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JWN - Q3 2016 Nordstrom Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 results. Expects full-year 2016 EPS to be \$2.85-2.95.



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PRESENTATION

Operator

Greetings, and welcome to the Nordstrom third quarter 2016 earnings conference call.

(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 - Nordstrom Inc. - Director of IR

Good afternoon, and thank you for joining us. Today's earnings call will last 45 minutes, and will include 30 minutes for your questions. Before we begin, I want to mention that our speakers will be referring to slides which can be viewed by going to nordstrom.com in the Investor Relations section. Today's discussion may include forward-looking statements, so please refer to the slides showing our Safe Harbor language.

Participating in today's call are Blake Nordstrom, Co-President, and Mike Koppel, Chief Financial Officer, who will discuss the Company's third-quarter performance, and the outlook for FY16. Joining during the Q&A session will be Pete and Erik Nordstrom, Co-Presidents, and Jamie Nordstrom, President of Stores. With that, I'll turn the call over to Blake.

Blake Nordstrom - Nordstrom Inc. - Co-President

Good afternoon, everyone. Our third-quarter results reflected our team's substantial progress in making both adjustments to align to current business trends, and longer-term changes to our business model. Before we get started, I'd like to first address the write-down related to Trunk Club.

In August 2014, we acquired this start-up as a new channel to serve customers in a personalized and relevant way. Unfortunately, the business has not performed to the expectations we had when we acquired it. And as a result, we have reduced the value of that asset. Trunk Club continues to be well-aligned with our customer service commitment and value proposition. We remain committed to this business, and view it as a part of our customer strategy.

Mike will later discuss the adjustments we are making to assure its future success. Now I'd like to move on to our third-quarter performance. From a top line perspective, our third quarter benefited from one week of our anniversary sale, shifting into the quarter. This shift contributed to a comp increase of 2.4% over last year.

To get a better sense of underlying trends, the combined second and third quarter comps were [a] 0.4%. This is consistent with the trends, we've been seeing over the past year. As the pace of customer expectations continues to accelerate, it's even more important for us to remain focused on the customer. We are in the midst of evolving our business model to better support shifts, in how our customers are shopping with us.

While this is a continuous journey, we've made considerable changes in the way we operate, to improve the customer experience and increase our productivity. We are extremely proud of our team's efforts over the past year to align inventories, and gain greater efficiencies. These outcomes have positively impacted our third-quarter results, and adds to our confidence as we continue to make improvements to our operating model. Our strategy is squarely focused on serving customers on their terms, with the high level of product and service they expect from us.

This quarter, we have executed on a number of initiatives to better serve customers, and drive top line growth. In our Nordstrom brand, we achieved another milestone related to our Canada expansion, with two successful store openings in Toronto at Eaton Centre and Yorkdale Centre. With Toronto being the fourth largest market in North America, we believe these stores will be among our top volume stores. They are in outstanding locations, and we're excited about their potential. We now have five stores open in Canada, and look forward to opening our sixth, also in Greater Toronto area at Sherway Gardens next fall.

In the US, we had a successful opening of our second store in Austin, Texas, at the Domain. Our Rack business serves as a great way of attracting new customers to Nordstrom. We expanded our reach with 15 new stores this fall, for a total of 215 Racks. These stores are complemented by our Nordstrom rack.com and HauteLook businesses, which are expected to reach over \$700 million in sales this year.

Offering a curated product assortment is an integral element of our customer strategy. In the third quarter, we launched new collaborations with J.Crew and denim brand, Good American. Also in collaboration with Nike, we rolled out a women's lifestyle concept shop at our downtown Seattle and Eaton Centre stores, followed by our Michigan Avenue store later this month. Through these partnerships, we are able to give our customers compelling product that has limited distribution.



We have an unwavering focus on serving customers. This approach guides us on how we set our priorities, allocate resources, and accelerate the speed of our execution. As we head into the holiday season, we are planning the business consistent with the sales trends we've been seeing over the past year. On the inventory and expense side, we have strong momentum in place, and remain committed to continuing our progress to ensure we're best positioned to manage our business. Now I'd like to turn it over to Mike.

Mike Koppel - Nordstrom Inc. - CFO

Thanks, Blake. Our third-quarter results demonstrated the progress we are making to improve our operating model. Over the last year, we have been addressing, not only the challenges of top line trends, but the longer-term impacts of operating a fast-growing e-commerce business. In this quarter's performance, we realized operating leverage generated by these adjustments, in particular from inventory and expense. We will continue to identify opportunities to improve our longer term performance, as our business continues to evolve.

Before providing more color on the quarter, I'd like to also address our plans related to Trunk Club. As Blake mentioned, because of our revised performance expectations, we recognized a non-cash impairment in the Trunk Club goodwill of \$197 million. While we have reset our performance goals, we continue to believe that Trunk Club provides us with a unique customer experience that we can build upon.

To that end, we are making a number of improvements to better serve customers. The initial results have been favorable for our customers, and improved our economics. To help give a Trunk Club customers a broader selection of brands, we are also integrating supply chain and fulfillment capabilities over the next year. We anticipate that these and other changes we're making will drive continued growth, and improve Trunk Club's results going forward.

Moving to our third-quarter performance, our top line trends were generally consistent with what we've experienced over the past year. We've continued our progress in growing relevant brands that have limited distribution. In our full price business, our top 20 fastest-growing vendors, which includes many of the brands with limited distribution, and our private label business collectively grew 20% in the third quarter. In response to the changes in consumer demand, we aggressively aligned our inventory plans, and made significant progress in stabilizing our operating margins over the past two quarters combined. We ended the third quarter with a positive spread between sales and inventory growth. Inventories are well-positioned and current, as we head into the important holiday season.

Stepping back, we've made a strategic investments over the past five years to meet to changing customer expectations. This enabled us to grow our top line by 50%. As we move forward, we will continue to adapt our operating model to provide an exemplary customer experience, and deliver long-term profitable growth. This year, we've made tremendous progress in right-sizing our expense trajectory, through increased efficiencies across our enterprise capabilities.

This includes our efforts to expand our digital experience, which is enabled through technology. For example, we've upgraded a vast majority of our website platform, which allows us to accelerate the continuous delivery of new customer-facing features. From a productivity standpoint, we prioritized our investments toward modernizing our infrastructure, and implementing the highest value customer experiences. In supply chain, we have implemented a number of initiatives focused on improving the customer experience, and reducing per unit cost. Based on these efforts, we are on track to achieve savings of roughly \$50 million in shipping and fulfillment costs this year.

In marketing, our expanded Nordstrom rewards loyalty program represents a meaningful opportunity to directly engage with customers, drive customer lifetime value, and increase the efficiency of our marketing spend. Since the launch of our non-tender offer in mid May, we now have more than 7 million customers in our overall program, up over 40% from a year ago. In the third quarter, the spend from our loyalty customers made up 45% of our sales, which increased around 600 basis points from last year.

Finally, I'd like to provide additional color on our financial outlook for the year. Excluding the impairment charge, we've raised our full-year earnings per share outlook to \$2.85 to \$2.95 from our prior outlook of \$2.60 to \$2.75 to incorporate third-quarter results. From a top line perspective, we anticipate a continuation of trends, yielding flat comps for the year.



In closing, we will continue to aggressively prioritize our resources to ensure that we provide a relevant, best-in-class experience for our customers, while achieving profitable growth. Through our ongoing efforts, we are confident that Nordstrom will remain relevant to customers now, and in the future. I'll now turn it over to Trina for Q&A.

Trina Schurman - Nordstrom Inc. - Director of IR

Thanks, Mike.

(Caller Instructions)

We will now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Matthew Boss, JPMorgan.

Matthew Boss - JPMorgan - Analyst

Thanks, guys. So gross margin performance this quarter, the best in over five years. Mike, if you broke down the 100 basis points here in the third quarter, what was the underlying merchandise margin trend, any impact from the Trunk Club change? And just the best way to think about ongoing opportunity into the fourth-quarter and beyond?

Mike Koppel - Nordstrom Inc. - CFO

Yes, sure, Matt. Well, thanks for your question. Of the improvement in the gross profit line, roughly one-third of it was direct from merchandise margin performance. The balance was leverage we're getting on sales and the buy-in in occupancy cost. The story is pretty consistent with what we've started to see, as we've aligned inventories, not only our inventories, but inventories around the industry. There's less promotion out there. We have less excess inventory, so we're seeing more stability in margins. I think, in terms of how we feel going forward, we've reflected that in our outlook. And certainly, any variance from the outlook would be determined by how we perform on the top line.

Matthew Boss - JPMorgan - Analyst

Great. Best of luck.

Mike Koppel - Nordstrom Inc. - CFO

Okay, Matt. Thanks.



Operator

Lorraine Hutchinson, Bank of America.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Thank you. I wanted to follow up on SG&A. I was wondering which initiatives drove the 70 basis point positive variance in the quarter, and also would you expect similar leverage in the fourth quarter?

Mike Koppel - *Nordstrom Inc. - CFO*

Yes, Lorraine, this is Mike. We didn't really break out the elements of that 70 basis points. I will tell you collectively, we've seen some great progress amongst those three main areas that we called out, as well as just generally operating our business in the core, every day element of it. In terms of what we see going forward, again, I will give a similar answer as I did with gross profit. We've reflected our expectations in the outlook, and any ability for us to gain additional leverage will purely be driven by sales.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Thank you. Jeff Stein, Northcoast Research.

Jeff Stein - *Northcoast Research - Analyst*

Hey, Mike. So if we look at the fourth-quarter outlook, basically at the high end, you're looking for relatively flat, and at the low end, down about \$0.10. And with the improvement that you saw in gross margin and SG&A in the third quarter, what's changing between Q3 and Q4 that would cause you to be at best flat, based on your revised guidance?

Mike Koppel - *Nordstrom Inc. - CFO*

Well, Jeff, that's a great question. I think there's a couple of elements to consider. One is the fact that part of the leverage, while we did get 70 points of leverage from a normal activity, we're still looking at a sales environment, that while some folks may feel a little better about, the trends have been pretty consistent for the last couple quarters, and we're managing our business accordingly. So it's purely driven by the expectations of the top line. We expect to continue to achieve some good expense performance, but again, in terms of the margin impact of it, it's going to be sales driven.

Jeff Stein - *Northcoast Research - Analyst*

Okay. But it would seem to me, if you're looking for flat for the year, flat comps for the year, that would imply a similar comp trend in Q4, that you saw in Q3, correct?

Mike Koppel - *Nordstrom Inc. - CFO*

That's correct.

Jeff Stein - Northcoast Research - Analyst

Okay. All right. Thank you.

Mike Koppel - Nordstrom Inc. - CFO

Thank you, Jeff.

Operator

Thank you. Neely Tamminga, Piper Jaffray.

Neely Tamminga - Piper Jaffray & Co. - Analyst

Great, and good afternoon, and congrats, Mike, on your pending retirement in 2017 --

Mike Koppel - Nordstrom Inc. - CFO

Well, thanks, Neely.

Neely Tamminga - Piper Jaffray & Co. - Analyst

Much deserved, big shoes to fill, guys, big shoes. Okay, so -- (laughter)

Blake Nordstrom - Nordstrom Inc. - Co-President

Agreed. (laughter)

Neely Tamminga - Piper Jaffray & Co. - Analyst

So put me on the committee, okay. (laughter) So here is what we really want to know on the Rack side of the business. Rack has steadily just been performing pretty well here in this environment, and what we want to get a sense of, is just what does the content look like as you guys head into Q4? How are you feeling about things, how are you feeling about the Rack trends? And I guess, more specifically, how have categories within Rack been performing? I think you have some commentary in the release around the full line, but what are the category performances going on at Rack?

Blake Nordstrom - Nordstrom Inc. - Co-President

Hi, Neely, this is Blake. Yes, we're really pleased with our team's efforts that have been focused on a number of initiatives for a couple of years now. And it's a pretty simple playbook, in terms of what resonates with the customer, but the opportunity is to make sure that we're executing well on behalf of the customer. There's a whole range of things we're focused on, from improving the experience at point-of-sale, to the dressing room, and ensuring that the stores are filled in and sized. And so, I think the numbers are just reflective of the team's efforts, and the customer's great response to that. And inherent in all that, is do we have the right merchandise, and is it a good value, is there integrity in our pricing?

You mentioned, at the last part of your question is what's selling, and what's the content of our inventory? Well, just like a full line stores, the inventory levels in off-price Nordstrom Rack are as current as we've seen in a long time, and we're fluid we have open to buy, and the flow is



improving, and the customer's responding to that. So we've gone from maybe a year ago, or six months ago, where we didn't have that open to buy, and we had margin pressure. And there's just a good ripple effect or halo from that. So we're encouraged by that, and think we're heading in the right direction there.

Neely Tamminga - *Piper Jaffray & Co. - Analyst*

Thank you.

Operator

Thank you. Kimberly Greenberger, Morgan Stanley.

Greg Baglione - *MKM Partners - Analyst*

Hey, good evening, everyone. This is Greg Baglione on for Kimberly. I have two quick questions. One just on the slide deck. It says, it looks like here, you have total SG&A dollars, expect it to grow about 5% for 2016. Is that like a run rate that we should model going forward, do you think it's sustainable? And then, I think earlier you mentioned that your top 20 fastest-growing vendors increased 20% during the quarter? Can you just let us know what percentage of the business they comprised, and maybe what you're seeing in the other vendors outside of those? Thanks.

Mike Koppel - *Nordstrom Inc. - CFO*

Sure, Greg, this is Mike. I will take the first part, as the SG&A. In terms of the progress we're making we feel really good about how we've been able to bend the curve, and the growth of a number of areas. Whether or not that 5% is going to maintain past 2016, we'll let you know about that in February when we talk about our 2017 plans.

But suffice it to say, we feel like there's opportunity for us to continue to improve upon that. And certainly, the one challenge we do have there, is the fastest-growing piece of our business is the e-commerce piece, and that has the most variable element. So we have to keep all those things in mind, that there's many dynamics happening here, that prevent us from just fixing in on a locked number. But that being said, we think in terms of stabilizing operating margins, we've been able to make some good progress.

Pete Nordstrom - *Nordstrom Inc. - Co-President*

Yes, and this is Pete, related to the fastest-growing vendors. Yes, we have some bright spots, but I think you could just ascertain from the fact that our business is fairly flat in comps, that means we have some bigger brands that are probably decelerating too. So it all works itself out.

I think for us, though, it's nice to have some positive parts of the business to point to. And these brands cut across a lot of different categories. So it -- I think it gives us a lot of purpose about going forward, how we plan our business, the people that we're working with, where we feel that we've got a momentum and future with. And making sure conversely, on the brands that are maybe going the other way, that we're planning them accordingly to, so we don't get ourselves into an inventory pinch. A big part of what you've seen, in terms of our improved results have to do purely with the fact that our sales have grown faster than our inventory. And the benefit of all that is what you're seeing here in our results.

Operator

Thank you. Adrienne Yih, Wolfe Research.



Cody Ross - *Wolfe Research - Analyst*

Hi, this is actually Cody on for Adrienne today. How are you?

Mike Koppel - *Nordstrom Inc. - CFO*

Hi, Cody.

Cody Ross - *Wolfe Research - Analyst*

A quick question. So the beauty category has been growing for a while across the industry. One of your competitors recently cited a slowdown in this category. What are you seeing? And if you are seeing a slowdown, do you think this is more of a product of the industry slowing down, or is someone else taking market share? Thank you.

Pete Nordstrom - *Nordstrom Inc. - Co-President*

Yes, our beauty business has been strong relative to the other categories for -- it seems like a couple years now, and it continues to be that way. So beauty as a classification, performed above the average of all of our product categories, so we continue to see good progress there. We've got a good team that works really hard to bring newness, and some limited distribution vendors to our assortments, and that's been a good formula.

Cody Ross - *Wolfe Research - Analyst*

Great. Thank you, and best of luck.

Pete Nordstrom - *Nordstrom Inc. - Co-President*

Thank you.

Operator

Thank you. Paul Trussell, Deutsche Bank.

Paul Trussel - *Deutsche Bank - Analyst*

Yes, good afternoon, and congrats as well, Mike.

Mike Koppel - *Nordstrom Inc. - CFO*

Thanks, Paul.

Paul Trussel - *Deutsche Bank - Analyst*

When it comes to the multi-channel comp, fairly in line with maybe expectations we had, but the mix was quite different. Was very surprised, just given the anniversary shift to still see the full line comp down 4.5%. Were there specific initiatives that you all had in the third quarter to drive maybe more traffic towards the dot-com? Or if you can just speak on the brick-and-mortar full line versus the dot-com?



Jamie Nordstrom - Nordstrom Inc. - President of Stores

Paul, this is Jamie. I'll take that one. Yes, I think what you're seeing is the continuing trend that we've been seeing for a while around mall traffic. I don't think it's any secret out there that, there's been some declines, and depending on a lot of the reports that you look at, mall traffic is down anywhere 4% to 5%, based on a bunch of different reports that we see. And that's pretty consistent with how our trends have been. And so, what are we doing about that?

Well, we are investing a lot in our e-commerce experience, and you see the results there. We're pretty happy with the growth we're starting to see there. And there's been -- it's the paying off of some investments we've been making over the last couple of years. Within the store, there's also some encouraging signs of some -- in results around some new experiences that we're trying drive, using technology, using mobile, to not only make the customer's experience in the store more convenient, more compelling, but also drive more trips. So some things that we've been piloting over the last six months, we feel good about. And we're looking forward to continuing to drive some reasons for customers come to our stores, and maybe buck some of these trends going forward.

Operator

Thank you. Mark Altschwager, Robert W. Baird.

Mark Altschwager - Robert W. Baird & Co. - Analyst

Good afternoon. Thanks for taking the question. Maybe elaborating on that last comment, I guess, could you just talk a little bit more about some of the initiatives around your digital shopping experience? I think you've talked about efforts to edit the assortment, and maybe leverage salesperson, product knowledge. Just curious how all that's evolving, and what other opportunities you see to further differentiate your online experience, versus both pure play online and omni-channel competitors?

Blake Nordstrom - Nordstrom Inc. - Co-President

Sure, I'll take that, and Erik, if you want to jump in. A lot of what we're trying to do in the stores is give customers control, and mobile is such a great medium for that. So recently, we launched in our Seattle area stores as a pilot a feature called, reserve online, try on in-store. And it allows customers to pick merchandise out on their phone, through our mobile app, and they can have that merchandise placed in a dressing room. We know when the customer shows up. We have it ready for them.

They can walk in, and try on what they want to buy, we can check them out real fast. And the results from that over the last month or so have been really, really encouraging, and we're looking forward to rolling that out nationally in 2017. So a lot of deployment of technology that we've been investing in, and building over the last couple of years, into the customers hands, to make shopping our stores way more convenient and compelling. And we think that's going to drive some trips. E, do you want to take the second part of that?

Erik Nordstrom - Nordstrom Inc. - Co-President

Sure. I would reemphasize this, we brought up the last several quarters, just a context of -- we really run the business agnostic to those channels. And that's because that's how our customer shops. While we do accounting-wise break things out full line stores and e-commerce, there's so much overlap between those businesses, and that is increasing.

And Jamie gave one example there, of the store reserve, which is we're excited about because it's a very explicit, seamless experience that connects a shopping journey that starts online, and ends up in a store. We know that's how lots of our customers have been shopping. But they had to start, they start online, and when they go into the store and want to actually see it, touch it, feel it, try it on, they have to start over. This allows them not

to start over. So a lot of our initiatives are around, continuing to take out friction between the channels, and really deliver a experience that is consistent with how customers want to shop.

And that being said, online in the last quarter, some of our initiatives that got put into place. We have a redesigned homepage experience that is performing well. We have a store mode and search and browse that is both on our full website and in our app. And that's again, would be an example of really connecting the online and off-line shopping experience.

We've improved our navigation, had some personalization, small steps that we're excited about. And a redesign of our order confirmation, order history. A lot of these are some subtle changes that don't pop off the page, but have had positive results as we've done [AV] testing on them.

On the app, in addition to the store mode, we launched visual search. We also integrated, we had a separate catalog app we've integrated into our main Nordstrom app. We've also launched search and messaging within iMessage. All these are looking to make the shopping experience more friction-free, and on the customer returns.

Operator

Thank you. Brian Tunic, RBC Capital Markets.

Bilun Boyner - RBC Capital Markets - Analyst

Hi, good afternoon. This is Bilun Boyner on for Brian. I wanted to ask about gross margins longer term. Beyond the opportunity to recover maybe some of the gross margin declines in Q4, what are some of the buckets within your cost of goods sold, or the investments that have been hurting your gross margins over the last few years, that you maybe see most opportunities to improve, to help you get gross margins closer to 36%, 37% range over the next few years?

Mike Koppel - Nordstrom Inc. - CFO

Sure, this is Mike. There is several components that have been affecting that line, and the ones that have had the most significant impact are really related to the evolving mix of our business, and the way our business is changing. So a couple of examples there are, as the Rack business, the off-price business continues to grow faster than the other businesses, that has a lower gross margin element. It also has a lower expense element, so the operating margin tends to be pretty comparable, but it does affect that gross profit line.

In addition, the growth of our loyalty business has put some pressure on that over time. I think in terms of what had been the more shorter-term impacts, and some of the good news we've seen recently, that's been a function of the sales trends we've seen, the excess inventory last year. And as we start to come out of that, and have better controls over our inventories based on the current environment we're in, we're seeing positive in the margin. But I think it's fair to say, it's tough to see getting that line back to historical highs, because there's structural elements to it, both at the business level, as well as the assortment level where we're seeing some changes in mix.

Operator

Thank you. Bob Drbul, Guggenheim.

Bob Drbul - Nomura Securities Intl - Analyst

Hi, good afternoon, Mike, congratulations again on your retirement



Mike Koppel - Nordstrom Inc. - CFO

Oh, thanks, Bob.

Bob Drbul - Nomura Securities Intl - Analyst

Just a couple of quick questions. In the Trunk Club, can you detail little more on the operational changes you are making to make it more profitable? And can you comment a little bit around the full line category, how you're positioned, the selling season, winter boots and fashion boots?

Mike Koppel - Nordstrom Inc. - CFO

Sure, Bob. E, can you comment on Trunk Club, please?

Erik Nordstrom - Nordstrom Inc. - Co-President

Sure, yes, I'm actually in Chicago. We spent the day with our Trunk Club team here. Yes, I would want to emphasize, while we're taking the write-down as needed, we're actually very encouraged with what we've learned, the team's learned and how to make the model better.

And the model, and what we're focused on is really making it better for customers. When we make the model better for our customers, the economic model improves as well. And two areas, I guess, I would call out without getting too specific, one, we think we have an opportunity, we've seen some early results, and just better connecting with our customers in a more consistent basis, that gets them sticky with the brand. And the other is that we could be more accurate in what we put in the Trunks, and what we're sending out to customers. That makes for a much better customer experience, and helps the model significantly.

Bob Drbul - Nomura Securities Intl - Analyst

Thanks.

Pete Nordstrom - Nordstrom Inc. - Co-President

This is Pete. Related to the question about shoes and boots, in particular, seasonal. We got an early view of that, with anniversary sale. And so, the fashion-oriented part of the boot classification, of short booties to over-the-knee boots was all strong and really good. So I think as the weather starts kicking in across the country, we expect that that will be a good classification for us, it's still early days on that, but it seems like we have a pretty good handle on what's happening with that trend. I'd also say that the sneaker business continued to be strong, across all the different genders of shoes and what we're selling.

Bob Drbul - Nomura Securities Intl - Analyst

Great. Thank you.

Mike Koppel - Nordstrom Inc. - CFO

Thank you, Bob.



Operator

Thank you. Ed Yruma, KeyBanc Capital Markets.

Ed Yruma - KeyBanc Capital Markets - Analyst

Hey, thanks for taking my questions, and congrats, Mike.

Mike Koppel - Nordstrom Inc. - CFO

Thanks, Ed.

Ed Yruma - KeyBanc Capital Markets - Analyst

On the credit card business and loyalty, I know that you attempted to fund some of the nontender rewards through efficiencies and advertising. So I guess, have you begun to implement that? And I guess, second, have there been any implications or changes in sign up patterns to the traditional credit card, now that you can get the rewards with the nontender system? Thank you.

Mike Koppel - Nordstrom Inc. - CFO

Sure, Ed. Well, this is Mike. In terms of what efficiencies in marketing, I think it's a little early for that. As you know, we just introduced it in May. We've had a very nice response.

We've built a good book of business around that, with people signing up, but I think that's going to take a little bit of time in order for us to see, I would say, tangible impact of our ability to be more efficient with our marketing. But that being said, we're up to 45% of our business, connecting with those customers, so that's a very, very positive as we look forward. In terms of, could you please remind the second part of the question?

Ed Yruma - KeyBanc Capital Markets - Analyst

Yes, just asking if there have been any changes in credit card sign-ups --

Mike Koppel - Nordstrom Inc. - CFO

Right.

Ed Yruma - KeyBanc Capital Markets - Analyst

Or how the invitation nontender may impact that business?

Mike Koppel - Nordstrom Inc. - CFO

Yes. Ed, we have seen a slow down in that sign them up, sign ups of the tender related side of the business. In the aggregate, for both sides, we've seen very, very promising results, but certainly on the tender side, it has slowed down a little bit.



Operator

Thank you. Richard Jaffe, Stifel.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Thanks very much, guys and Mike, my congratulations to you, and wish you the best in the next part of your career.

Mike Koppel - *Nordstrom Inc. - CFO*

Well, thanks, Richard.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Sure, Mike. We're going to miss you. The main floor business, if you could just comment, and that would be fragrances, beauty, handbags, accessories. I know you called out women's apparel as strong, and I assume that's not the main floor. Could you go into some of these other categories, and how they are doing vis-a-vis to women's apparel business?

Pete Nordstrom - *Nordstrom Inc. - Co-President*

Yes, this is Pete. The women's apparel business -- it's been pretty good for us. And where we've had the best success is what we would classify as the young customer stuff, that largely has to do with our Top Shop business. But really, anything that's about acquiring a new customer, and it's speaking directly to a millennial customer, that's been particularly good in women's apparel.

In terms of the main floor part of it, beauty has been strong, shoes has been relatively strong. The challenge has been really in the accessory categories, particularly like jewelry, accessories, and a chunk of a handbag business, kind of that more for us would be the entry or middle type prices. Our designer business across shoes, handbags, apparel has been good, that continues to outperform.

So it's a large portfolio of categories to look at there, but we definitely have some parts of the business that have gone well. I mean, you heard us call out the J.Crew and the Good American brand. And there's a lot of initiatives and things that we are trying, particularly in women's apparel, that maybe speaks to a bit of a younger customer that's helping us with sales, and helping us acquire new customers. And again, giving us something really to focus on going forward, that's going to hopefully bear some good results for us.

Operator

Thank you. Paul Lejuez, Citigroup.

Tracie Kogan - *Citi - Analyst*

Thanks, this is Tracie filling in for Paul. I had a follow up on merchandise margin. I think you said was up about 30 basis points over all. But how was the performance by division, in full price and Rack? And did the shift in the anniversary sale have any impact on that line item? Thanks.

Mike Koppel - *Nordstrom Inc. - CFO*

Yes, Tracy, we don't usually break it out to that level of detail. Appreciate the question though.

Tracie Kogan - *Citi - Analyst*

Can I sneak in another one?

Blake Nordstrom - *Nordstrom Inc. - Co-President*

Yes. Sure.

Mike Koppel - *Nordstrom Inc. - CFO*

Go ahead. (laughter)

Tracie Kogan - *Citi - Analyst*

You raised your credit outlook, your outlook for credit income, and I was wondering, it sounds like it wasn't because of an increase in sign-ups. What is really driving the underlying profitability there? Is it higher balances, I guess, just tell us the reason for the increase?

Mike Koppel - *Nordstrom Inc. - CFO*

That's a very good question. Yes, part of it is related to higher balances, and part of it is related to operating efficiencies that we continue to realize in that side of the business. Thank you.

Operator

Thank you. Oliver Chen, Cowen and Company.

Oliver Chen - *Cowen and Company - Analyst*

Congrats on solid results, and Mike, we will miss you, and best regards there.

Mike Koppel - *Nordstrom Inc. - CFO*

Thanks, Oliver.

Oliver Chen - *Cowen and Company - Analyst*

Regarding the trend for inventory ahead, inventories have been really sharp, so just for the next few quarters, should we expect a continued conservative stance on inventories versus sales? And another question we had is on shipping costs. Shipping cost as a percentage of sales, what do you think will happen to that line item, as the business and as consumers, and the DC, and non-linearization of supply chain kind of occurs? Just curious on your thoughts?

Pete Nordstrom - *Nordstrom Inc. - Co-President*

Well, I'm going to let either Blake or Mike deal with that shipping one (laughter) But in terms of -- if inventory levels -- yes, I mean, it's fundamental to our bottom line performance to manage inventories well. And you go through those cycles, and learn painful lessons along the way. And we



did a pretty good job correcting -- first of all, our sales plans to be more reflective of what the reality of the trends are, and then getting the inventories down. We did that at the beginning of the year, and we're benefiting from that now.

So our plans going forward reflect the last year or so trends which Mike talked about earlier, have been pretty consistent. So I guess, some might view that as conservative, but I think that serves us well. If business does improve, it's usually been our position, that it's pretty easy to find inventory out there, when things are improving. So we feel like we're in pretty good shape and well-served to keep a conservative viewpoint in our planning, so that the inventory stays in line.

Blake Nordstrom - *Nordstrom Inc. - Co-President*

Oliver, this is Blake. I'll touch on the shipping subject. Supply chain has become an integral part of customer service. And as we've said over and over, our focus is on the customer. So the last couple of years, we've made some pretty big investments to ensure that our supply chain is in lockstep with our customer's demands.

I think the biggest thing as you mentioned some of the fees or costs, Mike pulled out in his remarks, I believe roughly \$[50] million in savings throughout this year that we're finding back of the house in some efficiencies. But the bigger picture is the mix subject, and you touched on distribution centers versus fulfillment centers. We continue to see year in and year out, of core efficiencies in the distribution part of it, which is more of a, apples for apples.

The mix of the timing, and type of goods, and how we're getting goods to customers. And then there's the return reverse logistics subject, in aggregate means more costs. And so, we're working really hard on that to, number one, first of all, meet the customer's demand, and number two, meet our goals and results and our shareholders, that we're doing it in an efficient manner.

Oliver Chen - *Cowen and Company - Analyst*

Okay. And lastly, we took a walk of Toronto, which has a lot of principles which really don't seem easily replicated by Amazon, in a unique innovative approach to service. What are some of the learnings from your store to the future, that you'll prioritize in terms of getting out to your other stores as soon as possible, just because that store in Toronto had a lot of unique excitement around service and experiences, which seemed quite lively, and helpful for store traffic?

Jamie Nordstrom - *Nordstrom Inc. - President of Stores*

Well, Oliver, this is Jamie. Thanks for that. I'm glad you got to see that store. We just opened two stores in Toronto over the last couple of months. And we always say, whenever we open a store, that it's our best store ever, and those stores particularly, we're very proud of, and we're going for it. We've got a good team up there. Our store managers are, of those two stores are two of our best. And in terms of service, we're really going for.

You mentioned some special things that we've been doing there. Along with some of our other, what we would call, of our bigger more flagship stores in Michigan Avenue, and Chicago, Vancouver, downtown Seattle, where it's not just about having a broader offering of designer goods, which we do, but having more specialized services to serve customers in lots of different ways. And that could mean anything from delivering merchandise to their house, picking them up, bringing them to the store.

We've got food and beverage offerings in those stores that are pretty unique, and so far customers are giving us great feedback on. And ultimately, we want those stores to be really compelling places that people want to go, and see something new. And the better job we do in all of our stores, but particularly our higher traffic stores, of showing the customer something new, giving them a reason to buy something new, the better our business is. So we're really, really encouraged by some of the early results from those stores, and things that we can replicate across our entire fleet. And I think you'll see us doing that over the next year or two.



Operator

Thank you. Michael Binetti, UBS.

Michael Binetti - UBS - Analyst

Hey guys, good evening. Let me add my congrats, Mike, to you, on the next leg of your adventure.

Mike Koppel - Nordstrom Inc. - CFO

Thanks, Michael.

Michael Binetti - UBS - Analyst

Can we just get an idea -- a lot of my questions have been answered -- but can I -- let me throw two in here. Can we just get idea of the profile, maybe of the new rewards customer, compared to the narrower credit card reward customer from before, changes in frequency you've noticed? Or maybe more importantly, how does the gross margin on the sale of the nontender loyalty, compare to the previous generation of rewards customer?

Mike Koppel - Nordstrom Inc. - CFO

Michael, I would say, just in general, the nontender customer tends to be -- it's a broader appeal product. The tender product qualifications for having that card, we had very, very high FICO standards, it tended to be somebody that had a longer history of spending, that could justify getting that card. The nontender, we don't have that, and so we're attracting a much broader customer. It's allowing us to engage with a younger customer that is coming through their cycle with us, and introduce them to some of our benefits, and to the conveniences of shopping with Nordstrom.

In terms of the economics, I would say, just by its very nature, you're going to have higher spend with a credit card-oriented product versus a non-credit card oriented product. In terms of margin, I'd don't think I have any numbers in front of me that tells me the impact of that. But I think the most important thing, it's like we talk about opening the Rack stores, we're attracting a lot of new customers to our brand, and those customers will continue to grow with us.

Michael Binetti - UBS - Analyst

If I could sneak one more in. I know you're not going to talk about the plan for beyond this year, but could we talk about just some of the high-level items impacting the cost lines today, and what you think we should be thinking about longer term, as we go into next year? And maybe some of those that will not be a factor? Looking out past this year, we see the cost savings you guys have rolling through in the report today. But I think you lap some dead rent in Canada next year, and you probably have less Trunk Club amortization now, maybe on the gross margin line, some of the price matching continues into next year. Can you help us think about some of the puts and takes on the bigger buckets, as we look into next year for our model?

Mike Koppel - Nordstrom Inc. - CFO

Michael, it sounds like you figured it out.

Michael Binetti - UBS - Analyst

(laughter) I would like your blessing on this stuff though?

Mike Koppel - Nordstrom Inc. - CFO

Yes, okay. (laughter) that's what I kind of thought. I would just reinforce the fact that the three main areas that we continue to focus on, technology, supply chain and marketing, they continue to be critical, because those are the areas of investment that are driving the new platform for growth, and that's e-commerce and anything digital related.

So we're going to have to continue to figure out how to use those resources more effectively, and find ways to deliver the experience more efficiently, because they're very, very highly variable in nature. And of the more that that business grows, the more those costs are going to go up. So I think that's going to be a multi-year effort on our part.

I think the other things we talked about, you're right, tend to be a little bit more shorter-term. The investments we have made, yes, we are starting to see the impact to the earnings line start to narrow. We saw some improvement in 2016. We should see additional improvement next year, and the years to come.

Trina Schurman - Nordstrom Inc. - Director of IR

Great. We'll now take one more question.

Operator

Thank you. Lindsay Drucker Mann, Goldman Sachs.

Ed McLaughlin - Goldman Sachs - Analyst

Hi, this is Edward McLaughlin on for Lindsay.

Mike Koppel - Nordstrom Inc. - CFO

Okay.

Ed McLaughlin - Goldman Sachs - Analyst

I had a follow-up on the breakdown of your comp performance between Nordstrom.com and rack.com. It seems like they converged here in the third quarter, compared to the second quarter. Is there any detail you can provide on customer flow, you're seeing between the two, or anything else that might be driving that?

Blake Nordstrom - Nordstrom Inc. - Co-President

This is Blake. Erik, do you want to take it, or you would like me to take it?

Erik Nordstrom - Nordstrom Inc. - Co-President

Well, I think, jump in if you -- we had an initiative in our fulfillment center for our Nordstrom Rack and HauteLook e-commerce business that delayed some shipments getting out. And it took some sales out of the third quarter and we'll shift them more to the fourth quarter.

Blake Nordstrom - *Nordstrom Inc. - Co-President*

That's absolutely correct. And so, there's a timing difference there. And so, we saw a slight improvement in Nordstrom.com and what you're looking at, Lindsey, is the NordstromRack.com and HauteLook was down from its trend. When we make that adjustment for what happened in our supply chain side, it's pretty consistent with our trends.

Trina Schurman - *Nordstrom Inc. - Director of IR*

Again, thank you for joining today's call. A replay along with the slide presentation and prepared remarks will be available for one 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, and thank you for your participation.

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