NORDSTROM Q2 2017 EARNINGS

Prepared Remarks - Blake Nordstrom, Co-President, Nordstrom, Inc.

Good afternoon, and thank you for joining us. As you know, we've just completed our Anniversary Sale. It's a unique event and one that distinguishes us in the industry, as it includes brand new arrivals at reduced prices for a limited time. Our customers look forward to our Anniversary Sale every year, and its one-of-a-kind element attracts new customers as well. This is our biggest event, consistently generating significant volume that rivals the holiday period.

Our Anniversary results outperformed our recent sales trends as customers responded favorably to newness and the ability to shop the way they prefer - in stores, with a mobile device, and online. Our event continues to generate a strong call to action for our customers, and we increasingly see a higher penetration of digital sales. We delivered online growth of more than 20 percent, compared to last year's sale. We also grew buy-online pick-up in-store sales by roughly 50 percent.

Our results demonstrated our progress in offering customers a differentiated selection of the best brands and products. In addition to a strong sell-through rate of our Anniversary product, we had increases in our regular-price sales over last year. Beauty and Women's Apparel led our results, and three of our Nordstrom-proprietary labels were among our top five selling brands.

Our Nordstrom cardholders - who are among our most loyal customers - highly value the rewards benefit of shopping the sale early. Unfortunately, we had some website performance issues on the first day of Early Access. Our teams responded and resolved these issues within hours. Because our customers are our top priority, we subsequently offered Nordstrom cardholders 10 points per dollar spent on purchases made during the start of Early Access. Our customers appreciated this approach, and we saw a substantial recovery in sales throughout the remainder of the day. In fact, we had the biggest day of online volume in our company's history.

Turning now to our overall sales results - we ended the second quarter with a total sales increase of 3.5 percent and a comp increase of 1.7 percent. This growth was driven by our digital businesses, with Nordstromrack.com and HauteLook up 27 percent and Nordstrom.com up 20 percent.

In our full-price business, the Anniversary Sale contributed to positive gains with total sales increasing 2.4 percent and comp sales increasing 1.4 percent in the second quarter. While our full-line stores improved during the sale, the underlying trends outside of this event were consistent with our recent trends. Keep in mind that our Anniversary results won't necessarily inform our second half performance. Recall that last year, after a strong Anniversary Sale, our second half was more reflective of the trends prior to the event.

In our off-price business, total sales increased 9.8 percent and comp sales increased 3.1 percent. This represented an improvement of roughly 100 basis points from last quarter but fell slightly below our expectations.

Looking to the rest of the year, we continue to focus on enhancing the customer experience and reaching new customers by leveraging our digital capabilities and investing in our top markets:

- As part of our customer strategy, we're continually testing and rolling out new ways to connect the physical and digital shopping experiences. We're expanding our Reserve Online and Try In Store service from six stores in the Seattle area to four more in the Chicago markets. We plan to offer this feature in roughly 50 stores by the end of the year. We've been encouraged to find that around 80 percent of customers who try this service choose to shop this way again.

- We're executing on our digital strategy to meet our ambition for continued double-digit online growth. Through our ongoing efforts to elevate the digital experience, we expect our online penetration to exceed 25 percent by the end of the year. We've modernized our platform, enabling us to increase the speed and agility of enhancements to our product pages, navigation, and content.
- In our efforts to gain market share, we continue to prioritize our investments in the top North American markets. In September, we will complete our planned full-line store expansion into Canada with a sixth store - at Sherway Gardens in Toronto. And in October, we will relocate two full-line stores in California - one from Westside Pavilion to Century City in Los Angeles, and the other into a new space at University Towne Centre in La Jolla.
- Our Rack business is an important way to attract new customers to Nordstrom. We opened six stores this spring with 11 more opening this fall, which will bring our total Rack store count to 232 at year end. These stores incorporate our latest store designs, with improvements to the layout and fitting room experience. Additionally, we're further integrating the digital and store functionalities to improve speed and convenience for the customer. For example, we enhanced our mobile app so that customers can scan an item in-store and buy it online if they want a different color or size.
- Through strategic partnerships with our vendors, we continue to focus on providing customers with newness and relevant product. Our efforts to expand product with limited distribution helps us provide customers with the most relevant brands while strengthening our regular-price business.

In closing, we view our business through our Nordstrom and Nordstrom Rack brands, rather than through discrete store and online channels. The combination of our physical and digital assets represents a competitive advantage. Our local market assets - our stores, salespeople, product, and services - are the core of our brand and play an important role in engaging with our customers. Nearly 80 percent of customers who shop with us across multiple channels began at our stores. With our customers at the center of everything we do, we're appreciative of the ongoing efforts by our team to better serve them in more ways, which has contributed positively to our second quarter results.

I'd now like to introduce Anne Bramman who joined our team as chief financial officer on June 2nd. She is a tremendous addition to our executive team and the company as a whole and has hit the ground running in supporting our various initiatives. Anne, I'll now turn it over to you.

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Prepared Remarks - Anne Bramman, CFO, Nordstrom, Inc.

Thanks, Blake and good afternoon, everyone. Before we get started on our results, I'd like to say how excited I am to be a part of this company. I've long admired the Nordstrom brand and the management team. Since being in the role for the last couple of months, my appreciation of the company's unique culture and customer-centric philosophy has only grown.

During a time of transformative change in the industry, I consider Nordstrom a leader in strategically investing for the future. In supporting the company's commitment to operating excellence, I'm focusing on evolving our business model to better serve customers and improve our performance.

Moving on to our second quarter results, our earnings per share of $0.65 achieved our expectations. This reflected our positive Anniversary results, ongoing inventory and expense discipline, and continued strength of our financial position.

Now some additional color on the drivers of our earnings:

Beginning with merchandise margins, we had an improvement over last year, driven by the strength of our regular price selling. This exemplifies our ongoing progress in providing customers with newness and limited-distribution product. We ended the quarter in a good inventory position, with sales growth of 3.5 percent outpacing inventory growth of 2.2 percent.

Our merchandise performance was more than offset by higher occupancy expenses related to new Rack and Canada stores, in addition to the unplanned 10-point loyalty accommodation that Blake mentioned. We believe this offer contributed to our top-line performance, but impacted gross profit by $7 million, or 20 basis points. From an EBIT perspective, we estimate the overall impact was roughly breakeven for the quarter, with potential future upside as customers redeem their points. The net impact of all these factors was a 25 basis point decline in gross profit from last year.

Moving to our expense performance, we've made meaningful improvements to our operating model. As we've accelerated our investments to fuel growth over the past several years, our technology, supply chain, and marketing expenses grew 20 percent on an annualized basis from 2010 to 2015. Last year, we made a significant step change by making a number of adjustments to increase our efficiencies. As a result, the expense growth of our enterprise capabilities was cut in half to 10 percent. Throughout this year, we continued to maintain this moderated expense rate for these areas.

For the second quarter, SG&A expense increased 5 percent from last year, or approximately 45 basis points, driven by a couple of items:

- As we've shared at the beginning of the year, we planned total technology investments, on a cash basis, of $540 million, or 3.5 percent of sales. This all-in view captures the changing nature of our investments as we continue to shift to a cloud-based platform. This transition results in an immediate expense impact rather than capitalization. In the first half of the year, we stayed on track with our plan as we continue to focus on improving our technology productivity.
- In addition, there is a mix impact from higher supply chain costs associated with the growth of our online businesses, which accounted for 25 percent of our sales in the second quarter. In terms of our underlying supply chain performance, our average cost per unit came in better than planned.

Our Credit EBIT increased $23 million over last year, driven by a 30 percent increase in credit card revenues. This was attributable to our successful partnership with TD Bank, which continues to exceed our expectations.

Turning to our financial position, we ended the second quarter with a cash balance of approximately $900 million, essentially flat to a year ago. Year to date, we generated operating cash flow of $574 million and free cash flow of $115 million. Our debt leverage remained consistent with our expectations, at 2.4 times on an adjusted debt to EBITDAR basis.

These metrics reflect our strong financial position, which is supported by our robust e-commerce platform and high-quality store portfolio. Even through this current retail environment, we've demonstrated industry-leading growth, increasing sales by 6 percent on an annualized basis over the past three years. Since 2009, we've consistently generated annual operating cash flow in excess of $1 billion while maintaining a solid investment grade rating.

We are well-positioned in the market, with our stores generating positive cash flow. As Blake mentioned, we are disproportionately investing in the top markets in which we serve customers. Our omni-channel business model provides favorable economics related to the cost of serving customers and strengthening our brand. As we continue to refine our approach, we'll keep you updated on how we're aligning our metrics to better reflect the underlying performance of our business.

Turning now to our full year outlook, we've narrowed EPS to the high end of our range, which represents $2.85 to $3.00. This incorporates our second quarter performance while holding our assumptions for the second half of the year.

- Our top-line expectations are consistent and reflect the trends we've seen over the past year and a half. Total sales are expected to increase approximately 4 percent - including $200 million for the 53rd week - while we expect comp sales to be roughly flat to last year.
- Retail gross profit assumes higher new store occupancy expenses and the mix impact from off-price growth. Merchandise margins for the year should be relatively stable.
- Our SG&A outlook remains consistent and incorporates higher technology and supply chain expenses associated with our growth initiatives, offset by our continued progress in productivity improvements.
- Our second quarter income tax rate of roughly 42 percent was impacted by timing.

  We expect to end the year with a tax rate of approximately 40 percent.

In closing, we remain focused on delivering a differentiated customer experience. This enables us to continue creating value for all stakeholders, including our shareholders, customers and employees.   With that, I'll turn the call over to Trina for Q&A.