

NORDSTROM Q3 2017 EARNINGS

Prepared Remarks - Blake Nordstrom, Co-President, Nordstrom, Inc.

Good afternoon, and welcome to our call. In addition to reviewing the third quarter results, I'll share some key initiatives that we're focusing on for the remainder of the year. For the third quarter, we reported earnings per diluted share of \$0.67. We estimate these earnings were reduced by roughly 4 cents from Hurricanes Maria, Irma, and Harvey, which affected our stores in Puerto Rico, southeast Florida, and Houston. The damage in Puerto Rico was particularly extensive, requiring us to close the store as we continue our repair efforts. We're grateful to our teams in each of these communities who have extended themselves to help our employees and customers.

We reported total sales growth of 2 percent and a comp decrease of 0.9 percent. Lost sales from the hurricanes accounted for approximately \$20 million or 60 basis points. When adjusting for this impact, our overall sales performance was generally in-line with our expectations. This reflected consistent trends in our full-price business while in off-price we experienced some deterioration relative to recent trends.

In our Nordstrom brand, total sales decreased 1.2 percent and comps decreased 1.9 percent. Sales in our full-line stores remained consistent with current trends. As we expected, Nordstrom.com sales reflected a higher volume of returns associated with Anniversary sales last quarter. When we combine July and August to adjust for this timing impact, Nordstrom.com grew at a mid-teens rate.

In our Nordstrom Rack brand, total sales increased 5.5 percent and comps increased 0.8 percent, which reflected a step down from recent trends. In hindsight, our sales plan at the beginning of the year was too aggressive. As a result, we found ourselves over-inventoried without the fluidity necessary to chase the business. This impacted our ability to provide newness, which led to softer results in the third quarter. We have made significant adjustments to our receipt plans to bring our inventories in-line, and believe we're well-positioned for the fourth quarter in this regard. We recognize the opportunity to improve our top-line results, and are committed to providing good inventory flow, fashion-right merchandise, and the best value possible. Our Nordstrom Rack business remains a highly productive model and is approaching \$5 billion in sales for the year.

Finding new ways to engage with customers on their terms is as important as ever. We're continually testing and learning from new concepts to deliver experiences that improve speed, convenience, and personalization for Nordstrom customers. This is core to our strategy of providing a differentiated selection of the best products, coupled with a high level of service and experience.

Our most recent example is Nordstrom Local, a test retail concept that's focused on services. Centrally located in West Hollywood, Nordstrom Local gives customers convenient access to personal stylists, alterations, online orders, and more. In the first four weeks since opening, we've had thousands of customer interactions and are applying the learnings to innovate further. Ultimately, our goal is to drive increased customer engagement and market share.

Another way we're engaging with customers on their terms is our Reserve Online and Try In-Store service, which we recently expanded to more than 50 stores across the country. Our customers appreciate its speed and convenience. It frees up their time, and if they choose to do additional shopping in our store, this results in a material lift in their spend. We're also connecting the digital and in-store experience with our Style Boards. This digital selling tool leverages the expertise of our salespeople and enables customers to receive personalized product recommendations on their mobile phones.

Providing newness is an important aspect of our approach with the customer, and we're encouraged by our recent collaborations with emerging brands.

- Our Pop-In Shops give customers access to highly sought-after brands like Warby Parker and Goop. Our recent partnership with Everlane has been our most successful Pop-In concept to date.
- Our partnerships with fashion influencers are another way we're creating inspiration and discovery for customers. We collaborated with the popular fashion blog, Something Navy, to launch an exclusive capsule collection with our in-house Treasure & Bond brand. It was our largest brand launch ever, generating \$2 million in demand for the first day.
- We made additional progress in growing limited distribution products and our private label brands continue to outperform the company average.

We view our stores as a competitive asset and have invested in the markets in which we serve customers. We've strengthened our presence in Southern California with the relocation of two full-line stores -- to Century City and University Towne Center. Both openings well exceeded our plans. Also this fall, we had 11 new Nordstrom Rack openings and one relocation in markets that include Los Angeles, Manhattan, and Seattle.

In Canada, we opened the sixth and final of our announced full-line stores with our new store at Sherway Gardens in Toronto. We look forward to introducing Nordstrom Rack to our Canadian customers starting next spring in Calgary and Toronto.

As we head into the fourth quarter, we're focused on making Nordstrom a convenient place for customers to do their holiday shopping. We have a number of initiatives in place:

- We've invested in key categories and brands that resonate most with our customers. This includes expanding our online selection and fulfillment capacity to support the peak volumes that we expect during the holidays.

- To make shopping faster and easier, we offer in our full-line stores Buy Online Pick up In-store with an option for curbside services.
- Also, in several markets, we have available Reserve Online and Try In-Store and same-day delivery services.
- Next month, we'll offer 24-hour curbside pickup in major markets, including Seattle, Chicago, Dallas, and San Diego.

During this holiday period, we believe the strength of our digital capabilities along with our local market assets - our people, product, and place - represent a significant competitive advantage in serving our customers. I'll now turn it over to Anne, who will provide additional insights into our third quarter performance and outlook for the year.

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Prepared Remarks - Anne Bramman, CFO, Nordstrom, Inc.

Thanks, Blake and good afternoon everyone. Our third quarter earnings, when excluding the hurricane impact, were generally in-line with our expectations.

Looking at the drivers of our results, our retail gross profit rate was down 12 basis points due to planned occupancy costs associated with new Rack stores in the U.S. and upcoming stores in Canada.

Merchandise margins continue to be relatively stable, reflecting our ongoing progress in supporting a healthy regular-price selling business. For five straight quarters, sales growth outpaced inventory growth, and we exited the third quarter in a relatively clean inventory position. For the balance of the year, our inventory plans are aligned with current sales trends.

Moving to SG&A, our rate was up approximately 160 basis points primarily due to technology and supply chain expenses. As we've commented over the past year, we made significant progress in improving our productivity, particularly around our technology, supply chain, and marketing capabilities. This required fundamental changes in the way we operate to improve the customer experience and support long-term profitable growth. Last year, we made a significant step change to the expense growth in these areas by cutting the recent historical run rate of 20 percent by half. This year, we are on track to hold this expense rate constant to last year's growth rate.

In supply chain, we continue to see the mix impact associated with the accelerated growth of online, which is approaching 25 percent of our sales. We've made operational improvements to reduce split shipments and canceled orders. This has resulted in a better customer experience while reducing our average cost per unit. Going forward, we see further opportunities to gain efficiencies.

Technology is another critical enabler in delivering customer experiences. As we discussed last quarter, we continue to modernize our platforms and investments are shifting to cloud-based solutions. This is creating more of an immediate expense impact rather than capitalization. To get a more holistic perspective on our technology investments, we continue to be on track with our plan for total cash spend of roughly \$540 million or 3.5 percent of sales.

Turning to Credit, EBIT increased \$16 million over last year, driven by credit card revenue growth of 25 percent. We also recently sold our bank charter, eliminating associated regulatory requirements and minimal costs.

We've been encouraged by the continued momentum in our Nordstrom Rewards program. With nearly 10 million active loyalty customers, our loyalty program represents more than half of our sales year-to-date. This growth has been fueled by the expansion of our program in spring 2016, which enables all of our customers to earn rewards regardless of how they choose to pay.

Turning to our financial position, we continue to have a healthy balance sheet and have generated around \$600 million in operating cash flow year-to-date. Our debt leverage remained consistent with our expectations, at 2.5 times on an adjusted debt to EBITDAR basis. We reported double-digit return on invested capital of 10.7 percent. These metrics reflect our overall favorable positioning in the market.

As Blake mentioned, our combined physical and digital presence is a key differentiator in serving customers and gaining market share. Our omni-channel business model also provides for favorable economics related to driving customer spend, reducing the cost of serving customers, and elevating the Nordstrom and Nordstrom Rack brands. We believe we have meaningful opportunities ahead to further leverage our investments and improve our long-term profitability.

Now I'd like to provide some additional color on our updated 2017 outlook. We narrowed our EPS range of \$2.85 to \$2.95, compared with our prior outlook of \$2.85 to \$3.00. This incorporates our third quarter results and the estimated full-year hurricane impact of roughly \$0.06. In addition, we adjusted our full-year tax rate to be in-line with the year-to-date rate.

- From a top-line perspective, we've held our full-year outlook for total sales growth of approximately 4 percent with roughly flat comps. This incorporates our underlying trends while taking into consideration expectations for continued uncertainty in retail. It also includes the 53rd week impact, which is estimated to add \$200 million in sales or two to three cents in EPS.
- Retail gross profit assumes higher occupancy expenses and the mix impact from off-price growth. Merchandise margins reflect a solid inventory position heading into the fourth quarter.
- Our SG&A assumptions remain consistent, reflecting higher technology and supply chain expenses associated with our growth initiatives. As a result, the deleverage in our SG&A rate for the full-year is expected to be relatively similar to what we've experienced year-to-date. This is normalized for one-time items, such as a \$22 million legal settlement gain in the fourth quarter of last year.
- Based on better than expected performance, Credit EBIT is estimated at \$165 million, compared with our prior outlook of \$145 million.

In closing, we're well-positioned to execute on our holiday plans and remain focused on delivering a differentiated customer experience. With that, I'll now turn the call over to Trina for Q&A.