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JWN.N - Q3 2023 Nordstrom Inc Earnings Call

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**OVERVIEW:**

Company Summary

## CORPORATE PARTICIPANTS

**Catherine R. Smith** *Nordstrom, Inc. - CFO & Treasurer*

**Erik B. Nordstrom** *Nordstrom, Inc. - CEO & Director*

**James Duies** *Nordstrom, Inc. - Senior Director, Investor Relations*

**Peter E. Nordstrom** *Nordstrom, Inc. - President, Chief Brand Officer & Director*

## CONFERENCE CALL PARTICIPANTS

**Blake Anderson** *Jefferies LLC, Research Division - Equity Associate*

**Brooke Siler Roach** *Goldman Sachs Group, Inc., Research Division - Research Analyst*

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

**Matthew Robert Boss** *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

**Michael Charles Binetti** *Evercore Inc. - Senior MD*

**Oliver Chen** *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

## PRESENTATION

**Operator**

Greetings, and welcome to the Nordstrom Third Quarter 2023 Earnings Conference Call. (Operator Instructions). As a reminder, this conference is being recorded.

At this time, I'd like to turn the call over to Jamie Duies, Head of Investor Relations for Nordstrom. Thank you. You may begin.

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**James Duies** - *Nordstrom, Inc. - Senior Director, Investor Relations*

Good afternoon, and thank you for joining us. Before we begin, I want to mention that we'll be referring to slides, which can be viewed in the Investor Relations section on nordstrom.com. Our discussion may include forward-looking statements, so please refer to the slide with our safe harbor language.

Participating in today's call are Erik Nordstrom, Chief Executive Officer; Pete Nordstrom, President; and Cathy Smith, Chief Financial Officer, who will provide a business update, discuss the company's third quarter performance.

And now I'll turn the call over to Erik.

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**Erik B. Nordstrom** - *Nordstrom, Inc. - CEO & Director*

Thank you, Jamie, and good afternoon, everyone. Thank you for joining us today. I'll start with our Q3 performance. For the third quarter, we delivered revenue of $3.3 billion, earnings per share of $0.41 and adjusted earnings per share of $0.25. Our teams executed against our priorities, adapted quickly to shifting sales trends and delivered year-over-year profit growth despite lower sales in a challenging macroeconomic environment. We managed our inventory well, as evidenced by the positive sales to inventory spread, while leaning into pockets of demand. As we enter the holiday season, our teams worked hard to deliver the right assortment and engaging experiences for our customers.

In the third quarter, we continued to make progress on our 3 priorities: improving Nordstrom Rack performance, increasing inventory productivity, and optimizing our supply chain. We will continue to focus on these areas in the quarters ahead in order to drive growth, profitability, and an improved customer experience. Based on our year-to-date results, we remain confident in our outlook, and expect to deliver full year results within our updated guide range.

Turning now to our priorities. Our brand purpose is to help our customers feel good and look their best. At Nordstrom Rack, we know what works and believe in our strategy, delivering great brands at great prices, expanding our reach and convenience with new Rack stores in key markets, and driving greater engagement and profitability at nordstromrack.com. Throughout the quarter, our team stayed focused on our assortment and moved quickly to meet shifting demand, providing a compelling flow of new and relevant products for our customers. In the third quarter, we continued to grow the most desirable brands, which had over 300 basis points higher sell-through than other brands in our Rack assortment and feel good about our offering as we head into holiday.

We also know that Rack customers value convenience, and we believe our stores are underpenetrated. We opened 11 new Rack stores during the third quarter and one early in the fourth quarter, bringing the full year total to 19 new stores. We saw a strong customer response at each opening and have received positive feedback from customers. Rack stores continue to be a great investment for us, delivering returns well in excess of their cost of capital, with a short payback period. They also continue to be our largest source of new customer acquisition.

The scale of our digital off-price business is differentiated and unique, allowing us to serve our customers via omnichannel offerings in a way that other off-price retailers do not. And, while we still have work to do on our digital offering for the Rack, we're making progress as we've reworked the business model to ensure sustained profitability. The Rack digital channel is now profitable on a year-to-date basis, and we expect it to continue to be profitable for the full year. This digital channel plays an important role for the Rack in serving customers across stores and digital.

Turning to our next priority. Increasing inventory productivity is critical in providing our customers with a consistent flow of the most relevant merchandise when and where they want it. Total inventory was down 9% in the third quarter and resulted in a positive sales to inventory spread. This lower level of inventory required fewer markdowns than last year and helped to drive expansion in our gross margin by 180 basis points in the third quarter.

We're also pleased with the traction that our Nordstrom private brands are gaining. As a retailer of the best brands in the world, we believe our own brands will play a critical role in our overall mix as they have higher margins and lower return rates.

Additionally, our investments in RFID technology continued to deliver improvements, enhancing the integrity of our inventory by providing improved stock accuracy and creating operational efficiencies across our stores and supply chain. Thanks to the hard work of our teams all year long, our overall inventory position is healthy heading into the holiday season.

We also continue to make good progress on our third priority of optimizing our supply chain capabilities. Following four consecutive quarters of reductions in variable supply chain costs of more than 100 basis points, we were able to drive another 50 basis points reduction in the third quarter. Looking ahead, the absolute level of cost savings will stabilize as we've now been focused on this priority for over a year. However, we'll continue to seek out additional efficiencies and flow and improve productivity through inventory management initiatives.

Our efforts to improve our supply chain have also contributed to increased productivity and store fulfillment for online orders at the Nordstrom banner and better inventory positioning and flow across the company. Q3 marked our seventh consecutive quarter of year-over-year improvement in click to delivery times. We've been able to improve click-to-deliver times by nearly 20% over the last couple of years. All of this translates into a better experience for our customers and cost savings for us through faster delivery, lower cancellation rates and increased accuracy of inventory.

During the quarter, we announced some key leadership changes and welcomed a new member to our Board of Directors. Jamie Nordstrom was appointed Chief Merchandising Officer. Jamie has worked across nearly every aspect of our business and has held broad-based leadership roles, including in merchandising, store operations, and across our digital channels. Fanya Chandler was named President, Nordstrom stores. She has held several leadership positions, most recently serving as Senior Vice President and Regional Manager of the Southwest region. Gemma Lionello was appointed the role of President, Nordstrom Rack. She has served in numerous executive positions, including in both merchandising and stores and she spent 11 years in within our Nordstrom Rack business.

And Lisa Price rejoined Nordstrom as Chief Human Resources Officer. Having most recently served as a CHRO of a large U.S. consumer company, Lisa understands that the success of our business starts with our people. All 4 have proven track records of leading successful teams while maintaining a relentless focus on our customers, and we look forward to what they will accomplish in their new roles. We also welcomed Guy Persaud to our Board of Directors. Guy is a senior leader at Procter & Gamble.

In closing, we are well positioned for the holiday season as we navigate near-term macroeconomic headwinds, while continuing to advance our long-term strategic priorities, and remain focused on improving the customer experience.

Before I hand it over to Pete, I'd like to recognize the teams throughout our company that have been instrumental in driving our progress this year despite a challenging environment across the retail landscape. Their focus on and passion for our customer is what makes our success possible.

With that, I'll turn it over to Pete.

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**Peter E. Nordstrom** - *Nordstrom, Inc. - President, Chief Brand Officer & Director*

Thanks, Erik, and good afternoon, everyone. I'll focus my remarks on category performance and inventory position and provide some highlights of the actions we are taking to drive holiday sales.

Starting with category performance. The majority of our categories improved sequentially from the second quarter in terms of year-over-year trends with active, beauty, and accessories leading. Active sales growth was led by footwear, driven by New Balance, HOKA and On Running, and in apparel, Vuori.

Beauty was strong at both banners as well, driven by designer brands and fragrance. Beauty has been a consistently solid performing category for us and continues to be a top trip driver. This quarter, the introduction of a new beauty 5x points promotion for our Nordy Club loyalty program members supported category growth in stores and online. In anticipation of holiday, our in-stock rates at Nordstrom are above last year's levels, and we have a strong gift selection in beauty.

The accessory category also posted positive growth in the quarter, led by sales at the Rack, where handbags as well as jewelry and watches were strong.

As Erik mentioned, we are gaining traction with our Nordstrom private brands, which are more profitable with lower return rates, which suggests strong content at a good value.

Consistent with trends all year, designer remains pressured, primarily in shoes and handbags, and we continue to rightsize our inventory to meet that demand. Looking ahead, we expect to end the year with an improved inventory position in this category.

Heading into holiday, we're optimistic and pleased that our offering strikes the right balance of newness and relevance that our customers want. We've launched a number of efforts to drive sales and create memorable experiences. From a merchandise perspective, we're offering more newness than we had at this time last year. And we're investing in hot brands and products. For example, we've set up our investment in holiday favorite Ugg, and we've leaned into beauty gift sets, cashmere sweaters, and affordable stocking stuffers.

We've also teamed up with Disney to celebrate its 100th year anniversary. Not only are we offering Disney merchandise from over 80 brands, we're also hosting events and immersive in-store experiences to celebrate. The Disney merchandise is featured in 25 Nordstrom stores and is also available online.

We're taking a differentiated approach to connecting with customers this holiday season. Based on customer feedback, we're providing new ways for customers to discover gifts for everyone on their list, including more than 20 inspirational gifting guides and curated gift categories. We're also leveraging our data and analytics to show more relevant and personalized content on nordstrom.com and on our app, based on shopping behavior to further our key differentiator, and that is serving customers.

We've also positioned the Rack as a holiday destination, and we're prepared to welcome some with an enhanced assortment. We're excited that our teams took a sharp focus around gifting to enhance the customer experience.

Ahead of the holiday season, we've announced actions designed to not only drive sales in-store and online, but to also improve the customer experience. We're expanding free 2-day shipping to all Nordstrom.com customers in our top markets as we know that customers are more likely to make additional purchases and remain a Nordstrom customer if they're confident their purchases will arrive quickly. And given the success that we've already seen with the new loyalty beauty promotion, we will continue to offer it throughout the holiday season.

Looking ahead, we are excited to serve our customers this holiday season and into '24. Our teams have worked hard all year to provide a curated and diverse assortment of brands and products that balances relevance and inspiration. We've made meaningful improvements to the customer experience that will help our customers shop seamlessly across both of our banners, both in stores and online. By doing this work, we're fulfilling our brand promise: to help customers feel good and look their best.

And with that, I'll hand it over to Cathy to discuss our financial results.

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**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

Thanks, Pete. I'll start with our third quarter results and then discuss our outlook for the remainder of the year.

For the third quarter, we reported earnings per share of $0.41 compared to a loss of $0.13 per share in the year ago quarter. After excluding a favorable true-up related to the wind down of our Canadian operations, third quarter adjusted earnings per share was $0.25. Last year's adjusted earnings per share was $0.20 after excluding an asset impairment charge. We are pleased with the year-over-year gross margin and EPS increase despite lower net sales.

Net sales and gross merchandise value, or GMV, both decreased 7% in Q3. Net sales included a negative impact of 270 basis points from the wind down of Canadian operations. It also reflects a positive impact of approximately 200 basis points from the timing shift of the Anniversary sale with about 1 week falling into the third quarter this year. Excluding the impact of these 2 items, net sales would have been down about 6% versus last year.

Nordstrom banner sales and GMV decreased 9% and 10%, respectively, versus last year. The wind down of Canadian operations had a negative impact on Nordstrom banner net sales of 410 basis points, and the Anniversary timing shift had a positive impact of approximately 300 basis points.

Nordstrom Rack sales decreased 2%. The decision to eliminate store fulfillment of Rack digital orders starting in the third quarter of 2022 had a negative impact to this year's Q3 sales of approximately 100 basis points, and we've now lapped that change. As Erik said, new Rack stores continue to be a bright spot. New Rack stores performed well during the quarter.

Digital sales decreased 11% in the third quarter. This includes an approximately 100 basis points negative impact from eliminating store fulfillment of Rack digital orders last year and an approximately 400 basis points positive impact from the Anniversary timing shift.

Gross profit as a percentage of net sales increased 180 basis points, primarily due to lower markdowns, increased inventory productivity and lower buying and occupancy costs, partially offset by deleverage on lower sales.

Ending inventory decreased 9% versus last year compared to a 7% decrease in sales. As Pete said, we are continuing to work through some aged designer inventory. However, we're pleased with our overall inventory position as we enter the holiday season. Looking ahead, we expect to continue to benefit from improved inventory management routines and disciplines while meeting customer demand.

Reported SG&A as a percentage of net sales of 36.3% declined 5 basis points versus Q3 2022. Compared to adjusted SG&A in the year ago quarter, SG&A increased 200 basis points, primarily due to deleverage from lower sales and higher labor costs, partially offset by improvements in variable costs from supply chain efficiency initiatives. Adjusted SG&A expenses as a percentage of net sales of 34.3% in the third quarter last year excluded an impairment charge.

We have been pleased with the results that our supply chain initiatives have delivered over the last year. As Erik mentioned, following 4 consecutive quarters in which we were able to deliver over 100 basis points of savings each quarter, we were able to drive another 50 basis points reduction in variable supply chain costs in the third quarter.

EBIT margin was 3.2% for the third quarter. After excluding the $25 million favorable true-up related to the wind down of Canadian operations in this year's third quarter and the impairment charge in the third quarter a year ago, adjusted EBIT margin improved 25 basis points to 2.4% despite lower sales leverage this quarter. We continue to maintain a solid balance sheet and financial position, ending the third quarter with $375 million in cash as well as the full $800 million available on our revolving line of credit.

Turning to our outlook for the rest of the year. I'll start by discussing the current environment and related assumptions underlying our guidance.

Regardless of external impacts, we expect to make continued progress on our key priorities, which will help drive sales, improve our profitability and mitigate inflationary cost pressures. We continue to see a cautious consumer, and it remains to be seen how changes in inflation, higher interest rates and the resumption of student loan repayments will affect discretionary consumer spending during the holiday season. Considering these factors and the consistent execution all year long, we are maintaining our full year revenue guide and narrowing our EPS guidance range.

I'll highlight a few factors that shape our outlook for the rest of the year, starting with revenue. We continue to expect full year revenue to decline 4% to 6% versus 2022. This outlook includes an approximately 2.5 percentage point negative impact from the wind down of our Canadian operations, which delivered sales of approximately $400 million in 2022. It also includes an approximately 1.3 percentage point positive impact from the 53rd week in fiscal 2023, which we expect will add approximately $200 million in sales to the fourth quarter.

Year-to-date credit card revenues have increased 9% versus last year, primarily as a result of our credit card partner agreement. This improvement has come despite credit card losses, which have risen at a slower pace than expected. As we mentioned last quarter, we have seen delinquencies rise gradually, and they are now above pre-pandemic levels. However, delinquencies remain below industry levels and are contemplated in our guidance.

Turning to EBIT. We now expect adjusted EBIT margin of 3.8% to 4.1% for the full year versus 3.3% in 2022. Our forecast assumes that adjusted EBIT margin expansion would be driven primarily by gross margin improvements in the fourth quarter from our focus on inventory productivity, when compared to the elevated markdowns we took in 2022.

We are updating our outlook for adjusted EPS for the full year. Our GAAP earnings per share outlook is now $0.74 to $0.94 for the full year, which includes the Canadian wind-down charges and related tax impact. Excluding the impact of these charges, we now expect adjusted earnings per share of $1.90 to $2.10 for the full year.

Shifting to capital allocation, our priorities remain the same. The first is investing in the business to better serve our customers and support long-term growth. We continue to plan for capital expenditures of 3% to 4% of net sales. Our second priority is reducing our leverage. We remain committed to an investment-grade credit rating through a combination of earnings improvement and debt reduction and continue to target a leverage ratio below 2.5x. Our third priority is returning cash to shareholders. Last week, our Board of Directors declared a quarterly cash dividend of $0.19 per share.

Our third quarter results, along with the progress we've made on our priorities of improving Nordstrom Rack, increasing inventory productivity and optimizing our supply chain capabilities, position us well to drive profitable growth in the fourth quarter and over the longer term. We are navigating through near-term uncertainty while remaining laser-focused on delivering shareholder value over the long term.

With that, Jamie, we're ready for questions.

**James Duies** - *Nordstrom, Inc. - Senior Director, Investor Relations*

Thank you, Cathy. Before we get started with the Q&A, we ask that participants please limit themselves to 1 question and 1 follow-up. We'll now move to the Q&A session.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Our first question comes from the line of Dana Telsey with Telsey Advisory Group.

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

Good afternoon, everyone. And as we're getting to the end of the year with the fourth quarter and the guidance that you provided, the Rack banner improved a touch in the third quarter as compared to the second quarter. And then taking a look at the Nordstrom banner, also improved a touch. What are you seeing in the different categories while some of them remain the same, like active and like beauty? Was it a step up? Was it a pickup in terms of the categories? What were the components of the same-store sales that drove that improvement? And then as you think about the EBIT margins and the work on the supply chain that you've done, how are you initially thinking about framing 2024? Thank you.

**Peter E. Nordstrom** - *Nordstrom, Inc. - President, Chief Brand Officer & Director*

Hi, Dana, it's Pete. I think what really drove the improved sales is the continued improvement we have in the balance and the content and quantity of our inventory. We've rightsized our inventory. We definitely got it in the right place in terms of the aging and the categories that matter.

As the year has gone and particularly in the last few weeks, as is always the case this time of the year, you're waiting for the weather to change so you can flip the switch to selling more sweaters and boots and coats, what have you. It's gotten a little bit better of late.

But yes, I think in terms of the stuff that's performing well, generally beauty is a good example of that, that's kind of working across the board. But I would say, in general, if you're looking for reasons why we've had sequential improvement, and actually have had better inflection most recently. It's just the quality and content of our inventory.

**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

And then Dana, it's Cathy. Nice to hear you again. With regards to 2024, obviously, we haven't given guidance yet. We do look forward to sharing our 2024 guidance next time we're together. But a couple of things you should expect to see, which is we're going to continue to see the strength of our Rack strategy, great brands at great prices is continuing to work.

You'll see us continue to lean into those trends that Pete just noted, like active and beauty. Clearly, that's what's resonating with the customer. And we'll continue to refine our inventory productivity to enable us to be agile as we respond to our consumer demand. So more to come in 2024, but that's what we're thinking about.

**Operator**

Next is Blake Anderson with Jefferies.

**Blake Anderson** - *Jefferies LLC, Research Division - Equity Associate*

I wanted to ask on SG&A initiatives. You've obviously done a good job of improving the supply chain there. As you think about marching towards your medium-term margin goals for EBIT, what are the other drivers that you can deploy to improve SG&A? And on top of that, how much sales leverage do you feel like you need to also maybe improve leverage there?

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**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

Good afternoon, Blake, it's Cathy. So with regards to SG&A, as you noted, we've seen great progress this year first with -- really driven by our supply chain initiatives, the 4 quarters of 100 basis points improvement. And then back to begin this quarter with another 50 basis points. So seeing great strength there continuing to drive in SG&A. Offsetting some of the other headwinds that we've seen. So the cost of inflation coming through some of the SG&A categories, which we've been offsetting.

Each year, though, as we go into planning, we task ourselves with offsetting inflation with productivity improvement. So we would expect to see that same challenge coming into next year pretty much across all of our categories in SG&A. It's an extreme focus of ours right now.

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**Blake Anderson** - *Jefferies LLC, Research Division - Equity Associate*

Got it. And then the follow-up would be more of a high-level question, but as you look at the gap between the Nordstrom banner sales decline and Nordstrom Rack, what do you really attribute that to? And as we think about next year, are there any puts and takes or thoughts on if that gap could close or what banner might be positioned better than the other?

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**Erik B. Nordstrom** - *Nordstrom, Inc. - CEO & Director*

Hi, this is Erik. In a lot of ways, the banners are independent. There's certainly a synergy to our business. Rack stores are our #1 source of new customer acquisition and we get good migration between the brands. But they do -- they have a very separate and distinct business model. And so I'd be hard-pressed to predict, it depends a lot on the external environment.

As far as what's driving the results, how we came into the year, very focused on our Rack business, and we saw opportunities and it really goes to last year where the supply chain challenges we had were most acute in our Rack business, and it really disrupted our flow, our mix from being what we wanted it to be. So that's been a big focus of the team this year, and that's where we're seeing our sequential improvement as we've had the quantity right where we can be more aggressive in responding to what we're hearing from the customer, and we can bring in a bigger mix of these strategic brands that we know really make the difference in customers coming to Nordstrom Rack.

For the Nordstrom banner business, the stores have been -- I think you're seeing around, there's been a bit of a return to stores this year. Digital business has been a little more pressured in that. For us, we really don't look at the separate channels much. We want to be there for how the customer wants to shop with us. And so our inventories are in great shape, as Pete mentioned, and we're set up well for the holiday business in both banners.

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**Operator**

Next is Michael Binetti with Evercore.

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**Michael Charles Binetti** - *Evercore Inc. - Senior MD*

I want to just, you might have said something to Dana about what you're seeing in the current quarter just because I think the -- there's a little bit of wood to chop through some of the normalizations here for the 53rd week and Canada, but I think it embeds a little bit of an acceleration in the underlying rate. I wanted to see if that was something you're seeing today. You might have mentioned that it was something related to the -- you're feeling better about the content of inventory heading into the holiday. If you don't mind just talking about for a minute, let us know what you're seeing.

And then I also want to zero on the SG&A, the 100 basis point run rate kind of rolling off, you said you got another 50 in this quarter. It didn't sound like you were suggesting that that kind of level of 50 basis points would go forward. Is there any reason that wouldn't? The figure that you saw this quarter wouldn't continue for the next few quarters? And maybe just a few comments on what the new 50 basis points from what you guys are actually able to do as you did work on the supply chain.

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**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

Hi, Michael. On the first one, sales drivers, as we shared, we're pleased first off, to drive more profitability on fewer sales year-over-year. So we'll start there with just the quality of earnings continues to have seen strength. And it's really around all of the initiatives we've been driving. But with regards to the drivers of the sales, it's clear that customers are responding to newness and promotion, as Pete shared in the prepared remarks.

And we're seeing it in a couple of things the actions like our 5x beauty to our Nordy Club members and the free 2-day shipping as we move into the holidays is really resonating, I think, with our customers. So great progress there with newness and promotion.

On SG&A, what's the new 50 basis points, I like the way you asked that. So as the supply chain has continued to drive improvements now for a number of quarters. It will just be more challenging to lap those improvements. And so I would expect those to start to moderate over time, we're seeing really good progress across every element of the supply chain, but those will start to moderate. And we'll continue to work to offset the other lines of SG&A with productivity and initiatives.

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**Operator**

Thank you. Our next question comes from the line of Oliver Chen with TD Cowen.

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**Oliver Chen** - *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

Hi, Erik, Pete and Cathy. Regarding the 2 banners, as you think about full line as well as Rack, what would you say are key aspects to positive comping and returning to growth just more generally or specifically and also as we think about the e-comm channel. And Cathy, as we look at the credit card income, just what are some key variables you're assuming in terms of the next quarter and also perhaps like the framework from which that may differ if you have any thoughts.

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**Erik B. Nordstrom** - *Nordstrom, Inc. - CEO & Director*

This is Erik. Let me start on the Rack banner. We definitely see Rack as a growth vehicle for us in a couple of ways. Number one, just kind of our core strategy that I touched on of great brands, great prices, getting that assortment right. And that's an evergreen subject. We always have opportunities to get that mix better and better. And our teams have done that.

I would say when we were really pouring the gas on there is having more and more dedicated roles there. So you saw our announcement of Gemma [Lionello] as Rack President, that follows earlier that we really have built out a separate Rack buying team there. So we think we're better positioned to be more agile and really get the product mix right.

The second part, Rack growth would be around new stores. We see a lot of opportunity to add profitable new Rack stores. And we've been opening up more this year. We have more planned for next year and we're getting really great returns out of those investments there. And again, we see lots of runway there to keep adding new stores.

The other piece is really around the digital part and omni-channel capabilities that Rack.com affords us. And as you know, there's really not many players in the online off-price space. It's a hard business to be profitable at. Our Rack.com business is profitable, and that was really the first step of leveraging that asset is to get to profitability. Now we're there, we've we see more opportunity around profitability. But we see opportunity to leverage that capability to engage with customers more and more. And so we have a path forward of a lot of omni-channel capabilities that we feel good about driving some growth there.

In the Nordstrom banner, I really would start with our digital business there. We see opportunities and are well underway of having different inventory models that allow us to bring greater selection on the digital journey, whether we own the merchandise or not. So having other models to bring selection to our customers, it's got a step one. Step two is then using the data capabilities we've been building out to curate that larger offer for our customers.

In the end, it's about winning on the discovery journey for customers and having a flow of newness is important. But having that selection and being able to offer up the right curated offering for customers on their journey is super important as well.

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**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

And then Oliver, I'll answer on the credit card revenues. Just remembering that, first and foremost, they're a part of our loyalty program and they're part of our most loyal customers. And as we think about the credit card revenues for Q3, they were up year-over-year, and that really was driven by higher customer balances, higher interest rates, a little bit of benefit from the new relationship with our TD partner and then offset a little bit by increased losses. As we move into Q4, I'd expect them to be around the same level, around that 3% or so of sales, so about the same level as we clear out the rest of the year.

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**Oliver Chen** - *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

Happy holidays. Best regards. Nice work on the marketplace model. Thank you.

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**Operator**

Next is Matthew Boss with JPMorgan.

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**Matthew Robert Boss** - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

So Erik, maybe could you just elaborate on the continued softness at the full line business? Maybe how much should we attribute it to the macro backdrop relative to company-specific execution? And then Pete, just maybe to tie into that from a category perspective, could you touch on trends in women's apparel relative to the above-average performance that you cited in active and beauty?

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**Erik B. Nordstrom** - *Nordstrom, Inc. - CEO & Director*

Hi, Matthew. I'll start with, we feel good about our execution. And that starts with having the right inventory levels that allow us to be responsive to the customer and get our mix right. And our merchandising teams have done a great job on that. Really pleased with our inventory levels and the agility that's affording us. We still have some designer inventory to work through. Outside of that, we feel really good about that execution.

I think our execution is good. Now that being said, sales is a controllable for us. That is the scoreboard and on how we're serving customers. And we see lots of opportunity to continue to do things within our control, in particular around traffic. Traffic has been soft. Our average order size has gone up, but traffic has been down a bit.

So we've done some things as of late. Like we have a 5x beauty rewards promotion going on right now through holiday that we're getting good response from and that is driving extra traffic and conversion. And we also have expanded our free 2-day shipping. We've had -- we've built out free 2-day shipping capabilities as part of our loyalty program and it really leverages our Closer to You market strategy capabilities that we've talked about for a while.

That's built out to the point that we're able to expand that for the holiday season and get customers faster delivery, which we know is always a good thing, both for conversion and for return rate. So again, in short, I think the execution has been really solid and put us in a good position to respond to the customers with the holiday season.

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**Peter E. Nordstrom** - *Nordstrom, Inc. - President, Chief Brand Officer & Director*

And this is Pete. Relative to women's apparel you talked about, look, it's a big and important category for us, and it's got a lot of our attention. We've been making improvements, and we're not where we need to be, but it's definitely got momentum and moving in the right direction. We've spent a lot of time in the last couple of months in our own stores and actually in the competition too. And I think what's been good about this whole process is the real return to the merchant stuff that's super important.

That's just being close to what customers are asking for, what their choices are out there in the marketplace. And we've got some areas of strength we're going to invest into. One of them is our own label programs. You've heard us talk about that and that it's an opportunity for us to grow, and that is true. Our sell-throughs in our -- in the Nordstrom product, our own label is up 30% year-over-year.

We have strong growth, and a lot of that's in women's apparel is why we're bringing this up. We have strong growth planned in '24. And when we can get that right, that's going to have a lot to do with the overall health of our women's apparel business.

The other thing I'd say is being out in the stores, the call out we tend to get is about the things that we can bring in that feel special, elevated, and aspirational relatively in every store that we serve in. And a lot of that ends up in the kind of advanced contemporary space. And so we're doing a good job of editing down and prioritizing and focusing on brands.

I would say one of the things that hurt us in the last couple of years, probably we're a little too wide with the breadth of our selection. Therefore, probably weren't making strong enough statements on the stuff that matter most, and we have an opportunity to improve that, and we've been working on it. So I'm going to have to give us a little bit of an incomplete here, but we'll definitely be circling back with you as time goes on to let you know about our progress, but there's a lot of reason to believe that we have a good improvement to make there in women's apparel.

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**Operator**

Our last question comes from Brooke Roach with Goldman Sachs.

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**Brooke Siler Roach** - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I was hoping we could get a deeper update on what you're seeing in the designer business. Is that trend starting to stabilize versus the softening trend that you had seen earlier in the year, either on a 1-year or a 4-year stack basis? And then for Cathy, can you elaborate on how you're planning markdowns for the year, particularly what's embedded for promotional recapture in your fourth quarter outlook relative to last year's outsized pressure?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - President, Chief Brand Officer & Director*

Yes, Pete. I'll start on the designer part. I think relative to what's happening, the trend is normalizing and stabilizing. And if you look at it over that -- the multiple year stack you talked about it, we're still doing more business in designer now year-to-date in '23 than we did year-to-date in '19, for example. So while it has come back from some of the heights that we had in the last couple of years, I guess, we would view that really more as normalizing. And I think that's natural given the big run-up we had there for a while.

It's an important part of our business. We continue to invest in it. And I think for us is making sure we get the inventory levels in a good spot, so we can have that flow in newness. I think particularly in that business, it's important that we keep having new things to show customers, and we're getting in a healthier position in that regard every month that goes forward.

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**Catherine R. Smith** - *Nordstrom, Inc. - CFO & Treasurer*

And with regards to markdowns, maybe I'll take it to a little bit bigger perspective, which is gross margin first. And that is we're really pleased with the gross margin improvements we've delivered this year for the whole year. And then that's really been largely driven by our inventory productivity priority. Our Q3 35% gross margin rate is a historically healthy rate for the third quarter.

And then so as we think about going into the fourth quarter with regards to the gross margin rate and then obviously, the embedded assumption around markdowns is, given that we're going into the fourth quarter and the holidays with a healthy inventory place, you would expect us to be favorable to last year, really driven by those improved year-over-year markdowns, just given the strength of our inventory.

So we're pleased with our performance all year, the inventory productivity has been driving it. Probably always room to continue to improve, but I am really pleased with where we're starting at.

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**James Duies** - *Nordstrom, Inc. - Senior Director, Investor Relations*

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

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**Operator**

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

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