Q4 2020 NORDSTROM EARNINGS CALL – PREPARED REMARKS

ERIK NORDSTROM

Good afternoon and thank you for joining us today. Looking back at 2020, we're deeply grateful for the way our entire team navigated through these challenging times. We made meaningful progress to better serve customers, benefitting from multi-year investments that supported our transformation into a digital-first business. The aggressive actions we took throughout the pandemic to increase our financial flexibility has enabled us to generate operating cash flow of more than $425 million over the past three quarters. We're confident in our ability to successfully emerge from this pandemic in a stronger position than before.

We are encouraged by the continued sequential improvement in our topline trends, including a 600-basis point increase from the third quarter when normalizing for our Anniversary event shift. We saw momentum build throughout the quarter and continuing into 2021. We had broad-based improvement across our two brands—Nordstrom and Nordstrom Rack—both in-store and online. Enabled by our market strategy, trends in our top 10 markets outpaced our average by 200 basis points. During the holidays, customers responded positively to our gift selection, which represented 67 percent of sales, up 600 basis points over last year.

While we're pleased with our improving topline trends, we are not satisfied with our bottom-line results. Since reopening stores in June, we faced inventory constraints throughout most of the year. Heading into the holidays, we increased our receipt plans to meet anticipated customer demand. However, we experienced delays in inventory flow that resulted in higher inventory levels at the end of the year.

Additionally, higher COVID-related labor and shipping costs contributed to earnings flow-through coming in below our expectations. We are currently taking actions to realign our inventory position, and Anne will go into additional detail on our execution and action plans.

An important component of our strategy is to increase convenience and create personal connections with customers. During the holiday season, we continued to scale digital and physical capabilities to offer greater access to our services. With pickup options at roughly 350 Nordstrom stores, Racks and Nordstrom Locals, about 10 percent of online orders were picked up in stores. Additionally, roughly 30 percent of online orders were fulfilled from stores, including Racks, which were recently enabled with this capability. These capabilities allow us to increase delivery speed, customer spend, and inventory efficiencies.

We're increasing our connections with customers by strengthening our digital capabilities to offer them discovery and inspiration. Remote selling options, such as looks created by our salespeople using Style Boards, are resulting in outsized customer satisfaction scores, conversion, and average transaction size. And, we know that when customers engage with us through order pickup, alterations, or styling, their overall spend increases by up to five times.

During the fourth quarter, we saw a significant improvement in customer acquisition trends, improving sequentially by roughly 15 percentage points from the prior quarter. We gained 1.8 million new customers online, a 40 percent increase over last year. We did this without losing sight of our existing customers, where we have seen improving retention trends over the past two quarters.

Encouragingly, our Nordy Club customers continued to shop with us during the pandemic. Approximately 40 percent of customers are in our loyalty program, contributing two-thirds of sales. This gives us growing confidence in our ability to sustain momentum in 2021 as our Nordy Club members shop with us more frequently and spend more than our average customer.

As we laid out in our investor event last month, our brand promise of getting “closer to you” is the guiding principle of our growth plans going forward. Heading into 2021, we are committed to significantly expanding the breadth of who we serve, and where and how we serve them. We’re doing this by unlocking the full power of the digital-first platform we have built to capture market share gains; drive profitable growth; and create significant value for our shareholders.

As we head into 2021, our team is dedicated to executing on our strategy across our three areas of highest priority:
First: Winning in our most important markets. We’re continuing to scale our market strategy by doubling our exposure from 10 to 20 markets by the end of March, making up 75 percent of our business. This includes key markets such as San Diego, Houston, Minneapolis, and Miami.

Second: Broadening the reach of Nordstrom Rack, which we see as a $2 billion incremental sales opportunity over time. We’re focused on growing our share of the price-oriented customer segment. Our efforts are underway as we recently repositioned 70 stores by reimagining the merchandising offering and store experience.

And third: Increasing the velocity of our digital business. We’re focused on more effectively translating the heritage of service that defines us in this digitally connected world. This means delivering personalization at scale by creating greater linkages between digital and physical experiences. As an example, we are currently migrating NordstromRack.com to the JWN e-commerce platform to enhance the customer experience while creating efficiencies in our infrastructure and operations.

These strategic priorities are enabled by our digital-first merchandising approach. We are extending beyond our traditional wholesale model to increase selection, reduce risk and share in the benefits with our strategic brand partners. For instance, yesterday we announced our partnership with Tonal, the smartest home gym and personal trainer, to expand their retail footprint to 40 Nordstrom stores this month. In terms of other partnerships, we also see meaningful opportunities to deepen our relationship with ASOS and Topshop to broaden our distribution and drive growth.

We’re grateful for our team’s efforts to strengthen our financial flexibility and accelerate our strategic priorities to serve customers in new and differentiated ways. These actions have put us in a strong position to capitalize on our market share opportunity as customer demand recovers. While the timing and pace of demand recovery remain uncertain, we see potential to reach $17 billion in revenues at expanded EBIT margins of more than 6 percent over the next three to five years.

In closing—we have two powerful brands – Nordstrom and Nordstrom Rack – as well as highly integrated digital and physical assets, fantastic brand partners, and employees who are truly unmatched when it comes to their commitment to the customer. We’re confident in our direction and look forward to sharing our progress in the quarters ahead.

With that, I’ll turn it over to Anne to discuss our financial results in greater detail.

ANNE BRAMMAN

Thanks, Erik. We’re pleased to deliver another quarter of sequential improvement in sales through the actions we’re taking to unlock the full potential of our digital-first platform. We’re also proud of our team’s efforts to generate another quarter of positive earnings and operating cash flow in what remains a very uncertain environment. We continue to satisfy our customers’ desire for digital shopping experiences, accelerating online penetration across both Nordstrom and Nordstrom Rack, even as our store sales continue to recover. Overall, we have seen strong customer response to our initiatives to evolve our operating model, positioning us well to drive market share gains while improving profitability, returns, and cash flow generation.

That said, the quarter was not without its challenges, and there were unanticipated headwinds that limited our ability to flow our improving revenue momentum to the bottom line, which I will discuss in detail shortly. We also exited the quarter with excess inventory that we are working quickly to address. Overall, we are confident in our ability to support a continued recovery in both demand and profitability, and we remain focused on executing our long-term growth strategy.

For the fourth quarter, we reported positive earnings per share of $0.21, which included an income tax benefit related to the CARES Act. Earnings before interest and taxes were $30 million. We continue to be in a strong financial position, fully paying down our revolver and ending the quarter with $1.5 billion in liquidity, including $700 million in cash. We delivered a third consecutive quarter of positive operating cash flow, generating more than $425 million over the past three quarters. For the year, our expense savings well-exceeded our targeted range of $370 to $420 million, primarily from rebasing our cost structure. More than $300 million of realized savings are considered permanent overhead reductions.

Our fourth quarter sales decrease of 20 percent slightly exceeded expectations. This reflected improvement in sales throughout the quarter across both Nordstrom and Nordstrom Rack, with momentum as we head into 2021. Digital demand was strong, with sales growing 24 percent over last year and representing 54 percent of total sales. Sales trends continued to improve, increasing by six percentage points compared to the third quarter after normalizing for the Anniversary shift. Notably, we saw strong sequential improvement at both Nordstrom – up 5 percentage points – and Nordstrom Rack – up 9 percentage points.

From a merchandise perspective, we saw a strong response to our focus on gifting items. Expanding our offering in categories of highest demand, we delivered double-digit sales growth in both Home and Active and had strong results in Beauty, Kids, and Designer handbags and shoes.

Overall, we're encouraged by the sequential improvement in our topline trends, giving us increased confidence in our pivot to market-share capture and a return to profitable growth in 2021. That said, we are not satisfied with the flow-through to the bottom line from our improving revenue momentum. EBIT margin was down 590 basis points from last year, versus our expectation for a decline of approximately 500 basis points.

There were three key factors that contributed to greater pressure on margins in the quarter, most of which we expect to be temporary and reverse as we progress through 2021. First, merchandise margins were lower than expected. Our decision to take a stronger inventory stance for Holiday, combined with delays in inventory flow over the course of the quarter, resulted in higher than anticipated markdowns.

Second, we experienced higher than expected selling and labor expense, primarily due to premium pay related to COVID-19 and higher costs associated with product fulfillment. Strong growth in ecommerce and the ramp of new capabilities at Nordstrom Rack led to some fulfillment inefficiencies that have been clearly identified and are not expected to recur going forward.

Third, we saw higher than planned outbound freight expense due to carrier surcharges and costs associated with our decision to mitigate carrier shipping constraints by shifting to higher-cost shipping options.

Versus last year, our overall SG&A rate deleveraged by 470 basis points, largely due to lower sales volume and higher labor and shipping associated with COVID-19. These costs were partially offset by continued benefits from re-basing our cost structure, which led to a reduction in Q4 overhead costs of approximately 15 percent from the prior year. Roughly 300 basis points of these expenses are not expected to recur this year.

From an inventory perspective, we increased our receipt plan for the quarter. Much of this inventory came in later than expected, which resulted in not being able to fully support demand during the holidays and higher inventory levels exiting the year. Most of this inventory reflected current receipts and non-seasonal merchandise, with improved availability of replenishment items and relevant products with extended selling seasons.

We are taking action to mitigate the impact of seasonal and underperforming merchandise categories, particularly in apparel, including cancellation of orders, return-to-vendor, and clearance activity where appropriate. Importantly, we are quickly building additional flexibility into our buying plans in the first half. We plan to cut our sales-to-inventory spread in half by the end of the first quarter, with inventory realigned at Nordstrom Rack. We expect inventory levels for our Nordstrom brand to be fully realigned in the second quarter after normalizing for the Anniversary shift.

Looking ahead to 2021, given the continued uncertainty with respect to COVID-19, we remain prepared for a range of scenarios to ensure that we can sustain and grow our business. Based on the assumption that our stores will remain open over the course of the year, we expect to deliver revenue growth of more than 25 percent, with digital representing approximately 50 percent of sales.

Given expectations for improving gross margin and moderating cost pressures over the course of the year, we expect to deliver EBIT margin of approximately 3 percent of sales. Our income tax rate is expected to be around 27 percent for the year.

This guidance contemplates some pressure in gross margin as we work to align inventory in the first quarter, a moderation in COVID-19 related labor and freight pressure as the year progresses, and lapping of 300 basis points of non-recurring costs in the fourth quarter. Should the pace of demand recovery accelerate, or COVID-19 related costs moderate more quickly than currently anticipated, we do see a path to delivering operating margin of approximately 3.5 percent for the year.

For the first half, EBIT is expected to be approximately breakeven, reflecting roughly 45 percent of total year sales. This contemplates the shift of the Anniversary event to begin in July this year, with one week falling into the third quarter.

From a capital allocation perspective, we're planning capex at normalized levels of 3 to 4 percent of sales to support investments in technology and supply chain capabilities. We also expect to reduce our leverage ratio to approximately 3 times and to be able to return cash to shareholders by the end of the year.

We made meaningful progress to support the recovery in demand in the fourth quarter. Now, as we head into 2021, the strength of our financial position enables us to reinvest in our long-term growth strategy. We are confident in our ability to deliver profitable sales growth as demand recovers.