Q2 2019 NORDSTROM EARNINGS CALL – PREPARED REMARKS

ERIK NORDSTROM

Thank you for joining us today. In the second quarter, we delivered strong bottom-line results, demonstrating our inventory and expense execution. We exited the quarter with inventory levels in a favorable position and made significant strides in productivity. We are implementing key learnings from the quarter to drive our top-line and deliver bottom-line results.

In the second quarter, sales were down 5.1 percent, which was around the low end of our expectations. Full-Price decreased 6.5 percent and Off-Price decreased 1.9 percent. We anticipated first quarter trends to continue. However, we had a slow start to the second quarter and softer results in both Full-Price and Off-Price.

Last quarter, we emphasized our top-line focus related to loyalty, digital marketing, and merchandising. We've seen good outcomes from our efforts, including improvement in Nordstrom Note redemptions. From a merchandise perspective, we're improving our in-stock levels and addressing a gap between our opening and higher price points. We ended the quarter in a strong inventory position, giving us the ability to better align our assortment in the second half of the year.

Now I'd like to provide insight into two drivers of our business performance – our Full-Price Anniversary Sale and our Off-Price business. Starting with Anniversary, this is a unique event featuring new arrivals at reduced prices for a limited time. Our Anniversary strategy focused on three objectives: increasing customer satisfaction, driving sales, and improving the economics of the event. We are seeing early indications that our event resonated well with customers. That said, we planned Anniversary consistent with current trends, but sales were softer than expected.

Based on customer feedback, we curated our Anniversary assortment to highlight their favorite brands, which drove higher sell-through of Anniversary product relative to last year. We expect this to benefit merchandise margins in the third quarter, and we'll have a complete assessment of our overall Anniversary results at that time. While we increased depth in top brands, the event has become even more concentrated around key items. We did not have enough depth in key items, and we are actively addressing this in the second half, particularly with our top gift ideas for the holidays.

During Anniversary, we improved our operational metrics around satisfaction scores, delivery times in key markets, and site performance. This includes initial survey feedback from our top loyalty customers, who valued the enhanced benefits such as earlier access to merchandise.

We also leveraged our digital and physical assets through Buy Online Pick Up in Store, which increases customer engagement and is one of our most profitable transactions. During Anniversary, sales from order pickup more than doubled over last year, with nearly half coming from customers using this service for the first time. Customers who engage through order pickup tend to double their overall spend.

Turning to Off-Price, we are pleased with our profitability results. However, sales fell short of our expectations. Earlier this year, we made changes to improve our bottom line, which included reducing less-profitable flash events. Because these events help drive meaningful traffic to our Nordstrom Rack and HauteLook sites, we are increasing the number of high-quality flash events in the second half. We are also accelerating our marketing efforts to drive traffic, such as the upcoming launch of our Nordstrom Rack television brand campaign. The Off-Price business ended the quarter in a strong inventory position, improving turns across all merchandise divisions. As we head into the second half, we are being opportunistic in the marketplace with plans to accelerate fall receipts.

In this dynamic retail environment, we are evolving our business to create a seamless shopping journey. Historically, we know that more than a third of customers who place an online order will have visited a store to help inform that purchase. And, half of our customers who make a purchase in our store will have first spent time on one of our digital properties. Our local market strategy leverages our physical and digital assets to provide greater access to merchandise selection, with faster delivery and at a lower cost to us. This strategy focuses on gaining market share in our most important markets by leveraging inventory and increasing customer engagement through the services we offer.

Our business is highly concentrated in our top markets, with the top 10 accounting for 60 percent of our sales. This year, we scaled our local market strategy in Los Angeles, our largest market. We're seeing compelling results in predictive metrics for customer engagement and inventory efficiencies.

- We're seeing higher customer engagement and spend at our Nordstrom Local neighborhood service hubs. Customers spend two and a half times more on average; these service hubs account for 30 percent of order pickup; and alterations increased by more than 10 percent. In addition, product returns are coming in eight days faster, driving greater inventory efficiencies.
- To leverage inventory across the broader LA market, we began offering customers up to seven times more selection that's available next day. This contributed to sales from order pickup nearly tripling in July.

We are pleased with our results in LA and are accelerating key elements of our local market strategy in more of our top markets.

Our next milestone is expanding our presence in New York City, currently our largest market for online sales. This fall, we will significantly expand our presence with the opening of our flagship store and two Nordstrom Locals. We anticipate that the combination of our physical and digital assets will drive a meaningful sales lift in this important market. We will also leverage our seven locations in New York City, including Nordstrom Rack and Trunk Club locations, to take care of our customers through services such as returns, order pickup and alterations.

In closing, we're focused on driving our top <u>and</u> bottom-line results, and we are well-positioned for the second half. Nordstrom has managed through many cycles, and we will continue to evolve our business to better serve customers on their terms, no matter how they choose to shop. I'll now turn it over to Anne to provide additional color on our financial performance and outlook.

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ANNE BRAMMAN

Thanks, Erik. Our second quarter earnings demonstrated our continued inventory and expense discipline. We are in a strong position to re-balance our merchandise assortment with customer demand, across price points and key items. We also made significant progress in bending the expense curve, mitigating our sales shortfall.

Second quarter sales reflected consistent traffic trends while conversion was softer relative to the first quarter. Heading into the second half, we continue to take aggressive action related to loyalty, digital marketing and merchandise. Our progress in the second quarter and plans for the second half give us confidence in our ability to turn around our current trend:

- Beginning with loyalty, we continue to grow the program with 12 million active customers, increasing 12 percent over last year and making up 64 percent of second quarter sales. We have addressed the execution related to Nordstrom Notes, and redemptions are in-line with expectations. Enrollments are up over last year, and importantly, we saw a significant improvement in customer satisfaction scores during the quarter.

- With respect to digital marketing, we increased our level of investment in Full-Price and have further plans to accelerate Off-Price. For example, in the first half, we had a 25 percent year-over year reduction in flash events and plan to get back to prior year levels with high-quality events.
- And third, in merchandising, we made initial investments in Women's Apparel to address the gap in our assortment from a price point perspective. We are encouraged by the sell-through performance, and we're accelerating plans for the second half. In addition, we're applying our Anniversary learnings to increase depth of key items. Specifically, for the holidays we're amplifying our gift assortment across categories and increasing the mix of more accessible price points.

For the second quarter, our gross profit rate decreased 50 basis points from last year due to occupancy deleverage. Q2 merchandise margin rate relative to last year improved sequentially from Q1, and markdown levels were consistent with our expectations. We ended the quarter in a solid inventory position, reflecting two consecutive quarters of a positive spread to sales.

Expense performance well exceeded our expectations. Our SG&A rate in Q2 increased modestly by 26 basis points, reflecting fixed cost deleverage on lower sales volume. SG&A expense was down 4 percent compared to the previous year. This was primarily due to our expense savings in addition to performance-related adjustments. To date, we have delivered expense savings of $100 million, tracking ahead of our annual plans for $150 to $200 million. Our efficiency initiatives include realignment of our support structure in stores, end-to-end process improvements in supply chain and technology, and lower discretionary spend. These initiatives represent permanent reductions to our cost structure that position us well for strong EBIT flow-through.

During the second quarter, we also managed variable expenses well in a tough sales environment and maintained flat overhead expenses. Expenses related to digital capabilities—marketing, technology, and supply chain— were relatively flat to last year.

Our Q2 EBIT margin of 5.7 percent deleveraged by 47 basis points over last year, a meaningful improvement from Q1. EBIT for our generational investments met our expectations.

Moving to the full year, we lowered the top end of our prior outlook for a revised EPS range of $3.25 to $3.50. We expect a sales decline of approximately 2 percent for the year, versus the prior outlook range between a 2 percent decrease to flat growth. The impact of tariffs has not been incorporated in our outlook, but we believe it will be relatively immaterial for the year.

Now I'd like to provide color on our assumptions for the second half. Sales are expected to be flat at the mid-point, reflecting roughly a 400-basis point improvement from the first half. This incorporates four sales drivers, all of which are weighted equally:

- First, our merchandise plans include re-balancing our assortment, increasing depth of key items, and accelerating opportunistic buys for Off-Price.
- Second, we are accelerating our marketing efforts, including our Nordstrom Rack television brand campaign and additional flash events in Off-Price while continuing digital marketing investments in Full-Price.
- Third, we will lap last year's Nordy Club launch with respect to Nordstrom Notes, with most of the impact in the fourth quarter.
- And fourth, sales from the New York flagship opening on October 24 will primarily benefit the fourth quarter.

For the third quarter, we expect sales to improve modestly from the first half. We expect gross profit rate expansion from improved sell-through of Anniversary product. We also expect our

SG&A rate to deleverage from fixed costs, which includes pre-opening expenses for our New York flagship. Third quarter EBIT margin is expected to be relatively flat when excluding last year's estimated credit-related charge.

For the fourth quarter, we expect the New York City flagship opening to contribute sales in the fourth quarter as well as occupancy deleverage.

Taking a step back, our framework to drive shareholder value remains consistent: gain market share; improve profitability and returns; and maintain a disciplined capital allocation approach. We're focused on driving the top-line, leveraging inventory, and bending the expense curve. Over time, we expect our generational investments to further scale and contribute to improved profitability and return on invested capital.

We have a strong balance sheet and maintain a consistent approach to capital allocation. As we exit this year's heavy investment cycle, we expect moderating capex and accelerating free cash flow beyond 2019. Capex levels are expected to moderate from 6 percent this year to 3 to 4 percent of sales, an appropriate level to fund our strategic objectives. In terms of the long-term financial targets we shared a year ago, we're focused on delivering on our current year expectations and intend to revisit these targets after we finish the year.

In closing, our priorities are to drive our top-line, improve profitability and execute key strategies to enhance the customer experience. I'll now turn it over to Trina for Q&A.