REFINITIV STREETEVENTS

EDITED TRANSCRIPT

JWN.N - Nordstrom Inc at JPMorgan Retail Round-Up (Virtual)

EVENT DATE/TIME: APRIL 06, 2022 / 1:00PM GMT

CORPORATE PARTICIPANTS

Anne L. Bramman *Nordstrom, Inc. - CFO*

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

CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

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

Okay. Thanks. It's Matt Boss, Department Stores, Specialty Softlines here at JPMorgan. Happy to kick off this year's retail round-up with the team from Nordstrom. We have CEO, Erik Nordstrom; as well as CFO, Anne Bramman.

So format for this event is fireside chat. It's moderated questions on behalf of myself. Maybe with that, we'll kick off, and I'll pass it over to you, Erik, and any prepared comments.

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

Well, I'd like to -- yes, just to start -- thanks, Matt, a little context. Number one, I'll speak for myself. It's great to be like in person here. I hope you feel the same way. Some of us were talking about it right before here. It's a good example -- this gathering of. We're starting to see more and more as things open up, and people care a little more what they look like, particularly Zoom screen below. And that's good for us.

The context, I just wanted to start us with really going back to our comments from Q4, which I think our results are reflective of the times we're in. We delivered continued sequential improvement on the top line, a pretty significant improvement on the bottom line and equally as important progress on our longer-term strategic goals. And part of what's changed for us and was reflected in our Q4 results or the pandemic, particularly for how are companies built; geographically, where we're at; and mostly the categories we sell. It felt like everything was a headwind, a lot of headwinds externally. They're not all headwinds now. We're starting to get some offsetting tailwinds in there. That's externally.

Internally, we've got a lot of things to work on. And -- but I think the message I wanted to start with, our Q4 results kind of reflect the movement in both external and internal. Externally, again, there's some tailwinds that we're excited about, still lots of uncertainty that we have to deal with and I think plan cautiously going forward. And internally, still lots of work to do. But starting to see some green shoots that actually are reflecting in our top and bottom line results that I was very excited as we look into '22.

QUESTIONS AND ANSWERS

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

That's great. So maybe I'll dovetail directly off of the green shoots that you mentioned. So Erik, there were some comments made in the trade publication recently. I think it implied that your men's business has doubled. Maybe what is your take on that? To what extent is it a read through to the rest of your business? And does this mean that the customer backdrop is potentially more favorable than what you assumed when you provided your 2022 guidance?

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

Yes. I think there was a little confusion with that comment. Our men's business has not doubled. We're seeing strong double-digit increases, but not a doubling of the business. So for the customer backdrop. Our customer is healthy. There is a lot to feel good about there. And there's, I think, demographically, higher-end customer has done well.

But it's also to my earlier comments of what people are doing, looking to get out again. And it's -- it can be trips. It can be going back to the office. I think any of us expect return to office to be exactly like it was pre-pandemic. But getting out, even going to a restaurant is good for us. So there is help with the consumer that, again, we've seen in Q4 and has us more optimistic heading into this year.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. Matt, I'd just like to add to that. So first of all, I have to do the safe harbor language. Please refer to our website for any forward-looking projections and safe harbor language, but -- so the lawyers are now happy with me.

But what I would also say is, as we talked about in our earnings call in Q4, we saw some momentum in the business, the occasion-based customers coming back. In particular, we talked about some of the disparity in the geographies as well. So the areas of the country that had already been opened up, we saw that really coming back nicely. And then as other parts of the country have opened, we've seen that in Q4 and continue to anticipate that. I would say with Erik's comments about the categories and the occasion base and the customers coming back, we had contemplated that in our guidance for this year as we continue to see momentum in the business.

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

That's great. Erik. If you break down the business, maybe take a look historically and what you're seeing today. Are you seeing anything different from a demographic level, a lot's made of gas prices, inflation, I don't think historically that's been as much of a driver to your core customer. But to the point on health of the customer, what impacts your customer? What are some of the factors that your customer is watching or that you're watching that could actually impact the business going forward?

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

Yes. Historically, our customers' behavior is not tracked with gas prices very much. Its' -- stock market has been more of a correlation for our business. I think about it again, external and internal. And externally, there are things to be encouraged about, things to be cautious about. Inflation is a concern, something that in our lifetimes -- well, our working lifetimes really haven't had to deal with. Obviously, there's a war going on. There's plenty to be concerned about.

But there is an opening up. And to Anne's comments, we see that geographically. The southern part of the United States has been strong for us for most of last year and a pretty good spread to the northern part. And New York is a good example. You see it, things are opening up, restaurants are getting full. Our store traffic here has gotten much better. So that's important. Internally, which is what we spend most of our time on are things we can control and there's a lot for us to do.

We have robust agenda. And some of it is COVID related as we look back and in particular, our inventory levels from the uncertainty of the pandemic, the supply chain challenges, we've had swings in inventory levels that it's important for us to smooth that out a little more and have a more even flow of newness into our network.

So we certainly need to be mindful with the external factors. But the internal factors is what we're most focused on. And again, we're seeing some traction and that gives us some confidence that the puts and takes externally that we have a path. In particular, to quantify it to our financial commitments we made at our Investor Day last winter that we have line of sight to delivering those, and it's mainly dependent on us.

REFINITIV

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

That's great. So maybe with that, if we think about some of the categories, apparel and footwear, I think historically, have made up about 70% of your business. What is the time line for return fully to 2019 prepandemic in these categories. And then multiyear, to your point on traction with some of the initiatives, how would you rank the merchandising initiatives? What are you the most excited about exiting the crisis?

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

Okay. Let's start with shoes and apparel, obviously, is big categories for us. And it's one of the, I think, most conspicuous impacts of the pandemic has been the large shift in a short amount of time by categories. Our home business was up over 50% last year. Our active business, very, very healthy double digits. And -- but home is a small portion for us and shoes and apparel are the big chunks to your point.

So we haven't quite seen a return coming out of fourth quarter to 2019 levels but improving. As we saw through fourth quarter, overall shoes and apparel gained momentum. And in particular, I would say, again, within those broader categories, not just all about comfort that there is more of a little higher risk occasions. I don't know how many of you -- as you're preparing here today, you look great, by the way, like how to get extra thought to what you were going to wear or looked at your closet and said a week ago, boy, I've got this conference, and I need to replenish. And it's not about a return to super dressy wear.

It's -- there's been an overall trend of casualization in this country for a number of years. The casualization doesn't have to equate to not caring about how someone shows up. People do care as they get out more. So we're seeing a lot of strength in these categories, and it is, in general, getting back out there. Merchandise initiative-wise, once I'd call out. Category management, I'd call it, is one, we have a much more data-informed view the role that our categories play both in Nordstrom and Nordstrom Rack and are much more purposeful in our inventory investments to fill those roles.

So knowing what really drives a trip into a store or on to the site, what is a good add-on category and making sure our inventory investment reflects that balance. So that's super important. We see a lot of opportunity to improve our margins. And that's not -- traditionally, merchandise margin has been pretty much quantity driven of your initial sell-through at full price, what do you have left to mark down. And so managing that quantity is always important. But increasingly, there's data-driven opportunities to do things like the timing of markdowns and promotions, our initial pricing, particularly in the Rack where we have more autonomy to dictate price.

So we see a lot of opportunities there. The other one I'd call out would be customer choice count that we've been on this for a while to -- we think it's vital for us to add a lot of customer choice within our capabilities. And we've done that. And I think last year we had about a 50% increase in choice count. And that drives -- particularly online, this drives a lot of traffic. That's kind of step 1. Step 2 with more choice count is using the data that we have and AI to deliver to the customer what's most relevant to them.

And no one wants to see customer types in black dress to see 1,500 black dresses. How do we still deliver a curated assortment. But the difference for us, our curation used to happen at the buyer level and the buyer would go to market and write a purchase order, they would curate whatever line they were looking at for the customer. Really, we think today and moving forward, it is about us having the choice count to start with, a much bigger choice count and doing that curation, not at the purchase order level but doing it at the customer journey level. So wherever the customer is on their journeys that we're able to offer up from a bigger portfolio of choice count what's most relevant for them?

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

Erik, as we think about the recovery and the pace of recovery and you think about your business postholiday. I guess any -- if we think about by category, any surprises or any categories that you're really chasing into and maybe you had not anticipated. And with that, as we think about the mix, are there categories that you see on the other side of the crisis that you'd like to either accentuate and accelerate or maybe categories that may be smaller in the box. And last, with that, maybe just private label versus national brands, any material changes as we think about the mix?

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

Yes. Well, let me just start with the surprises, I'll get into the categories. It's been -- it's not so much a surprise now, but it's really a surprise kind of through last year of the challenges of getting product -- of getting flow, a regular flow of product. It turns important for our model. So we don't operate with a lot of back stock.

We've -- our off-price business does not operate with a pack-and-hold inventory. And that we felt affect us last year as access to product was slower than anticipated or wasn't there. And some of it even being just replenishment items that were used to flowing in on a regular basis. So it's bumpy. And that was a surprise that we didn't really plan for.

And again, it kind of led to that those peaks and valleys I referred to earlier. Category-wise, and I think this probably fits with what everyone is seeing. It's our strongest category, even pre-pandemic for past several years has been designer and luxury. For us, it's a true designer business. It's that -- those very highly sought, very limited distribution brands that continue to see a lot of demand.

And again, missing part of that is, I think designers sometimes people think suits and gowns and super formal. It's a much more casual take on designer. And that business and that customer continues to go really well. And it's an important part of our business. I think it's important when people look at our company, our mix is a little different out there. I mean we have a true designer business that competes at the highest end of the luxury competitors. But we have a broad assortment. And we have price points that would overlap with -- certainly with the Macy's and other department stores.

We have a bit younger customer than traditional luxury players. The outcome of that, and particularly when you add in to our ecosystem or Nordstrom Rack business is a customer acquisition and particularly for designer merchandise, introducing their brands to new people. That is the most compelling reason that these designer brands have distribution with us is our customer base and that we introduced their -- we introduced new customers to their brands.

And our environment is a more inclusive environment. It's not -- arm guards and velvet ropes being very intimidating to access that product. So that mix of product and mix of price points, our customer mix and matches, high to low. That is -- it's an important part of our business. So that higher end has been important. There's still growth in -- for us in these pandemic categories of home of active -- lot of beauty did very well during the pandemic, and there's still opportunities for us to grow.

As I mentioned, home's been a pretty small base for us. So we still think even as that industry softens as it laps a real strong business, there's still opportunity for us there. But the big categories to your earlier point, shoes and accessories that's a strength for ours. And I would say that the piece that cuts across all of our categories, that's really important for us to win and it is in discovery. We're in retail. There's a lot of retailers, some retail has done very well during the pandemic. What we sell is not commodities.

We're not -- it's not -- for most customers a shopping journey that's a shopping list of knowing exactly what they want and cross out the list or maybe just looking for product attributes to make their buying decision. So much of our business is customers coming to us either online or in the store and wanting something new, but not knowing exactly what that is. And one of the best experiences we can provide is customer leaving with things that they know they wouldn't have gotten on their own and it ends up being some of the favorite things in our closet.

That discovery journey is a place we need to win. We're not -- we're not the everything store. Again, selection is important for us, but that's not a place we're going to win at. But having a category mix, having the connected digital and physical assets that where the customer journey is seamless and having services like alterations and styling, having convenient returns. These things all -- I think one of things that cuts across that is it aids in discovery. And as we look at our categories, we're getting better and able to be more intentional in how we manage our inventories to really be good at discovery.

To your last point, remembering all these on private label, yes, our private label business is about 10% of our business. It's been that for a while. We do see opportunities there. Our private label business does very well. Our margins on private label is about 500 basis points higher. Oftentimes, our private label is able to deliver value and fill voids better in the marketplace. So we do see opportunities to grow that significantly in the years ahead and are very focused on that.

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

So you mentioned the seamless journey of your customer between brick-and-mortar and e-commerce. So maybe if we started with full line and we think about that interplay between the stores and digital. Has your thinking on stores changed as a result of the pandemic or how best to think about the local market strategy as we think about your full-line brick-and-mortar fleet going forward?

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

Yes. I wouldn't say it's changed so much. It's certainly accelerated. There's years before heading -- before the pandemic hit. For full-line stores, traditional malls, our country has been overstored, overmalled. And so really not a lot of opportunities to add store count. But we've been on this journey for a while of really connecting our digital and physical assets in a seamless way. And for what we sell, again, our categories, it tends to be a more broad and shallow.

So there's no store we have, even our big store here, where we have everything that would be on our website in a store. But we have found that by connecting particularly the inventory at the market level and being able to provide, for instance, next day delivery and a buy online, pickup in store, that we're able to bring to the customer a significantly more selection available in the next day real convenience and lots of pickup options, certainly at our Nordstrom stores, but we have looked in our Nordstrom Rack stores into Buy Online, Pick Up store -- Pick Up In-Store from Nordstrom.com also being able to do returns at a Rack store for Nordstrom purchases.

That added convenience is really resonating with customers. And it's something. Again, I think we're in a little unique position to provide that. So the results we've seen from our market strategy have continued to be very strong. And there is -- there's still more to go there. We're not in the ninth inning of that by any means. And in particular, I'd call out is the opportunity to better position inventory close to the customer. That is an advantage of stores.

There are places to do things like picking up orders and doing returns. There are places that house our terrific people to provide the service, but they also have inventory very close to customers. Most of our customers are live in markets where we have stores and having that inventory close to them is -- can be a huge advantage. But it needs to be a very data-driven model there. We have a lot of SKUs. So we see opportunity there to better position our inventory.

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

And then on digital, which I think now represents over 40% of your sales, what's the best way to think about from a customer perspective? What differentiates the experience or what drives the traffic to Nordstrom.com relative to maybe one of the brand-specific websites? and from an investment perspective, what are you the most focused on, on the digital side going forward?

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

Okay. From all the conversation we have, as you can imagine, a lot with vendors of why should they sell Nordstrom. And I'd be the first to say a vendor doesn't need as many retail partners as they did maybe 10 years ago, but they need at least one. And because there is an exposure to customers they won't get on their own. The scale of our digital business, to your point, it's well over 40% of our business. We've been at it for a while is -- for brands a scale that's much bigger than the brands get.

So they're just customers who are in our stores, on our site that a brand -- on a monobrand site will not be exposed to. And our customer base is very attractive. The demographics of our customer base, the size of our customer base is extremely attractive to brands. That's a big part of it.

But there is -- what we're just talking about the omnichannel services is something that is also unique and very attractive to brands that customers can utilize stores, and it's increasingly important as a pickup location even for an online journey. But the services of an alterations, of returns. We're known to be pretty good about returns in a customer-friendly way. That is something that's different than what the brands do on their own.

And lastly, I would say the customer acquisition piece of -- having that mix that we have and being able to expose brands to customers who aren't coming and maybe typing in that brand name into a search bar, but they're coming to Nordstrom for something new and because of the mix we have and in that journey, we're able to expose them to new brands and brand they haven't tried before. And that's been very advantageous for brands.

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

And then maybe...

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

What was your last part -- oh, digitally, what we're excited about. Yes. There's -- certainly, we continue to see strong growth in the digital part of our business. For 2020, it was actually over half of our business as stores were closed for quite a bit. So it's absolutely an important growth driver for us. But for us, it is in the context of the customer journey of how do we serve customers better with the assets we have. We have strong digital assets. We have strong physical assets. So that linkage is super important.

I would turn you back to, I think, a North Star for us in customer journeys, but particularly online, more and more journeys start out online. And that discovery piece that I referenced earlier is super important. And so being relevant to customers in their journey, you don't have much time online. So the use of customer data, the use of AI is vital in offering up newness and inspiration to customers that is highly relevant.

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

In your partnership model, where are you today? What's the opportunity? I know this is something newer that you were walking through.

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

When you say partnerships with?

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

I think it's the brand partnership model...

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

Okay. Yes, yes. Part of the means to the end of having significantly more selection available for us to serve our customers. And I think it's just also changes in the world in our industry. We have found we need more than the traditional wholesale model of a retailer going to a brand and buying at a wholesale price and taking ownership and putting in one of our stores or warehouse, having other means of getting product in front of our customers.

The biggest example we've had the last several years has been drop ship, being able to tap into our brand partners, inventory and dispose that to our customers and get back to our customers in a seamless way is we've seen a lot of growth there. But we think there's more there and that there needs to be more there. I would point to last year, our example of ASOS, our example of Fanatics are 2 examples of bringing selection that our customers want, but that requires some different models.

So we start with really what brands do we want to have on our side, do we want to expose to our customers. And then what's the means to get there. And certainly, wholesale is not going away. It's going to be an important part of our business. But an increasing part of our business is going to be what we've put in the bucket of alternative models. It could be drop ship, could be concession. It could be ASOS, was a shared investment. But there's different models there that we're not too precious about where we have flexibility in doing. But really, the end we want to get to is how do we bring the brands that will get our customers excited and then the full expression of those brands to our customers.

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

So if we switch gears to off-price, maybe if we talk about 2021, off-price was, I think, a bit softer relative to some other off-price peers. I guess, have you course corrected what's the time line to think about improvement at the Rack concept from here?

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

Yes. I'll start with the time line. We we've had sequential improvement quarter-over-quarter for a number of quarters now, but we started in a pretty big hole from earlier in the pandemic. And so we are committed to continue showing sequential improvement there and that we get back to 2019 sales in our Rack business. And how we're getting there kind of goes to some of the hole that we were in.

The biggest hole is we have had inventory flow issues. And earlier in the pandemic, just getting pure quantity of inventory that we needed was a challenge. Some of the sources of goods that we've traditionally had in our Rack business weren't available -- as much availability as we're used to. And in particular, what's really the compelling point of difference for our Rack business versus some other off-price retailers is the brands we have. I think it's 95% of our Nordstrom brands are also in Nordstrom Rack.

And those brands tend to be a little higher priced than some other off-price retailers and truly compelling to get brands that customers recognize and love at an off-price is super compelling. A lot of those premium brands through the pandemic pulled back on their production given the uncertainty. And so the excess goods that we would tap into for Rack business just wasn't there. So getting that quantity right and that flow is important. And we start to see improvements in Q4 on that. That's certainly our plan is to have a much smoother flow there. The other piece I'd call out would be around price point, and these were related, part of not having as much inventory of these premium brands as we traditionally had. They tended to be our higher price points in the Rack business.

And you combine that with we had a purposeful strategy starting the year of layering in some lower-priced products that -- to compete with more traditional off-price players. And our execution of that wasn't great. And I'm not surprised by that. I think when you take a shift merchandising-wise, you try some things, you learn and you adjust along the way. But we went a little too far in adding lower-priced product.

And you add to that, we were missing some higher-priced product. It kind of compounded each other where our average price point last year in our Rack business was down in the kind of mid-single digits in an environment where prices were increasing. And I think you've seen a lot of retailers point to higher AURs as being a factor in their improved business. We didn't have that last year. We're starting to -- we're getting that corrected. So managing quantity of inventory, the price point is super important.

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

If we stay on the inventory point, I think exiting the fourth quarter, you talked about at full line elevated inventories. I guess where do we stand today? What's the content or maybe the quality of that inventory? What's the time line to get back inventory relative to sales that you'd be comfortable with? Is it category specific? Maybe just -- any way to kind of provide a little additional context on the inventory front?

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

Yes. We exited Q4 with higher inventories. And I'd say about half of that was purposeful that coming out of some holes in our inventory needing to fill. I referenced how earlier we didn't -- it's been a few years since we reutilized pack and hold inventory for our Rack business. We believe that's important to go back into that and partly to mitigate the bumpiness in the supply chain.

But part of it is to be opportunistic too, when there's great merchandise available even if it may not be seasonally correct to be able to get that product and then put it into our system as a seasonality is important. So those are some of the reasons that we're purposeful in having more inventory. The part that wasn't purposeful was the bumpiness of the supply chain. We were experiencing lot of shortages in our orders versus what we had ordered compared to what we're showing up and more starts showing up in December.

So there's a bumpiness there. We anticipated bumpiness, and we were more aggressive for Q4 with our inventories. And we think that's the right thing to do given these times we're in, having -- running really lean inventories and getting inventory like just in time, the supply chain network just isn't there to accommodate that. So to have a little more cushion there, we think, is the right thing to do for our business. And so we're very purposeful about the content. It's quantity is one thing, but if it's to state an obvious example. If it's coming out of the fourth quarter with a bunch of ugly Christmas sweaters, it's a bad thing.

If there's some other categories, replenishment items, beauty that aren't as seasonally sensitive. So we've been purposeful on that. We feel good about the content of our inventory. The quantity is something that -- I would put in the category of my opening comments that there's still bumpiness there. It is more challenging to manage flow of inventory with precision than it was prepandemic. And there's things we can do internally to mitigate that. There's certainly external factors that contribute as well.

So I don't think we're in an environment to operate with that level of precision. But the quantity is super important, and we anticipate bring those inventory spread between inventory growth and sales growth. It's not going to be -- and we don't want it to be even. We want our inventory growth to be a little bigger than our sales growth when we compare it to 2019, but that spread will shrink.

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

Great. Maybe, Anne, on the margin front, if we think about gross margin, I'm just -- is there any way to kind of lay out the path from here, whether it's merchandise margin opportunity, structural changes that you've made on the buying or inventory front. I think if you look back 37% or so past peak, just kind of thinking where we go from here on the gross margin front, maybe just puts and takes?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So we haven't necessarily given specific guidance by line item, but there are a number of things that we've pulled, and you saw a lot of improvement in Q4 for us in this line. So I would just say some of the things Erik talked about as far as how we're really looking at categories that are destinations. We're really looking at how we're managing those categories and life cycle of items and being much more data-intensive and looking at when do we take a mark, how deep do we take the mark? And what markets do we take a mark and being much more dynamic with that.

So you're seeing that. We're also -- we've talked about in the guidance that we gave for this year that we're doing to mid-single-digit price increases, which will also help our margins going forward. Up until now, we've been absorbing the inflationary cost headwinds we've seen both in labor and in supply chain.

So this year, we're actually taking both in our Rack business, but also we're seeing it in the market with our brands in our Nordstrom banner, which is also going to help us from a margin perspective as well. So there's a number of layers that we're pulling and that we're seeing. And I think Q4 was a good indication of the progress and trend going forward for us as well.

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

And then to Erik's point, on the interplay between brick-and-mortar and digital, for you on the profitability side, if we think about a brick-and-mortar sale relative to a digital sale, are you agnostic at the profitability level? Or maybe just could you walk through some of the differences at the profit side.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So I will take it into 2 pieces. Our Nordstrom banner, we've been doing this for quite some time. And so we're really at the size and scale where. We're very agnostic about how a customer shops is with. We just want them to have a great journey. And what we're finding is people cross-pollinate. We'll start online. They'll come in stores. Sometimes in their store, they're actually shopping online at the same time. And so from a contribution margin perspective, we're actually agnostic because, again, our the way our Nordstrom banner is structured from a labor perspective, it's commission-based.

And so when you think about your fulfillment costs, your shipping costs, they're kind of at parity with each other, it's a shared inventory, which we've been talking about. So your margins are the same as you come through at a contribution margin at parity. It's interesting because Erik talked a lot about our Buy Online, Pick Up In-Store next day and how we really lighten this up in our markets. That's actually our best customer satisfaction journey, and it's also our most profitable journey as well. So as we see more customers engaged in this way of shopping with us and the discovery piece, it's something we're really excited by.

Now on the Rack side, it's a little bit different. It's a different selling model in the stores. It's something that we've been working towards, getting towards parity. There's a number of things we've been doing during the pandemic we were busy behind the scenes. So first of all, we have our rack.com on the same platform now as our Nordstrom.com. And so we're able to leverage that scale as we do enhancements and features in order to really drive that through. The second thing is we combine the inventory components to really lift that up. So we can do store fulfillment both in stores and fulfillment centers.

And with the return perspective, it also helps us well. And we did this in Nordstrom banner several years ago. We really saw a margin improvement in that as well. So do we ever think we'll be at parity in the Rack business, probably not a parity, but much closer from a profitability perspective, and that's the journey we've been working on as well.

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

Great. And then on the expense front, maybe if we could break down the drivers of expense dollars going forward. How best to think about SG&A dollars relative to sales or what you're targeting? And then I know over the last couple of years, you've had significant efficiency savings opportunities. Where are we on that journey going forward?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So I'll just remind everyone because we're a little bit different. In our SG&A, we actually report our supply chain fulfillment costs. And that's really where you've seen the growth coming through. As Erik talked about, on the Rack business in particular, we had a lot of units. Our price points were down. Our units were higher. If you look at it on a unit basis, you're really driving some cost through on a variable piece to it. We made a lot of tough choices and reset our overall fixed cost structure in 2020. And we've really held the line on that. We've been very disciplined in that. And we made some -- we made targets and commitments as far as where we want to be on a fixed cost basis. And we actually met and exceeded those in '21, and we're continuing to hold that discipline in '22.

We are seeing some erosion of that with inflation on the labor side, on the salary increase side but in general, really holding that. So the pieces that we really see the opportunities to drive efficiencies in our supply chain. And so we really talked about unit flow price points, getting even a smoother inventory flow really helps efficiencies in our supply chain.

And we've been making investments in our West Coast opportunities, which is 40% of our customers are on the West Coast. As we continue to get that investment scaled up, that's also going to drive efficiencies in that top line -- or for that line. So are we going to be back to -- we're going to continue to see some pressure in there, but we're looking at a lot of ways to continue to drive efficiencies, particularly in supply chain.

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

Great. And then when you put those pieces together, operating margins this year at the high end were guided 6% in line with your Analyst Day target. I guess what's the journey from here. Is 6% the right operating margin for this business? Is there further opportunity? What are you aspiring to? Or what do you think is the right operating margin for your businesses going forward?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So as we talked about in the guidance, we see line of sight both on the top line getting back and beating '19 levels as well as that 6%. And I would say when we gave guidance at our Investor Day a year ago, we said it was 6% plus. So we're trying to balance how do we get back. That would be actually better improvement or profitability than we saw in '19.

But the plus is pretty important because we continue to look at ways to drive both the top line and the bottom line improvement in the business. We're not going to be satisfied just at 6%, but we certainly think it's a good goalpost to start having as part of the journey and building credibility back.

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

Okay. That's great. And then maybe just to wrap up on the balance sheet. How best to think about priorities for cash going forward as we rank free cash flow opportunities with the business.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So we -- as we come back this year, we are expecting our operating cash flow to exceed $1 billion, and we continue to see that going forward. As we think about our balance sheet, first of all, our first priority is reinvesting back in the business. We think it's really important. We typically look at 3% to 4% of sales getting reinvested back in the business and the significant majority of that is going into technology and supply chain, both on the digital side and technology pieces to it, but also in our supply chain pieces.

So that's priority #1. Priority #2 is really making sure we've got a really short up investment-grade balance sheet. We've been doing -- going into the pandemic, we were in a very good position, a very conservative balance sheet that really served us well to weather the storm. And as we're coming out in the last, I would say, 12 to 18 months, we've really worked to get that balance sheet cleaned up. We exited the year with just over 3x EBITDA leverage on a lease-adjusted basis. And our plan and our target for this year is to get to be around 2.5x. We think that's about the right metric for us.

And then anything extra from a capital allocation goes to dividends and to share buyback. And we were very happy to be able to line up our dividend again this quarter. So that's paying out this month.

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

Great. Well, with that, I think that's a good place to close. Erik, Anne, thank you so much for joining us today and best of luck with the business.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Thank you, Matt. We appreciate you having us.

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

Appreciate.
