NORDSTROM

Consumer & Retail Conference: Conversation with our CEO and CFO

December 9, 2020

CEO Erik Nordstrom and CFO Anne Bramman recently participated in Morgan Stanley's Consumer and Retail Conference to discuss our Q3 results and plans for the future. Below are highlights from their remarks.

First and foremost, everything we do starts and ends with the customer.

Erik started the conversation with a reminder on our top priority: customer service. "We have a long history around customer service. We're proud of the reputation that our teams have developed over these many decades. And that may sound obvious, but the definition of service is changing. And like a lot of elements of our business, COVID hasn't been so much about dramatic change but instead about a dramatic acceleration of trends that have been in place for several years.

"We view service today as really having two components. First, convenience, which is really the basis for good service. But to get to great service, it must also include connection. How we connect with customers is changing and certainly requires increasingly having digital capabilities along with the connection to our physical assets. We feel good about our ability to offer both and create synergy through the combination of the two."

Our Q3 results reflect not only how we pivoted when the pandemic hit, but also the outcome of investments we've been making for a couple of years now.

Erik shifted to our Q3 results, saying, "We are really encouraged by our performance. Our results reflect not only how we pivoted when the pandemic hit, but also the outcome of investments we've been making for a couple of years now. For example, our investments in digital helped get us to where 54% of our business last quarter was done online. Scale matters moving online but these digital capabilities get amplified when they are connected to our physical assets.

"The resulting model that we have is profitable. Even with the disruption, we're going through and a big shift to digital, we had earnings of over $100 million, operating cash flow of over $150 million and we feel really good about how we're positioned for the future."

We're focused on our three growth drivers in our market strategy, Nordstrom Rack and digital business.

Erik continued, "First, building on the success of our market strategy. When we first start talking about market strategy a couple of years ago, we talked about as the business model of our future. Well, the future is here. We scaled it to our top 10 markets. We've also added pickup capabilities not only in our Nordstrom stores and Nordstrom Local service hubs, but also at our Nordstrom Rack stores. That's nearly 350 locations where we can serve customers through order pickup. Also, by connecting the store inventory we have in a single market along with our digital business, we're able to offer up to 7x the selection to a customer for next day pickup at a store or two-day delivery.

"Second, fueling the growth of Nordstrom Rack. It is 1/3 of our business right now. Our Rack business is where we get the biggest chunk of new customers, and about 1/3 of those customers end up becoming Nordstrom customers, Full-Price customers within a year. To grow Rack, we think there's opportunity for us to expand our price points, particularly lower price points in our stores. We think there's growth to be had there. We also see opportunity for growth from integrating our online business with our physical store business. Last month, we connected our inventories, integrated them between Nordstrom.com, Nordstromrack.com, HauteLook and our Rack stores. The result of this was we added 30,000 customer choices online in our Off-Price business last month. About 1/4 of our online orders from Off-Price are being fulfilled from our stores now and more than 10% of our orders from Rack.com and HauteLook are being picked up in our stores. So we think we're just at the very start of the benefits of that integration and are encouraged with the opportunities ahead.

"The third area of growth for us is to increase the velocity of our digital business. We view it as a way to drive personalization at scale to build connections. The rate of digital growth accelerated with COVID, but it is keeping with where we've been going. However, it's still big for us to be at a point of having 54% of our business online. And a big part of that is continuing to increase the linkages in our digital and our physical business across full and Off-Price. We think with the combination of these assets we have, there is a real synergy there and provides growth opportunities for us."

Combining stores with our online offering creates a synergy across the business.

When asked about the future of the store, Erik emphasized its importance. "Stores play an increasingly important role, especially with the shift to online sales because we can provide services, be it in a Nordstrom Local or Nordstrom Rack now, for things like order pickup and alterations. And so that mix of assets, Nordstrom full-line stores, Nordstrom Locals, Nordstrom Racks gives us a lot of flexibility. Part of having a robust and integrated inventory allows us to put more inventory into the stores to offer online and in-store customers more offerings without the downside risk of having markdowns from the inventory being trapped there thanks to store fulfill.

"There is something of a treasure hunt in Off-Price that makes our Rack stores super productive. We think by expanding the price points, we could open up more growth opportunities. We are the only Off-Price player who has a robust Off-Price online business, so we're able to create a synergy between that and our store business."

We've achieved margin parity across in-store and online for Full-Price and are getting closer to parity in Off-Price.

Anne highlighted our advantage in our digital business thanks to our scale, saying, "We have been at parity for quite some time in our Full-Price business thanks to the scale of investments we've made and our ability to leverage inventory between online and in stores. As we continue to leverage store fulfill to help us meet demand and have products closer to the customer, that's really helping us drive that parity for Full-Price.

"As we pivot to the Off-Price space, the unlock we did last month with the combination of store fulfill and shared inventory, that is a huge path to getting us closer to parity in the Off-Price space. And we're continuing to leverage the investments in platform and back-end pieces to this between our Off-Price business and Full-Price business and —that will also help us get to more parity and, quite frankly, offer more opportunities and choices as we make these investments for our customers as well.

We're making sure we have the right inventory in the right place to serve customer demand.

Anne then talked out our strong inventory position that sets us up to quickly respond to customer demand. "We finished Q3 with inventory down 27%, and that was pretty much in line with sales when you exclude the shift in anniversary sales. With so much uncertainty, we've been disciplined to make sure not only that we have dollars to chase new product, but also that we have flexibility to meet changes to customer demand.

"Anniversary is a great example of our ability to pivot to relevant categories, which was reflected in our record sell-through rate. We're continuing to see newness through for Holiday, which will have the freshest offering we've had in some time. The other piece to it is the market strategy. That really unlocks having inventory closer to the customer and making sure that we can sell as much as we can at full price without having to take markdowns. It's a balancing act that we will continue to make sure we've got the right offering, the freshest inventory while ensuring the opportunity to chase into new trends emerging."

We're executing in categories to reflect this moment in time and are prepared for the future.

When asked if the current categories trends are expected to continue, Erik responded "I think there's some important context here. For example, active is not a new business for us. We've had a big active business for quite some time. Zella is our own active label which has always done well and is growing quickly. We think there's plenty of opportunity to continue that. Home is a little different. We've been in it, but certainly it's been a smaller business. We see growth opportunities there, but that's off a smaller base where active is growth opportunities off a bigger base.

"We recognize that there's been a multi-year trend toward casualization, which has accelerated. However, people will still get back to buy other categories. It could be for going to work, going on a date night or going to the coffee shop. There is going to be a time where we interact with each other again. That doesn't mean formal categories. Are we going to sell as many suits and ties to people wearing suits and ties to work as before? No. But that's been a multi-year trend for quite some time. But we are highly thought of in customers' minds for higher-state dressing. It doesn't have to be formal —customers trust in us to expose them to new brands. And one of the best compliments we get from customers is that they came to our store or website and ended up buying something they wouldn't have bought on their own, which ends up being their favorite thing in their closet. That's a big part of our business, that newness and the mix we have.

"Spending 95% of our lives at home is a moment in time. Once things open up, a much broader range of categories will come into favor. Those are categories that we still hold a good spot in customer's minds with, and we'll be ready to flip that dial and get after it when we see that happening."