REFINITIV STREETEVENTS

EDITED TRANSCRIPT

JWN.N - Q4 2023 Nordstrom Inc Earnings Call

EVENT DATE/TIME: MARCH 05, 2024 / 9:45PM GMT

OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Catherine R. Smith *Nordstrom, Inc. - CFO & Treasurer*

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

James Duies *Nordstrom, Inc. - Senior Director, Investor Relations*

CONFERENCE CALL PARTICIPANTS

Blake Anderson *Jefferies LLC, Research Division - Equity Associate*

Brooke Siler Roach *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Chandana Naga Sai Madaka *KeyBanc Capital Markets Inc., Research Division - Analyst*

Dana Lauren Telsey *Telsey Advisory Group LLC - CEO & Chief Research Officer*

Edward James Yruma *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Lorraine Corrine Maikis Hutchinson *BofA Securities, Research Division - MD in Equity Research*

Neil Goh *TD Cowen, Research Division - Associate*

Warren Cheng *Evercore ISI Institutional Equities, Research Division - Associate*

PRESENTATION

Operator

Greetings, and welcome to the Nordstrom Fourth Quarter 2023 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. At this time, I'll turn the call over to Jamie Duies, Head of Investor Relations for Nordstrom. You may begin.

James Duies - *Nordstrom, Inc. - Senior Director, Investor Relations*

Good afternoon, and thank you for joining us. Before we begin, I want to mention that we'll be referring to slides which can be viewed in the Investor Relations section on nordstrom.com. Our discussion may include forward-looking statements, so please refer to the slide with our safe harbor language.

Participating in today's call are Erik Nordstrom, Chief Executive Officer; and Cathy Smith, Chief Financial Officer, who will provide a business update and discuss the company's fourth quarter performance. Please note that when discussing our results and outlook, we will be referring to them on an adjusted basis for EBIT, EBIT margin and earnings per share. Reconciliations to the most directly comparable GAAP measures can be found at the end of this presentation and our Q4 2023 earnings press release, both of which are available on our website. And now I'll turn the call over to Erik.

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

Thank you, Jamie, and good afternoon, everyone. Thank you for joining us today. I'll start with our fourth quarter performance, then discuss our 2023 priorities and cover what we're focused on for 2024.

We delivered a strong fourth quarter with net sales of $4.3 billion and earnings per share of $0.96. For the full year, our results were within or better than the guidance we laid out, and we accomplished what we set out to do: enhance the customer experience and drive better financial performance.

Ahead of the holiday shopping season, our teams worked hard to deliver the right assortment as well as provide engaging experiences for our customers. As a result of these efforts, we achieved sequential improvement in net sales, profitability, number of customers and purchase trips in the fourth quarter.

Throughout 2023, we remain focused on 3 priorities intended to drive better financial performance while keeping the customer at the center of everything we do.

Our first priority was to improve Nordstrom Rack performance. One way that we did that was by opening 19 new stores in 2023. New Rack stores continue to be an excellent investment as they deliver well in excess of their cost of capital with a relatively short payback period. However, it's not just the new stores that drove the Rack's impressive net sales growth in the fourth quarter as Rack comparable store sales also grew by high single digits. Our Rack digital business also improved in traffic and conversion in the fourth quarter, enabling sales which contributed to NordstromRack.com's full year profitability. From a merchandise standpoint, we focused our efforts to improve our offering at the Rack as we know that delivering great brands at great prices is what our customers want.

Our second priority in 2023 was to increase inventory productivity. We continued to focus on managing inventory effectively as evidenced by the positive sales to inventory spread in the fourth quarter, which sets us up well from a merchandise standpoint as we start the new fiscal year. Additionally, our efforts to reduce the overhang of designer inventory met our target, and our overall newness of inventory is stronger than it was a year ago, given we had fewer aged items to clear through.

Our third priority of 2023 was to optimize our supply chain capabilities, a continuation of efforts that began in 2022. In Q4, for the sixth consecutive quarter, the team delivered another 50-plus basis points of improvement in variable supply chain expense savings, while at the same time, improving our click to delivery speed.

Building on the momentum of our efforts to optimize our supply chain, we have made the strategic decision to relocate operations from our Fulfillment Center in San Bernardino, California, to our West Coast Omnichannel Center, just 25 miles away in Riverside. WCOC has been scaling for several years now and is well positioned to serve our customers across Nordstrom and Nordstrom Rack banners following the investments we have made to enhance capabilities at the facility. It is our newest, most automated facility, offering a substantially lower processing cost per unit. We recorded a $32 million asset impairment and related charge due to this relocation.

We're pleased with the results of our efforts against our 3 priorities for 2023 as not only did they drive better financial outcomes for the company, but also supported our efforts to improve the customer experience. Next, I'd like to take a moment to discuss merchandise performance in the fourth quarter as Pete is away in market and unable to join us today.

We came into Q4 at a much healthier inventory position than in the prior year, resulting in fewer markdowns during the quarter, which helped to drive an expansion of our gross profit margin by 125 basis points. Active, Beauty and Women's Apparel were our best-performing categories in the fourth quarter, with strong growth versus the prior year.

The Active category was led by Shoes, with strength from brands like On Running and HOKA as well as apparel brand, Vuori.

We leaned into Beauty with a strong gift selection for holiday as well as a 5x point promotion for our Nordy Club members. This offer drove incremental trips and conversion while creating a halo effect in other categories. Fragrance was the top performer in Beauty at both banners, highlighted by brands such as Burberry, YSL and Marc Jacobs. At the Nordstrom banner, designer makeup drove strong growth from Chanel, Tom Ford and Dior while the skincare category improved compared with the previous year. At the Rack, the rollout of an expanded offering of haircare products supported our outsized growth.

The improvement in Women's Apparel was supported by seasonally relevant newness in addition to our turnaround with the young customer, which is an area we have a multiyear plan to improve. We are pleased with the progress in this area in Q4, which was led by our Nordstrom private brands. At the Nordstrom banner, dressier categories were the best performing. Brands such as Vince, Veronica Beard, and Cinq à Sept delivered solid growth.

Overall, we exited 2023 with improved inventory levels versus the prior year, which provides us the opportunity to have a consistent flow of relevant product as we move towards spring.

Turning to 2024, we're confident in our plan for the year. Building upon the work we did in 2023, we've refreshed our 3 key priorities for 2024: Driving Nordstrom banner growth, optimizing operationally, and building on momentum at the Rack.

The first priority is to drive growth at our Nordstrom banner. Our customers value the relevance and inspiration that we offer. We aim to provide that by offering a compelling product mix along with creating an environment where they not only shop their favorite brands and products but also discover new ones. We will focus our Nordstrom banner efforts on digital-led growth supported by our stores.

One thing we're excited about is the launch of our digital marketplace on Nordstrom.com starting in April. By reimagining the way we work with our brand partners, we'll grow our curated online assortment to serve more customers on even more occasions through increasing our use of unowned inventory. Marketplace will allow customers to shop more products and sizes from their favorite brands while providing them more access to new and emerging brands.

As we do this, we're also creating a more personalized digital experience that makes it easy for our customers to navigate our growing assortment. Expanding our assortment through unowned inventory has the potential to drive GMV growth in addition to providing compelling economics.

We'll also drive Nordstrom growth by amplifying the brands that matter most to our customers, along with ensuring we have the depth in these brands consistently across our stores and online. Beauty will also continue to play a prominent role in our assortment and growth. Our efforts are designed to create more engagement in addition to improving retention while serving customers on more occasions with the breadth of assortment that they expect from us.

Our second priority for 2024, operational optimization, builds upon the success that we've had in optimizing our supply chain capabilities. This entails a focus on driving faster fulfillment and delivery for our customers as well as maximizing our inventory value through its life cycle.

We will continue our efforts to improve inventory integrity and optimize inventory positioning along with increasing the speed of product to the customer. We are making investments in systems and technology enablers to standardize and streamline our inventory processes, expanding the scale of our RFID utilization and improving the inventory movement within our business, all with the end goal of enhancing the customer experience and improving our cost position.

Our third priority for 2024 is building on the momentum at the Rack. Opening new Rack stores is a profitable investment as well as a key way to reach more new customers and drive Rack banner growth. As we're opening more new stores, we're finding our performance and efficiency continues to improve. Expanding our network of stores brings our omnichannel services closer to the customer, giving them more reasons and opportunities to engage with us. We consistently hear how customers enjoy the convenience of shopping between our banners, taking advantage of the services we offer, including cross-banner in-store returns, Buy Online, Pick Up In-Store and alterations.

In 2023, we opened 19 new stores, and our intent is to open 22 new stores in 2024. Rack stores continue to be a growth engine for our company as they are our largest source of new customer acquisition, accounting for over 40%. Growing our store count also supports long-term customer retention. In fact, roughly 1/4 of retained Rack customers migrate to the Nordstrom banner within 4 years.

We aim to deliver top line Rack growth led by stores and supported by enhanced digital capabilities in 2024. To that end, in addition to growing the number of Rack stores, we also intend to continue the profitable momentum at NordstromRack.com. By leveraging our digital assets, our suite of omnichannel offerings will enable us to grow our selection online as well as enhance the customer experience as we strive to deliver great brands at great prices for our customers regardless of how they choose to shop.

Before I turn it over to Cathy for a review of the financials, I want to thank our teams for their focus on exceptional service to our customers and execution of the day-to-day business while remaining steadfast on our priorities. We're proud of the efforts that we undertook in 2023 as well as the outcomes that enhance the customer experience and drove improved financial results. Through a clear set of priorities, we're confident that we'll end 2024 as an even stronger company. And with that, I'll hand it over to Cathy.

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Thanks, Erik, and thank you all for joining us today. Although it was mentioned in the forward-looking statement at the beginning of this call, when I speak to our results and outlook, it will be on an adjusted basis for EBIT, EBIT margin and EPS, for which the relevant reconciliations can be found at the end of this presentation and in our earnings release, both of which are available on our website.

I'll begin by covering our fourth quarter results, then provide some additional commentary about our transition from retail to cost accounting, discuss our outlook for 2024 and quarterly timing and close with our capital allocation priorities.

For the fourth quarter, we reported earnings per share of $0.96 compared with $0.74 in the year ago quarter. We were pleased with the financial results and momentum throughout the year and that we delivered on our guidance. In Q4, we finished with year-over-year increases in gross margin, EBIT and EPS, despite net sales that were essentially flat on a like-for-like basis.

Net sales increased 2% in the fourth quarter, which includes a benefit of 460 basis points related to the 53rd week and 250 basis points unfavorable impact from the wind down of Canadian operations. Total GMV increased 2% in the fourth quarter. Nordstrom banner net sales decreased 3%, including a 410 basis point benefit related to the 53rd week and a 355 basis point negative impact from the wind down of Canadian operations. Nordstrom banner GMV decreased 3% in the fourth quarter. Nordstrom Rack net sales increased 15%, including a benefit of 580 basis points related to the 53rd week. Throughout the year, we saw steady progress quarter-over-quarter in the top line as we focused on this growth driver. Although digital sales in the fourth quarter decreased 2% compared with the same period in fiscal 2022, we saw quarter-over-quarter sales improvement. Digital sales represented 38% of total sales during the quarter.

Gross profit, as a percentage of net sales, of 34.4% increased 125 basis points compared with the same period last year due to lower markdowns, lower buying and occupancy costs and leverage on higher sales. Ending inventory decreased 3% in the quarter. We are pleased with the progress on inventory productivity we delivered this year. As Erik mentioned, we exited the year with improved inventory levels versus last year, which set us up well to start the new fiscal year.

Reported SG&A expenses, as a percentage of net sales, increased 85 basis points in the fourth quarter, including a $32 million supply chain asset impairment and related charge. Excluding the charge, SG&A expenses as a percentage of net sales were in line with the year ago quarter as the impact of higher labor costs was offset by improvements in variable costs from supply chain efficiencies and leverage on higher sales. Our supply chain initiatives continue to deliver strong results over the last year.

Our EBIT margin for the fourth quarter was 5.7% versus 4.5% in the year ago quarter, and we ended the fourth quarter with $1.4 billion in available liquidity, including over $600 million in cash. Our balance sheet and financial position remain solid.

Next, I want to take a moment to speak about our fiscal 2024 conversion from the retail method of accounting for inventory to the cost method. This shift to operating in units and cost lays the foundation for us to deliver on our business priorities more effectively. We will see profitability at the item level, guiding us in executing with intention and speed. We anticipate that utilizing cost accounting for financial reporting purposes in 2024 will result in a slight headwind in our 2024 results. More on that in a moment.

Turning to our outlook for the year, I'll start by discussing the current environment and related assumptions underlying our guidance. We expect 2024 to be a year of continued momentum toward the long-term strength and durability of our business. We continue to see a cautious consumer that is mindful of discretionary purchases in light of inflation, higher interest rates and the resumption of student loan payments. Regardless of the external environment, we will remain focused and expect to make progress on the 3 2024 priorities that Erik discussed, following the solid execution against our 2023 priorities.

In 2024, we expect full year revenue in the range of a decline of 2% to an increase of 1%, which includes a headwind of approximately 135 basis points from the 53rd week in 2023's results. We expect revenue to follow a typical quarterly cadence. In 2023, our credit card revenue represented slightly over 3% of net sales. We anticipate credit card revenues should be closer to 3% of net sales in 2024.

Now that we are consistently opening new Rack stores, we will be providing comparable sales data on a quarterly basis beginning in Q1. As such, we expect total company comparable sales in a range of a decrease of 1% to an increase of 2% in 2024 versus 52 weeks in 2023.

Turning to profitability. We expect EBIT margin in the range of 3.5% to 4%, with EBIT reflecting slight pressure due to the aforementioned conversion from retail to cost accounting and modest increases in SG&A to support Rack growth.

We expect a 2 percentage point increase in our effective tax rate, relative to 2023, to be back at our typical rate of 27%.

From an earnings per share perspective, we anticipate full year results in the range of $1.65 to $2.05, again, weighed upon modestly by the accounting method change as well as the anticipated increase in our effective tax rate relative to 2023.

Although we don't typically focus on our guidance on a quarter-by-quarter basis, I would like to offer a few comments on our expectations for the cadence of the year. The estimated timing of markdown recognition under the retail method versus the cost method is anticipated to weigh heavier on the first half results, primarily in Q1. Under the retail method of accounting, last year's Q1 benefited modestly to the timing of markdown recognition in Q4 2022. However, under the cost method, we do not anticipate that to repeat. We expect this Q1's results to be near breakeven to a slight loss and Q2 to have about 1/3 of the year's earnings. As the year progresses, with our Anniversary Sale almost entirely in the second quarter as 1 week shifts back out of Q3, the rest of the year should follow a more traditional cadence as the estimated headwind from the change in accounting method lessens throughout the year.

Turning to capital allocation, our priorities remain the same. The first is investing in the business to better serve our customers and support long-term growth. We continue to plan for capital expenditures of 3% to 4% of net sales. Our second priority is reducing our leverage. We remain committed to an investment-grade credit rating through a combination of earnings improvement and debt reduction and continue to target a leverage ratio below 2.5x. We have a bond maturity of $250 million in April that we intend to retire using cash on hand. Our third priority is returning cash to shareholders. Last week, our Board of Directors declared a quarterly cash dividend of $0.19 per share.

In closing, we made great progress against our priorities and delivered on our guidance for the year in 2023. I'm looking forward to the progress that we'll make this year and getting after the growth opportunities we have, both at Nordstrom banner and the Rack. As I mentioned earlier, we expect 2024 to be a year of continued momentum toward the long-term strength and durability of our business.

We thank you for your interest in Nordstrom. And with that, Jamie, we are ready for questions.

James Duies - *Nordstrom, Inc. - Senior Director, Investor Relations*

Thank you, Cathy. (Operator Instructions) We'll now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ashley Owens with KeyBanc Capital Markets.

Chandana Naga Sai Madaka - *KeyBanc Capital Markets Inc., Research Division - Analyst*

This is Chandana on for Ashley today. So looking at Rack store openings, I think you mentioned intent to open 22 new stores in 2024. Could you speak to the cadence of those openings throughout the year? And maybe if you could help us break down how much of the Rack banner's growth this year will come from new stores versus same stores?

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Chandana, this is Cathy. So first off, throughout the course of the year, just like in 2023, we'll see -- there'll be a spring cohort and a fall cohort. We don't specifically time them one or the other, but you'll see that it's spread through the course of the year. We're -- we continue to be very, very excited about the Rack opportunity. They have continued to drive a strong return on investment. They're a great source of new customer acquisition to the Nordstrom banner, and they have great economics. So we continue to be excited about them as we move forward.

Operator

Our next question comes from the line of Ashley Helgans with Jefferies.

Blake Anderson - *Jefferies LLC, Research Division - Equity Associate*

It's Blake on for Ashley. First, I wanted to ask on the sales guide range for 2024. Just any color you can give on expectations by banner, and then your expectations for AUR versus transactions? And maybe if you could talk about what that was for those 2 items in 2023.

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Maybe, Blake, I'll start and Erik can answer on as well. So with regards to the guidance for revenue, so first, let me parse a little bit of comp versus revenue -- comp guidance versus revenue. Comp guidance is a little stronger as we think about -- it's a 52- to 52-week impact, so I just want to acknowledge the revenue guidance is versus the extra week we had in 2023.

That said, though, to your question, we're excited to grow where the market is growing. We're going to grow with Rack and the off-price channel. You're going to see us continue to lean into that growth driver for us, and then you'll see -- we expect digital to grow as the market is, but we're going to be below the market's growth as we move from this year into next. We're very, very focused on driving digital growth. We know that things like choice count matter there, and so we're excited about the marketplace comment that Erik shared in the remarks. That will help obviously drive choice count.

We're focused on assortment for digital, and we're going to continue to drive that lower price point, like that under $100 price point, to drive growth there, and then the overall experience in digital. So we're continuing to focus on driving there. And then the last place of growth would be the Nordstrom stores. Erik talked about that in his prepared remarks. Expect that to be a little bit more in the flattish range as you think about by the banner and the channel, but we're really excited about having the assortment in the stores that matter most for our customers. We have a concerted effort on making sure that we do that this year, having great service and experience that we're known for.

So that will hopefully help you with a little bit of color around each of the banners and channels inside that guidance. And then on AUR, that one is difficult to predict. We're all expecting, I think, for AURs to start to come down, but that's going to be a little bit more difficult to predict.

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

Yes. I guess, Blake, other color I'd add. One more detail. First of all, store traffic. Store traffic continues to be on the soft side, although traffic at the Nordstrom banner stores did improve sequentially throughout the year. It is AUR that is in both banners helping to drive improved selling prices, which is leading to average trip value going up. Digitally, also some soft traffic, but again, average order value and average selling price, both of those increased at both Nordstrom.com and Rack.com.

Blake Anderson - *Jefferies LLC, Research Division - Equity Associate*

That's super helpful. I appreciate the color. And then our follow-up is on EBIT margins. Can you just elaborate on the puts and takes for those this year? I know you said the accounting change and then you're investing in store growth. The guide is 3.5% to 4%, slightly below 4% this year. What's -- any more detail you can kind of give for us on the headwinds next year? And then would love to hear any commentary on what kind of top line do you need in the future or any other initiatives you need to see on the top line in order to get margin expansion.

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Yes. So thanks. We're very focused on continuing to drive both market share gains as well as margin expansion. So know that that's where our focus is. Inside the guide for 2024, to answer your question, though, we made great progress in gross margin expansion this year in 2023, the year we just concluded. We would expect to continue to drive a little bit of gross margin expansion. It is being offset, though, by some SG&A headwinds, so expense headwinds. While we continue to drive productivity in places like supply chain, we're offsetting it with investments in new Rack store openings and a little bit of inflation in things like labor that we're not fully offsetting.

Operator

Our next question comes from the line of Ed Yruma with Piper Sandler.

Edward James Yruma - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Two quick ones for me. I guess, first, if you could give us an update on some of your kind of city center, big box Nordstrom stores. I know for some period of time, they were pressured by traffic trends, but we'd kind of love to hear any color you have there.

And then as a follow-up, on some of the newer Rack stores, would love to understand maybe the return profile. Have they been ramping as quickly as you had expected, particularly those in new markets?

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

Yes, this is Erik. I'll take the first one. Cathy can get second one. Yes, we have really not seen that difference between urban and suburban stores through '23 like we did kind of through the pandemic for a couple of years. Some of our fastest-growing stores this past year or our big urban flagship stores, in particular, New York has shown real strong growth.

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

On the Rack stores, the return profile, to answer your question. As you know, it's kind of a new muscle. We started rebuilding this last year, so in 2023, we opened 19 stores kind of in 2 cohorts, a spring cohort and a fall cohort. We took all the learnings we had from the earlier ones into the later ones. We'll take the learnings from both of those into this year as we continue to evolve a little bit around the edges. So things like the amount of investment in a new store, how much we support it with inventory, all of those things. They just keep getting better and better.

They come out really strong, as you would imagine. We are working to make sure we sustain that growth throughout the duration though. We are great about supporting with lots of inventory upfront and lots of marketing, and we need to make sure we continue to do that. All in, though, we're really, really excited about the great return on investment, great acquisition of new customers for our total banner -- our total brand.

Operator

Our next question comes from the line of Brooke Roach with Goldman Sachs.

Brooke Siler Roach - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I was hoping to get an update on what you're seeing on profitability of the dot-com business. It sounds like you saw some nice improvement in Rack.com's profitability this year. Where does that sit today compared to full line and total company margin rates? And what's the opportunity for continued improvement in 2024?

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Maybe I'll start, but obviously, Erik can add on as well. So it has been a distinct effort of ours to get the Rack digital business profitable. As we've spoken to, it is profitable for 2023, the full year. Really proud of the work that the team has done to drive that business improvement. The Nordstrom.com business, though, is actually quite profitable. It's one of our most profitable channels, and so we'll continue to have that Nordstrom.com digital business lead our growth in the Nordstrom banner. It's a great vehicle for us, and it's how the customer is choosing to shop.

Going forward, though, to your question on where is maybe Rack.com versus Nordstrom.com, still growing or still expanding in margin. We'll continue to work on that. Some of the fundamental things we worked on in '23 were things like inventory integrity that allows us to then start turning on omnichannel capabilities more completely for our customers as they come into Rack. So where -- we'll continue to expand Rack.com's profitability, but pleased with both of them that they're solidly in the black and Nordstrom.com is well past that.

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

Yes, Brooke, I'd just -- I'd add on -- first, I think in the context, you look at our digital business, first and foremost, we look at it through the customer lens, which is a customer experience that cuts across digital and physical. Almost every customer does that. So we really look at how we can leverage our physical and digital assets to serve the customer better.

That being said, if you look back over our bigger actions over the last couple of years, we have taken some -- made some decisions and some tough ones that were really about reducing unprofitable sales. So closing Canada would be a part of that, doing -- shutting down store fulfillment out of our Rack.com business is another example.

So as we look at it, to Cathy's point of -- the financial model in our digital business is really strong, and it scales well. It scales really well. We have, over the last couple of years, really addressed the unprofitable parts of the business. Both platforms are very much poised for growth, and we need growth out of both of them.

Brooke Siler Roach - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Cathy, if I could just ask one quick follow-up. You gave some helpful color on the credit card revenue at close to 3% of sales in 2024. Can you elaborate on the assumptions that are embedded within that, and what the impact is of the late fee changes in credit revenue based on the announcement today?

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Yes, happy to. And interesting timing on the announcement today for sure, given it's our day of earnings release. So I want to start with reminding us that the average credit quality of our portfolio tends to be higher than some of our peers, so therefore, late fees are a smaller piece of the overall credit revenue to our P&L. So I'll start there.

We do expect there to be some legal challenges, too. I suspect as soon as the federal register actually registers the new regulation, we'll see some legal challenges, and we'll continue to monitor that. But most importantly, the estimate -- our best estimate has been included in our guidance that we've given today.

So we've been monitoring it. We expect there will be continued pressure both politically and from consumers on late fees. And so we did build that into our guidance, the best estimate we have.

Operator

Your next question comes from the line of Dana Telsey with Telsey Advisory Group.

Dana Lauren Telsey - *Telsey Advisory Group LLC - CEO & Chief Research Officer*

Good afternoon, everyone. Just expanding on some of the merchandising comments, with Active, Beauty and Women's Apparel being the most improved this year -- this quarter, last quarter, I believe accessories was in that mix. What was different this quarter from last quarter with accessories and what are you seeing there?

And then also just following up on the merchandise margin. Any impacts on Red Sea or how you're thinking about freight costs and delivery costs for this year embedded in the margin?

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

Yes, accessories, handbags in particular, which is a big category in accessories for I think for everyone, has not been as strong kind of through the year. So we continue to see that. That being said, every single merchandise category that we have did improve sequentially from Q3 to Q4. So we're also encouraged about that.

On the merch margin question, we really don't see at this point, an effect from what's going on in the Red Sea on our merch margin. We have some portion of our goods that's delayed a bit, but we don't see any material effect to our results.

Operator

Our next question comes from the line of Oliver Chen with TD Cowen.

Neil Goh - *TD Cowen, Research Division - Associate*

This is Neil Goh on for Oliver today. Nice to see inventories managed pretty well in line with sales growth. What are your expectations on inventory management throughout the year? And then how would you describe the promo environment leading into spring, summer? And any implications on merch margins as we get through the new fiscal year?

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Neil, maybe I'll give a start and then Erik can add. So on inventory growth, to your point, thank you for the comment on inventory productivity or the management of inventory. I think the team did a terrific job of building some new disciplines and really being sensitive to the trends and chasing into it. I think we're poised really well as we ended the year in inventory health. As we ended the year and then begin the new year, it allows us to have some newness, which is always important for customers. So very, very excited about where inventory is at and the progress we've made around inventory productivity.

As we move through the year, we'll be prudent. So we're going to continue the same disciplines of making sure we're chasing into demand. The team's really excited to be at a year where we feel like we're on the front foot there. And so that's nice. So we would expect that when you think about inventory. We're going to continue to support Beauty. We're going to continue to support the new Rack stores. So that will continue to be a little bit of a place that we'll support with extra inventory. And then on promotional environment, maybe I'll ask Erik to opine on that as we think about it going forward.

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

Yes, Neil, I'd say we really are not seeing an elevated promotional environment. We didn't see it through Q4. We're not seeing it right now. So as best as we can tell, we don't anticipate an unusually elevated promotional environment.

Operator

Next question comes from the line of Michael Binetti with Evercore ISI.

Warren Cheng - *Evercore ISI Institutional Equities, Research Division - Associate*

This is Warren Cheng on for Michael. I just had a follow-up on Brooke's question on the CFPB ruling. The last time you broke out credit income, I think that was back in 2015, late fees were low teens percentage of the credit card revenue stream. Is that still a fair benchmark used for today's business? And I also just wanted to clarify your comment that your best estimate for the outcome is already included in the guidance today. Could you just elaborate on what that means?

Catherine R. Smith - *Nordstrom, Inc. - CFO & Treasurer*

Yes, happy to, Warren. So first off, I didn't know that we actually supplied that information in 2015. So thank you for the information there. Obviously, that's been a long time ago, and the business continues to evolve. That said, our loyalty customers are still our best customers. And as you know, a good portion of them pulled the Nordstrom card.

The comment I shared around our best estimate of the impact of the CFPB ruling that came out today is included in our guidance. It is. It's exactly what we had estimated. I know there's been a ton of speculation. I don't know if we just -- we're fortunate there, but our team, I think, estimated that we knew it'd be coming out, and there's going to be -- obviously, all of the guidance had said it's going to be about where it came out at. So we tried to include that in our guidance we gave today.

With regards to the amount of late fees as a percentage of our income, we haven't disclosed that, but it is less than our competitors, given the quality of our credit portfolio.

Warren Cheng - *Evercore ISI Institutional Equities, Research Division - Associate*

Got it. That's very helpful. And then I just had a follow-up on the Rack business. I was wondering if we could focus for a second on the new Rack stores that have opened in the last 12 months. How does the productivity stack up against the base? And then can you also discuss the ramp behavior for these stores relative to prior cohorts and also versus your expectations?

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

Sure. Warren, this is Erik. Yes, our new stores productivity is a little above our average on a sales per square foot basis. So they do tend to be smaller volume stores. As you imagine, we've -- our portfolio to date has been in -- we start with the best locations. And -- but the average size of our stores is a bit smaller than what we had previously. So productivity is really good. The ramp -- we do see an opportunity for us to build upon the excitement we get at a Rack opening, particularly when we go to new markets. We get really strong traffic and a lot of energy in the community. For some of those communities there where we don't have a Nordstrom store, it's the first entry of our company into that market.

So we do think we have opportunities to build upon that knowledge of the second year -- of the first year and continue to drive the growth. And I think that's kind of the main takeaway for Rack businesses. The focus on our key strategic brands really cuts across all aspects of the Rack business. The new stores, comp business, our online business, and we think there's still a lot of opportunities there for us to really leverage, which we think is a competitive advantage. The access to these coveted brands that customers associate with Nordstrom. And as we continue to focus and emphasize those strategic brands, it really is lifting all boats.

Operator

Our next question comes from the line of Lorraine Hutchinson with Bank of America.

Lorraine Corrine Maikis Hutchinson - *BofA Securities, Research Division - MD in Equity Research*

I wanted to ask about the supply chain initiatives. They've been very successful in reducing your distribution costs. What inning would you say we're in of that program? And where do you see the expected benefits on a go-forward basis?

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

Yes, I'll start. Cathy can chime in if I leave something out. You may notice we changed our wording a bit from optimizing supply chain to optimizing operationally. And the point with that really is internally that it's not just about technically our supply chain network that we see opportunities, in addition to continuing to drive productivity out of our network, to managing our inventory throughout its life cycle.

You look at our model, it is unique. Most retailers have stores and have a digital business. We also have 2 banners, and the banners are connected. The life cycle of our product or a lot of it starts in the Nordstrom banner, and it ends up in the Rack. So there's a lot of choices for us to make in pricing and placement of that inventory, and we see opportunities to gain value in better managing product through its entire life cycle.

So I would say the supply chain -- we really have a strong team in supply chain. And by leveraging them beyond the narrow walls of supply chain, to really leveraging across the whole operational sides of our business, we see continued opportunities to drive productivity.

Operator

We have reached the end of our question-and-answer session. And with that, I'll turn it back to Jamie Duies for closing remarks.

James Duies - *Nordstrom, Inc. - Senior Director, Investor Relations*

Thank you for joining today's call. A replay, along with the slide presentation and prepared remarks, will be available for 1 year on our website. Thanks again for your interest in Nordstrom.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.
