NORDSTROM

2020 Virtual Retail Conferences: Evercore ISI and Cowen

June 18, 2020

Our CEO Erik Nordstrom and CFO Anne Bramman recently completed two retail virtual fireside chats to discuss our business model, Q1 financial performance and how we remain focused on serving customers during this time. They spoke with Oliver Chen with Cowen on June 9 and Omar Saad with Evercore ISI on June 16. Below is a summary of their remarks.

During the Cowen's New Retail Ecosystem Virtual Conference, Oliver kicked off the session summarizing the external outlook on Nordstrom: "In our view, Nordstrom is an iconic and modern retailer with what we view as the most advanced local market inventory strategy. This strategy drives speed, agility, as well as an unmatched customer experience. Nordstrom is also one of the leading partners to brands as the company has stuck to its long-term goals of executing and redefining what it means to be customer-centric."

Before Q&A started for either fireside chat, Erik addressed the painful times we are in for our country, stating, "The deaths of George Floyd, Ahmaud Arbery, Breonna Taylor, and far too many others for far too long have been painful examples for our country that change is needed. We know we have a role to play in that and take that responsibility very seriously."

We have a unique mix of assets, and the flexibility of our business model continues to serve us well.

Erik described the flexibility that's inherent in our model. "When I say model, I mean our Nordstrom and Nordstrom Rack brands, stores and a robust online business and how they all work together — all of which has served us well over the past several years as there have been changes to how customers want to shop and has certainly served us well these last couple months. More importantly, it allows us to be more customer centric. The customer has been changing clearly, there's been more changes last couple of months. We see the changes in our industry as an acceleration of previous trends and we're confident in our strategy.

"A good example of this is store fulfillment. In the last couple of months, our ability to fulfill orders from our stores has been a huge asset. We normally fulfill about 20% of online units from Full-line stores — that ramped up to more than 50% while our stores were temporarily closed. This flexibility and synergy have helped us during these uncertain times, but most importantly, it helps us serve customers on their terms."

By the end of this week, we will have about 90% of our stores open, furthering our ability to be flexible and serve customers on their terms.

"Right now, we have about 75% of our store fleet open that includes Full-line and Rack stores," said Erik. "By the end of this week, we will have around 90% of our stores open, which is ahead of our plans." In general, about half only opened a few weeks ago and was more focused on smaller markets, so we are early in our journey and still learning as we go. But I would tell you that our results are ahead of expectations. Our Rack results are strong and we're seeing improvement sequentially over the weeks."

"We've learned a lot in these past few months and feel really good about our safety plan. We've gotten great feedback from our employees and customers regarding these safety measures, and we will continue to adjust and refine our approach as we learn more about this new environment. We already had a productive use of people in our stores to begin with thanks to store fulfill, so opening our doors isn't a big burden from a labor scheduling standpoint. Store fulfill also helps clear out inventory and adds to our flexibility of moving inventory around. With all the sizes and colors in fashion, you have to buy broad and shallow, so inevitably, what our customer may want is in another location. Our model allows us to leverage the inventory we have and move it around very quickly for customers, which has always been important, but especially right now."

Online demand, an indicator of underlying trends, grew 9% in Q1, consistent with trends in the second half of 2019.

Anne addressed our digital results of Q1. "We had a high velocity of units that went out the door in Q1 — more than 20%. This was an incredibly promotional environment, so price went down, but units went up. While trends remained consistent with what we saw in the second half of the year, our focus really turned to cash, with inventory as our biggest lever of flexibility.

"As retail continues to evolve, our flexible model supports a continued shift from mall-based business toward a more diversified model that includes digital and Off-Price," Anne added. "To keep up with changing customer demands, we're continuing to invest in critical capabilities across technology, data analytics, and supply chain. This includes scaling our end-to-end platforms to support a single view of customers, inventory and product across Nordstrom as well as further integrating our physical and digital capabilities in Off-Price."

Our actions resulted in an inventory decrease of more than 25%, enabling us to bring in newness for customers starting this month.

Anne went on to explain how our reduction in inventory positions us well for the future, stating, "we know our customers like fresh product, so it really helped to have some dollars available to be able to invest in that, particularly in categories that are currently resonating with customers. We look at our Rack business as this very efficient, effective channel to clear out older merchandise, which especially helped us get to this favorable position in Q1. That was the premise of launching Rack to begin with, keeping our Full-Price business clean and enable us to bring in newness."

In 2019, our Off-Price and e-commerce business accounted for nearly 60% of sales.

"Sometimes we get lumped into a mall-based department store category, which misses the diversity of the business we have," said Erik. "The amount of business we've done in mall-based Full-Price was less than 40% last year and will likely shrink this year. The rest is really made up Off-Price and e-commerce. We have a very large online Off-Price business — it's over $1 billion and is growing rapidly. Also, our Rack stores require less investment and are much faster to build and our leases are shorter, so we have a lot of flexibility to where we can pilot different approaches, merchandise mix, price mixes and move from there. We acquire more customers through Nordstrom Rack than any other channel we have. About 1/3 of those customers become Full-Price customers within the first year, so there's lots of synergy. We see Rack as a growth opportunity for us, but we will test our way through and flex to where we have success.

We're very confident in our liquidity to execute both this year and for the long term.

Anne added some context to our business before COVID-19 hit, stating, "the momentum we had in the business from the second half of 2019 continued into February. From a top-line perspective, we were actually ahead of expectations — exceeding some of our plans in terms of guidance for that month. Then in March, when COVID-19 hit and our stores temporarily closed, we took immediate action to strengthen our financial flexibility, pivoting to liquidity, cash and managing inventory. We're very pleased with the results on both those fronts."

Anne addressed actions taken to increase liquidity, "we started Q1 with around $850 million of cash on the balance sheet. We drew down our revolver, so we had $800 million from that and did a debt financing of about $600 million. We also pulled a number of other levers, including suspending our dividend, and then we stopped our share buyback program. On top of that, we had given guidance at the beginning of the year that we were continuing to look for ways to reduce our overhead or cost base. We had given a target of about $200 million to $250 million of planned savings. I would say we're well on our way of achieving that. Additionally, we pulled another $500 million of cash opportunities between reducing expenses further, reducing some of our CapEx as well as looking at our working capital pieces.

"We also significantly decreased our cash burn as we exited the quarter, and we expect to get to a breakeven monthly cash burn by the end of Q2. And we're confident based on these actions and additional actions we did to raise funds that we've got sufficient liquidity to execute our strategy in 2020 and well beyond."

Our thinking around physical assets has changed quite a bit in the last couple of years as part of our market strategy.

"We see this as a significant acceleration of trends from before COVID and don't see any indications that it will go back," said Erik. "Customers don't view their life through channels. They don't think about an e-commerce outing versus a store outing, they just want a great experience. We've been investing in this for some time which has benefited us during these times. For physical retail, the use of stores is changing. We don't think stores are going away, but they do become more of a place to discover and pickup product. We do benefit from engagement with customers and that physical engagement can take on more forms like alterations. So leveraging physical assets that we already have in different ways is a trend that will continue."

Erik transitioned to talking about our two focuses in our market strategy. "Our market strategy is still our future business model and really has two components: inventory and services. For inventory, it's how can we leverage what inventory we already have in a market, which is our biggest investment. The majority of our inventory is in our stores, which is where we do most of our business, so we've been investing in ways to leverage that inventory and give customers a significantly bigger selection with a faster delivery. That's done by taking a market-by-market approach as opposed to looking at stores individually. For services, it could be meeting a stylist, doing a buy online pickup in store, alterations, but all our services benefit from a physical location. It's all about serving customers on their terms, so we keep challenging ourselves to bring these services to the customer more conveniently.

"Almost all the store closures we announced were smaller, older stores, in multi-store markets where we think we can still serve those customers through our digital tools and through, again, rethinking the physical experience. This can include the Nordstrom Local neighborhood service hubs, express services at our Rack stores where a customer can do an order pickup, returns and alterations. Those services used to be only at our Nordstrom stores, but we found that customers really appreciate the convenience of having them our Rack stores, which we have in more locations.

"We're very excited and think we've had some real proof points, both in Los Angeles and New York, to this strategy."

Our Anniversary Sale that is all about offering fresh new product at great prices.

"There're a lot of clearance sales — everyone does it," said Erik in a response to a question about our Anniversary Sale. "We do it to clear out older merchandise. That's not what our Anniversary Sale is about — it's brand-new merchandise at lower prices, which is why it made it for such a powerful event for us over decades. We thought moving into August would give us time to separate it from the highly promotional environment in June and July and allow us to buy into it. We're getting back to what we've historically been very good at, exposing a customer to new products, at great prices from their favorite brands, and bringing in new receipts to do that. August lines up really well for that."

A mix of products across a price range inspires a sense of discovery for customers and gives us the flexibility to adapt to changing customer trends.

Erik expressed the importance of not being an occasion-only retailer, especially today with fewer occasions. "The overall trend of casualization is an example of an acceleration that's happened. We're being purposeful in moving our mix in that direction, as well as focusing on our unique mix across price points. That mix of high and low is important because it all collectively works together — everything from designer to Off-Price.

"For example, our Rack business is not just about price points, there's also an overlap in brands with Full-Price and is our #1 source of new customers — about 30% of those customers end up becoming Full-Price customers within the first year. But even our Full-Price business offers an assortment of high-low products. We know customers like to mix and match styles and brands, so that discovery of new product is something that we need to continue to be good at. It drives our merchandise mix, and a range of price points is important to that — but that range also gives us the flexibility of moving to where the customer goes."

Our Nordy Club loyalty customer continues to drive our business forward.

On the topic of loyalty programs, Anne explained how valuable our Nordy Club members are to our business, "we had 13 million active Nordy Club customers, which made up about 2/3 of our sales in Q1. They tend to visit about 3 to 4x more than any other customer, so they're a big driver for our business. Anniversary Sale is another opportunity for us to really serve that customer and give them some opportunities to get different looks at our inventory and exposure to special offerings. We're continuing to leverage feedback as we evolve this program."

We need to be a great place for customers to discover new product, which requires great relationships with our brand partners and a flexible business model.

When asked about our future positioning, Erik responded, "less than 40% of our business is the mall-based store and that's accelerating, which gives us flexibility and market share opportunities. As I mentioned, we need to be a great place for customers to discover new product. We're not a place where customers come with a shopping list and they're just crossing off exactly what they want. A lot of our business is done from customers that are curious, that may know they want something new but don't know exactly what it is. To ensure we have the right products requires a strong partnership with our best brands. Being the retail partner of choice has long been vital to our business. I think it's safe to assume that brands won't need as many retail partners as they did in the past, so keeping those relationships is very important to us.

"We think our future should include more flexible models like rental, resale, or different ownership models of inventory. Those are means at the end. The end is having a compelling mix for customers where we can leverage both our physical and digital assets to be the leader in product discovery."