eckerd lines. By 1997 all drug stores were converted and then streamlined to the Eckerd name and format.

JC Penney shares reached a high of \$80 in June of 1998 after years of strong earnings growth. By that time however, many of JC Penney's department store customers were starting to flock to off the mall retailers such as Kohl's and Target, which offered centralized checkouts, bigger aisles and better signage. By the end of 1999, JC Penney shares had fallen to \$40, one half its \$80 peak. By the end of 2000 the shares halved again, falling to \$20 and by the end of 2000 could be purchased for less than \$10. The collapse was not without reason. JC Penney was clearly behind the times. At the end of 1999, JC Penney was still operating on a decentralized platform. All purchasing, marketing and pricing decisions were being made by the individual store manager. As a result, JC Penney stores had inconsistent merchandising assortments, delays in the procurement of goods and promotional limitations. Under the decentralized method, buying and marketing departments could not promote specific items because there could be no certainty that the item would be available when the customer arrived.

By 2000, JC Penney's board of directors decided it was time to make a change. In September, Allen Questrom was hired as the company's new CEO. A celebrity of sorts, Questrom made a name for himself by turning around the struggling May department stores and later the Federated Department store line. Upon arriving at the company, Questrom immediately put together a five-year plan for JC Penney that would see it transition to a centralized operating platform. This included opening 13 centralized distribution warehouses and shifting to centralized buying. Centralized buying would allow JC Penney to leverage its size with national brands while placing it in a stronger negotiating position to attain better prices. The plan also aimed to implement changes in marketing and store operations. For example, all advertising and signage would be consistent from store to store and would be supported by nationwide television and radio commercials. By the end of 2001, JC Penney had positive same store sales for the first time in 4 years. In 2002, JC Penney earned \$1.37 a share: the first increase in earnings since 1998.

We believe that based on JC Penney's current share price, the market is undervaluing the sum of its parts. Essentially, JC Penney's share price represents a very good deal-buy JC Penney and gets Eckerd for free. Based on comparable market multiples of publicly traded companies, we believe that the department stores alone are worth the price of the shares. In fact, the combined net asset value, or break-up value of JC Penney and Eckerd together is likely worth between \$26 and \$28 per share. At current levels, JC Penney shares sell at a 38% discount to our net asset value and a 24% discount to its book value of around \$22. Downside risk in the stock should be mitigated by its tangible book value of \$12 and its 3% dividend yield. We are confident that the market will eventually price JC Penney in line with its book and net asset value. With warmer spring weather soon approaching the Northeastern United States, we believe this gap could very well narrow if JC Penney can string together a few consecutive weeks of positive same store sales.

UPDATES

On August 12th, JC Penney reported results for the second quarter. The company lost \$0.02 per share compared with a loss of \$0.05 in last year's quarter. Analysts had expected a loss of around \$0.05 per share. JC Penney's department store and catalog divisions performed very well. Comparable department store sales increased 2.1% while operating profit more than doubled to \$51 million from \$22 million last year. Catalog/internet sales increased 3.9 percent, representing the first quarterly sales gain in three years.

Conversely, results at JC Penney's Eckerd drugstore division were clearly disappointing. Operating income for the quarter declined 26 percent to \$54 million compared with \$73 million last year. Profit margins declined by 60 basis points while comparable store sales decreased 0.8 percent. Management believes that the decreases in sales and margins are a result of increased competitor store openings, particularly in Florida and Texas coupled with execution issues. We believe the recent deteriorating results at Eckerd could prove to be a catalyst for the company by either prompting a change in management or bringing about an outright sale of the company.

JC Penney shares have appreciated 20 percent since our original recommendation in May. We believe the sum of the department store and Eckerd drugstore divisions is likely worth between \$26-\$28 per share, representing a further 30 to 40 percent appreciation from the current share price. In addition, JC Penney still trades below its book value of \$22.65 a share. Performance at the department stores should remain strong in the third quarter. Other department store companies have already reported strong sales in many back-to-school categories, an area in which JC Penney has traditionally been very strong. It should also be noted that child tax credits are now arriving in the mail with some families receiving as much as \$400 per child.

ABC Funds
September 5, 2003

JC Penney's third quarter results continued to trend as they did in the second quarter. Results at the department store and catalog/internet division performed well with operating profit up 22% to \$207 million compared with \$170 million in last year's period. These results were driven by strong back to school sales and a 190 basis point improvement in gross margin. Conversely, results at Eckerds continue to disappoint. Operating profit fell 57% to \$34 million from \$79 million last year. The drugstore chain continues to be hurt by poor execution and strong competition in the Texas and Florida markets.

JC Penney shares have appreciated nearly 40% since its second quarter results last August. We believe that much of what has driven this rally is speculation by the investment community that JC Penney is preparing to sell the struggling Eckerds drug store chain by the end of the year. Recent articles in both the Wall Street Journal and the Financial Times appear to confirm these rumours. Both newspapers, citing sources familiar with the situation, are reporting that a number of interested parties have already submitted bids for the Eckerds assets.

We believe that news of an Eckerds sale will be positive for JC Penney shares. First of all, with Eckerds out of the picture, JC Penney will once again be a pure department store play. As a result, its shares could command a higher price earnings multiple than its present valuation as a holding company. Second, with the proceeds from a sale, JC Penney would be able to substantially reduce its long term debt. This would give JC Penney a stronger balance sheet and would likely result in a better credit rating. Finally, in the event of a sale, we expect that JC Penney would generate a greater amount of free cash flow. This increase in free cash flow might be used to increase JC Penney's dividend, which now stands at \$0.50 per share, or even fund a share buyback.

ABC Funds
December 5, 2003

JC Penney reported that same store sales rose 6.4% in January. This growth rate exceeded the company's expectations. The increase reflected early success in spring apparel as well as the successful clearance of seasonal merchandise. Catalog and Internet sales increased 9.8%, which was also above plan. It is interesting to note that JCPenney.com has now become one of the largest apparel and home furnishing sites on the Internet with 2003 sales exceeding \$600 million.

As we move into JC Penney's 2004 fiscal year, it is becoming clear that the company is getting closer to selling its struggling Eckerds division. On January 30th, JC Penney officially announced that it has provided substantial information to interested parties and that discussions are currently talking place. Further, on February 6th, the Wall Street Journal reported that JC Penney has received at least two bids for the drugstore division. CVS Corp, a U.S. drugstore chain, and Quebec based Jean Coutu Group have apparently both made offers for the Eckerds. The offering price is said to be in the range of \$4 to \$5 billion or between \$14.65 and \$18.31 per JC Penney share.

UPDATES (cont'd)

We continue to believe that selling Eckerd would be positive for JC Penney shareholders. Without Eckerds, JC Penney would once again become a pure department store play and its shares could command a higher multiple. Also, with the proceeds from the sale, JC Penney could pay off all of its long term debt and use the excess cash to fund a share repurchase and/or a possible dividend increase.

ABC Funds
February 13, 2004

We purchased JC Penney in August 2003, with an initial target of \$25 a share. At this time, we felt that we were buying the JC Penney department stores and essentially getting its Eckerds drugstore chain for free. When it became evident that JC Penney was in fact planning to sell Eckerds, we moved our target on the stock to \$30.

With shares of JC Penney currently trading above \$30, our primary target has now been met. However, while we originally purchased JC Penney as a deep discount investment, the shares appear to have entered a momentum phase at this time. We believe this is due to the company's recently announced better than expected fourth quarter results and that a sale of Eckerds appears to be imminent.

Although we see further upside potential in JC Penney shares, the company is no longer a deep discount investment. Therefore, we have chosen to be prudent and have sold half of our position in the company. It is important to remember that no definitive agreement has been reached pertaining to the sale of Eckerds. Should JC Penney decide not to sell Eckerds or should the sale occur at too low a price, the shares could come under pressure and fall back to the mid \$20 level.

ABC Funds
February 27, 2004

On February 27th 2004, we reported that we had sold half of our position in JC Penney. Although shares of the retailer had reached our target of \$30, we felt that the stock had momentum. This week the stock rose a further 7-8% and with this appreciation we believe the stock is no longer fundamentally undervalued. With a good earnings announcement and the pending sale of Eckerds, the shares have mostly factored in all the positives. As a result, we decided to sell the remainder of our shares. We believe it is prudent at this time to take our profits and reinvest the proceeds in new and undiscovered deep value stocks.

ABC Funds
March 5, 2004