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PRESENTATION

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Good afternoon, everybody. My name is Kimberly Greenberger, and I'm the specialty softline department store and branded apparel analyst here at Morgan Stanley. And we're very pleased to welcome Nordstrom management today.

Nordstrom is a leading fashion retailer with over 350 locations in the U.S. and Canada, including 100 full line Nordstrom stores, 248 off-price Rack locations as well as 6 smaller format Nordstrom Local service hubs. The company also serves customers through Nordstrom.com, Nordstrom.ca, Nordstromrack.com, HauteLook.com and Trunkclub.com, yielding a 1/3 pre-COVID digital sales penetration and accelerating to more than half of the sales here in the third quarter.

Today, we're joined by CEO, Erik Nordstrom; and CFO, Anne Bramman. Erik held a number of positions throughout the company, including buying and regional management, before becoming Co-President in 2015 and then CEO in 2020. Anne joined Nordstrom in 2017 from Avery Dennison Corporation, where she had served as CFO since 2015. She had previously held CFO roles at Carnival Cruise Lines and Henri Bendel.

Welcome to you both, and thanks so much for being here with us today.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Thanks, Kimberly.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Thanks, Kimberly.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Before we begin, I do -- I want to let you know we're going to run today's session in a fireside chat style question-and-answer format to explore some of the investor questions that we've been getting over the recent months. And I also want to remind everyone that for important disclosures, please see the Morgan Stanley research disclosure website at www.morganstanley.com/researchdisclosures.

Before we start the fireside chat portion of today's session, Erik, I'd like to turn it over to you for some opening remarks.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Thanks, Kimberly, and thanks, everybody, for joining us today. It's great to be with you.

If I step back, I'm not sure how familiar all you are with our company, our history. But I think first and foremost, everything we do starts and ends with the customer. It must be done through the customer lens.

We have a long history around customer service. We're proud of the reputation that our teams have developed over these many decades. And that may sound obvious, but the definition of service is changing. And like a lot of elements of our business, COVID hasn't been so much about dramatic change out of left field. It's been about an acceleration of trends that have been in place for several years. Massive acceleration, but acceleration. We really like the capabilities we have, our ability to serve customers in the modern ways that they want. And it's not just the capabilities we have from the different businesses that we have. Really, it's the combination of them. It's the synergy that comes from that, and I'm sure we'll get into that.

We view service today as really having two components. First, convenience. It starts with convenience. It's really the basis for good service. But to get to great service, we think, for us, it also includes connection. This builds upon our heritage of service as, really, connecting with customers is in our DNA. How we connect with customers is changing and certainly requires increasingly having digital capabilities along with the connection to our physical assets.

So where are we right now? We recently released our Q3 results. Really encouraged by our performance over Q3. I'll take you back to when the pandemic hit. To state the obvious, really brought with it a level of uncertainty that we haven't had to deal with before. Our response was to pivot to a very intense focus on cash and the risk around our inventory, but also in making changes that are in concert with and accelerate where we need to go. Again, a lot of what's happening in our industry, what's happening with our customers, but these changes have been in place, we've been making investments against them, but we certainly saw quickly the need to accelerate that direction.

When stores close, obviously our digital business took on more importance. But our Q3 results, they reflect not only how we pivoted when the pandemic hit, but also the outcome of investments we've been making in this direction of travel for a couple of years now. We think there's some proof points in our Q3 results. 54% of our business last quarter was done online. So we have a big business. The majority of our business is online now. Scale matters moving online and having these additional capabilities, but these digital capabilities get amplified when they are connected to our physical assets. And there's some good proof points in there.

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

So our focus right now, just broadly, we have a growth focus and we see three specific areas of growth: Number one, building on the success of our market strategy. We talked about -- when we first start talking about market strategy a couple of years ago, we talked about as the business model of our future. Well, the future is here. It is our business model today. We scaled it to our top 10 markets. We've also added pickup capabilities not only in our Nordstrom stores and Nordstrom Local service hubs, but also at our Nordstrom Rack stores. That's nearly 350 locations where we can serve customers through order pickup. So that's number one.

Number two, fueling the graph -- the growth of Nordstrom Rack. Our off-price business, we believe, has a lot of growth opportunities there. It is 1/3 of our business right now. And again, like our digital business, a big business standing alone, but there is synergy with it. Our Rack business is where we get biggest chunk of new customers. So it's a great vehicle for customer acquisition. About 1/3 of those customers end up becoming Nordstrom customers, full-price customers within a year. So it's a big important area for us in being connected to what we do.

So how are we going to grow that? Number one, we think there's opportunity for us to expand our price points, particularly lower price points in our stores. We think there's growth to be had there.

Secondly, we think there's growth from integrating our online business with our physical store business. Last month, we connected our inventories, integrated them between Nordstrom.com, HauteLook -- excuse me, Nordstromrack.com, HauteLook and our Rack stores. The result of this was we added 30,000 customer choices online in our off-price business last month. About 1/4 of our online orders from off-price are being fulfilled from our stores now and more than 10% of our orders from NordstromRack.com and HauteLook are being picked up in our stores. So we think we're just at the very start of the benefits of that integration and are encouraged with the opportunities ahead.

The third area of growth for us is to increase the velocity of our digital business and really kind of going back to my first comments of building on our heritage of service and we're defining it in a digital age. We view it as the personalization at scale in making these connections. And a big part of that is continuing to increase the linkages in our digital business, our physical business. It also includes -- we're appropriately connecting our full-price business and our off-price business. We think the combination of these assets we have, there is a real synergy there and provides growth opportunities for us.

So a quick example from last quarter. Styling is an important component of our business. About 30% of our styling appointments last quarter were done virtually. And as an example, I think, of this connection that's historically for us been one-to-one with a salesperson in the store and how we're set up well to bring that service reputation to digital format.

So with that, I'll hand it back. Kimberly?

QUESTIONS AND ANSWERS

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Okay. Great. That is an excellent overview. Thank you so much for that.

I thought I'd start today, Erik, with a few questions for you and then move into the financial questions after that. And I just want to go back to the local market strategy that you just talked about in your introductory remarks. As you indicated, it's now been expanded to 10 markets, which I think together represent more than half of the company sales. Can you remind us of what makes this strategy a key differentiator for Nordstrom and what efficiencies it provides to you? And any consumer response or feedback so far would be great.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Sure. Yes, again, I think first and foremost, it's got to be great for customers. I mean that is the motivation behind the market strategy. And there's really, I think, 2 buckets to think about it. One is how do we bring a bigger selection to customers with faster delivery. By connecting the store inventory we have in a single market along with our digital business, we're able to offer up to 7x the selection to a customer for next day pickup at a store or 2-day delivery. So that's a big thing. To bring that much more selection to customers with faster delivery without having to make bigger inventory investments is something the customers had really responded to.

The second part would be around our services, engagement of our services. As I mentioned, there's no doubt that service is changing and how customers define it is changing, but there are physical services that are essential and really complement our digital business. So we have physical assets. We have our full line stores. We got Nordstrom Local. We have our Rack stores in our markets. So things like store pickup, curbside services that we can offer at all of those locations, Nordstrom, Nordstrom Local, Nordstrom Rack, is really important.

But also services like alterations and styling. We're the biggest employer of tailors in North America. It's a skill we've had for decades, and we're good at it. And so to be able to offer alterations services but on the customers' terms in a way where they can do it at multiple locations has been important, so that engagement -- increasing engagement with our physical services not only is something that a customer -- it really resonates with customers. It does directly lead to increased customer spend, and we've seen that. We've had -- where we've had our market strategy are -- really, all of our metrics have gotten better. Our sales results, our engagement, our overall customer spend has improved.

So as you mentioned, we had 10 markets through this year. And well, we added 5 markets this fall. We had 5 at the beginning of the year. So we're up to over 50% of our sales. We are looking to expand that, and we'll expand it to 10 more markets next year. We've expanded order pickup to over 350 locations, Nordstrom and Nordstrom Rack. So we're very encouraged.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Excellent. So I just want to make sure I got some of those statistics down because there's a lot of power here in sort of leveraging the digital and the physical capabilities. You talked about integrating store and online inventory, which I think you said you did in October. And the 10%, I think it is right, of online orders were picked up in a Rack store and about 12 (inaudible) online orders were fulfilled by stores.

How does this really improve your key strategy, which is, first and foremost, customer service? And then if you have those data points for order pickup at full line stores, we'd be very interested to hear that number as well.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Yes. I don't have that off the top of my head. We've had -- just to be clear, there is a separation between our off-price business and our full-price business. We've had that inventory integration on our full-price business for about 10 years now or we've been doing store fulfillment and order pickup in our stores. And we've seen not only better customer engagement, better customer satisfaction through that and no doubt sales growth, there is an inventory efficiency outcome of that. We get more demand, more eyeballs on existing inventory we have. So we've got 10 years of history on that. Just last October, we launched at Nordstrom Rack, as you mentioned -- those stats you mentioned there.

So for full-price, we've been historically about 20% of our online orders have been fulfilled in our stores there. The nice thing about that is that capability, and now we have in off-price, is very flexible. So think back when stores were shut down, we -- one of the big concerns certainly was the trapped inventory in our stores. We were able to do store fulfillment out of those stores pretty seamlessly and increase it significantly. So I don't know exactly what the number is right now, but it's grown quite a bit. And we -- it's really one of the daily levers we use in managing our business is how much of the demand -- online demand point to our stores or to our fulfillment centers. And that flexibility, that is super important in both our full-price and our off-price business.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Okay. Excellent. I wanted to step back and just talk about the industry. I wanted to know how do you think about pure luxury store closures that have been announced this year. You've heard from Neiman Marcus, Brooks Brothers and some others.

Are you going after some market share there? And if so, how do you plan on capturing that customer? And what long-term opportunities do you think this presents to Nordstrom? And are there any other market share opportunities you see on the horizon, for example, over the next 3 years or so?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Yes. Well, we think there's lots of market share opportunities. I mean, there's massive disruption going on, and that provides opportunity.

So luxury, I think it's important to kind of get on the same page of what that means. For us, luxury and really a true designer business, it's a big, profitable business for us. When I say true designer, it's not just cosmetics and sunglasses. It is mostly really separating by having shoes, handbags and apparel. That area, our designer business has been the fastest-growing merchandise area for us for the last several years. It's a vital ingredient of what we're trying to do overall to have a legitimate, big, powerful luxury business.

But like most everything we do, the real impact is in combination with our total enterprise. Our customer base, we have a very attractive customer base. It tends to be younger than a lot of the traditional luxury venues. And it's a very attractive place for brands, these big designer brands, for new customer acquisition. One of, I think, the most clarifying stats that we have is that we are the #1 spot for a customer to make their first designer purchase. And I think it's a good example of kind of how the breadth of our inventory and our merchandise offering comes together. Our -- certainly, our approach to service is to be an inclusive environment, not an exclusive environment, very welcoming, and we're selling customers high and low. And so when a customer is ready to make that first designer purchase, they come to us more often and I think because it is a more comfortable spot and they're able to mix it with what they already have and are shopping for. This introduction of new brands, this newness is a big part of what we do.

So we think that separates us from a lot of the other luxury players and has for a while, frankly. And we solely have gained distribution over these last number of years. We think there's opportunities to continue to gain distribution from the very best designer brands in the world, but we also think there's opportunities to grow our designer business as there is with the rest of our business through the growth strategies that we're embarking on.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Excellent. I wanted to talk a little bit about real estate. Earlier this year, you announced the permanent closure of 16 full line stores and 3 -- and the 3 Jeffrey boutiques that you operate and as well as the acceleration -- the accelerated integration of Trunk Club into your Nordstrom stores.

How does your smaller real estate footprint fit into your broader business strategy? Do you continue to see brick-and-mortar opening opportunities for Rack or full line? And how does Nordstrom think about the combination between digital and physical assets as well as where you see the long-term optimal mix between the two channels?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Yes. I would say it's fluid. And I think it would be wrong for us to have a hardened view of what the optimal mix is. We have flexibility in what we have. And you mentioned the 16 stores -- full line stores we closed this year. That certainly wasn't our plans coming into it, but it is in keeping with, again, an overall direction. The vast majority of those stores were located in markets where we have multiple full-line stores. To close the smallest store in a market is something we've done for the last number of years.

And I think a way to think about it is a smaller store whose appeal was really around convenience. Is it as important as -- and partly is the shift to online, but partly, we can provide services, be it in a Nordstrom Local or Nordstrom Rack now, for things like order pickup and alterations. And so that mix of assets, Nordstrom full line stores, Nordstrom Locals, Nordstrom Racks, it continues to evolve for us. We like that mix. It gives us a lot of flexibility. And as leases come up, we'll certainly look at that. But part of having a robust and integrated inventory and being able to do store fulfill, it allows us to put more inventory into the stores to make the stores more appealing. And we don't have the downside, the risk of having markdowns from the inventory being trapped there.

To your question about do we see new store opportunities, I would say yes for off-price. I think the off-price business, outside of us, is very much dominated by physical stores. And there is something of a treasure hunt in off-price that makes our Rack stores super productive. We think by expanding the price points, that very well could open up more growth opportunities towards your physical stores.

Again, the difference for us in our off-price business, well, I know -- I think we are really kind of the only off-price player who has a really at-scale robust off-price online business. And again, there's a synergy between connecting those that will help our store business, but we really look at it by a market, by total, be it physical stores or online business, how do we mix those assets and grow the pie.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Excellent. And Nordstrom was really early to e-commerce. As you mentioned, about 1/3 of the business last year was online. I'm wondering, obviously, you talked about the, I think, 54% penetration here in third quarter. So COVID has clearly had an impact on this channel.

But I'm wondering if how you view the long-term opportunities in e-commerce for Nordstrom? And then also can you comment on the increased competition in the luxury space from players such as NET-A-PORTER or Farfetch?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Yes. I mean -- again, I think it's just this glaring example of an acceleration of trends that have been in place before. I mean, clearly, there's been a trend of a bigger share of our business and the industry's business being online versus stores. For us to be at a point of having 54% of our business online, that's big. We've talked about that internally, but boy, it's coming or we're going to be a majority digital business. It got accelerated, no doubt about it, with COVID, but it is in keeping with where we've been going. And we think, we sit here right now, really we have a platform. We have a platform for full-price business, a platform for off-price. There's a synergy between them. There's a synergy between stores and online.

So that is how we view the digital business. Our goal is not to grow e-commerce in a silo and grow it for some metric. It is to grow market share. And the assets we have to grow market share are physical and digital. So bringing those -- that connection, those capabilities to our off-price business as we did last month by connecting our inventories is a big, big step. And to have already 10% of our off-price orders being picked up in stores -- we know good stuff happens when a customer comes in a store, even for order pickup. There's no doubt that it increases engagement in a store. And we know the more places we can engage with the customer, stores, online, full-price and off price, each added step of engagement leads to greater customer satisfaction and greater customer spend.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Great. We wanted to dig a little bit into the profitability of e-commerce, so Anne, maybe this is for you. You've mentioned on previous earnings calls that full-line digital operating margins are at parity with brick-and-mortar operating margins, leaving the business somewhat indifferent as to whether a sale is made online or in a store.

Can you talk about why this is the case for your full-line division and if we should expect to see that same parity at some point in the future for the Rack business or not?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. Great. Thanks, Kimberly.

So yes, we have been at parity for quite some time in our full-price business. And I think the thing to think about is when you get enough scale out of the investments that you've made, and I think one of the biggest unlocks has been the fact that we've been leveraging the inventory between either online and in stores. And we've been doing that for quite some time. That is a big piece of unlocking margin in your inventory. And if you think through the rest of your cost base on that, you've got some trade-offs between -- we have a variable cost selling labor model in our stores versus the supply chain fulfillment cost. And again, as we continue to leverage store fulfill, and as Erik talked about, really making that choice everyday as far as where to fill demand and having it closer to the customer, that's really helping us drive it to be more -- it's really at parity for full-price.

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

So we're really excited about the opportunity. And I think even more importantly, as you saw, 54% penetration in Q3, and we were profitable. And that's -- we were really proud of that because there was a lot of hard work in our team's efforts to get there.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Absolutely. And particularly at a time like this where e-commerce fulfillment costs are inflating, that is obviously an accomplishment.

Anne, there's been a sort of subtle trend in gross margin. It was flat in 2019, which was a nice show of stability. There was very slight pressure, 20, 30 basis points, in the prior years.

How should investors think about your gross margin on a normal basis, let's say, on the other side of COVID when the world gets normal again, and as compared to 2019 as a base year? For example, do you think you'd get back to that 2019 gross margin? And -- or do you think there is an opportunity to maybe combat some of that very slight pressure you've seen over time?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So I think, as you mentioned, in Q -- in '19, we had a margin percent. In Q3, I think if you step back and look at even the volume that we had in Q3, our gross profit was down 150 basis points, of which about 2/3 of that was just the shift of Anniversary Sale into Q3 because it is a promotional event for our customers, and then the remaining 1/3 was really due to deleverage in the sales volume. So if you pull that apart, it's actually a pretty consistent trend from what you've been seeing.

I think the thing to think about is, for us, in our merchandise margins, we really used the time in the first half of the year to get our inventory incredibly clean. We really worked to get through the perishable pieces to it, but also really look at the different assortment and offerings that were resonating with the customers. So as we enter into this time in Q4 as well as in '21, it's really starting with a very fresh slate of inventory. It's not very aged and it's -- will continue driving the categories and price points that really resonate with our customers.

As Erik talked about, we have a very strong designer business, but we've also been looking at -- the beauty of our offering, I think, which is unusual, is the high and low. So you see a lot of people mixing different brands, different price points in their purchases and what they wear. And so for us, that's what we're continuing to drive on. And so by being so clean, it actually allows us to chase, which helps our margins in full-price selling as well.

I think the other thing is we're continuing to see freshness in our receipts in inventory. We talked about this a little bit a couple of quarters ago that was -- as we started to wind back up into -- and stores being open, which happened faster than we thought, and as we continue to look at the refresh in our inventory, Anniversary Sale was a really big opportunity for us to see what was resonating with the customers from a demand perspective. And we were really pleased. It was the best sell-through we've ever seen on an Anniversary Sale, which again goes to your margin piece to it.

I think longer term, as we think through '21, and I will tell you, we're very big in the scenario planning. So we've got a lot of scenarios and different levers that we're pulling and reacting to what we're seeing to help drive us to be more flexible and nimble, but I think the continued inventory discipline is something you should continue to see from us and as well as inventory levels in line with sales. And I think the bigger opportunity that Mark -- that Erik talked about earlier was really about leveraging the omnichannel piece, the market strategy, the fact that we can do store fulfill, that we can offer order pickup across the multiple physical assets and then the unlock we've had with the off-price space. I think those are big levers for us as we move forward.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

That's great and very encouraging, and obviously evident as you pointed out in that third quarter number that you just reported.

On SG&A, there were a number of measures you took this year in response to COVID. You announced a restructuring that is expected to result in expense savings of about $150 million, combined with what you already have, which was $200 million to $250 million of a savings plan that you previously announced. These actions represent a 20% reduction in non-occupancy-related overhead expenses.

I'm wondering how should investors think about the permanence of these savings beyond 2020 and the potential SG&A rate leverage opportunity in the future longer term? And do you have targeted SG&A ratio as a percentage of sales that you would like to get to?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So we did -- the team was busy the first half of the year. That is for sure. And we used the opportunity to really think through what we wanted to be, how to be more a leaner organization. As Erik talked about, we've had a lot of internal discussions about that we would be -- ultimately be a majority digital business. It got accelerated. And so we used this opportunity to really step back and think about what do we want to be as an organization, and what does that look like and how do we need to structure ourselves in order to really drive that flexibility.

So we did that. We created a very lean, flexible organization. We pulled out a lot, both in expense and also, quite frankly, as Erik talked, about cash and liquidity was one of the biggest focus areas we had with all the uncertainty in the first part of the year. So we really did a lot to actually work through our cash expenses as well.

And so when we think about it, we really -- we looked at rightsizing and combining our full-price and off-price regional teams, our functions. We really looked at our corporate teams, where do we want to lean in because we did make -- continue to lean in, in certain areas like technology and supply chain. And what are other areas that we just need to get a little bit leaner as we think about the shift in how customers are shopping with us.

And so we did use that as an opportunity. And so as -- we also realized year-to-date cash savings of $550 million. We did that with three levers. One was the expense piece that we talked about, the second was on CapEx and the third was on working capital. And we're continuing to track against that and the high -- and we're going to exceed our high-end of our targeted cash savings of $750 million for the year.

From an expense standpoint, we have, so far, about $330 million in savings across our P&L. And we think about 80% of that is going to be permanent going for '21. So we've been really -- I mean, the team has been super disciplined, super focused. You're seeing it in our numbers. And we're really using it as an opportunity to help drive some flexibility in the business.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

80%. That's fantastic. You mentioned the improvement in working capital as well. So I wanted to follow-up with inventory.

As you mentioned earlier, Anne, inventory has been just absolutely lean over the last several quarters. I think at the end of Q3, you were down about 27% year-over-year in inventory. Where do you see the relationship between inventory growth and sales growth going forward? And has this year changed in any way the way that you think about inventory management going forward?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So when we finished Q3 down 27%, and that was pretty much in line with sales when you exclude the shift in Anniversary Sales. So we really did try to have that lineup of the sales versus the inventory mix. Now we have been lean. And again, there was so much uncertainty. And as we talked about, we've been doing -- we've been very disciplined on this to make sure that we've got -- we can -- we have dollars to chase, but also to make sure that the freshest inventories -- we see shifts in consumer demand and what the -- and what's really resonating with them.

In the second quarter, we did face some temporary inventory constraints as we reopened stores, but we've been flowing newness through. Anniversary is a great example of that. And we're continuing to see newness through -- I would say holiday is probably the freshest holiday and offering that we've had in quite some time. We're really excited by the offering that we've got. And we're going to continue to have that tension, I think, as far as making sure we've got the right offering, the freshest inventory, but making sure that we have some ability to chase into it as well as we see trends emerging.

So for longer term -- and I think the other piece to it is the market strategy. That really unlocks for us -- having inventory closer to the customer and making sure that we can sell as much as we can at full price without having to take markdowns on it. So we're really -- it's kind of a -- it's like an equation of making sure we've got the right inventory in the right place to serve customer demand, and that we've got the right depth in certain areas as well. So it's really become a balancing act.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Great. That's excellent. And then two quick other questions, and then I want to go back to Erik for a post-COVID world question. And this quarter, credit card revenue decreased a little bit more than sales. I'm wondering if you can talk about the relationship between credit card revenue and sales going forward? And how should investors think about how these two numbers track to one another?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

I would say yes. So in general, credit card sales does track with revenue, but there's typically a quarter lag, 1 or 2-quarter lag on it because as you see the charges coming through and then the revolver interest and that type of thing, so it's generally a little bit of a lag.

I would say stepping back and looking at our portfolio in general, it's a very healthy portfolio. And I think you're hearing this from a lot of other folks. Customers have been paying down debt. They've been staying current. I think we're all coming into this wondering what was going to happen. It's been -- but we -- in general, we're really pleased with where the portfolio is and think the customers -- it's healthy going forward.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Excellent. Okay. And last question for you, Anne. Obviously, free cash flow is starting to come back to the business. How should we think about your capital allocation priorities, particularly in light of the recent completion of your generational investment cycle that, I think, finished with the completion of the New York City flagship and that opening a year ago?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

So we have not strayed from our general principles. So first and foremost, we are going to invest in the business, and we've been talking about this, but we generally, outside of the generational investments, we're targeting around 3% to 4% of sales of being reinvested in.

Now where we are investing is to change. It's shifted a bit, and you're continuing to see that. But really, as you think about where we've been and where we're going forward, it's really about investing in our supply chain technology in a lot of the initiatives. And you're seeing that coming through in some of the things that we've been implementing this year despite COVID going on. We actually used this as an umbrella, an opportunity to really accelerate some of that -- those initiatives and investments.

I think the other piece to it is we -- so the second piece to it is -- that is really getting investment-grade and making sure we've got the right leverage ratios in our balance sheet. Now we entered the year in a really strong place, we had $1.5 billion as we finished Q3, but we ended the year with a lot of cash in the balance sheet and a lot available on our liquidity. So we used some of that up and we're -- as you can see, we're paying back as much as we can to get the balance sheet back in line with that investment-grade ratios and getting the debt in the right leverage ratio places to it.

And then anything left from that is reallocate it back out to investors, either through dividends or share buyback. Now that, we suspended that this year, but those priorities long-term have not changed and you can see that we're actively getting back into shoring ourselves up and ensuring that we continue to have a really strong balance sheet, which we do. And that's actually helping us a lot, both with our vendor community, but also as we think about investing in the business and really we're eyeing things beyond this holiday into '21 and '22 to make sure that we're staying a really relevant customer service-oriented company that's really gaining profit and market share.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Excellent. Erik, I wanted to get back to something you talked about earlier today. Obviously, this year, we've seen a lot of shifts in the customer. We're all working from home now. And there have been headwinds to certain apparel categories like wear-to-work, special occasion dresses, some things that Nordstrom is known for. But you talked about really pivoting and pivoting and reacting, adjusting the assortment. And I think for the Anniversary Sale, you really amped up your ownership in casual product, comfort, wellness and home.

How have customers responded to your initiatives in categories maybe that historically you had not been as well-known for? And then as you think about life after COVID, you've got, we can -- let's all hope we get there sooner later. Do you expect any sort of longer-term shift away from sort of more occasion or wear-to-work categories to some of these categories that have been hot sellers during COVID? Or how should investors think about category mix longer term?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Yes. Yes, it kind of really makes sense -- had a big impact this year. Let me start with the Anniversary. Really pleased how our merchants were able to pivot and change our inventory investment on short notice. I think the proof point is in the sell-through we have by quite a bit, the highest sell-through we've ever had for an Anniversary Sale. So the investment by category did resonate with customers.

I think there's some important context here. When you talk about active, active is not a new business for us. We've had a big active business for quite some time. Zella is our own label, active label. It's our biggest brand outside of Nordstrom that we have. And so it's a -- it started from a big base, and there's no doubt it's growing quickly. We think there's plenty of opportunity to continue on that.

Home is a little different. Home has been a smaller business for us. We've been in it, but certainly it's been a smaller business. So we see growth opportunities there, but that's off a smaller base where active is growth opportunities off a bigger base.

You're talking about kind of events, occasions. I worry a lot of people here, the word occasion and they think like a gala or a big party to go to. Again, there's been a multiyear trend towards casualization, and that certainly has been accelerating. But there is no doubt an impact on our business of people being with other people. And I don't know if occasion is the best word for it. I mean, it could be going to work. It could be going on a date night. It could be going to a restaurant, going to the coffee shop. There's some place where you're going. It could be even going to the gym. There is a difference between being out amongst them and wanting to -- sending them eye signals and caring about what you look like versus being home like this and no one can see our feet, so we're wearing 10-year-old slippers around.

There's -- that part is a moment in time. There is going to be a time where we interact with each other again. That doesn't mean formal categories. Are we going to sell as many suits and ties to people wearing suits and ties to work as before? No. But that's been a multiyear trend for quite some time. But we are highly thought of in customers' minds for higher-state dressing. And it doesn't have to be formal, but when people care and we hear it a lot that people have confidence, have trust in us to expose them to new brands. And one of the best compliments we get from customers is I came to your store, I came to your site and through whatever our capabilities, they ended up buying something they wouldn't have bought on their own and it ends up being their favorite thing in their closet. That's a big part of our business, that newness and the mix we have.

So I do believe that there is that general trend towards casualization will continue, but we also believe that this is a moment of time where we're in, whatever, 95% of our lives are at home. But once things open up, it doesn't have to mean suits and ties, but it does mean a much broader range of categories to come in favor. And those are categories that we hold a good spot in customer's minds with. And we'll be ready to flip that dial and get after that when we see that happening.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Well, I think we're all looking for that movement -- forward to that moment when we can be out and be social with one another again.

Erik, Anne, it's been an absolute pleasure. Thank you for joining us today.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Thanks, Kimberly. Appreciate you having us.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

And on behalf of Morgan Stanley, I wanted to thank all of you for tuning in today. We hope you have a happy, healthy and safe holiday season, and enjoy the rest of the conference. Thank you.