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PRESENTATION

Operator

Greetings, and welcome to the Nordstrom Third Quarter Earnings Conference Call. (Operator Instructions)

We will begin with prepared remarks followed by a question-and-answer session. (Operator Instructions) As a reminder, this conference is being recorded.

At this time, I'll turn the call over to Trina Schurman, Director of Investor Relations for Nordstrom. You may begin.

Trina Schurman

Good afternoon, and thank you for joining us. Today's earnings call will last 45 minutes and will include around 30 minutes for your questions. Participating in today's call are Blake Nordstrom, Co-President; and Anne Bramman, Chief Financial Officer, who will discuss the company's third quarter performance and the outlook for 2018.

Before we begin, I want to mention that we'll be referring to slides, which can be viewed by going to Nordstrom.com in the Investor Relations section. Our discussion may include forward-looking statements, so please refer to the slides showing our safe harbor language.

With that, I'll turn the call over to Blake.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Good afternoon, everyone, and thank you for joining us today. We're focused on our aspiration to be the best fashion retailer in a digital world through our 3 strategic pillars: one, providing a compelling product offering; two, delivering exceptional services and experiences; and three, leveraging the strength of our Nordstrom brand.

For the third quarter, we achieved total sales growth of 3% and a comp sales increase of 2.3%. This demonstrated ongoing strength in our Full-Price and Off-Price businesses. Our early investments in our digital capabilities are paying off. The combination of our digital capabilities and local market assets have enabled us to be at the forefront of serving customers on their terms.

Last month, we celebrated the 20th anniversary of Nordstrom.com. This business has grown to roughly 2.5 million visitors per day, ranking among the top 10 e-commerce retailers in the United States. Year-to-date, overall digital sales grew 20% and made up 30% of our business.

Before I provide an update on our key initiatives, I'd like to address the estimated earnings per share charge of $0.28 taken in the third quarter. In a recent review of credit card accounts, we identified some cardholders with delinquent accounts being charged higher interest in error. We estimate that less than 4% of Nordstrom cardholders will receive a refund or credit, with most receiving less than $100. We have taken action, including the appropriate steps to ensure the problem is addressed and does not happen again. We sincerely apologize to these cardholders. We realize customers and shareholders place a great deal of trust in us, and that's a responsibility we take seriously.

Excluding this charge, our third quarter earnings were slightly ahead of our expectations, and Anne will provide further details of this matter in her remarks.

Looking ahead, we're scaling generational investments in our digital businesses and new markets. Nordstromrack.com and HauteLook are on track to exceed $1 billion in sales this year. Trunk Club has delivered sales growth of nearly 50% year-to-date, demonstrating successful efforts to improve the customer offer.

We continued our expansion into Canada with 3 additional Racks: in Toronto, Edmonton and Ottawa. Our 6 Rack stores open to date are performing ahead of our expectations. We expect further synergies from having a Full-Price and Off-Price presence in this market.

Last spring, we took our first step in serving customers in Manhattan with our Men's Store. We're building on our initial learnings as we focus on expanding our presence in this premier retail market with our flagship women's store opening planned in fall 2019.

Our strategy in our local markets is another cornerstone of how we will win with customers and drive increased shareholder value. Through our focus on our top markets, we are leveraging our inventory, along with our digital and store capabilities, to serve customers in new and relevant ways. We're on track with our rollout beginning in Los Angeles, our largest market. We believe that when executed at scale, we can better serve customers, driving market share gains, engagement and improved profitability.

Last month, we introduced Get It Fast, a new feature that gives customers a significantly expanded view of merchandise selection that's available next day in the Los Angeles market. Since the launch, we have seen a 50% lift in Buy Online and Pick Up in Store. This is a great example of how we're leveraging our digital and physical capabilities to increase convenience for our customers.

Enabled by our supply chain investments, we have potential to increase selection by 4 to 7x for product available same or next day in a given market. To support customers on the West Coast, we recently announced plans to open a new fulfillment center and a local omnichannel hub next year. These facilities should increase inventory efficiencies, and more importantly, they should significantly improve the customer experience by getting product to them faster.

Nordstrom Local, which are small neighborhood hubs, provide customers with more convenient access to our services. A year ago, we opened our first Nordstrom Local in West Hollywood. Encouraged by our initial results, we recently introduced 2 additional locations: in Brentwood and downtown Los Angeles.

In addition to service and convenience, providing newness is an integral part of our merchandising efforts. Our strategic brand partnerships enable us to offer compelling products to customers and strengthen our product margin. In the third quarter, our strategic brand made up roughly 45% of our full-priced sales.

Our partnerships with influencers are an important way we're creating inspiration and a sense of discovery for customers. Following a successful launch last fall, we partnered with Arielle Charnas to introduce a new stand-alone brand, Something Navy. Additionally, we launched a collaboration between Atlantic-Pacific and our private label brand, Halogen. Both product launches outperformed our expectations.

We're also leveraging the Nordstrom brand to drive increased customer engagement. We know that when customers engage with us across various touch points, both their trips and spend increase. Our robust loyalty program gives us the opportunity to serve customers in a more personalized way. We have more than 11 million loyalty customers contributing 56% of year-to-date sales, an increase of roughly 15% over last year.

Last month, we launched The Nordy Club, an evolution of our loyalty program that offers enhanced services and experiences and a faster earn rate for credit card members. While it's still early, we're encouraged by the uptick in enrollment trends. We look forward to building on the connections our customers have with our brand through The Nordy Club.

As we head into the fourth quarter, we're focused on establishing Nordstrom as the gift-giving destination and making it more convenient to shop. We're well positioned to improve the customer experience and believe our combination of digital capabilities and local market assets, our people, product and place, make us uniquely positioned for success in the market.

I'll now turn it over to Anne to provide additional insights into our results.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Thanks, Blake. Before I discuss the drivers of our third quarter performance, I'd like to provide additional color on the nonrecurring charge.

As Blake mentioned, in a recent review of credit card accounts, we identified some cardholders with delinquent accounts being charged higher interest in error. This occurred as a result of settings implemented in 2010. We estimate that less than 4% of Nordstrom cardholders will receive a refund or credit, with most receiving less than $100. We are currently assessing the impact to each individual account and will communicate directly with impacted cardholders. We estimated nonrecurring costs of $72 million or $0.28 in EPS, primarily representing refunds and other fees, which we recorded in SG&A in the third quarter.

Excluding this charge, we expect to achieve an inflection point for profitable growth this year. We're focused on 3 key deliverables to increase shareholder returns: continuing market share gains, improving profitability and returns and maintaining disciplined capital allocation.

Starting with our first deliverable, continuing market share gains. Our third quarter reflected consistent underlying sales trends. As you may recall, we know the timing considerations that impact year-over-year comparisons, including the new revenue recognition standard and event shift, resulting from last year's 53rd-week calendar. We reported third quarter total sales growth of 3%, which included an unfavorable timing impact of roughly 100 basis points from Q2. As a reminder, this primarily represented in-transit sales that were recognized as shipment under the new revenue accounting standard rather than deferred. At the end of the second quarter, there was an elevated impact due to the high volume of online anniversary sales. Given these timing considerations, we're continuing to provide color on comparable sales, which are aligned with the 53rd-week calendar in 2017.

In Full-Price, underlying trends were consistent and in line with our expectations. This reflected ongoing strength of strategic brands, which grew 8% over last year. The Full-Price comp increase of 0.4% was impacted by planned anniversary turns from last quarter. To normalize for this, Q2 and Q3 combined Full-Price comps increased by 2.5% compared to flat comp growth last year.

We're pleased with the momentum in our Off-Price business, which delivered a comp sales gain of 5.8% and exceeded our expectations across all merchandise divisions. This reflected our focused efforts throughout the year to accelerate inventory turns and strengthen our merchandise assortment.

Moving to our second key deliverable of improving profitability and returns,generational investments are continuing to scale. These investments contributed approximately half of our year-to-date net sales increase. We're tracking against our expectations for 2018, which we shared at the beginning of the year. Generational investments are expected to deliver $1.8 billion in sales and achieve our EBIT plan.

Our strength in product margin is another driver of long-term profitable growth. For the year, we remain on track for product margins to be flat or slightly up. Third quarter gross profit decreased 137 basis points from last year, and this was primarily due to timing, including Q2's revenue recognition impact of $30 million, in addition to off-price mix. Year-to-date, our gross profit rate decreased 19 basis points, consistent with our expectations. This reflected flat product margins and occupancy rate, offset by the mix from off-price growth.

Ending inventory increased 7% over last year, primarily due to timing associated with holiday. We pulled forward receipts to set holiday product earlier as part of our strategy. In addition, we had higher inventories in-transit due to the end of the quarter, shifting 1 week closer to holiday relative to last year. Excluding this timing impact, Q3 inventory growth approximated sales growth. We expect to end the year with inventories in line with sales growth.

Excluding the nonrecurring charge, our SG&A rate was generally flat to last year. This reflected ongoing progress in bending the curve in expense growth. Our digital capabilities in marketing, technology and supply chain are critical enablers of the customer experience.

Through productivity improvements, we expect moderate expense growth for our digital capabilities to mid-single-digits this year compared with 10% annual growth over the last couple of years. Excluding the nonrecurring charge, our overall SG&A grew 6% year-to-date, on track for mid-single-digit growth for the year.

Our third key deliverable is maintaining disciplined capital allocation. Our long-term philosophy is to have a consistent and balanced approach between reinvesting in the business and returning cash to shareholders while maintaining an investment-grade credit rating. Year-to-date, we generated operating cash flow of approximately $640 million and free cash flow of around $250 million. In August, our board authorized a $1.5 billion share repurchase program, and we repurchased $70 million in the third quarter.

Turning to our full year expectations. We updated our annual EPS outlook to incorporate third quarter results, raising the low end of our range by $0.05, when excluding the nonrecurring charge. From a top line perspective, we are assuming a continuation of underlying trends with a comp increase of approximately 2% for the year, compared with our prior outlook of 1.5% to 2%. As a reminder, for the fourth quarter, we expect leverage on occupancy expenses as a result of fewer Rack store openings. We will also lap a one-time employee investment of $16 million associated with last year's tax reform.

To wrap up, we expect to achieve an inflection point for profitable growth this year when excluding the nonrecurring charge. We remain focused on strengthening our product margins, scaling our generational investments and improving our expense efficiencies. We are well positioned to execute against our long-term plans and deliver a differentiated customer experience.

I'll now turn it over to Trina for Q&A.

Trina Schurman

Thanks, Anne. (Operator Instructions)

We will now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Jay Sole from UBS.

Jay Daniel Sole - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

Great, thank you. So I want to ask a question just on the guidance on 4Q. What's implied for 4Q just because of some of the variability in the comp because of calendar shifts and it could be inventory, it's a little bit higher for the timing shifts. What do you expect for a comp for Full-Price and Nordstrom Rack, generally speaking? And how has November started? And then also, what do you expect for gross margins in 4Q relative to last year?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Hi Jay, thanks for the question. So in general, the way that we are giving guidance for the full year, I think you can kind of back into it, we don't typically give guidance for between Full-Price and Off-Price. But I will say this, we set the total JWN comp guidance. It was really in-line with consistent trends that we see in the business over time. So if you -- we gave a comp guidance of 2% for the full year -- approximately 2%. I think if you look at underlying trends in both businesses, you can kind of back into what Q4's sitting at is pretty much in line with what we've seen for the rest of the year. As far as the margin components to it, as we talked about, we're expecting to get product margin to be flat to slightly up, and we're expecting to get some leverage out of our occupancy expense. And we believe, and kind of back into Q4, but based on our guidance, it would infer that we are at an inflection point for the year as far as the EBIT rate.

Operator

Our next question comes from Oliver Chen from Cowen.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

The holiday receipts being earlier, what are your thoughts on how that strategy has gone and what you continue to see with the buy now/wear now and versatility of the consumer preferences? And just a follow-up. The local fulfillment centers sound quite compelling with respect to really answering the consumer demand for speed. But how should we understand how that interplays with inventory efficiency? It sounds like you're being innovative about balancing the capital commitments relative to what can really happen when you unlock superior speed with your local market strategy.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Thank you, Oliver. This is Blake. In terms of holiday receipts, we tried to signal that in the last quarter's call. But as was pointed out in both Anne's and my comments, there was some timing factors, but we also felt it was important to be in a strong position as we got into the holiday season. There's a 1-week change with the holiday this year. But we've seen -- your question was if you've seen any outcomes from it. No question, last month, we saw some reaction to cold weather, so starting with outerwear and boots. So we feel optimistic about this holiday season. We've worked hard to take the friction out for the customer experience. And we want to be a destination for gift-giving, and that requires having the right product and being in-stock and adding that inventory where their demand is for the customer. So our merchandising team has really taken to heart both last year and previous year's holidays results and have made some adjustments to it. We think we're in a good position there. But again, we also try to convey that inventory management's important. We've managed inventories well throughout the year. We don't want that signal to be mixed because we fully intend to continue to have our inventories in line. The last question you had was regarding fulfillment. It's such a key component of our strategy and the ability to take care of the customer. So fulfillment, years ago, was done in bulk and just from a store point of view. And now it's about eaches. It's about anywhere the customer wants to be able to buy it or return it. And our fulfillment centers outside of our distribution centers are based on the Midwest and the East Coast. We do a lot of business on the West Coast and specifically Southern California. So we were challenged in terms of our delivery times to be able to service those customers. We've made a significant investment for a local omni hub there and 2 facilities to be able to not only take care of fulfillment, the stores, Full-Price and Off-Price, but to be able to service the customer that we're aspiring to do through our Nordstrom Local efforts and which we are embarking on in L.A. So a key component of being able to execute Nordstrom Local is improving the supply chain, and we've certainly made a significant investment along those lines. And that hopefully will bear fruit over the next 24 months.

Operator

Next is Dana Telsey from Telsey Advisory Group.

Dana Lauren Telsey - *Telsey Advisory Group LLC - CEO & Chief Research Officer*

As you think of the strength of the Off-Price business with that 5.8% comp, what delivered that comp for you? What did you see in the different merchandise categories? And then secondly, with this charge being taken for the credit cards, how -- with those customers, are they loyalty customers? How do you capture them going forward? And has there been an assessment that this isn't happening going forward with anything? What process has changed?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Thanks, Dana. So I'm going to take your credit card question first, and then Blake can talk about the off-price comps. So first of all, we estimate that less than 4% of our cardholders will receive a credit or refund, and these are certain cardholders that had delinquent accounts. We -- and we believe most impacted cardholders are going to receive less than $100, either in the credit or refund. We certainly are very sorry and take full responsibility for this, and we have addressed the problem and are ensuring it won't happen again.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

So Dana, in terms of Off-Price, we've been working hard on that. And there's a pretty basic principle, whether it's Full-Price or Off-Price, that are we fluid with our inventories? Are we able to have newness to the customer, a curated and balanced buy? And when we get overbought, we get choked up, it puts a real pressure on the margins, and it affects that newness. It's particularly true in Off-Price, our ability to be in the market and be able to respond more timely to the customer feedback we're getting. And all of 2017, we found ourselves on the other side of that ledger. So this past year, our merchandising team, which we're really proud of, they've worked really hard to get their inventories in line and to work on that balance and flow. And we really think the results are a reflection of those efforts. Also, we'd point out, we're very unique, and we feel very fortunate to have a very strong digital Off-Price business. Most of our competition doesn't have that. It's how the customer wants to shop. And just like in Full-Price, we view it collectively. So that 5.8% was driven in large part through the Nordstromrack.com and HauteLook, with the Rack side of the business being a little bit flatter if you silo it. But we don't look at that way, and the customer doesn't look at that way. It's very seamless for how the customer wants to buy and return the merchandise between those 2 channels, and we want to continue to get to work on that. And again, that's how the customer wants to shop with us.

Operator

Next is Paul Trussell from Deutsche Bank.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Excuse my voice. Wanted to just inquire about the third quarter gross margins. Even if we were to exclude the $30 million shift, it still seems like there was some pressure that took place on GPM. If you can just detail that a bit more for us. And also, on the Full-Line comp, I just want to better understand your assessment of performance. I understand you had a negative impact from the Anniversary Sale returns. So are you suggesting that as you got past that period beyond Anniversary Sale, you saw really strong traffic and response to the assortment and that there's momentum in the fourth quarter or heading into the fourth quarter? Just want to understand how you feel about that 0.4 comp because certainly, optically, it looks quite weak.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So let's talk a little bit about the gross margin first, and then I'll go back to the Full-Price business. So really, in the gross margin component to it, I think the way you got to look at it, our year is so, quite frankly messy with all the calendar shift, event shifts, 53rd week that, I think, really, the way you got a look at it is on a year-to-date basis. For the Q3, again, we have revenue recognition as well as a lot of other timing adjustments associated with it, which is why we are looking at this more of a year-to-date basis. And then you had a higher mix of Off-Price versus Full-Price, which had a little bit of a margin impact for the quarter as well. So it's really a lot of it is just timing-related. And that's why we start to give additional color for the year-to-date where we are as well as where we are going to land for the full year so that you can kind of see that we're very much in line with our expectations in the guidance we've been giving. As far as Full-Price for the comp, the reason why we're talking about Q2, Q3 together is because of the impact of the Anniversary Sale shift in the calendar and with the returns coming in, in the third quarter. So when we look at a 2.5% comp, we're actually pretty pleased with where that landed. And as far as the 0.4, it's pretty much in line with our expectations. I think, from a traffic perspective, what we have seen from a Full-Price business for the quarter is it's been really consistent trends with traffic growth when you look at both our digital and physical combined.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

This is Blake. I would just add. There's not a function of the return rate rising itself. It's just the amount of volume that we do in the month of July that then, through normal returns, comes back in August and even in September is when the two quarters, as Anne said, you really need to put together, and I believe one of our slides, we did that, to try to give you more apples-for-apples comparison.

Operator

Next is Erinn Murphy from Piper Jaffray.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Just a couple of questions for me. First, just on the Full-Price business. What merchandise categories outperformed or underperformed that average if you look throughout the quarter? And then secondly, on Trunk Club, I think you mentioned it was up 50% in the quarter. Can you just talk about where that accelerated growth is coming from? Is it men's? Is it women's? And then if there's anything you can share in terms of what you're noticing in that service business on frequency of use, that would be helpful.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Erinn, this is Blake. So regarding Trunk Club, it's had a significant improvement, so I was really pleased to be able to point out that year-to-date, we're up 50%. And so there's been a lot of work by that team since we purchased that business. And the adjustment to the strategy, you asked where that's coming from. The women's side of the business, very strong. And the actual Trunks themselves, how we service the customer, is really resonating with the customer. And we think this business represents tremendous growth and value for Nordstrom. We see, in the near-term line of sight, $500 million, but long term, we think it has lots of ways to, again, service to customer and contribute. You had a question before that, though. I'm trying to remember.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Full-price.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Full-price.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Yes. Just on the full-price merchandise categories. How they do -- yes, what do you think outperformed and underperformed, just the overall trend in terms of category callout?

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Sure. Sure. So at a high level, by merchandising division, pound for pound, the men's area performed the best. Within the merchandising divisions, designer continues across all areas of Designer, contribute in a meaningful way. The Handbag business was strong. I mentioned earlier about cold-weather business, the coats, but dresses and coats have been good, and again, part of men's, men's sportswear. So those are the areas that we're above the company average and contributing significantly.

Operator

Next is Brian Tunick from Royal Bank of Canada.

Brian Jay Tunick - *RBC Capital Markets, LLC, Research Division - MD and Analyst*

I guess, 2 questions on the generational investments here. I guess, first on Canada. Was curious about what are the puts and takes on maybe how margins in Canada would compare to the U.S. business, I guess, as you ramp towards that $1 billion mark. And then secondly, what learnings from the Men's Store currently in Manhattan are you able to apply maybe to the women's store before it opens next year?

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Brian, this is Blake. On Canada, when you go into our due diligence that the operating model is slightly different in Canada and there is pressure on the margin in a number of areas in terms of some of the duties and extra things that are added to an item that when it crosses the border, supply chain and just the competitive market up there. So we have that. We also had the disadvantage in our initial opening where we didn't have Racks at first, and that impacted our margin. Now that we have 6 Racks, we're getting closer to parity in the U.S. There is more work to be done. We'll continue to focus on that but there is a slight difference currently between the margin in Canada and the U.S. Your next question was on the Men's Store in Manhattan, and we're just really pleased with the opportunity to be able to have this store and to open it and particularly in advance of the Tower. We're learning a lot. So although we were in Manhattan with the Rack, and though we have really, our most strongest digital business there, we're learning a lot how to service the customer there. And it ranges from the supply chain to the talent there to just the seasonality of the rhythm of the business within the city. It's been a great experience, and we're really pleased with some of the customer feedback we're getting. And we're looking forward to continuing to apply that to the business and, roughly, a year from now, in the fall, when we open the Tower, to apply those learnings as well.

Operator

Next is Ed Yruma from KeyBanc Capital Markets.

Edward James Yruma - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

I guess, just any other early signs you're seeing on Nordy Club? Kind of what -- how is the consumer responding to it? And as it relates to kind of the rich rewards -- the richer rewards for the card customers, is that something we should be thinking about from a gross margin perspective going forward?

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Well, Ed, this is Blake. Loyalty is marketing, and we've worked hard over the years to have a personalized approach with our customers and to improve that relationship and bond. We've had various programs over the years to enhance the loyalty experience, and The Nordy Club is just another step along those lines. We've only got about 30 days under our belt. But as I indicated in my remarks, we're getting some really positive feedback. We see that through just the adoption in the Nordstrom app. It's up considerably. We now have the ability to get the rewards or points back to the customer quicker. We're able to communicate closer with the customer. We had 4 levels before now. Now we have 5. We're able to, again, in a more personalized way, support our most loyal customers. As I mentioned, it's 56% of our sales, and we've seen at 15% gain. We think The Nordy Club is a step along those lines. In terms of the margin, we don't see a material change, particularly this year, as we're just getting started. So there's some startup costs and then plus the gains with the sales, we think it's going to be relatively neutral from a bottom line point of view. But again, it's the right thing to do on behalf of the customer. It sets us up well for the holidays and particularly for 2019.

Operator

Next is Mark Altschwager from Robert W. Baird and Company.

Mark R. Altschwager - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Anne, you've consistently been talking about fiscal 2018 as the turning point from a margin perspective, and it's great to see the company on track for that goal. But I'm wondering if you could talk about, relative to your views as we enter the year, what are the buckets where you're seeing incremental pressure on the expense structure? And what are the buckets where you may be seeing greater leverage or greater benefits than you originally thought? And then separate question, just to follow up on the credit charge. Does the issue you discovered have any implications on your go-forward expectations on the earnings for the credit segment?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So we -- on the pressure or how we're looking at things for '18, it's coming in fairly consistent with what we thought the beginning of the year. So we take up part of the different components of the P&L, the gross margin, gross profit components to it. Pretty much in line with our expectations of when we've given guidance in the beginning. And then on the expense side, there are puts and takes, and we look at ways to make sure we're delivering on that productivity initiatives. So overall, I think we're pretty much in line with what we thought beginning of the year as far as how we're going to land the year. As far as the credit charge, we don't believe that it's going to have much of an impact to the total credit guidance. In fact, we didn't change our guidance this quarter for credit revenue.

Operator

Next is Simeon Siegel from Nomura Instinet.

Simeon Avram Siegel - *Nomura Securities Co. Ltd., Research Division - Executive Director & Senior Analyst*

First off, how was traffic versus ticket at Full-Price and Off-Price? And then congrats on the great success with Something Navy. How large of an opportunity do you see that progressing into? And then, Anne, just want a quick clarification on the credit. So thanks for the go-forward. Just to understand it, is it reversing a gain in the prior periods? And if so, any help on the impact to which quarters?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So on the credit piece, we're taking a onetime, nonrecurring charge in the quarter, and it's flowing through SG&A. And so that's how we're accounting for it. As far as your question on Full-Price and Off-Price, I would just say, overall, in both businesses, we have very consistent trends. In Full-Price, we've had traffic growth. And in Off-Price, we had transaction growth.

Operator

Next is Matthew Boss from JPMorgan.

Steven Emanuel Zaccone - *JP Morgan Chase & Co, Research Division - Analyst*

This is Steve Zaccone for Matt today. So with Full-Line up 2.5%, normalizing for the timing shift, do you view this as the appropriate run rate for the business in your multi-year plan? And then secondly, you had nice performance on SG&A in the third quarter. Can you talk to how some of the generational investments will impact your earnings profile next year? Understanding you're not giving guidance for 2019 yet, but should we expect next year to have a higher SG&A spend as you deal with incremental cost to open the New York City Tower?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So the SG&A component, you're right, we're not giving guidance for next year. We'll talk about that in the next earnings call. What I would refer you to is the Investor Day material where we laid out our targets for 2020. As we're finishing out '18 and we laid out our targets for 2020, I think there's a lot in there that you can decide for as far as how we're landing '19 and '20. And as far as the top line comp growth of the 2.5%, I think we're -- the way we're looking at the business is very consistent trends, and that's how we set our guidance. I think the thing that you should take away from this is that with -- we're using our consistent trends with that top line comp guidance for the year. We're expecting to deliver the inflection point for the P&L for EBIT margin. So it doesn't require a significant growth in top line to deliver that.

Operator

Next is Chuck Grom from Gordon Haskett.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Just on the question on the gross margins. They're down about 23 basis points in the first quarter. You said 2Q and 3Q combined, they're down 19 basis points. Just wondering how you're feeling about the fourth quarter, given where inventories levels are. And then just on the charge, when you think about looking back, is it safe to say you guys are overstating your earnings because of that? Or is that not how we should look at it given whether you own the card or if you didn't own the card at that time of when you were, I guess, overcharging these customers?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So let's start with the credit piece to this first. So I think the way you need to look at this is this was something that was put in place in 2010. And so from a $72 million charge, I think that's the way to go back and think about it for how we've done this since 2010. So it's -- when you look at it each year, it's really -- it's not -- you can do the math on that. And again, it's pretty small, so it's really about identified cardholders with delinquent accounts that we are being charged the higher interest in error. And it's less than 4% of our cardholders,so I think it's understanding the materiality of it. Having said that, we certainly do not like having this happen with our customers, and we are very sorry that it took place. As far as the inventory and gross margin, if you go back to my comments from the call, and we really -- we feel like we're in-line with our expectations, and we feel like we're going to deliver the gross margin for the full year. We certainly believe inventories will be in-line with sales. This is more of a timing. And certainly, in our merch margins, we expect to be flat to slightly up as we finish the year as well. And really the big piece was the occupancy which we should get some leverage on in Q4.

Operator

Next is Kimberly Greenberger from Morgan Stanley.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Anne, I just wanted to clarify. Are you going to be adjusting your Q1 or Q2 credit income lower because of this? And if we wanted to sort of think about the $72 million over the last 7 years or so, would it be fair if we just took a look at your sort of annual credit number and cut it by $10 million to get what the real number would have been? And then beyond credit, I'm just looking at inventory, it looks like it's up 7% here at the end of the third quarter and that looks like it's on top of the 7% increase last year. So we're looking at inventory up about 14% on a 2-year stack, which, I think, is well in excess of sales growth. So I'm just wondering how we should think about the way you're targeting your inventory growth and if this is maybe a temporary bubble that you would expect to have corrected by year-end.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. Thanks, Kimberly. So I think for the inventory piece, if you look at 2017, it was actually up 1%, not 7%. And so you're really not looking at a stack, as you put it on that 14%. So as we look at Q3 for this year, the 7% increase, when you take out the in-transit components to it, we're very much in line with our sales. So this is just a timing with the shift in the calendar. And we also pulled forward some of the holiday deliveries. As far as the credit impact, we are taking a onetime, nonrecurring charge in the third quarter, and that's how we're handling that. I don't think it's -- if you're trying to back in for each of the years, the thing to remember is that the $72 million includes refunds as well as associated fees and other items. So it's not strictly just credit income.

Operator

Next is Paul Lejuez from Citi.

Paul Lawrence Lejuez - *Citigroup Inc, Research Division - MD and Senior Analyst*

Can you maybe talk about delivery expense, the impact of the P&L this quarter versus prior quarters, how you see that going forward into 4Q? And then just second, now that we've got second quarter and third quarter, we can look at it combined to neutralize the impact of the Anniversary Sale. How do you look at the businesses performing outside the Anniversary Sale versus during the Anniversary Sale? If you could maybe just separate those 2 pieces for us.

Blake W. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Okay, I'll take the -- this is Blake. Let me take the Anniversary Sale just business in general Q2, Q3. Anne's comments a couple of times now, we've seen very consistent trends for some time now for a couple of years. And we had a slight, and it gave you a little reflection of how the business both Full-Price and Off-Price. We don't break out anniversary from those time periods. And certainly, as you mentioned, when you put Q2 and Q3 together, it might blurred out a little bit, but if you take a step back from that, our trends in the business outside of anniversary and inside of anniversary has been very, very consistent. And so we don't see any anomalies there that are material that are worth noting. On supply chain, Anne, you want me or you want to talk about?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

So I can talk about the supply chain. So as we've given guidance, we look at this as our digital capabilities between marketing, technology and supply chain. And the way that we've been talking about this is we are investing in supply chain components. We talked about our West Coast facilities coming online next year. As far as the -- we look at these combined and we are giving guidance that we expect our expenses to be mid-single-digit growth for the year because we're finding some productivity pieces to this as well, and that's how I would look at it.

Operator

Next is Michael Binetti from Crédit Suisse.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Can I -- I want to ask about the credit revenue aside from the excludable event in the quarter here. But if we look at the underlying growth rate of credit in 2Q and 3Q, it's decelerated a bit. I guess, that's a little counterintuitive versus what we've seen from some people in the peer group this earnings season where we see credit growth accelerating -- at an accelerating pace and way, way above comp growth rates. And I guess, the thinking would be as more as the industry moves towards more customers purchasing through loyalty or getting benefits from purchasing on a credit card, they're more incentivized to do that for free shipping, that you're seeing the credit rates accelerate quite a bit. I'm curious why they would be decelerating for you because I would assume you'd have some of those similar dynamics.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So we're giving guidance as far as mid-teens growth for our credit revenue, and we're on track for delivering that for the year. As we had talked about in the last earnings, I think it was even last or two earnings calls ago, we are -- in the first half of the year, we were anniversary-ing some programs that we have launched, offering $40 notes, which we were -- we've actually anniversary-d the second half of the year. So for the full year, we're still on track to deliver mid-teen growth.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Is that how you would look at it on a go-forward basis just because -- okay, so you have a couple of puts and takes there in the near term but as we look out on a multi-year basis, is that a growth rate that we're maxing right now do you think is too low as we look at multi-year?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So I think, again, we're not giving guidance going out, but we did talk about what we would assume for credit revenue growth, which I think we are pretty much in line with total sales growth when we look at our 2020 and 2022 targets.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And then if I could just ask last one on the growth rate in SG&A in the quarter. It slowed a lot in the third quarter. Any puts and takes that landed that at a slower year-over-year growth rate here? Or maybe if you pulled back on anything, if you wouldn't mind highlighting it? And then how do we think about that on a go-forward basis since the quarter-to-quarter trends are a little bit unpredictable?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So I think we talked about the fact that we gave you full year guidance for the SG&A growth rate, which we think is going to be around the mid-single-digits. There was some puts and takes in the quarter, but there was nothing that we did that is going to materially or inversely impact Q4 and we are still very much in line with we thought we would deliver for the year.

Trina Schurman

Again, thank you for joining today's call. A replay, along with the slide presentation and prepared remarks, will be available for 1 year on our website. Thank you for your interest in Nordstrom.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.
