Nordstrom

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Jay Sole: All right. Good morning, everybody. I am Jay Sole, UBS's Soft Lines Analyst. And I am really honored to be joined today by Anne Bramman from Nordstrom. I also want to point out Trina Schurman, who is sitting in the front row, and Putbory is here as well. Thank you for coming today. And what we're going to do is we're going to start off with a short video and then Anne is going to make some opening remarks and then we're just going to have a little discussion about the business.

Anne Bramman: Sounds great.

Jay Sole: Okay? So maybe without further ado, can you roll the video?

[Video Playing]

Anne Bramman: Thanks Jay for hosting, I'm super excited to be here today and thank you for your interest in Nordstrom. I'm pleased to see everyone in the audience today. I wanted to give a few opening context comments and then we'll go into Q&A. It's a great opportunity to be here, especially the timing of this conference, since we just came off our earnings call last week. It feels a little longer than that, but it was last week. And it's a great way to think about, on hindsight, 2018, both from our investor day as well as how the year landed.

So I think we could all say or see that retail is really and our customers continue to change and evolve. And when we think about Nordstrom, we think about our offering, we believe we're best differentiated and we're best positioned to serve that customer because it's really about the service and the experience. And when you think about the Nordstrom brand, that's really what we represent.

Over the past decade, we've made early investments in our digital capabilities and we've been investing in things we call generational investments; so Nordstrom Rack / Hautelook.com, Trunk Club, Manhattan and Canada. And what I'd also like to say is this year is the last year that we've got heavy investment. So we're opening up our tower in New York as we're entering and expanding into the New York market. And we're super excited to have that open so we invite everyone to come shop in October when that opens, 58th and Broadway. Just a plug.

We're also talking -- when we think about the earnings call and investor day, I think it's also we reflect on the fact that we're in a really unique position from both our digital and our physical assets. We think about off-price and full-price. We think about digital. And we think about the stores. And the way we think about it is; how do we serve that customer across the board?

And we're also focused on the financial targets that we made in our investor day. And we're doing this through three ways. Number one, gaining market share, and we're doing this through local market strategy and we're doing this through our generational investments. And number two is driving returns for our shareholders through productivity and margin, and we're doing this through a number of ways, through our strategic partnerships and also through bending the curve in our cost curve for the digital capabilities and leveraging our SG&A. And then third is really our really consistent disciplined approach to capital allocation to our shareholders. As we talked about on the earnings call, this was our tenth consecutive year of over $1 billion of operating cash flow, and we've been continuing to invest in our business. And last year we distributed -- or we distributed $1 billion of cash back to our shareholders through share buyback and dividends.

So with that, we're very excited to be here and I open it up to your questions.

Jay Sole: Okay, great, Anne. Thank you. So I guess the first thing I want to talk about is just sort of the high-level strategy-type question. Because the goal, as you've talked about before and you've just talked about right now, is to be the best fashion retailer in the digital world. I love ambitious goals. And the irony is that's one that seems very much within reach for a brand like Nordstrom with its 100-year reputation for service.

For all these investments that you're making, you know, what is the key -- what are they going to do to get you to the point where you are the best? In other words, how is it going to differentiate you? Because everybody in this room -- not everybody -- a lot of people in this room are going to wonder, "Okay, department store." That has certain connotations to go along with it. How are you going to sort of rise beyond that sort of perception that, okay, people aren't shopping department stores the ways they used to, and become that best retailer, best fashion retailer in the digital world?

Anne Bramman: Yes. So first of all, we don't see ourselves as a department store. We see ourselves as a fashion specialty retailer. So when we think about what our offering is, again it's about the service and experience and the customer journey. So we have been around since 1901, and when you're relentlessly focused on serving the customer and making sure that it's a great experience and a frictionless experience, it really kind of dictates and serves as kind of the umbrella of how we think about our business.

So as I mentioned earlier, we feel like we're really uniquely positioned between off-price and full-price. And we're measuring ourselves in a number of different ways. So when we talk about market share, that's one way to differentiate, as far as being the best fashion retailer, is how much market share are we gaining in each market. It doesn't matter how the customer is shopping us as long as they're shopping us.

The second component to it is really about making these investments in the digital component. So we've been investing for quite some time. In fact, our Nordstrom.com site is 20 years old and we've been offering BOPUS, buy online pickup in store, since 2008. We have a shared inventory in our full-price business, which really allows us to leverage that with our customers. So again, we're continuing to drive choice and service and making sure that they're -- no matter how they want to shop us, we're there to serve them.

The third component to it is the generational investments; and so again, entering markets like Manhattan and Canada, buying some of these digital capabilities, really expanding that out to serve the customer.

When we think about how we're measuring ourselves against market share, it's also on customer acquisition. So we talked about the fact that we acquired new customers last year. We served 35 million customers last year, and what we also found that, of that 35, about a third of them actually shopped multiple ways with us. And as you know from our investor day, the more people shop with us in multiple ways, they're four to 11 times more engaged with us from a top-line perspective, from a sales perspective, and they're a more profitable customer for us as well. And the third piece that we're looking at is between customer acquisition and market share is really just looking at customer engagement. So I mentioned the multiple ways they shop us. The more we drive that experience, the better we are as a company.

Jay Sole: Okay. So I typically, in these kind of conversations, I like to stick to some of the bigger-picture questions that are going to drive the business over five years. But it's a hot topic. I do want to ask you about the full-price business in 4Q.

Anne Bramman: Sure.

Jay Sole: I think that the comparable sales decreased 1.6% versus it was up 2.5% in the previous two quarters. Can you just sort of deconstruct what's going on in the full-price business right now?

Anne Bramman: Yes. So it was quite surprising to see the slowdown in the fourth quarter. As you mentioned, the first three quarters of the year were actually pretty strong and pretty consistent trends. We did call out in the earnings call last week that traffic -- we saw a sharp decline in traffic in the full-price stores.

We are a fashion retailer. And so when we started seeing this, we immediately started taking action. We started editing our assortment. We took about 10% of the counts, choice counts out of our assortment. We also started really making sure that our inventory exiting the year was as clean as possible. And we feel overall we're in really good shape. There are some pockets, as we talked about on the earnings call in Q1, that we're still working through in comparison to the sales trend. But overall, we really felt like we needed to get our -- make sure that we were exiting the year in a really good shape on that.

And then quite frankly, we are pulling levers on the marketing side. So we launched the Nordy Club loyalty. We're also looking at our other marketing capabilities to see how we can drive some of that top-line piece to it.

And the reality is we're a fashion retailer. We've seen this before. It's happened before. So we know how to work our way through this on the levers piece to it and we're pulling all those levers. I think a great example of what happened with off-price in Q1 with Rack -- of 2018 -- it was slowed down and we really worked to get the assortment back in line and make it more compelling for the customer. And by second quarter of last year, we were back on track. So as I mentioned, we're seeing the levers, we're pulling those levers; we've been here before and we're working actively to get after it.

Jay Sole: Got it. So maybe I just want to try to just ask one more question about this because, from an outside point of view, we see the stock market was very volatile in the fourth quarter.

That can have an impact on spending especially for the Nordstrom customer; it's a little bit higher income. There was a government shutdown. It was like five or six weeks, unprecedented. It's been sort of a -- a lot of tension around just the country. There's that aspect. We've seen a lot of retailers talk about there was a lot of promotions in December, from the retailers that have reported; many have already. So there's this whole macro component, retail component.

But you're talking a lot about fashion. So can you sort of just differentiate for us like what's going on? How much of what's being impacted for Nordstrom right now is sort of a macro thing and then sort of that's why you're pulling the levers around marketing and maybe cutting back some inventory? Or versus maybe like the fashion piece isn't quite where you want it to be and you're going to fix it.

Anne Bramman: Yes. So for us, I can't -- I really can't comment on what's going on macro. What we know is what we can control and what is in our wheelhouse. So for us, it's really about making sure the inventory is compelling and that we've got a great offering and we're talking to the customers in the way that we can reach them.

One of the things that we are also doing is making sure that we're staying agile in 2019. So we're setting our inventory buys below our sales trends in order to be able to chase some of that in '19 as well. So again, all of that, as well as really focusing on our strategic partnerships limited distribution. The highly curated offerings, very limited, very unique to Nordstrom to drive that compelling experience is also a differentiator for us. So we're pulling the levers that we can control. I can't control the things going on around me.

Jay Sole: Right, okay. And then maybe one small one lastly is; was there a difference between the online business and the stores' business in terms of how they sort of moved down from that 3Q run rate that we're at? Or did the stores really move and online has sort of been the same?

Anne Bramman: So what we talked about for the year is that we actually grew our digital penetration to be over 30% and digital grew 16%. So what we've called out was really the traffic in the full-price stores is what we really saw the deceleration coming down. So overall, other traffic was generally in line with what we had been seeing both in off-price and the digital side for full price. It was really that store traffic.

Jay Sole: Got it. Interesting. Okay. So now you decided to move away from reporting store comps in 2019. And next year you're going to report just net sales growth instead.

Anne Bramman: Right.

Jay Sole: Can you tell us about that?

Anne Bramman: Sure. So I think as I mentioned, we're looking at it -- we measure ourselves on market share gains both -- and really we're internally we're focused on that as well. We're looking at total growth. And as we looked at the full year, the spread between total sales and comp sales, there was really no spread. And so as we -- and we talked about this in the investor day -- as we continue to grow the business digitally and migrate towards the digital side and the fact that we're really measuring ourselves on market share, we made the decision to just do total sales growth. Now I know there was a lot of concern about; what happens when the tower opens in Manhattan in the fall and how do I get visibility? We're going to provide some additional visibility to that to everybody out there. So rest assured we're not going to go dark. But it is, for us, it's really kind of a part of the journey of how our business model is evolving.

Jay Sole: Okay. So there's obviously, near term there's some leverage. Bigger picture, there's other things happening within the company that's going to drive the top line over time; not just opening the New York store, which is obviously a huge piece. But you talked about the Nordy Club. Maybe as we sort of break down some of these pieces that are sort of bigger picture and I think, frankly, in line with where retail is going, with where the consumer is going, can you talk about personalization? Data analytics and personalization is a hot topic at this conference. We've had a lot of people talking about it. It's something that Nordstrom has been investing in for a long time. Where are you with that now? Where is it going? What kind of a driver is it of sales over time?

Anne Bramman: So we've been, as you mentioned, we've been investing in this for quite some time. We have a very good team in Seattle that works on this. And we see it in a couple different ways.

So one is on the marketing side. We use it as part of our digital marketing capabilities and have for quite some time. So we're using this to look at return on the different digital capabilities and where we're talking to the customer. And it's allowing us to make some pretty easy and quick -- not easy -- but quick decisions as far as what levers to pull and react to what's going on to how we're spending our digital marketing dollars.

The other piece to it is really the personalization, the communication to our customers both in what we're showing them on our site as well as how we're talking to them from a marketing perspective. The piece that we're really getting into quite heavy, and we talked about this on the call as well, is on the merchandising side. So we're looking at this as far as allocation and some of the editing choices we're making in our assortment as well.

Jay Sole: Okay. You talked about acquiring customers. Is there a component of using data analytics to acquire new customers and sort of when you acquire them, to retain them longer term?

Anne Bramman: Yes. So really it goes back to how we're talking to the customer and the marketing side of things. And so it's do I share with you -- I know you like certain brands that you like to shop or there's certain sizes that you shop. How do I take that data and analytics when you come on the site or when you're in the store and making sure that it is something relevant and personal for you? So we're constantly evolving that offering and that communication to our customers. So that's the piece of it, the marketing side.

And then quite frankly, the inventory. If it's compelling, if it's we're able to predict the returns and buy in to those returns and where they're coming and what's coming back. We're using that a lot from the data analytics as well as how we're allocating it out as well. Because part of it's having the right product at the right place.

Jay Sole: Got it. And so I guess having the right product in the right place is sort of enhanced by this Nordstrom Local, as you call it, strategy.

Anne Bramman: Absolutely.

Jay Sole: Where just, for those who might not be aware, obviously Nordstrom is a very large store, multi-floors, big malls. But Nordstrom Local is like a maybe 2,000, maybe 3,000, something like that, square foot store in a local neighborhood.

Anne Bramman: Right.

Jay Sole: You sounded incrementally bullish on it on the call.

Anne Bramman: We are. We are. So it's if you read the headlines, it's the inventory-less store. And so it's really about the service and experience and engagement. And so in L.A. that's a piece of it we were doing as well as we have what's called the Project 18. We engaged about 800 customers in the L.A. market and they really helped us develop an offering and an app for that market. And we're using this to scale. And what it does is it allows you to open up the inventory in that market and leverage your digital and physical assets. It opens up the choice count by 7 times for inventory, but it also allows the customer to determine where they want to pick it up or how they want to receive it. So it can be same-day, next-day delivery. As part of this, we're also investing in supply chain quite heavily in the West Coast component, too, that will help facilitate this as well. The local markets [correction: stores] is a piece of it. So what this allows is, one, returns. So people can return items quickly. They can meet a stylist there. They can get alterations and service done as well.

What we're seeing is that one of the economics on this is, one, it's better engagement, that people tend to shop with us more, higher engagement as well as higher market share for the L.A. market compared to the rest of the company. So early reads are -- we're really happy with what we're seeing. The nice part about the returns is this is -- it's a finite product. It's got a shelf life on it. So the faster we can get the return in, the faster we can get it back on to be re-sold. And so what we're seeing is it's actually cutting the times of returns by about 7 days.

Jay Sole: Interesting. Okay so maybe let's talk about margins.

Anne Bramman: Sure.

Jay Sole: Because I think that's a key part of the story. Margins, they used to be 11% -- I guess we'll go back many, 20 years. They used to 6% and then they got to 11%. Now they're 6% again. But what's interesting is that you guided to margins up zero to 20 basis points this year even though it's going to be maybe a little bit slower from a top line, at least to start the year, than you expected. A big source was new SG&A efficiencies that you're talking about. Can you give us more detail on what those are?

Anne Bramman: Yes. So let me step back a little bit about this because you're talking about EBIT, you're talking about product and you're talking SG&A. So let's step back and look at the EBIT component to it. So as you mentioned, back in the heyday it was 11% in the strictly bricks-and-mortar model. As we talked about last summer in our investor day, the model has changed and so what we see over time is that you can still get really good shareholder returns if you look at ROIC, return on invested capital, over time. And the levers you can pull for the return on invested capital is not a distributed capital investment; it's more contained in your key capabilities like technology and supply chain and you can get more scale and leverage out of that, which drives more free cash flow and a better return. So we think we can get back to a mid-teens return on invested capital. We exited the year at 12% in 2018 and that, over time, we see as being a really good corollary between total shareholder return. So the model has changed, but you can still get the returns based on what that is on an EBIT basis. So that's the EBIT component to it.

On the product margin side, as we talked about on the call, it was slightly better. It's really about a tighter inventory, better turns through strategic partnership limited distribution penetration. Really important for us as far as that moat around our margin. And then with that, it allows us to have more selling at first price without markdowns.

On the SG&A side, we've been talking about this, we've invested a lot in our key capabilities; marketing, technology and supply chain. I think back in 2012-ish, it was about 20% growth in that area; so really outpacing top line. About 2015, we call it, bent the curve so it cut it in half. And then in the last couple years, we've been mid-single digits. When you pull -- so we're getting scale and leverage out of that. The other initiatives we're doing in SG&A is getting more productivity and scale out of our core business.

So we're not talking about specific initiatives at this time. We will give you updates throughout the year. But we are pulling -- we are looking at different ways to drive efficiencies in the business because we are coming out of this heavy investment cycle. I think the thing to note on our SG&A rate is if you pull out the investments we're making in the West Coast, which are pretty substantial this year, we're actually relatively flat year-over-year from a rate basis.

Jay Sole: So all right, so you are making these big investments in West Coast distribution and capacity. I think one big issue for retail in general is fulfillment costs. And you mentioned -- you used a phrase just a moment ago, "bending the cost curve". Can you give us a high-level kind of idea of what the potential is to bend the cost curve in fulfillment?

Anne Bramman: So West Coast is a really big deal for us. We are opening up a 1 million square foot we call it a West Coast omni-channel facility. So right now, about 40% of our customers are on the West Coast and that's being fulfilled out of either the Midwest or Pennsylvania. So if you think about a customer experience, and I'm in Seattle, it takes me five days to get my shipments so it's not a great customer experience and it also costs more to do that. So by opening up this facility, it allows a better customer experience, more efficient, more access to inventory. And then the (inaudible) for us is actually more beneficial from a cost perspective, from a shipping and getting returns back in quicker and processed as well. So that's a really key unlock on the West Coast as well as what we're calling a local omni-channel hub for L.A. This is actually kind of a pushed model on the inventory. It's getting us quicker on the working capital components to it, less investment in inventory overall for the market, because we can open it up and then we can take that into other markets as well. So that is a really big deal for us.

Jay Sole: That's a really big deal. That's clear. As far as returns, because you just touched on that a moment ago, at a high level, what's the potential to lessen -- bend the cost curve on the cost of processing returns? And not just in process, just how many you receive and how much the consumer wants to use that free returns option. It seems like table stakes at this point.

Anne Bramman: So we do have free shipping and free returns. What's interesting is when our customers return back to us, 60% of those returns actually come back into the store. So even though we offer free shipping back in, they choose to come in the store to do it from a convenience perspective. So from a processing perspective, it actually is -- it works for us. Nordstrom Local is another way for us to unlock that. It's a lower-cost option as well as getting the returns in faster. So it helps our margin component to it. So overall, that is something we're absolutely focused on and continue to drive efficiencies in that.

Jay Sole: Got it. Is there a type of -- there's different types of returns. There's people who buy three of one thing to figure out what they want and then keep the one that fits and then they return two. There's people who just don't know. They try it and they don't like it. They return it and they don't buy anything. Is it possible to sort of manage to one or the -- is it possible to say like with Nordstrom Local, if people want to buy three that's great because as long as they keep one that's still fine. Is there types of returns that are actually more economical to sort of process and give that customer that experience where you're still going to make the kind of return ROIC on that transaction that you want?

Anne Bramman: Well clearly. if someone buys something, that's a great thing for us at the end of the day. But I think really at the end of the day it's also about how easy is it for them and is there an opportunity to, when they come back in, to sell them something new. So whether they buy three and keep one or they just didn't like it and they come back in, if you make it a great experience then they're going to continue to try.

Jay Sole: Okay. So maybe let's talk about inventory management because I think -- you mentioned ROIC. Part of that is, I think, less working capital. You mentioned a push model, which is sort of something we've heard from the footwear companies a little bit; not so much from the large specialty retailer side. Can you give us an idea of what the opportunity is on inventory management and maybe what KPIs you're using to measure it and what the goals are?

Anne Bramman: So always you want to make sure you're as efficient as possible, but have a great offering and selection for our customers. We are focused on -- for us, it's really focused on making sure we've got choice count and a great offering. So the L.A. market that we're doing with the supply chain investments that we're making is a great opportunity to make sure that we're getting the product out as quickly as possible and exposed to the customer. So from that perspective, it's a great working capital margin component to it. I think for us when we step back and look at our business, it's about your turns. It's also about the penetration for our strategic partners limited partnership is really about our margin component to it. So that helps us drive more selling at first price versus a promotional markdown cadence. To us, that's really how you're going to drive value both from a customer experience, but also from investor return as well.

Jay Sole: Okay. Another big spend over the years has been tech spending. I'm going to estimate the company spends $500 million a year on tech. Can you bend the cost curve in that bucket?

Anne Bramman: Yes, we already are. So we've been making a lot of investments along the way. You think about it, we're 100-year-old company so there's been a lot of infrastructure components to it. So it's really getting that base to the point where you can layer on the digital capabilities component to it. Part of what this allows us to do is, from a digital component, is make it frictionless for our customers as well as be more agile. And so you're seeing a lot of agile development in our tech space as part of the customer experience; so both on the digital marketing side as well as on the dot-com side. So yes, because we've been going after this for so long, it's really getting that tech stack in a place where we can layer on the digital capabilities.

Jay Sole: So one perception about tech spending I think that we have, as sort of the investing community, is that it's sort of the cost of doing business these days in this digital world, but it doesn't necessarily drive ROIC that we're talking about. Obviously, digital sales have grown. That's more about channel shift and people just choosing to buy the product in one place versus maybe the stores where they used to buy it. Is there a point where it's not just that you sort of leverage the tech stack, as you said, but it's sort of like you get smarter with more investing in tech and eventually, whether it's through personalization, using the Nordy Club, that you start to drive top line because that type of investment that's in that $500 million is really being used more efficiently, more effectively, just based on the 100-year history, the collective learnings and wisdoms that are inside the company?

Anne Bramman: You kind of answered the question.

Jay Sole: Well I'd rather hear you say it, though. Tell me why I'm right.

Anne Bramman: You're absolutely right. I mean when you think about it, it allows you to have more shots on goal. More A/B testing allows you to really react to what the customer response when you send them a digital marketing component or you have something on your website. Yes, I mean all of this. We're looking at returns. We're looking at return on invested capital. We're looking at how it enhances the customer experience, reduces friction, and allows more top line growth. So if you think about our investments overall going forward, once we exit out of investing in Manhattan, we've given guidance that 70% of our investment is going to be supply chain and technology from a CapEx perspective. So you can really see that's where it's heading.

Jay Sole: Right. All right. So we talked about generational investments, but I want to talk about how this is something that can sort of impact the company's margins because we're sort of coming through a big period of spending on generational investments. Obviously, there's New York stores, the Canada stores, Trunk Club, Haute Look. Can you talk about, first of all, the digital investments, Haute Look, Trunk Club? You give a great chart. I don't know if you guys have seen it. But it's like a column chart and it shows the spending in terms of -- the columns are pointing down because it's like a negative impact on EBIT because it's spending without necessarily sales on top of it. But for those digital investments, you've already owned them now for a few years, is the amortization starting to run off in those businesses where you start to see a benefit, at least on the income statement that we look at, because you already own those?

Anne Bramman: To be really honest, that's so immaterial that's really not the story around generational investments. The story around generational investments is actually scaling the investments we've been making in the top-line growth. And then we like to say that with the tower opening this year, we're going to start cashing checks versus writing checks. So that's the last big component on the horizon coming through. We're continuing -- when you look at Nordstrom Rack / HauteLook.com, Nordstromrack.com was actually our fastest business to hit $1 billion in sales last year. They did it in four years. Trunk Club, we're very excited. In the investor day we sized the opportunity of a $500 million opportunity with that business. It's actually well in line and meeting those and maybe even exceeding those expectations. And so -- and we're continuing to grow the Canadian market. And then, as I mentioned, the tower in Manhattan is really a great opportunity to gain market share in New York. And so we're really excited about (inaudible) on and ramped up so that we can get the flow through and return on that.

Jay Sole: Got it. So maybe let's focus on Haute Look for a second because, to you point, I think when you bought it, it was like a $200 million business and now it's a $1 billion business. That's awesome. Questions a lot of people have is; how profitable is it? And I guess, more importantly, can you make it more profitable?

Anne Bramman: Well, I think a great representation is our full-price business. So we've talked about the fact that in our full-price business between the stores and dot-com, we're actually at parity because we've got the scale and size in that business. So from a contribution margin perspective, we're agnostic how a customer shops us. We make the same amount of money from a contribution margin whether they're in the store or they're buying online. And as we talked about the off-price business, we're not quite there yet as far as that parity, but we're working really hard to get scale and leverage out of those investments as well.

Jay Sole: Do you think you can get there?

Anne Bramman: Well, we're going to give it every effort we can to get there.

Jay Sole: Okay. Well I guess on the slide that I referenced, I think it says that the estimated sales and EBIT from these generational investments is about $2.2 billion this year.

Anne Bramman: Yes.

Jay Sole: At a cost of about $125 million.

Anne Bramman: Yes.

Jay Sole: So it's a negative contributor to overall EBIT.

Anne Bramman: Correct.

Jay Sole: Big question. Is it fair to assume that these investments turn profitable over time?

Anne Bramman: Yes. So we have talked about the fact that we expect to be breakeven by 2022. And that's one of the biggest drivers. When we talk about meeting our targets for our financial goals by 2022, a big piece of it is the generational investments becoming breakeven by 2022. We're continuing to see the top line, and as you mentioned, we're getting scale out of that.

Jay Sole: Okay. I mean -- look it; the slide is right there. So it's a big part of the story.

Anne Bramman: It's a big part of the story.

Jay Sole: All right. So let's switch gears a little bit in the few minutes we have left. Let's talk about the credit business because this comes up a lot as well. First, Anne, can you just talk about how you manage the credit business? I assume credit reports to you.

Anne Bramman: Recently.

Jay Sole: Recently?

Anne Bramman: Yes.

Jay Sole: So do you manage it separately from the retail business?

Anne Bramman: Really the way we look at our credit business it's there to support the off-price and full-price business from a customer experience. And so it's really, when we look at it, it's actually incorporated into their overall profitability.

Jay Sole: So when you think -- so I guess the way investors think about it, it's like; okay, you get in a quarter, full-price store traffic is down a little bit. Maybe get TD Bank to extend a little bit more credit to some customers. You get a little bit more credit income. And you sort of can say; hey, I've pulled that lever. Which there's nothing wrong with that, but I think people would worry -- you know what I mean? Like people don't want you to get overextended on credit. Do you think about the credit business that way? Because traditionally we haven't thought about Nordstrom using the credit business that way. But I mean is that -- I mean maybe that's okay. Can you just tell us about that a little bit?

Anne Bramman: So we do have relationship with Toronto-Dominion Bank. We sold them our receivables, I believe, in 2015. And so they manage that piece of the business. Again, the way we look at this is it's really an enhancement to our customer. And so when we talked about the guidance for credit revenue this year, it's really tied to the growth in our loyalty program. So they really go hand-in-hand, from a Nordy Club and a card perspective. And that's really the levers we're pulling, is to make sure that we're supporting our retail business.

Jay Sole: Got it. Okay. Everybody talks about a downturn. It was supposed to be this year. Now we've sort of had whatever we were going through this year and so maybe it will be next year. On the credit piece, people worry about what kind of exposure you have to the receivables owned by TD Bank. Like can you just talk to us about what kind of credit risk Nordstrom has around that piece of the business? Just so we can sort of model out how to think about if there is like a recession scenario, like what that impact would be.

Anne Bramman: Yes. So the relationship we have with TD is it is a co-share revenue-share model, which I think is pretty traditional in the marketplace. I think the way I would approach it is when you go back to the great recession in 2008, our portfolio was very resilient and we had a lot of customers who -- and we still have a lot of customers in our portfolio that have been with us for 10-12 years. And so overall, I would say we've got a -- I think if you look at how we've managed this in the past, we've actually been pretty good about having a really resilient portfolio.

Jay Sole: Right. Fair enough. All right. So maybe a couple more. I want to just go back to one thing because we talked about big picture and I think the one area that we didn't -- we talked a bit about product in the sense of being able to manage inventory and pulling back. I think one thing that, to me, is compelling about Nordstrom, and especially in relation to some of the other competition that is maybe highly leveraged and maybe isn't quite as in a healthy position, doesn't have quite the balance sheet, doesn't have quite the investment capabilities, hasn't made the investments; Nordstrom has great product. And everybody talks about Amazon. Oh, what's Amazon -- how is Nordstrom going to compete with Amazon? First, let's talk about product. Let's talk about it in the sense of what's distinct about what Nordstrom offers relative to everybody else out there, Amazon or not, or just other people.

Anne Bramman: Yes. So we talked about a lot about the strategic partnership limited partnership. So there's several components to that. It's some of the work that we're doing with some of the digitally native brands, some emerging brands. We spent a lot of time building relationships and a pipeline with those folks. And they really like working with us; one, because we've got price integrity for them versus what you may find in other people's digital sites. Secondly, they like the fact, they like the interaction we have with customers and how it represents their brand with the customer. And then third, we really work with them to make sure that they can scale and support our customer base from a production perspective.

So there's a lot in the pipeline as far -- and I'll give you some examples. So Allbirds was a really good one for us. We did a collaboration with Something Navy with a blogger, an influencer out there. So there's a lot of those type of things. It's a curated journey. It's a unique journey for our customer. But it helps us stay to where you're not into that transactional comparison with some of the other folks out there.

Jay Sole: I think at the investor day you gave us a stat around like what -- private brands, exclusive relationships. Can you share some of those stats with us? Because I think it's an important differentiator.

Anne Bramman: Yes. So it's really those brands, that product actually sells more at first price versus the rest of the portfolio and it is actually more profitable. There is a stat we gave. It is about 14% higher margin on that overall than what you see in maybe some of those things that are more distributed out in the marketplace. So when we talk about building the moat around our margin, it's really a great piece of how we're leveraging not only the experience, but also from delivering on what we need from a product margin perspective.

Jay Sole: Okay. And maybe last topic area is going to be free cash flow because to me it's always surprising when I look at the cash flow statement and I see $800 million of free cash, very little long-term debt. Most of the real estate in the full-price stores is owned. Obviously there's a lot -- the Rack has leases, but I mean this is a really strong company from a financial perspective. How much -- and you talked about CapEx coming down. So just can you paint a picture for us about what you feel like the free cash flow is going to look like over the next couple years given these investments that you've made and where you see the business going?

Anne Bramman: Yes. So we talked about the fact that we've had 10 consecutive years of operating cash flow over $1 billion. This is a very strong cash-generation company. We are investment-grade. And even with that investment grade on our debt we still returned $1 billion of cash back to shareholders while still making some pretty heavy investments. So if you come out of that investment cycle, we're going to be generating quite a bit of cash. And so we laid out in the investor day a plan on giving cash back to shareholders, but continuing to invest in the business. And so in 2020, the target we gave for free cash flow was about $800 million. So this is the last big year of writing checks, so to speak, but it's not that we're pulling back on investing. We'll continue to invest. Our goals is, number one, to stay investment-grade rated. We're a BBB+. Two is to make sure that investing in the business. And three is being disciplined and returning cash back to shareholders.

Jay Sole: So I guess to that point, the last quarter the company bought back a fair amount of stock in the last quarter.

Anne Bramman: Yes, we saw a great opportunity.

Jay Sole: Well, you know what? There still could be great opportunity. I think that the question is; can you make the kind of stock buybacks that you're making and maintain that investment-grade rating? It's probably even important for the brand, not just for the balance sheet and for investors. Can you manage both with the kind of cash flows coming? Or would you have to sort of maybe move that leverage ratio a little bit higher to sort of accomplish everything?

Anne Bramman: So our target ratio is up to a 2.5. So 1.5 to 2.5 leverage ratio. And that's really what we focus on maintaining. So as I talk about giving back cash back to shareholders, it's really about after you maintain that investment grade, having that leverage ratio and investing in the business. So once you have that, then it's excess cash that you're returning back through dividends and share buyback.

Jay Sole: Right. And then, I think -- I might have missed this -- but the CapEx part. This will maybe be the last question. CapEx has been, you mentioned, big and it's kind of going down into probably more historical -- well I think maybe 4% was the normalized run rate historically. Can you just talk about where you've been and where it's going?

Anne Bramman: Yes. It's really a really big year for us. We're going to be almost 6% of sales in CapEx because, again, we've got a lot of payments left in Manhattan. So it's going to be roughly $900 million of CapEx this year. Again, going forward what we talked about in the investor day was coming back down to that 3% to 4% range. What's interesting is how we're spending it going forward. It's really going to be more the story towards supply chain and technology.

Jay Sole: Okay. All right. Well, let's stop there. That's great. I'm a huge -- well, as -- thank you for being with us, Anne Bramman, this is fantastic, Nordstrom. Give her a big hand everybody.

Anne Bramman: My pleasure. Thank you.