NORDSTROM Q4 2017 EARNINGS

Blake Nordstrom, Co-President

Good afternoon and thank you for joining us today. Before we get started on our results, we'd like to take a moment to provide context on our journey ahead as we aspire to be the best fashion retailer. Our customer strategy is centered on three strategic pillars: providing a differentiated product offering, delivering exceptional services and experiences, and leveraging the strength of our brand. As we continue to evolve with customers, we're combining our digital and physical assets to create new ways for them to shop.

We invested early in our omnichannel capabilities, integrating our inventory across our stores and online over a decade ago. This has enabled us to serve customers in multiple ways -- today we have more than 60 combinations in which merchandise is ordered, fulfilled and delivered. Through these investments, we have strengthened our foundation to better serve customers and gain market share.

Turning to our performance in 2017, we had record sales of approximately $15 billion. This represented annualized growth of 5 percent over the last five years, reflecting the investments we've made to expand our reach and improve the customer experience. We're encouraged by a number of key achievements over the past year.

First, we continue to see positive customer trends. At the close of 2017, we had 33 million customers who shopped with us during the year. Additionally, 9 million customers shopped in multiple ways, a 6 percent increase over the previous year. It's noteworthy that customers spend nearly 70 percent more when shopping with us through multiple touch points.

In our Nordstrom business, we made meaningful progress in meeting customers' expectations around speed, convenience, and personalization. We offer a number of ways to serve them on their terms, seamlessly across stores and online. Our services such as Buy Online Pick Up In Store, Reserve Online and Try In-Store, and Style Board grew by more than 30 percent over last year. Nordstrom Local is a recent example of how we are testing new ways to engage and provide customers with convenient access to our service offerings. And, our accelerated investments in our digital platform continue to pay off with digital sales representing 30 percent of our full-price business. Nordstrom.com has 700 million annual site visits, offering expanded selection in key brands and categories.

Our Nordstrom Rack business continues to be our leading source of customer acquisition, gaining 6 million new customers in 2017. Over time, about one-third of our off-price customers cross-shop in our full-price business. In addition, Nordstromrack.com and HauteLook represent our fastest growing business to reach $1 billion. In 2017, it accounted for 18 percent of off-price sales and had new customer growth of 45 percent. Its integrated digital and physical experiences led to 85 percent of online returns being made in-store, which drove more than 4 million store trips in 2017.

We continue to evolve and grow our strategic brand partnerships with a focus on establishing Nordstrom as the partner of choice. Benefits of this strategy include creating a source of newness and discovery for customers, strengthening regular-price selling, and driving long-term collaborations with preferred brands. These brands -- including designer, product with limited distribution, and our private label -- delivered outsized sales growth of 14 percent in 2017 with healthy gross margins. Over 60 percent of full-price brands have limited promotional exposure, a 17 percentage point improvement from two years ago.

Our Nordstrom Rewards loyalty program continues to drive engagement while providing valuable customer insights. In May 2016, we expanded our program so that all of our customers can participate regardless of how they choose to pay. We continue to reap the benefits, with more than 10 million active Nordstrom Rewards customers, an increase of 35 percent, year over year.

As we look ahead to 2018, we’re executing on our strategic pillars through a series of initiatives. First, we’re excited to announce that we will be opening the doors to our men’s New York City store on April 12th. Together with our women’s store, which is slated to open in fall 2019, this flagship is our largest project to-date. We expect this store to be the biggest and best statement of the Nordstrom brand, serving as a gateway to new customers both in the U.S. and internationally. It will be our highest-volume store in one of our top markets. Based on our experience of introducing full-line stores in a new market, we also expect this store to drive a material lift to online sales and market share gains.

Second, we’re focusing on further integrating our digital and physical assets in our top markets to deliver best-in-class services and experiences. We will bring our capabilities together - across supply chain, technology, marketing, product and services -- to create a digitally-connected and differentiated experience for customers to shop on their terms. We're starting our integration in L.A., our largest market, where we serve 4 million customers online and through our local assets, including 16 full line stores, 27 Nordstrom Racks, distribution and fulfillment centers, Nordstrom Local, and Trunk Club. We believe that we will gain terrific learnings from our experience in L.A. that we can apply to other markets.

Another key initiative for 2018 is the introduction of Nordstrom Rack in Canada, where we completed our full-line store expansion plans with our sixth store opening in Sherway Gardens, Toronto, last September. This year, we're planning to open six Nordstrom Rack stores in the Toronto, Calgary, Edmonton, and Ottawa areas. Similar to our experience in the U.S., we expect strong synergies between our full-price and off-price businesses and plan to grow our total Canada business to $1 billion.

Finally, we'll continue to curate our assortment to provide newness and the opportunity for discovery for our customers. In our full-price business, our focus is on strategic brand growth through new launches and our existing partners. In our off-price business, leveraging our vendor partnerships enables us to offer the best brands at the best prices.

We have made meaningful progress in laying the groundwork to better serve customers and look forward to our opportunities. We believe we have unmatched local market assets -- our people, product, and place -- that, combined with the strength of our digital capabilities, make us uniquely positioned in the market.

I'll now turn the call over to Anne, who will provide additional insights into our financial performance and thoughts about the year ahead.

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Anne Bramman, CFO

Thanks, Blake and good afternoon everyone. Our fourth quarter earnings demonstrated our solid holiday execution, ending the year with clean inventories and stable merchandise margins. We maintained a strong financial position, marking the ninth consecutive year of generating more than $1 billion in operating cash flow.

We had a strong finish to the year. For 2017, total sales growth increased 4.4 percent and comps increased 0.8 percent, which were slightly ahead of our expectations.

In our Nordstrom brand, fourth quarter sales reflected both favorable store trends and double-digit online growth. In our Nordstrom Rack brand, we had a meaningful improvement from the third quarter, a direct result of our focused efforts to provide good inventory flow and fashion-right merchandise.

Fourth quarter retail gross profit was down roughly 40 basis points from the prior year, due to occupancy expenses associated with our growth plans. Merchandise margins were consistent with both our expectations and the prior year, reflecting continued strength in our regular-price selling. Ending inventory growth of 7 percent was in-line with our plan and included a shift in timing of in-transit receipts. When normalizing for this, inventory growth was consistent with sales growth.

Our SG&A rate increased approximately 240 basis points, which included roughly 90 basis points of non-operational items. We had a one-time contribution to our employee profit-sharing plan associated with tax reform as well as a legal settlement gain in 2016. The remaining increase primarily reflected planned supply chain, marketing and technology expenses.

We reported EPS of $0.89 for the fourth quarter and $2.59 for the full year. The impacts associated with tax reform were not contemplated in our prior outlook. This consisted of a one-time charge of 25 cents primarily related to the revaluation of our deferred tax assets. Additionally, we made an investment to employees of 6 cents mentioned earlier. Our results also included year-end adjustments to our incentives based on our top-line performance, bringing earnings to the lower end of our expectations.

Now, I'd like to provide our perspective on how we're measuring success as our business model continues to evolve. The economics of serving customers are greatly enhanced by having combined digital and physical assets in a given market. In our full-price business, we have a high-quality portfolio of around 120 full-line stores in roughly 50 markets across the U.S. In these markets, the profit per customer is more than double that of markets without a Nordstrom store presence. This market-focused approach informs how we allocate capital, leverage our capabilities, and measure our success.

As we previously shared over the past several quarters, we're increasingly managing our business primarily through two brands -- Nordstrom and Nordstrom Rack -- rather than by channel. This includes migrating our metrics from a legacy store view to those that are more relevant to how customers are engaging with us. We continue to further align our incentives based on markets rather than individual channels.

Beginning in 2018, we will make a number of reporting changes and introduce additional metrics around our customer and market performance as indicators of the underlying health of our business. These changes, which are outlined in today's release, will impact our segment and sales reporting. Specifically, this means that we will be allocating our credit business to our full-price and off-price businesses. Additionally, our sales reporting will represent a combined stores and online view and will include allocated corporate adjustments, such as estimated sales returns. As the year progresses, we will be providing clarity and transparency to help make this reporting transition go smoothly.

Next, I'd like to discuss our path forward to achieving long-term profitable growth. We have now reached a point where our full-price digital business is at a scale in which costs to serve customers are comparable across our stores and online channels. This year, we are planning for a turning point in improved profitability as we scale our generational investments and leverage our enterprise capabilities.

In 2017, generational investments in Canada, HauteLook, and Trunk Club contributed roughly $1.5 billion in sales. As these investments continue to scale, we anticipate profit improvements.

We accelerated investments in our foundational capabilities for supply chain, technology and marketing, resulting in an annualized expense growth of approximately 20 percent from 2010 to 2015 in these areas. Over the past two years, we have cut this growth in half through our focused efforts to drive productivity, and plan to further reduce it to a mid-single-digit range in 2018.

We're planning to maintain our marketing expense as a rate to sales, focusing on personalization at scale through our data and analytics capabilities. With the speed and agility enabled by our modernized technology infrastructure, we expect to incur cash spend of $525 million towards technology, consistent with the prior year. And, in supply chain, we have maintained our cost per unit with further opportunity to optimize our network.

Finally, I'd like to turn to our 2018 guidance. Our EPS range of $3.30 to $3.55 includes a benefit from corporate tax reform of around $0.55, partially offset by an EBIT reduction from revenue recognition changes of approximately $30 million.

- In terms of top-line performance, we expect a continuation of underlying trends, yielding total sales of $15.2 to $15.4 billion and comps of 0.5 percent to 1.5 percent. This incorporates sales from generational investments of roughly $1.8 billion and 12 new Nordstrom Rack stores -- 6 in the U.S. and 6 in Canada.
- Our gross profit rate assumes modest improvement in merchandise margins. Occupancy expenses as a rate to sales are expected to be relatively consistent with last year, with higher expenses in the first half due to timing of new store openings.
- Pre-opening expenses for our New York City flagship are estimated to be $25 million in 2018, consistent with 2017.
- Additionally, SG&A expense growth is expected to be in the mid-single-digit range.
- From an EBIT perspective, these drivers are expected to result in flat to a slight improvement in margin rate at the midpoint of our guidance.
- The 2017 estimated EPS impact of the 53rd week is approximately $0.05.
- Our income tax rate, including state and local taxes, is estimated at around 27.5 percent, down from 39 percent due to tax reform.

Given the impacts related to the 53rd week, tax reform, revenue recognition, and event shifts, please refer to the appendix section in today's slides for additional color.

Moving to our capital plan, we expect to invest roughly $3.2 billion over the next five years, or 4 percent of sales. Technology and supply chain are key enablers of the customer experience, representing nearly 50 percent of our plan. Canada and our New York City flagship investments, making up 17 percent, will moderate as they near completion. For 2018, net capex is expected to be approximately $740 million, an increase of $70 million from 2017, primarily due to our New York City flagship and the buildout of an additional West Coast fulfillment center, which shifted from 2017.

In closing, our strategic brand partnerships and combined digital and physical assets make us uniquely positioned in the marketplace. We believe our diversified and resilient business model will continue to serve us well while creating value for our shareholders, customers and employees. And now I'll turn the call over to Trina for Q&A.