Q4 2018 NORDSTROM EARNINGS CALL – PREPARED REMARKS

ERIK NORDSTROM

Thanks Trina. Good afternoon, everyone, and thank you for joining us today. Before we get into the call, I'd like to take a moment to comment on Blake's passing. As you can imagine, this has been a painful and difficult time for our family and our company. Blake's impact around here is immeasurable. He loved this business and was so good at it. I think the most important impact Blake had on our company was with our people. In many ways, he brought our culture and values to life. He was the most genuine person I have ever known, and his authenticity helped him make real connections with people inside and outside of our company, many of you included. Pete, Blake and I worked closely as a team our entire lives, most especially over the last 20 years and most recently as co-presidents. We miss Blake terribly but are inspired by his example, and all of us are committed to keeping his legacy alive by being the best retailer we can be, particularly me and Pete. Lastly, Pete and I would like to thank those of you who have reached out with your condolences and stories about Blake. It is greatly appreciated.

Okay. I'd like to start out by saying that we are confident in our strategy to serve customers and drive market share gains. Our unique business model is a key point of difference. It allows us to serve customers in multiple ways – through stores, online, Full-Price, and Off-Price – with meaningful synergies across Nordstrom. Heading into 2019, we're focused on leveraging our digital and physical assets to provide our customers with a best-in-class experience.

While we have the right strategies in place, we are not satisfied with our current financial results. We planned 2018 as the inflection point for improved profitability, and we missed this objective. We have a high sense of urgency to deliver on our profit margin expectations. This means executing our levers to drive our top and bottom line. We're focused on getting back on track with our profitability goals, and we reaffirm our financial targets that we laid out during Investor Day last July.

Turning now to our fourth quarter results, we had a slightly positive comp sales increase driven by momentum in Off-Price. In Full-Price, we saw an unexpected slowdown in full-line store traffic, during and after the holidays. This resulted in softness across most merchandise categories, with Women's Apparel being the most challenging. We're taking immediate action to improve our merchandise assortment by leveraging data analytics for inventory and allocation planning.

At Investor Day, we outlined a number of initiatives supporting our customer strategy. First, we're encouraged by our customer trends. Of our 35 million customers, nearly 10 million shopped across our multiple channels over the past year. We expect this to lead to incremental customer spend of 4 to 11 times. During 2018, more than 7 million new customers were introduced to Nordstrom through our Off-Price business, our largest source of customer acquisition. This is impactful because one-third of these customers are expected to cross-shop in our Full-Price business within a year.

Second, our early investments to build a robust digital business gives us a competitive advantage. Digital sales made up 30 percent of our business in 2018. As we shared during Investor Day, Nordstrom.com has achieved scale with contribution margins at parity with full-line stores. Customers are increasingly engaging with us across stores and online. As an example, we've seen annualized sales growth of 40 percent from buy online, pick-up in-store over the past five years.

Third, we continue to leverage our strategic brand partnerships to offer customers newness and a sense of discovery. These partnerships include emerging brands such as Reformation and Something Navy, as well as established partners like La Mer and Birkenstock. We also had successful limited-time launches of digitally native brands like Away and Allbirds, with more coming this year. Our strategic brands delivered growth of 9 percent and made up more than 40 percent of our Full-Price sales.

Finally, we're pleased with our team's execution in Off-Price to build momentum over the past year. Through focused efforts to strengthen our merchandise offering, we delivered improved topline trends and faster inventory turns. We continued our expansion into Canada with the introduction of six Nordstrom Rack stores that have outperformed our expectations. Similar to our U.S. business, we've already seen synergies between Nordstrom and Rack stores. For example, the Rack serves as an exhaust for full-line stores, enabling more newness and improving product margin in Canada.

This year, we have two key priorities to drive sales and market share gains – our local market strategy and The Nordy Club loyalty program. Beginning with our local market strategy, we're leveraging inventory, along with digital and store capabilities, to serve customers in new and relevant ways. We launched this strategy in Los Angeles as a proof of concept. The outsized share gains in this market give us confidence as we continue to scale. Our "Get It Fast" feature offers customers an expanded selection of merchandise available next day. We also opened two more Nordstrom Local neighborhood hubs. We're experiencing higher customer engagement through services such as alterations and personal styling, which lead to an exponential lift in customer spend. In the L.A. market, demand for buy online, pick-up in-store increased by four times. Customers who visit Nordstrom Local spend two and a half times more on average.

This year we're planning to reach scale in L.A. by leveraging our inventory. Our supply chain investments will give customers greater access to merchandise selection, with faster delivery, and at a lower cost to us. This spring, we plan to open a local omni-channel hub in L.A. to accelerate inventory efficiencies. We also plan to open a one-million square-foot supply chain facility in the fall. This will enable faster delivery to the West Coast, which represents 40 percent of our customer base.

We're looking forward to expanding our presence in New York City. We introduced our men's store last spring and plan to open our women's store this October. This flagship will be the biggest and best statement of the Nordstrom brand, in one of the world's top retail markets. We expect that our flagship, coupled with our digital presence, will contribute a meaningful sales lift in the New York City market.

Our second key priority is to leverage our loyalty program. We continue to evolve our program to remain relevant with customers. In 2018, our loyalty customers contributed more than half of our sales. Last fall, we launched our enhanced program, The Nordy Club. Cardmembers are now earning three points – up from two – for every dollar they spend. We also added experiential elements, such as exclusive access to services and experiences. For example, we offered our loyalty customers early access to our recent Something Navy drop. Going forward, we are pursuing additional opportunities to further personalize the customer experience and drive increased spend.

In closing, we're well-positioned for success through our unique business model that enables us to serve customers in differentiated ways. As we focus on delivering our profitability goals this year, we're prepared to take further action to drive our top and bottom line. I'll now turn the call over to Anne, who will provide additional insights into our results and expectations for 2019.

ANNE BRAMMAN

Thank you, Erik. To reiterate, we're disappointed that we missed our EBIT margin inflection point in 2018. We're focused on getting back on track through our levers around inventory and expense. As we approach the end of our heavy investment cycle this year, we expect our generational investments and digital capabilities to further scale and contribute to improved profitability. In addition, our strong financial position enables us to remain agile in changing business conditions.

Turning to our fourth quarter performance — from an EBIT perspective, our results were generally consistent with our updated expectations in our holiday preannouncement. While Full-Price sales came in lower than expected, this was offset by strong expense management.

Full-Price comp sales decreased 1.6 percent. As Erik mentioned, we saw broad-based declines across most merchandise categories, with the exception of Shoes. To address our opportunities going forward, we took immediate action to edit our assortment, which represented about 10 percent of our brand portfolio.

In Off-Price, our comp sales increase of 4 percent was in-line with expectations, with gains across most divisions. This reflected successful efforts throughout the year to improve our merchandise assortment and accelerate inventory turns.

Our total company gross profit rate decreased 33 basis points over last year. We took higher markdowns due to softer Full-Price trends and in response to an elevated promotional environment. We ended the year in a solid inventory position overall, with a decrease of approximately two and a half percent. That said, we have some pockets of elevated levels based on our current sales trends.

Our SG&A rate was down 23 basis points over last year. We managed expenses well, outperforming our expectations. We continued to bend the curve as our annual expense growth moderated to 4 percent, below the five-year historical average of 7 percent. This was driven by productivity gains in our digital capabilities particularly in marketing and technology.

Our fourth quarter earnings also reflected a favorable income tax impact associated with our deferred tax assets. This included a $0.05 EPS benefit related to prior periods, in addition to a reduced effective tax rate beginning in 2018.

As we look back on the year, our strong financial position is a key differentiator in the marketplace. We have a healthy balance sheet and generated annual operating cash flow of more than $1 billion for the 10th consecutive year. Our consistent and balanced capital allocation approach enabled us to return $1 billion to shareholders during the year and maintain an investment grade credit rating.

As we shared during Investor Day, we are targeting increased shareholder returns through the following financial priorities: drive market share gains; improve profitability and returns; and continue our disciplined capital allocation approach. We’re focused on achieving our long-term financial targets — and in fact, sales, ROIC, and free cash flow performed in-line with our goals.

While we fell short of our EBIT margin expectations in 2018, we're confident that we can achieve our long-term targets. We're focused on scaling our generational investments, leveraging our digital capabilities, and strengthening our product margin. Inventory is our biggest near-term lever of profitability. We've positioned our inventory plans below our sales trends, giving us flexibility to chase demand. We're also further leveraging data analytics to inform our merchandise levels and allocation. Our second lever of improved profitability is expense. Relative to our long-term targets, we are planning incremental savings between $150 to $200 million related to efficiency initiatives across our company.

Turning to our 2019 guidance, our EPS range of $3.65 to $3.90 is based on net sales growth of 1 to 2 percent. This assumes consistent trends in Off-Price and gradual improvement in Full-Price throughout the year.

As we have mentioned before, we're measuring success through sales, customer, and market metrics. In 2019, we expect net sales growth to approximate comps due to the ongoing shift from stores to digital. As a result, beginning this year we will only report net sales growth.

For EBIT, we expect a range of $915 to $970 million. This implies an EBIT margin range of 5.9 to 6.1 percent, tracking toward our 2020 goal of 6.3 to 6.5 percent. Relative to our long-term targets, we have assumed lower sales growth in 2019 offset by incremental expense initiatives.

From a gross profit perspective, we're planning modest expansion through efforts to increase inventory turns and grow strategic brands. Our occupancy rate is expected to be flat.

Moving to SG&A, we're planning for modest deleverage when excluding the estimated credit charge in 2018. This includes $150 to $200 million of expense savings and ongoing productivity gains in our digital capabilities. Excluding our West Coast supply chain investments, we expect to maintain a mid-single-digit expense growth for digital capabilities.

Another lever of improved profitability is our generational investments. In 2018, they contributed nearly $2 billion to our topline and exceeded our bottom line expectations. Nordstromrack.com and HauteLook became our fastest business to hit $1 billion in sales. Trunk Club sales grew 35 percent for the year, on track to reach its market potential of more than $500 million. In 2019, we're planning for our generational investments to deliver sales of roughly $2.2 billion, with an EBIT improvement of approximately $15 million over last year.

In terms of our quarterly cadence, we expect EBIT for the first quarter to decrease from the prior year. This assumes a continuation of current sales trends with higher markdowns to clear out pockets of excess inventory. From an expense standpoint, we assume greater deleverage on fixed expenses resulting from lower volume in the first quarter relative to the year.

We're planning for EBIT margin to leverage beginning in the second quarter. In addition, we estimate $35 million in pre-opening costs for our New York flagship leading up to our planned October opening.

From a capex perspective, there are no material changes to our 5-year plan. We're estimating approximately $900 million of investments in 2019, or nearly 6 percent of sales. This includes a shift of around $100 million in projects from last year. We're investing in our key priorities, with 50 percent of our plan for technology and supply chain and 30 percent for the New York flagship. As we near the end of our generational investments cycle, we expect capex levels to moderate in 2020.

Through our unique business model and strong financial position, we believe we have the appropriate plans in place to succeed. Together, as an experienced team, we’re prepared to make hard choices and pull additional levers around inventory and expenses to drive improvement in our business. Heading into 2019, we’re focused on delivering our profitability expectations and long-term financial targets. I’ll now turn it over to Trina for Q&A.