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Nordstrom Inc Management Fireside Chat with Telsey Advisory Group

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PRESENTATION

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

Good afternoon, everyone. Thank you so very much for joining me today. I'm -- it's Dana Telsey of Telsey Advisory Group, and I am very excited to be here with the executive management team of Nordstrom. Joining me for this fireside chat are Pete Nordstrom, President and Chief Brand Officer, with a long history of directing and executing the merchandising strategy of Nordstrom; Ken Worzel, Chief Operating Officer with Nordstrom since 2010, with a focus on strategy and development, and most recently, the Chief Digital Officer before becoming the Chief Operating Officer; and Anne Bramman, the Chief Financial Officer, having been with Nordstrom since 2017.

We're living through unprecedented times today, and the investments that Nordstrom has made in its business model for many years allows them to serve customers across multiple touch points through their 2 brands of Nordstrom and Rack in both stores and online. It's all about creating memorable experiences for the customer through engagement and whether it be through the market strategy, bringing inventory closer to the customer, along with increased selection of getting products to customers faster or leveraging stores to fulfill orders. The customer's at the center of all what Nordstrom does.

Recently, Nordstrom has increased their cash and strengthened their financial position along with announcing the closure of 16 full-line stores, along with 3 Jeffrey stores. The pivot is emerging stronger, and the goal is to be even more relevant to their customer as everyone emerges from the other side of this pandemic.

Before I hand it over to Pete for opening remarks, I'd like to mention that this fireside chat may contain forward-looking statements, and please refer to Nordstrom's safe harbor language in its first quarter earnings release that came out on May 28, 2020.

Pete, thank you so much for joining us today, and I'd like to turn it over to you for some opening remarks.

Peter E. Nordstrom *Nordstrom, Inc. - President, Director & Chief Brand Officer*

Thanks very much, Dana. You did a great job actually of introducing us. You stole some of my thunder in terms of what our intentions are, but we appreciate the opportunity to get some transparency and context with what we're seeing with our business and how things are going.

So I guess I'll just start by saying that -- and Dana, actually, I heard you mention this on a previous interview I saw, where basically, everything that's happening right now is just stuff that's been accelerated from what we may have thought was going to be happening before, part of our plans. But as the COVID thing came upon us, it accelerated all those themes. And so that is true for us as well.

I think one of the backdrops that's important for people to understand about our business is even going into this, we had a diverse plan that was, we thought and still believe, is really well positioned for the future given how things have evolved. And again, based on the acceleration of what we've seen, we think that's true.

So for some context, one of the things we talked a little bit about is we're actually not literally a department store. I think when you think about a business being described as a department store, you think about something that is in a mall. And it is true, we are in malls, and it's a big part of our business. But if you look at our entire portfolio and the balance that we have in our business, I think it bodes well for how we can evolve to be more relevant really in these times. So as an example, in 2019, we ended the year, we did a little less than 40% of all our business in a mall-based store. And I think that's important context. It obviously speaks to the fact that we've got a very large



Rack business. Well, those are in physical buildings. They are in strip centers, and they are not caught up with a lot of the dynamics that have been detrimental, I think, to malls largely, the things that people really understand. That business has been solid and strong, and even during the COVID times, has performed better in terms of being a physical store than a mall store is. Again, that's the strip center versus a mall store. And then it also speaks to the fact that we've got a very capable online business that's synergistic with the physical stores as well. So when we talk about that, a little less than 40% of the business was done in 2019 in a mall. Clearly, it's going to be less than that in 2020 as well. So I think if you look at Nordstrom in totality and the value, I think it's important that -- and we'll be able to get into that with whatever questions you have, but how the different pillars work for us and how it all works together so that it does create the flexibility to be able to evolve.

I'll say kind of last before we get into it -- to this, that we took a very conservative approach when this all happened. I give Anne and her team, in particular, a lot of credit for that. We said there's a ton of uncertainty out here. We've got to pivot and manage the business more around a cash perspective, which was relatively new for us. But we did that by reconciling expenses, reconciling inventory levels, getting the sales plans down where we thought they need to be and then positioning the business accordingly. We've had to make a lot of tough decisions to do what's right based on the size of the business as we know it to be today, what we have visibility to. That all starts with the sales. We've made some serious expense cuts, and Anne will be able to talk about that. We were very intentional about our inventory planning. You've probably heard us use the term melting the pile. We had a lot of inventory when it started, and we had to figure out a way to work through that because it just became more and more aged and distressed as time went on. I think we did a really good job of that. We got the inventory levels down. We reconciled the expenses, and then we started opening stores back up. I will tell you, as well as I think we did there, the fact still remains that we're going through a time that has uncertainty and that we've never gone through before.

So we didn't do it perfectly. I think with the benefit of hindsight, we can talk a little bit about that today, some of the consequences that happened. As an example, we got the inventory levels way down. And then we thought we would be in a position to not have that hangover of inventory that's going to create a bunch of markdowns, but to be able to buy into a bunch of new products. That was not -- it's not been as easy as we thought it would be to buy into new product in the immediate term. And that's because, as you might imagine, all the suppliers we work with as well, they shut their deal down, too. So it was a little harder to ramp up on that.

And I think the last thing I'll say before we kind of turn it over to others and the questions is that if you walked into, gosh, any number of our stores right now, and I'm talking about full-line stores, you might say, "Gosh, they don't have a lot of inventory in there." And that is true. That's a result of us taking a very conservative approach and also being able to fulfill online demand from our stores. The problem was we weren't able to get into product as quickly as we hope. Now that's being dealt with right now. We are ramping it up. We are building up to anniversary. It's our hope that, certainly, by that time, we will have stores that have the necessary amount of inventory to do the sales that traffic is going to warrant.

So I guess that's the opening position. We feel good about where we are. There's still a lot of uncertainty going forward. But we are positioned well to be more flexible and reactive, certainly more than we were 3, 4 months ago.

QUESTIONS AND ANSWERS

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

And Pete, when you think of the response to COVID, what are the learnings? How has the business model become more synergistic? And is there any update on the reopening and sales recovery?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Well, I guess how it became more synergistic was just things that we worked on like fulfilling out of stores inventory, something we've been able to do, but super grateful that we had that ability going into this because it'd be difficult to figure that out on the fly. And then I think customers, them really being at the center of how we do these things, how we serve them. Going into a store for many people and even as it exists today now that they're all open, is not something everyone wants to do. But in many cases, they love the ability to be able to pick something up from a store or return something to a store and using that in combination.

So I guess it's just we've seen the fact that the physical assets do matter. They're helpful in terms of improving the customer experience,

and then the ability with the back end around all our systems and processes that links it to the online part of the business. That has all been confirmed in very dramatic ways through the COVID experience. And we'll see how it all evolves from this, but for right now, it's pretty clear that I think there's still a level of reticence and caution by a lot of customers to go into an actual physical store. And we've seen that -- the result of that as we've seen less traffic, and that's been a pretty steady situation now.

Anne L. Bramman Nordstrom, Inc. - CFO

So Dana, this is Anne. I'll jump in a little bit later when we have some of the financial questions. But just in general, all -- our fleet is open. And actually, we were able to open a little bit sooner than we thought in some of our key markets. And our -- the sales in those stores are actually exceeding our expectations, and I'll give a little bit more detail later on. But in general, for total JWN, the store sales, as they're opening up, are exceeding -- we're seeing Rack do better as anticipated than our full-line stores, but both full-line and Rack are actually exceeding expectations.

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

Good to hear. And as you think about operating the stores differently, how is the labor model being adapted? How do you have to operate the stores differently now and in the future?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Ken?

Anne L. Bramman Nordstrom, Inc. - CFO

Ken, do you want to take that?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

You're on mute.

Kenneth J. Worzel Nordstrom, Inc. - COO

Sorry about that. Happy to take that. Thanks, Dana. Yes. I think even going into this, even pre-COVID, you've seen us start to spend quite a bit of time on rethinking how we use labor in our stores and really doing that through the lens that Pete referenced, which is through the lens of the customer. So we'd already shifted quite a bit of our labor, for example, in our full-line stores to be available more from a service and experience perspective beyond just selling. Activities like order pickup and returns, styling and alterations have become a very big part of the service proposition. And we'd already started to shift our labor model to reflect that.

I think post-COVID, if you've been in any of our stores, you'll appreciate that we've also had to shift and invest labor differently to provide the comfort that both our employees and our customers expect from us to have a safe customer experience and journey in our stores. So you'll see that we've invested in more labor to make sure that we have folks available to clean, whether that's dressing rooms or at point of sales, but also even at the greeting doors. And that's true across both Rack and full-line.

So I think the nice thing about our model is we've got a lot of adaptability in that labor model. We've got a lot of experience in continuing to evolve that. And we've continued to evolve it again, I think, to support a lot of the seamless journeys that we've created for customers, where they start a lot of their experience digitally and they finish a lot of it in stores or vice versa.

So I think in general, we continue to flex on those things. And the other thing about our labor model in stores is it does flex with sales. And so just from a financial perspective that Anne can speak to, we're able to make sure that the investment we're making is commensurate with the volume we're seeing through the channel.

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

Talk about promotional planning. What are you seeing in terms of planning promotions? How are you thinking about the timing of new inventory coming in, Pete?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Well, our promotional cadence really hasn't changed. And we do have a reactive thing that we've always done, responding to promotions out there and marking down the same merchandise. And it's pretty clear, I think, in this moment, when you think about stores reopening and people having excess inventory, not so much us, but that there's some reactive stuff we're having to do to promote. And typically, July is kind of a promotional time anyway. So we're going through that.

But our big thing on the calendar is anniversary sale, and that's full steam ahead. We planned that, obviously, quite a ways out. We've been able to make some changes, and most of that has to do with the relevance of specific categories and merchandise in this moment. As you might imagine, Dana, our ability to sell things that are traditionally about wear to work in an office or about some kind of occasion is just not nearly what it was. So when this all started, we took a look at our anniversary sale content and tried to pivot as much as we could to more relevant categories and classifications on the theme of casualization of America, and in particular, like active in a lot of those categories. So we're going to be locked and loaded for a good anniversary sale starting the beginning of August.

In terms of the rest of promotional cadence, we've not introduced anything new there. Any promotional activity we've been engaged in up until this time has been about marking down distressed and old inventory and/or responding to competitive markdowns from other stores.

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

On the customer learnings, what are you seeing in capturing wallet share from existing customers, gaining new customers? Anything from your loyalty members, learning about them and servicing them.

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Ken, you want to take that?

Kenneth J. Worzel Nordstrom, Inc. - COO

Yes. I can start on that, and you guys can weigh in. Say, like a lot of other retailers, one of the interesting things for us during our store closure period is we attracted a lot of new customers, both in Full-Price and in Off-Price, both through our Nordstrom.com offer and our Nordstromrack.com and HauteLook digital offers.

So one of the things that we're trying to do right now is make sure that we're doing a good job of engaging with those new customers, customers who came to us. We saw quite a big jump in new customer acquisition online for us during that period. And I think part of that's just a reflection of the fact that a lot of folks sitting at home are looking for something to do, and in that process, discovered us and discovered our brands.

And so on that -- on the new customer side, I think obviously, when stores are closed, one of our big channels for acquiring new customers will shut off. But on the digital side, we have a lot of success in activating and acquiring a new set of customers.

On the loyalty side, I mean, it continues to -- our loyalty base and our program there with Nordy Club continues to be a big part of our business. And we saw that during store closures. We saw a lot of our business -- still a lot of loyalty and a lot of transactions coming from our existing customers, particularly our loyalty customers. And I think now that we have newness coming back in, back to the inventory point, we're starting to see a lot of new receipts flow in, both in stores and online. That's -- we're already seeing the reactivation of folks who had shopped for us during the first period when stores were closed and then were looking for something new, and that's particularly true of our loyalty customers. We're seeing them come back now in a fairly significant way, shopping new receipts.

And then anniversary, for us, as you know, Dana, that's one of our biggest events of the year, but that's really an event really targeted at our best customers, really targeted at our loyalty customers. And so part of the reason we shifted that event out this year by roughly a month was to give ourselves the opportunity to make sure that we were through this period of clearing through old merchandise and

really be able to open up with really fresh merchandise for all of our customers, for particularly our loyalty customers, during that event. And I think we're super excited about momentum going into that with our loyalty base. But we also think that's a key event for us to engage with our most loyal customers and to engage with, frankly, really compelling product at a great price point.

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

I always think of anniversary, it's just like it's a synonym for the word holiday. So it's super big, and it's coming up soon, which is very exciting.

As you think about the omni platform that you have, full-line, Off-Price, digital, staying ahead of the marketplace, Ken, anything in terms of how you think about the business channel positioning and what customer shopping will look like post-COVID?

Kenneth J. Worzel *Nordstrom, Inc. - COO*

Yeah. I think as Pete referenced, I think we're thankful that we've been on this journey for a while, and that doesn't mean that the journey's complete. I'll give you 2 points of reference, certainly, that COVID has accelerated and has helped us accelerate.

One is we've had for a long time in our Full-Price business, in our Nordstrom full-line and Nordstrom.com business, a really seamless set of experiences we can provide for customers across digital and physical. We've been fulfilling out of our full-line stores for close to a decade. We obviously have Buy Online, Pick Up In Store and ship to store and other experiences that we've lit up that provide a lot of convenience for customers. And now, a lot of that's being served through contactless curbside services.

That's proven to be, obviously, a big part of how we serve customers while stores were closed and even now where stores have reopened and a set of customers feeling less comfortable being in a physical environment. But one of the things that we certainly learned and knew but have accelerated was we need to have all of the same set of capabilities for our Off-Price customers. We were already working on that, but we've really accelerated that journey significantly through COVID.

COVID closure, store closure period was the first time we did store fulfillment in our Off-Price business, meaning that we took orders on Nordstromrack.com and HauteLook and actually fulfilled them with the inventory out of our Rack stores. And we did that by lighting up some new technical capabilities that we were working on, but we hadn't gotten to full fruition yet.

We've really accelerated now our ambition to provide all of the same suite of services for our Off-Price customers that we do for Full-Price. And part of that's because we saw how our Off-Price customers responded to that, and we know that the appetite is there.

And so we're on a path now to really get to a point where all 350 of our physical store nodes, whether they're branded Nordstrom or Nordstrom Rack, are going to be places we can serve customers across the full set of their experiences, whether that's picking up a Full-Price order, doing a Full-Price return, doing an Off-Price order or return, and really being able to do that in a way that makes it super seamless for customers. We've seen that, that really works for them. It also really works for us.

The biggest increase we see in the lifetime value of customers was when we get a customer who previously was shopping 1 of our 2 brands, whether it's Nordstrom or Nordstrom Rack, and get them to shop in the other brand. It has a 10x increase in customer lifetime value when that happens. So when we provide these convenient service experiences for customers, we're also introducing them to the new brands.

And that's the second thing. We'd already started to do this pre-COVID. In New York City, as part of our market strategy, we had set up what we called express services in our Rack locations in New York. And what -- really what that was, was allowing full-line customers, Full-Price customers, to pick up their orders, do their returns and even get alterations done for their Full-Price orders at our Rack locations in New York. And we already have gotten the data to show that what happened from that is a number of those customers then subsequently became Rack customers, even though they hadn't previously shopped the Rack.

And so I think what we've really learned across these journeys is just being there for customers, serving them on their terms, serves us really well as well as serves them really well because it introduces them to the full expression of what we can do for them. And certainly,

what we're doing with market strategy is sort of that on steroids in our top markets, but we can do that everywhere we have physical locations across the 2 brands. And that's really what we're excited about at this point.

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

We see some people confused by the local strategy and the market strategy. Any way you want to define it for everybody?

Kenneth J. Worzel Nordstrom, Inc. - COO

Sure. I mean, when we talk about Nordstrom market strategy, what we're talking about is the opportunity to provide an enhanced level of service and selection for customers and in mostly our top markets where we have a lot of assets. We have products. We have people. We have place. We have a lot of inventory close to customers. We've got a lot of folks who can help serve customers, and we have a lot of physical locations to serve customers. That's really our Nordstrom market strategy.

And you see that we've already rolled that out in our top 5 markets, so in L.A., in New York, in Dallas, in San Francisco, Chicago. We're going to roll it out in another 5 top markets by the end of the year. And really, what that allows us to do is to provide customers with a lot more selection. The selection they have available for next-day pickup or delivery in market, it goes up 2 to 8x depending upon which market you look at.

And so selection matters in our business. So just getting more selection has been a big driver of engagement with customers. It also allows us to give customers a lot more convenience. Again, order from that enhanced selection and decide where you want to pick it up, any one of our locations in that market. You can also meet your stylist at any one of those locations or do an alteration.

And so that's the Nordstrom market strategy, it's really about bringing all those assets of people, product and place together with a lot of experience advantages and selection advantages for their customer.

Nordstrom Local is a subset of our market strategy. And what Nordstrom Local references is we have 5,150 to 3,000 square foot locations. We think of them as neighborhood service hubs. So they -- we have both in L.A. and in New York. So we have 3 in L.A. and 2 in New York. And what they are, are locations where customers with us of order pickup or returns or get an alteration or meet with stylist. But it's not -- those are not locations where we hold inventory. So Nordstrom Local's a part of the overall Nordstrom market strategy, and we'll continue to roll that out and learn from that.

We've learned a lot so far in L.A. and New York from that. But it's a part of the bigger Nordstrom market strategy.

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

Retail real estate. You've announced the closures of 16 stores. What is the right base? How do you think about and what's your perspective on the future of the mall?

Anne L. Bramman Nordstrom, Inc. - CFO

Ken, you want to take that one?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

On mute.

Kenneth J. Worzel Nordstrom, Inc. - COO

Anne could speak about some of the details about the financial aspects of the store closures. But again, I would reference back. The 16 store closures, it's sort of -- it is a very specific example of Pete's point about an acceleration of things we'd already seen.

As folks on this call will know, we've opportunistically closed 3 or 4 stores a year for a number of years, as we've realized we could serve customers in markets, particularly in markets where we have multiple stores, to serve customers as the business has become more digital. What COVID did was really accelerated that process, and it really both provided the need and the opportunity for us to think carefully about what is the footprint we really think we need, given what we've learned about what customers want from us. And most of

those stores, all but 1 I think, were in markets where we had multiple stores and had opportunities to serve customers with multiple locations. So it was really a rationalization of what we needed in the way of infrastructure to serve customers without really losing the ability to serve them in those markets.

And I think in terms of the future of the mall, I mean, this is an odd time to try to figure that out as Pete's referenced and as Anne has referenced. COVID has changed a lot of things. Some of that's, I think, going to be cyclical, and some of it's secular. Some of it's going to last a long time, and some of it's a point in time.

What we see as a point in time is as we've reopened locations, there's no question that customers have been more comfortable, for example, shopping in strip mall locations, where they're quickly in and out, where our Rack stores are. Traffic's been slower to come back to malls. But we still think that there's a great future in the experiential shopping experience that you can get in a physical location, particularly in a great mall.

And again, I think folks on this call know this, but over 90% of our full-line stores are in A, A+ malls. And those are places that have continued to thrive even as traffic is down generally to physical mall locations. And these also tend to be locations where the mall owners and our partners in that journey have been investing in experiential aspects and other things to upgrade.

So pre-COVID, and we think, ultimately, post-COVID, those really important retail centers are going to continue to be really important and they're going to be places we want to be to provide customers with a really experiential shopping and discovery journey when that's what they're looking for.

Now at this point in time, that's a little hard to read through the fog of what's going on with COVID. But we still think medium to long term, those are going to be important points of how we serve customers.

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

Thank you.

Anne L. Bramman Nordstrom, Inc. - CFO

Yes, Dana, on the financial piece to it, our stores ending 2019 were all cash flow-positive. And we just use this as an opportunity to accelerate that strategy. And we talked about in the last earnings call, the top line impact of the 16 stores. I mean, these were stores, as Ken mentioned, they were typically fourth, fifth, sixth stores in a market. Generally, they were over 20 years old and were going to require some investment as they were coming up for renewal. So we made the decision to shut those stores down. It was a very difficult decision, as Pete talked about. But the top line impact for total JWN is very small. It's less than 3%. We do think -- we have seen in the past the store transfer to other stores in those markets as well as to online, and it's actually EBIT-accretive. And so we just -- we saw the opportunity. We -- as we mentioned, COVID's accelerated a lot of things, and we made that decision.

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

Anne, as you think about by the numbers and the positioning post-COVID where you are, you increased liquidity, reduced cash burn, any details around that you can provide, or how you're thinking about the financial status of the business.

Anne L. Bramman Nordstrom, Inc. - CFO

Yeah. So just to remind you guys, and it seems so long ago, but in February, as we entered -- exited the second half of '19 and into February, we really had a strong momentum in the business, and we saw positive sales trends in February, certainly, against the guidance numbers we originally had in place and we've subsequently removed that, and so we really -- we saw a lot of strength in our financial flexibility.

And I think sitting here in Seattle, we -- early on, you saw probably a little bit more of an early indicator of what this could be and what the impact could be. So we did a lot of scenario planning really early on of how bad could this be? And what are we going to do?

And so we quickly pivoted, as Pete talked about, to cash and liquidity, flexibility in our financial model, and quite frankly, our biggest

investment, which is the most perishable investment, which is inventory. And so Ken and the team and the merchant team did a phenomenal job of going in, renegotiating with our vendors, truly taking a partner point of view to it, but also looking at, and very data-oriented, of what the most penetrable inventory was, where was it and how do we make sure that we sell through that as quickly as possible. Because we know that the longer you sit on that inventory, it's actually worth less. It's a value play. And so we were pretty aggressive. We exited Q1 with our inventory down over 25%. And so it was -- there was a very concerted effort on that.

As Pete talked about, we also did a lot of work on our working capital, and we also did a lot of work on our expense base. And so as we exited out of Q1 in the last earnings call, we talked about our monthly cash burn. We expect it to be towards -- to the back half of this quarter, to be breakeven from a cash burn perspective. And which was quite a feat when you think about stores. Most of our stores are still closed in the May time frame.

So as we've tracked ahead, I would say that one of the things that stood out for us is our plans as we've opened stores. We opened stores a little bit sooner than we thought in our plan, and they're also opening up more favorable.

For the stores that have opened up in June, we actually are -- actually, each tranche of stores we've opened, we've actually seen them perform better in those markets. And in June, our store sales are running, for total JWN, around down 40% as those stores are opening up and comping. And as you can imagine, full-line stores' are a little bit below that, and Rack is actually above -- or trending better than that. But overall, we're actually exceeding what we had planned for in the quarter.

Secondly, we are also seeing an enormous -- and this is a good guy, our returns. Our merchandise returns are not what we thought they were going to be and had reserved for. And so it's great from a sales and cash perspective, but it's also adding to some of the inventory short-term stress we've seen because we anticipated and forecasted that we would be having inventory coming back in, and we're just not seeing that happen.

So the good news is it's opening up dollars for us to buy fresh goods, which we know our customers love. And so as in June, we were starting to get freshness receipts going through. And as Pete talked about, has really amped up in July as we get ready, both for freshness of regular items as well as our anniversary goods and getting ready for that in the first part of August.

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

That's great to hear. Better sales trajectory and inventory not being returned and customers seeking newness. That's a nice formula.

Anne L. Bramman Nordstrom, Inc. - CFO

It is!

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

Speaking of formula, how do you think of the margin profile of the future? Where can you get back to what are the puts and takes in the profit contribution that you see from full-line, Off-Price and digital?

Anne L. Bramman Nordstrom, Inc. - CFO

Yes. So I think that what we're seeing is -- and we talked about this. Because we took so many of the early actions, we do expect this to be a highly promotional environment this year. So we're not kidding ourselves on that. We're not going to be at the same levels as we were in prior years.

But having said that, we felt like Q1 was a trough for us. Now we are going to see some deleverage in our margins as anniversary sales shifts from Q2 to Q3. But excluding that deleverage, we actually think that we should see some sequential improvement throughout the year, again, as we bring in more freshness and newness coming through.

I think the other thing that we're -- because we took a lot of actions on our expense base, we took a lot of actions as far as reducing our

overhead expenses, including some labor expenses, and the majority of those are fixed and so fixed expenses. And so we really -- as we see sales continue to ramp up, and even into 2021, we should get better flow-through because we did permanently reduce a significant majority of our expense base going forward.

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

And do you see that on the occupancy side, too? Or what opportunity is there, there?

Anne L. Bramman Nordstrom, Inc. - CFO

Well, I think you've heard from a lot of people in our space that every expense is a variable expense in this environment. So we certainly have had conversations with our landlords and are continuing to have some conversations with our landlords.

Through the end of Q1 and through May, we had paid our rent. And we are having conversations where we are looking at the sales in the stores versus the rent payment, and then we're having conversations about how to reconcile some in the second half because it's more of a cash play. But we certainly see some -- every -- as I mentioned, everything out there is considered a variable expense at this point.

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

Got it. And Pete, as you think about the future, how are you planning for holiday in a COVID world? What is Black Friday and the 10 days before Christmas? What do you think it looks like?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

I wish we had a perfect crystal ball for that. I -- we've been on a program for the last couple of years to try to improve our offer relative to gifting, and we learned a lot last year. And I think with the data that we have, really, objective information about categories and price points, we took that learning immediately after last year and applied it to this year.

And frankly, it seems like that all makes a lot of sense, particularly when you look at price, and I think given kind of the dynamics of what's at play with customer sensibilities, what have you. So we are going to have more inventory at lower prices really than probably we ever had, and certainly more around gifting category.

So I think for us, what we're thinking about is how do we connect with customers and give them the opportunity to make sure that Nordstrom is a convenient gifting destination because all the stuff we've been talking about relative to COVID, how that might create consequences on people's normal shopping patterns, perhaps, or going to the stores, we've got the ability to serve customers anyway they want to be served. And so we've been thinking a lot about how to present the gifting part of what we do, both online and in stores, how to enable that through one view of inventory across the entire fleet. So I think we feel good about our offer and where we're going with gifting.

I think the wildcard is going to be the traffic we get through physical stores, given the sensibility of customers around COVID and stuff. And no one's got a crystal ball on that. But our plan is conservative that way. And we know that there'll probably be more pressure put on the online part of our business. So we're doing a lot of scenario planning about what it's going to take to make sure that we can fulfill the demand if it's going to happen disproportionately in online channels.

So you know us, Dana. I mean, it's kind of the nature of retailing. I think you're always kind of looking forward to that next season, and we think that we're going to have a successful holiday, relatively speaking.

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

Yes. I can't wait to get through to that other side. But when you think about that word success, what's your definition of success for Nordstrom, quantitatively and qualitatively? What do you want to see over the next few years?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Well, I guess I'll take it more in the qualitative part. And, I guess, Anne can chime in from that. But we use this word a lot and others do, too, but it's really about being relevant for customers. And part of what's been invigorating about these times is it's really forced us to be

super connected around what's relevant for customers, whether that's the experience or the offer. We think we understand our customers well, and we're really committed to trying to evolve how we do it, so it's more relevant for their lives. So I think that's really the big theme for us.

I think we would measure success by customers feeling like Nordstrom was their #1 place to go to, to satisfy their needs around the stuff that we sell -- apparel, shoes, accessories, beauty, all that. So it really hasn't changed in terms of who the customer is. I think it's more how we serve them.

And I think it's also fair to say that given the dynamic what's going on out there, that we have a chance to gain market share given some of the challenges maybe that's going on with others. And we're aggressive about that opportunity. We think there's a way, certainly, a clear path for us to gain market share, and then ultimately, that's going to lead to more business. So I think we're playing the long game here, and we're going to continue to make investments around activities and capital and inventory and everything that we do to be more relevant for our customers.

Anne L. Bramman Nordstrom, Inc. - CFO

And Dana, to add on to that, we are very focused on gaining market share. Our principles, our financial principles have not changed. Our capital allocation principles have not changed. So part of us getting through this is cash is, as I like to say, cash is queen. And so it's really getting back to our capital allocation of our debt leverage ratios, starting to pay back the dividend or starting to pay a dividend, and then really looking -- and we'll continue to invest in the business. And we have not stopped investing, in particular, in our technology, supply chain and data and analytics space.

So for us, it's continuing those investments for the short and long term. It's getting back to our capital allocation principles. It's gaining market share and driving top line growth and really getting our cost structure in place that, that profitability continues to expand.

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

Great. Anything we're missing that we'd want to leave our audience with?

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

No. I mean, I think the thing we would caution people against is don't draw any conclusions based on a moment in time, and we're in a very unusual moment in time. And we're learning, too. And we're on it every day, iterating on what we've learned and how we can evolve. So if we had the benefit of hindsight, maybe we'd do some stuff different, but I feel -- I think we feel really good about the efforts that we've made and how it set us up for success.

So we're going to battle through this time. We're going to be there for customers. We're going to earn their confidence and trust. And we believe there's always room for the best-in-class of whatever it is, and we are going to be the best-in-class in what we do, and that's the retailer of choice for our customers.

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

Thank you. Thank you, Pete, Anne and Ken. Thank you so much for spending time with us today. We look forward to seeing the continued progress and returning to what we all knew about the sales recovery and hearing the good words today. And most importantly, we look forward to the anniversary sale coming up in August. Thank you very much, and stay safe and healthy. Thank you, everyone, for listening today. Thank you.

Peter E. Nordstrom Nordstrom, Inc. - President, Director & Chief Brand Officer

Thanks, Dana.

Anne L. Bramman Nordstrom, Inc. - CFO

Thanks, Dana.

Kenneth J. Worzel Nordstrom, Inc. - COO

Thank you.

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