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# EDITED TRANSCRIPT

JWN - Q2 2018 Nordstrom Inc Earnings Call

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## OVERVIEW:

Co. reported 2Q18 EPS of \$0.95. Expects full-year 2018 EPS to be \$3.50-3.65.



AUGUST 16, 2018 / 8:45PM, JWN - Q2 2018 Nordstrom Inc Earnings Call

## CORPORATE PARTICIPANTS

**Anne L. Bramman** *Nordstrom, Inc. - CFO*  
**Blake W. Nordstrom** *Nordstrom, Inc. - Co-President & Director*  
**James F. Nordstrom** *Nordstrom, Inc. - Executive VP & President of Stores*  
**Peter E. Nordstrom** *Nordstrom, Inc. - Co-President & Director*  
**Trina Schurman** *Nordstrom, Inc. - Director of Investor Relations*

## CONFERENCE CALL PARTICIPANTS

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**Jay Daniel Sole** *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*  
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**Paul Trussell** *Deutsche Bank AG, Research Division - Research Analyst*  
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## PRESENTATION

### Operator

Greetings, and welcome to the Nordstrom Second Quarter Earnings Conference Call. (Operator Instructions) We will begin with prepared remarks, followed by a question-and-answer session. (Operator Instructions) As a reminder, this conference is being recorded.

At this time, I'll turn the call over to Trina Schurman, Director of Investor Relations for Nordstrom. You may begin.

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### Trina Schurman - Nordstrom, Inc. - Director of Investor Relations

Good afternoon, and thank you for joining us. Today's earnings call will last 45 minutes and will include around 30 minutes for your questions.

Before we begin, I want to mention that we'll be referring to slides, which can be viewed on going to Nordstrom.com, in the Investor Relations section. Our discussion may include forward-looking statements, so please refer to the slide showing our safe harbor language.

Participating in today's call are Blake Nordstrom, Co-President; and Anne Bramman, Chief Financial Officer, who will discuss the company's second quarter performance and the outlook for 2018. Joining during the Q&A session will be Pete Nordstrom, Co-President; and Jamie Nordstrom, President of Stores.

With that, I'll turn the call over to Blake.



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**Blake W. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Good afternoon, everyone. Many of you joined us for our Investor Day last month. We appreciate the opportunity to share our customer strategy, our aspiration to be the best fashion retailer in a digital world and our long-term financial commitments. For those who missed it, we have made the webcast available on our Investor Relations website. We've laid out the strategy and will continue to build on this foundation as we execute and measure our outcomes.

Our second quarter results reflect our progress in achieving our long-term financial commitments. In the second quarter, we reported a total sales increase of approximately 7% and earnings per share of \$0.95. We remain on track for 2018 to be an inflection point for profitable growth.

As a reminder, over the course of this year, there are timing impacts related to the shift in the calendar and the new revenue recognition standard. In the second quarter, this represented a favorable impact of roughly 100 basis points on total sales and \$30 million on EBIT. This is expected to fully reverse in the third quarter, resulting in an unfavorable impact. To help provide further clarity, we posted our slides ahead of this call, and Anne will share additional insights in her remarks.

Because of these nuances on total sales this year, we're also providing color on our comp sales, which are reported on a like-for-like basis with no impacts on the calendar shift or revenue recognition. For the second quarter, comp sales increased 4%, driven by growth across both Full-Price and Off-Price.

We had robust digital sales growth for the quarter, reflecting our market-leading presence and significant progress toward our long-term goals. Digital sales grew 23% for the quarter, up 300 basis points from a year ago and accounted for 34% of our sales.

In Full-Price, we had a comp increase of 4.1% for the quarter. We recently completed our one-of-a-kind Anniversary Sale, an event that distinguishes us in the industry by featuring new arrivals at reduced prices for a limited time. Anniversary generates significant volume that rivals even our holiday period.

We continued to see a heightened shift of customers shopping online during the Anniversary. Digital sales accounted for more than 40% of our event. On the first day of early access for our Nordstrom cardholders, we had our biggest day ever online, exceeding our previous record by 80% at 10x our average daily demand.

We worked hard to manage our systems for peak demand. Despite our efforts, we experienced some website issues as we encountered unprecedented levels of demand on the first day of the event. While our team resolved this, we know we disappointed many of our customers, and in response, we offered cardholders 10 points per dollar on purchases made on the first day of Anniversary.

While we had a solid Anniversary overall, we're well aware that we have opportunities to better meet our customers' expectations. We've learned a lot and are highly committed to improving our execution.

From a merchandising perspective, our partnerships with strategic brands enable us to provide customers with compelling offers and strengthen our product margin. In the second quarter, sales from strategic brands grew 13%, making up around 45% of our Full-Price business. We are positioned to achieve our long-term plans for strategic brand growth that we shared during Investor Day.

Our Off-Price business delivered a comp increase of 4% for the second quarter. The strength of our inventory position allowed us to be fluid and respond quickly. We took swift action to accelerate inventory turns, strengthen our core assortment and improve our execution in stores. Our second quarter comp sales exceeded our plans by a couple of hundred basis points, and we expect to carry and build upon this momentum during the second half of the year. We also continue to deliver 25%-plus sales gains in our digital business, Nordstromrack.com and HauteLook.

One of the primary topics we discussed during our Investor Day was our local market strategy, a cornerstone of how we will win with customers and increase shareholder value. When customers engage with us across stores and online, on average they spend 5x more and profitability per



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customer doubles. Through our focus on our top markets, we're combining the scale of our national infrastructure with our local assets of people, product, and place to drive increased customer engagement and gain market share.

We're starting in our largest market, Los Angeles, where we're bringing all of our digital and physical assets together in a seamless ecosystem. We're continuing to invest in supply chain, a critical enabler of the customer experience. We have identified sites for our West Coast fulfillment center and local omni-channel hub, which are scheduled to open in late 2019. These investments in our supply chain network will help address our opportunities to better serve customers, improve our efficiencies and leverage inventory in our local markets.

Last month, we announced that 2 additional Nordstrom Local concepts will open in the L.A. market this fall. These neighborhood hubs are one component of our local market strategy to engage with customers through more convenient access to products and services, such as buy online pick up in store, alterations, store reserve and personal styling.

Technology is a critical component of our ambition to be the best fashion retailer in a digital world. On that front, we're pleased that Edmond Mesrobian has joined our executive team as chief technology officer. Edmond brings nearly 3 decades of experience from large and complex international companies, including Tesco and Expedia. He will support all aspects of technology across the company and focus on advancing our capabilities to deliver the best experience to our customers, however they choose to shop with us.

In closing, we believe we are leading the future of retail through our customer strategy centered on 3 strategic pillars: providing a compelling product offering, delivering outstanding services and experiences and leveraging the strength of the Nordstrom brand.

We are confident in our path forward and are well-positioned to achieve our financial plans for the year and over the long run. Now I'd like to turn the call over to Anne to provide more color on our second quarter and expectations for the year.

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

Thanks, Blake, and good afternoon, everyone. Before I review our second quarter results, I'd like to reiterate our key takeaways from our recent Investor Day regarding our long-term financial plan.

To begin with, we're targeting higher shareholder returns through 3 deliverables: growing market share, improving profitability and returns; and continuing our disciplined capital allocation approach.

Second, we're on track for 2018 to be an inflection point for profitable growth as we scale our generational investments and digital capabilities.

And third, as our model evolves and we near completion of our heavy investment cycle over the next couple of years, we plan to return to mid-teens ROIC and accelerate free cash flow.

Our second quarter demonstrated our progress in achieving these financial goals. Q2 EPS of \$0.95 reflected the top-line strength across our businesses and throughout the quarter. Based on our first half results, we have raised our full year outlook from a top and bottom line perspective.

Now I'll provide further details around the timing shifts. As Blake mentioned, quarterly comparisons to the prior year are impacted because of last year's 53-week calendar and revenue recognition changes. For the second and third quarters, the primary driver of timing shifts is revenue recognition. The shift of events -- Triple Points, Anniversary and Half-Yearly -- largely offset within the second and third quarters. For example, in the second quarter, the unfavorable impact of Triple Points was largely offset by the favorable impact of Anniversary.

For the second quarter, we had a total sales increase of approximately 7%, including a favorable impact of roughly 100 basis points, which will fully reverse in the third quarter. This primarily represented the impact of revenue recognition as it relates to the timing of Anniversary.



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As Blake mentioned, comp sales are reported on a like-for-like basis, which means there are no impacts from event shifts or revenue recognition. While we are providing color on our comp performance given this year's unique nuances, we're focusing on total market and sales performance as comps become less relevant over time.

As a reminder, at the beginning of 2018, we made changes to our sales reporting to align with how we view our results internally. We now allocate certain corporate adjustments such as estimated sales returns to our Full-Price and Off-Price businesses. These allocation changes do not impact sales at a total company level, but they do impact prior year comparisons for Full-Price and Off-Price.

It's also important to keep in mind that we don't believe our sales trends on a quarter over quarter basis are necessarily predictive due to the seasonal nature of our business. For example, Anniversary has become less of an indicator for second half performance as our merchandise offering continues to shift from fall to wear-now. We view our underlying trends over a longer-term horizon, which has generally been consistent over the past several years.

Now I'd like to walk through some timing impacts on the other areas of P&L and provide some color on our Anniversary execution.

First, the gross profit increase of approximately 90 basis points included a favorable shift of \$30 million due to revenue recognition as it relates to the timing of Anniversary. This is expected to fully reverse in the third quarter. More specifically, it represents in-transit sales that are now recognized as shipment under the new standard, rather than deferred. There is an elevated impact relative to last year due to the high volume of online sales for Anniversary at the end of the quarter.

The second call-out is related to an unplanned 10-point loyalty offering made in response to the site outage on the first day of Anniversary. This reduced gross profit by approximately \$12 million in Q2 and is expected to be roughly EBIT-neutral by the end of the year as customers redeem their notes. In Q2 last year, we had a similar loyalty accommodation, so the impact is minimal on a year-over-year basis.

Our gross profit performance reflected higher product margins from continued regular price selling trends and leverage on occupancy expenses. From an inventory perspective, we ended the quarter with a positive spread between inventory and sales growth, in line with our expectations.

Moving to SG&A, our rate increased around 70 basis points over last year. This reflected higher fulfillment and delivery expenses related to digital growth and peak online demand during Anniversary. Coming off the event, we expect supply chain costs to return to recent levels. We're focused on continuing to bend the curve in expense growth to remain on track for a mid-single-digit increase for the year.

Turning to capital allocation, our philosophy is to maintain a consistent and balanced approach between reinvesting in the business and returning cash to shareholders. We're also focused on maintaining a strong balance sheet and an investment-grade credit rating.

Our debt leverage remained consistent with our expectations at 2.5x on an adjusted debt to EBITDAR basis. We had approximately \$90 million in share repurchases year-to-date.

Turning to our full year guidance, we've raised our EPS outlook from a range of \$3.35 to \$3.55 to a range of \$3.50 to \$3.65. This incorporates our first half results while maintaining our assumptions for the second half of the year. From a comp perspective, we've raised our full year expectations from a 0.5% to 1.5% increase to a 1.5% to 2% increase. This assumes a continuation of underlying sales trends in the second half of the year. From a gross profit perspective, we continue to expect modest improvement in product margins and a consistent occupancy rate relative to last year.

For the second half of the year, we expect Q3 to contribute roughly 30% of EBIT and Q4 to contribute 70%. We have the following quarterly call-outs:

Q3 EBIT margin is planned to deleverage on fixed expenses and includes a \$30 million unfavorable shift from Q2 associated with the impact of revenue recognition.

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Q4 EBIT margin is planned to leverage on higher sales volume and reflects a favorable comparison of \$16 million from a onetime employee investment associated with last year's tax reform. When normalizing for this one-time impact, Q4's planned EBIT contribution in the second half is generally consistent with historical trends.

We remain confident that 2018 is an inflection point for long-term profitable growth. Our drivers of EBIT margin improvement include continued strength in our product margins, scaling of generational investments and leveraging our digital capabilities. We're encouraged by our progress to date, and we're tracking well against our financial plans.

I'll now turn it over to Trina for Q&A.

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**Trina Schurman** - Nordstrom, Inc. - Director of Investor Relations

Thanks, Anne. (Operator Instructions) We'll now move to the Q&A session.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Our first question is from Jay Sole with UBS.

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**Jay Daniel Sole** - UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury

Can you talk about what improved in the Off-Price business this quarter? Can you just take us through what were the elements of the improvement that led to a 4% comp?

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**Blake W. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Jay, this is Blake. I tried to make those comments in the remarks that, as I indicated in the previous call, that we had some opportunities in women's and there were some opportunities with the balance, whether that was seasonal items or some bets we made on fashion. The fact that our inventories were in pretty good shape, the team was able to react in a short amount of time and make some adjustments to that balance. And we had quite an improvement there. We're heading in the right direction, and we're encouraged by that. As we've indicated previously, we felt -- we've had good foot traffic in our stores and online and that the opportunities for the sales results -- resulted in our end, and we're pleased that we're making some progress.

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**Jay Daniel Sole** - UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury

So maybe a follow-up on your point about inventory. Can you just talk about how you were able to drive 7% total sales growth in the company in 2Q, even though inventory was down 2% at the end of Q1?

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**Blake W. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Okay, this is Blake. I think the biggest inventory change happened in the Rack. So we've had good inventory management for some time, and it's critical in this environment. And we, in 2017, were not as consistent in our inventory management, and Geevy Thomas and our merchandising team made that a real priority at the beginning of the year and have made great strides. And we alluded at the Investor Day that we felt that we were heavy with our inventories, and he's been able to, with the team, take some inventory back of the house. And so it's about \$85 million less



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on a comp store basis in our stores. We don't think it's changed what's happening in front of the house. And so the ability to turn it faster, have fewer touches, have more regular-price or full-price selling is really benefiting in many ways.

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**Operator**

Next is Mark Altschwager with Robert W. Baird & Co.

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**Mark R. Altschwager** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess just first, I'm curious about the Anniversary Sale performance in the L.A. market. I know it's easy -- or not easy. I know it's early, but you've got that beta group of customers that's on the market intensification strategy. So just curious if there's any learnings you can speak of as you look at how those customers interacted with the brand during the sale.

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**James F. Nordstrom** - *Nordstrom, Inc. - Executive VP & President of Stores*

Mark, this is Jamie. We've been -- spent most of the first part of this year building out a lot of those new experiences that we talked about at the Investor Day for L.A. customers. It's still a relatively small number of customers in Los Angeles that are exposed to those experiences, and they're helping us build those. We call it the beta group, and we're involving those customers quite a bit along the way. So I don't think there's a story yet. There are results to talk about how those experiences drove our total business in Los Angeles for the Anniversary Sale. I think we're going to start to get those results over the back half of the year. We'll have more to share there. But I will tell you that the results, so far, are encouraging. We know we've got a big opportunity there to increase market share and do a better job for customers, and so far, the results are really encouraging. But we'll have more in the coming quarters to be able to share on our results there.

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**Mark R. Altschwager** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And if I could just follow up with Anne real quick. Just a lot of moving pieces with the revenue recognition changes and some other items. Just maybe could you simplify it for us and walk through how we should be thinking about the gross margin rate progression in Q3 and Q4?

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

Yes. So we really tried to be as transparent as we possibly could to road map it out for you guys. So I think keeping -- you need to keep in mind as you look at the Q2, Q3 pieces to it is the revenue recognition piece, and gross margin is a good guy in Q2 and a bad guy in Q3. So that's going to have a negative impact on margin. As well as traditionally, Q3 is a lower-volume quarter for us. So as you would expect, and consistent with what we see with historical trends, the way we've planned it out is that our expenses, both in buying and occupancy and SG&A, would deleverage, consistent with what we've seen historically just based on the top line volume components to it. So that's really kind of the headlines around that.

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**Operator**

Next is Brian Tunick with Royal Bank of Canada.

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**Brian Jay Tunick** - *RBC Capital Markets, LLC, Research Division - MD and Analyst*

Curious about any comments you'd share about the learnings from the Men's Store in New York City so far and anything you wanted to comment on Canada as some of them enter the comp base. And then my second question would be, as you talk about the components of getting EBIT margin expansion, just on leveraging the digital capabilities, can you maybe talk about what are some things, over time, that you think, in that part of the business, will start showing leverage against ongoing investments?





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**James F. Nordstrom** - Nordstrom, Inc. - Executive VP & President of Stores

Sure, Brian. This is Jamie. I'll take the first part of that. In regards to Manhattan, we opened our Men's Store this past spring. It's the first time we ever had a men's-only store. And as we call it, it was opportunistic that we could get that space and open it over a year before our main store that will be mostly focused on women's. So we're learning a lot about operating a men's-only store. We're learning a lot about traffic trends in New York, particularly as summer comes along. But mostly, I think what we're really encouraged by is a lot of the qualitative response we've had from customers, from people in our industry who visited that store, the team we put together there, and we're encouraged by our long-term prospects. So a lot more to come there, particularly next fall, when we get the Tower open, and we'll really be able to have our full offer there and start serving Manhattan in a more robust way.

In regards to Canada, this past spring, we opened our first 3 Rack stores in Canada. Those were delayed. We'd hoped to have Rack stores opened earlier than this. And as we shared before, our Rack stores play a really critical role in allowing us to have a great flow of newness in our Full-Price stores. And so it's nice to get those stores open. I can tell you that we are exceeding expectations in those 3 Rack stores. The team has done a terrific job of getting them open. We've got 3 more opening this fall. And we think that by bringing our Rack business there, along with our Full-Price business, we'll start to be able to be offering more of the full Nordstrom experience. In addition, we continue to see opportunities to improve our flow of merchandise into Canada, getting across the border. It's different than shipping within the U.S. And we continue to see opportunities to improve our effectiveness there, and we're encouraged about getting after those opportunities in the back half of this year.

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

Okay, Brian. And then your question on leveraging digital capabilities, I think it's important to step back and look at the historical context. So if you look at the investments that we started making back in 2010, 2012, our investments in those 3 key capabilities, which is marketing, technology and supply chain, were growing at 20%. So there was a high-growth and high-investment period. From 2015 to 2017, we've bent the curve, and it went down to about 10%. And as we gave guidance for this year and also during the Investor Day, we spent quite a bit of time talking about this as well, is that our guidance on these capabilities is that it's growing at about mid-single digit. So we're continuing to bend the curve on this. I would say that -- and we talked about this in the Investor Day, but the 2 areas that we've already seen leverage in those areas are marketing and technology. And as we talked about in the Investor Day, supply chain is the kind of last frontier that we're focusing on. And the investments we're making in the West Coast, primarily in L.A., that Blake talked about in his script will help further that bending the curve in that cost model.

**Operator**

Next is Oliver Chen with Cowen and Company.

**Oliver Chen** - Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst

We were curious about, as you look forward to the holiday season, what are some characteristics that might be different from this year versus last year. Retail's definitely gotten fast in terms of just-in-time and buying close to need. So we'd love your thoughts with respect to that as well as digital. And just a quick follow-up on the merchandise margins. So the forecast for the merchandise margins, what are some of the aspects that we should think about in terms of markdowns versus AUC?

**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Yes, Oliver, this is Pete. Yes, for holiday time, it was mentioned that what we saw at Anniversary wasn't necessarily predictive of that. In years past, the Anniversary Sale was largely predictive of what was going to happen in the fall season. But we transitioned to a much more of a wear-now offer, which has been really good for our results. So I would need to be clairvoyant to tell you exactly what's going to happen for holiday time. But I think we're on a good trajectory in terms of what we're focusing on, and that is bearing fruit. So you heard about the strategic brands, and we increasingly have been working in a very kind of collaborative way strategically with that subset of brands to do things, like plan holiday. And for



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us, that means being the store of choice for gift-giving. We've got a lot of things that we think we can do to improve our gift-giving position, and so we're encouraged about that. One of the things that we've seen that's been a trend for a while that we think will play itself out also through the fourth quarter is just the ongoing casualization of America, and we saw that a lot through the Anniversary time, really, across all classifications. So I think more than anything else, we've kind of learned that the plans that we've had in motion have been validated largely by everything we've seen year-to-date. And then I think lastly, given the fact that our inventories are in relatively good shape and we're in a position where we can react, I think we feel like we're in a good position for the fourth quarter.

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

And Oliver, on your question on merchandise margins, so what we talked about today has reaffirmed the guidance we gave at the beginning of the year, that we expect modest merchandise margin improvement throughout the year or as we finish the year. So as we continue first half to second half, it was flat to slightly up, and I would expect to see the same thing in the second half as well.

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**Oliver Chen** - Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst

Okay, that's helpful. Last follow-up on the Rack. It's really great you made some really nice improvements there. It sounded like there's still parts of it that are work in progress. What are your thoughts on the state of your talent at Rack and things that you might need to do? I just would love context around where you think you are versus where there's incremental opportunity to get better.

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**Blake W. Nordstrom** - Nordstrom, Inc. - Co-President & Director

This is Blake, Oliver. We're very proud of our team leading the Rack. And we think these results are reflective of their efforts and their talents. But that said, there's always lots of opportunities with our business, and so we're really encouraged by those and believe some of the fundamental principles that they are particularly focused on represent tremendous opportunities as well as looking at it as an Off-Price. I mean, we are, this year, crossing the \$1 billion mark with our Nordstromrack.com and HauteLook business. And in the Off-Price world, there's really no one that has kind of our model and our approach and both that kind of multichannel/omni-channel experience in Off-Price that we have. And so we're excited about that and think that you'll see, going forward, continued improvement with those results.

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**Operator**

Next is Paul Trussell with Deutsche Bank.

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**Paul Trussell** - Deutsche Bank AG, Research Division - Research Analyst

I wanted to ask about the penetration this quarter and growth rate of your private label and limited distribution brands. And then second, while I know you don't break it out numerically anymore, if you can at least maybe provide some details on what you're seeing from a traffic, productivity and profitability standpoint of your business in-store.

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**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Yes, this is Pete. With regards to private label, we planned right at the very beginning of the year to have this be a growth year with private label, and we're still on that trajectory. So that continues to expand compared to last year. And with the strategic brands, I think you heard about how much of a business that makes up for us. That's growing, too. And when we say we're growing at 13% last quarter, so that obviously is outpacing the rest of our business. So it definitely has helped us in terms of our editing agenda and prioritizing, so making sure we're really investing the dollars where it's paying off most. And we definitely, again, feel like our strategy is the right one and will continue to bear fruit for a while.



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**James F. Nordstrom** - Nordstrom, Inc. - Executive VP & President of Stores

Paul, this is Jamie. I'll take the second part. In terms of store traffic, we've not seen a material change in our store traffic trends for quite a while now, frankly. Certainly, in the last few quarters, it's been pretty consistent. I think what's changed, and it has for everybody, is that when a third of your business is done online in any given market, the nature of that traffic is different. A lot of those customers are coming in having already decided what they want to buy because they've been shopping on our website, or they're coming in to get alterations on something they bought on Nordstrom.com or any number of different versions of a digital-to-in-store experience. And so part of our big opportunity is looking at our stores and figuring out how do we need to evolve the staffing model, the layout, the services and experiences that we offer in those stores to continue to be relevant to that customer who spent some time shopping on our website. When they come into the store, is their experience matching what their expectations are? And so that's a big focus of ours in Los Angeles. But for all of our major markets, we know that that's what the customer expects, and that's where our focus is.

**Operator**

Next is Ed Yruma with KeyBanc Capital Markets.

**Edward James Yruma** - KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst

I guess real quickly on Anniversary. Did you see a change, particularly as you head to more online, in return behavior? And I guess how do you deal with returns given that more of the inventory is wear-now? And then as a follow-up, were there any classifications or products that were particularly noteworthy?

**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Yes, this is Pete. I mean, clearly, the biggest difference with doing more and more business online is how that return rate impacts us, and usually, it has to do with the period of time by the time it gets sent to them, they receive it, if they decide they want to return it. So we're trying to do a better job all the time of having predictive modeling around how this will impact our results. And I think Anne spoke to some of it, how we think it's going to impact us in August. We have this incredible demand. We're going to probably have more returns, too. So that's part of it. And I'm sorry, the second part of your question was what?

**Edward James Yruma** - KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst

Were there any standouts from a performance perspective, classifications or products, during Anniversary?

**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Yes. The Beauty classification was the biggest standout for us, extremely strong. We had improvement in Shoes, which was nice. As you know, it's a big classification for us. Kids has done well. The other thing -- it was remarkably similar how the different divisions performed more so than normal, but what I would say is some of the things that set the different divisions apart is our regular-price business is really good. So we have so many people in the stores, and where we have newness and flow coming in, this is what's strong. And we noticed that, for example, in divisions like in the Designer part of our business, where our Designer business continues to be very strong, and that's almost entirely based on new deliveries.

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

So this is Anne. One thing I -- so Pete's actually correct on how we're looking at the returns. The one thing I just want to make sure you realize is that, consistent with how we've done this in past years as well, we take a look at that, and we set up a reserve what we anticipate those returns to

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be. So we've already contemplated, based on predictive analysis and historical trends, what that reserve is, and it's booked in the second quarter from a total sales perspective.

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**Operator**

Next is Erinn Murphy with Piper Jaffray.

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**Erinn Elisabeth Murphy** - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

I guess just going back to the Anniversary Sale in totality. You guys specifically called out the success you had online of 80% on day 1. Can you just quantify what the total sale performance was relative to last year? And then within the Anniversary Sale, can you speak to what you're seeing in Women's Apparel?

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

So overall -- so we don't really differentiate or give what the specific numbers are for Anniversary. What I can tell you is that, for the quarter, it was definitely in line with our expectations. And for the comps that we delivered, not only was Anniversary strong but also going into Anniversary. So overall, we had a very solid quarter.

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**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

This is Pete. With regards to how women's performed in Anniversary, it's a little bit of a mixed bag. As it all rolled up, it was pretty consistent with our other divisions. But we had really strong performance in most of the casual parts of the business that I've mentioned, and that really played itself out in women's. And in categories that we call more kind of the young customer categories, we had some success there, too.

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**Erinn Elisabeth Murphy** - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

Okay. And then just 2 more from me. Just, Anne, you just referenced in the answer to the former question on the sales return reserve, I think it was 900 basis points in the quarter. Did that impact Full-Line comp at all in the second quarter? And then just Trunk Club, any update on how that performed broadly in the quarter?

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

Yes. So let me just clarify. There's -- I would actually refer you to the press release, and there's specifics on the reserves. And Trina can talk to you guys off-line about how it works from an accounting perspective as far as how we look at that. From a comp perspective, it's pure comps. So it's handled the same way year-over-year, so it's really a pure number that you're looking at. On Trunk Club, what I would say is it's part of our generational investments. We continue to see -- we're very excited by where we're seeing that business model continue to play out and certainly see -- and as part of our Full-Price business, we see it's continuing to drive growth as part of our generational investments.

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**Operator**

Next is Dana Telsey with Telsey Advisory Group.

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

As you think about your business and categories, I think you have Anthropologie Home now in your stores. How do you think of taking a look at other categories and square footage by classification? Are there opportunities to flex, perhaps, with home or other categories that we should be thinking about?

**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Yes, Dana, this is Pete. You probably noticed from being in our stores over the years, what we've tried to do is have a more common floor surface with less-defined barrier so that we can contract and expand with different classifications as they're growing. And the Anthropologie example you used was pretty good. We don't have particularly large at Home departments, and when we got Anthropologie, that implied some furniture and stuff with that. So in many cases, because we have one floor surface on a floor like that, we have some flexibility where we could expand our footprint in at Home, and so we're able to do that in some cases. So we're just trying to keep -- have our whole physical setup being absolutely nimble and fluid as it possibly can be. Obviously, there's some limitations to that, but that's the theme that we've been on for quite some time when we talk about a lot strategically as a group of merchants, is making sure that we're really funding and chasing the things that are working and then working hand in hand with the stores to make sure that we got the floor space to do that.

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

And is Home a category that you find interesting?

**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Yes. It's interesting. We've had good growth just relative to last year. Comps in at Home -- gosh, it's been over a year now. Yes, for us, it's relatively small, so it means that there's a whole bunch of opportunity. And I think our biggest challenge continues to be the edit because that's a very broad category, and we don't necessarily have a whole kind of space, and we have the supply chain challenges of the size of the product you're shipping. So we are trying to be thoughtful about how to enter into that business and do it in a profitable way. And I guess I would describe it that we are really open to ideas. We are open to collaborating with people. We've considered a lot of different things, and we will continue to do that as we go forward.

**Operator**

Next is Omar Saad with Evercore ISI.

**Omar Regis Saad** - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

I wanted to follow up a little bit on the conversation around wear-now. It seems like a pretty interesting driver of some of the trends at the consumer level. Can you talk to us, maybe put a little -- a little into a historical perspective, how that has changed the share of the -- what's in the floor space and where we are now in terms of the wear-now percentage and how that's kind of helping drive the comps, maybe help frame it a little bit?

**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Yes, this is Pete. We don't really measure the percentage of business done with wear-now versus not. That would be pretty difficult to do. I think it just -- part of it's the way, I think, the digital and online part of the business affect it because people can buy things and get instant gratification that way and I think it is just the nature, they don't have to come in and buy things in preparation for several months down the road. They can wait a little bit. So what we used to see when we were all in this business years ago with buyers and merchants on the floor is you get people that would come in during Anniversary Sale and stock up for things in the fall and winter that they had no intention of wearing for a few months. That just

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doesn't really happen very much anymore. So that's just been a flow evolution that we continue to be on top of. And I think it impacts, obviously, the Designer business. You hear them talk about that, too, that shipping things so early in the season sometimes is difficult. And I think that's where some of the seasonless dressing comes in and that it's been easier for everyone to deal with it that way. But we also have the nuance of having businesses in Canada and Florida. So that has its own rhythm, too. Our allocation process is pretty sophisticated and challenging, just given, again, the diversity of our stores. If we want to really maximize the productivity in each location, we've got to be really good at that. And that's -- again, that's the journey that we're on, and it gets improved upon with technology and systems over time.

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**Omar Regis Saad** - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

That's really helpful. If I could -- can I ask a follow-up on kind of maybe a little bit more articulation on your social media strategy, where you think you are, how you're using social media across the different platforms and if you think there's more opportunity in some of those businesses?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Yes. No, it's been super positive for us. We really give our marketing team a lot of credit for being nimble in how we deploy those dollars. It's not dissimilar from many parts of our business. If you do a strict legacy approach, it's not super helpful. So we are really trying to keep a lot of our money flexible and kind of dry powder so that we can invest where it's working for us. So social media has been super impactful, and I think a large part of what made Anniversary successful was our ability to leverage social media platforms and direct-to-customer social media kind of channels and what have you. That's definitely played a big role in our marketing plan.

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**Operator**

Next is Matthew Boss with JPMorgan.

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**Matthew Robert Boss** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

So if you broke down full-line comps this quarter, with store traffic unchanged, as I think you said it earlier, any particular categories that are really driving the AUR improvement? Or is it more the inventory mix of clearance versus a year ago? And then just along those lines, do you believe the AUR increase that you're seeing today, do you believe that's a sustainable driver of comps going forward?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Well, this is Pete. This has been a theme for us for a long time. The regular-price part of our business continues to drive it, mainly coming through Anniversary. We really -- we've worked hard, actually, to try to clear as early as we could, so we weren't carrying that stuff over. And we haven't been 100% successful there, but that's an ongoing theme where we can get that stuff to the Rack earlier on and will pre-open the box for ourselves as we come through Anniversary and fall. So that's -- we've been on that theme for a while. I'm sorry, I didn't get the second part of your question.

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**Matthew Robert Boss** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Basically, if the comp today is AUR-driven, is it the mix of clearance, that you have less clearance on the floor today? And then as we think (inaudible) drive comps that's sustainable?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*



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It's not necessarily AUR-driven, although we do have some classifications with AURs higher where the business has been good. Our transactions are up. That's mostly what you're seeing.

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**Matthew Robert Boss** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay. So the traffic level were basically the same, but your number of transactions was higher with a little bit of (inaudible)?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

That's right. Our conversion was probably somewhat better.

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**James F. Nordstrom** - *Nordstrom, Inc. - Executive VP & President of Stores*

Yes. And this is Jamie. I'd just clarify. You may have picked this on what I said earlier. I was talking about store traffic. Store traffic's been consistent for the last several quarters. Online traffic, relative to our results, is up, and that's where you're seeing a lot of the growth. So yes, most of our comp increase is coming from more transactions. The biggest increase in those transactions is coming on Nordstrom.com.

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**Operator**

Next is Simeon Siegel with Nomura Instinet.

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**Simeon Avram Siegel** - *Nomura Securities Co. Ltd., Research Division - Senior Analyst of U.S. Specialty Retail Equity*

First, I'm sorry if I missed it. How many reward customers do you currently have? And what was the growth there this quarter? And then did you parse out the digital strength between Full-Price and Off-Price?

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

Who's taking this? Me? Okay. We have over 10 million loyalty customers. I'm sorry, what was the second part?

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**Simeon Avram Siegel** - *Nomura Securities Co. Ltd., Research Division - Senior Analyst of U.S. Specialty Retail Equity*

The growth of that number year-over-year.

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**Peter E. Nordstrom** - *Nordstrom, Inc. - Co-President & Director*

The growth? Yes, we're up nearly 20% there. So yes, it's growing well.

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**Simeon Avram Siegel** - *Nomura Securities Co. Ltd., Research Division - Senior Analyst of U.S. Specialty Retail Equity*

Great. And then within the digital strength, obviously very impressive, what was the -- how was Full-Price versus Off-Price?



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**Blake W. Nordstrom** - Nordstrom, Inc. - Co-President & Director

It's Blake. It was very similar. From a percentage point of view, Off-Price was slightly ahead, but it's a smaller base than Full-Price. But overall, very strong both in total over excess 20%.

**Operator**

Our last question is from Kimberly Greenberger with Morgan Stanley.

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

I had a question about Full-Price net sales. You talked about it in the press release being down 5%. I assume that relates to the Anniversary Sale shift, but I just wanted to make sure I understood that. And then the commentary about the shift in the Anniversary Sale inventory to more wear now styles and, as a result, not being predictive, as you said, of back half performance. When you say it's more wear-now, are you talking about summer transition and early fall goods that you're selling which may not be indicative, for example, of the winter product? I'm just -- I just want to make sure I understand that. And are you suggesting that there may be some shift, perhaps, out of Q3 into the Anniversary Sale as a result maybe of more compelling product each year in that sale?

**Peter E. Nordstrom** - Nordstrom, Inc. - Co-President & Director

Well, I'll let Anne take some of the math part. This is Pete. Related to wear-now, you're right. It's more about here we are in July and August, and the kind of stuff that someone will wear today isn't necessarily what they would wear in November. So in years past, we may have sold a disproportionate amount of coats, sweaters and boots. We don't as much now. We probably sell more knits and sandals and tops. So I mean, there's some nuance to this, obviously. It's not a complete one or the other. It's just a balance and a proportion and that we've learned over the years that the wear-now part of it is disproportionately more important than it used to be.

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

Yes, Kimberly, this is Anne. And I would refer you to the press release. There's a table in the back that has a footnote that describes the impact, the Full-Price total sales between Q2 and Q3 and the reversal. The only thing it has to do is that in the past, we held reserves for potential returns at total company. And with our segment change, we have now started allocating that out to the segment. So total JWN doesn't change. It's just the timing of when segments would have seen that. So last year, they would have seen that in Q3. This year, we were pushing it and then seeing it in Q2. So there's a specific footnote to describe that impact, and I would encourage you to talk to Trina off-line about that.

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

Okay, great. Sorry, just last quick question for you. The inventory looks like it's in great shape here. I'm wondering, with the 1 week later balance sheet close, was there a positive or a negative impact on your inventory because of that calendar shift?

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

Not meaningfully, no. So given the size of our inventory levels and the fact that we're in Anniversary Sale is really -- it really didn't have any impact.

**Trina Schurman** - Nordstrom, Inc. - Director of Investor Relations

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





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**Operator**

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

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