

Q1 2019 NORDSTROM EARNINGS CALL – PREPARED REMARKS

ERIK NORDSTROM

Thank you for joining us today. While we believe our customer strategy and business model position us for long-term success, our first quarter top-line results were well below our expectations. We had planned for a continuation of soft sales trends from the fourth quarter but saw further deceleration. Relative to the plans we shared at the beginning of the year, we successfully executed on inventory and expense, which helped mitigate our sales miss. We ended the quarter with inventories in solid shape, and our financial position remains strong. We're confident in our leadership team's ability to better serve customers on their terms and remain focused on achieving profitable growth.

During the first quarter, we had some executional misses with the customer experience, that had an impact on sales across Full Price and Off-Price, both in stores and online. We know we disappointed our customers, and we own it. We have identified three factors that contributed to this sales miss: loyalty, digital marketing, and merchandise. These areas are within our control to turn around, and we're already taking steps to course-correct and drive the top-line. I'd like to provide insight into what happened and how we're addressing all three areas.

Beginning with loyalty –we have a well-established program with nearly 12 million active customers contributing more than 60 percent of sales in the first quarter. Last fall, we evolved the program with the introduction of The Nordy Club, which allows customers to earn reward notes faster and provides early access to product and events. However, the execution of our rollout was not as successful as we had planned. As part of our decision to move to a digital-first program, we eliminated paper notes – but later discovered that a segment of our customer base relies on receiving these notes by mail. As a result, we saw a reduction in traffic across Full-Price and Off-Price. We are resolving these issues and our initial results showed improving trends for engagement, traffic and spend from our loyalty customers.

The second factor is related to digital marketing. We deliberately reduced our digital marketing as we shifted resources to loyalty. With The Nordy Club rollout not ramping as we had projected, we experienced incremental traffic declines in our business. We have since increased our investments in digital marketing to drive traffic and sales.

The third factor was merchandise. The breadth of our offering – across brands, price points, and styles – is a key differentiator in serving customers. We have opportunities to rebalance our assortment mix to better resonate with customers in Full-Price and Off-Price. This includes Women’s Apparel, which continued to have the toughest results in Full-Price. Beauty was another callout for the quarter, given the highly promotional environment and increased out-of-stock levels. It will take some time to adjust our merchandise assortment, but we have already started this process and expect improvement in the second half of the year.

All three factors – loyalty, digital marketing, and merchandise – contributed to a slowdown in digital sales growth of 7 percent in the first quarter, relative to last year’s annual growth of 16 percent.

We’re making the changes we believe are necessary to drive our top-line as we continue our aggressive focus on expenses, which Anne will discuss in more detail. Our strength is our commitment to the customer, and we know we have areas for improvement. Over the years, we have managed through many cycles, which give us confidence in our ability to adjust our business to better serve customers.

Our entire leadership team has a high degree of urgency to improve our top-line and profitability. Additionally, the team is focused on executing the following three key strategies this year:

- First, our local market strategy enables increased customer engagement through services and greater access to merchandise selection, with faster delivery, and at a lower cost to us. Last year, we launched in Los Angeles, our largest market, with four full-line stores and three Nordstrom Local service hubs. During the first quarter, we continued to see positive outcomes with outsized growth in digital sales and store traffic in this market. In addition, nearly one-third of order pickup services are done in our three Nordstrom Locals. We're planning to reach scale in the LA market, including 16 full-line stores, by further leveraging inventory through our supply chain investments.
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- Moving to our second key strategy, our market share gains in Los Angeles give us added confidence as we expand our presence in New York City, our largest market for online sales. We are on track to open our flagship on October 24th, along with two Nordstrom Local hubs this fall. We expect these physical assets to greatly add to our ability to engage with customers across multiple touch points. We know that engaged customers spend more, which is expected to result in a meaningful sales lift for this important market.
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- With our third strategy, we're focused on improving the customer experience during our two key events. Our Anniversary Sale is a unique event, offering brand new arrivals at reduced prices for a limited time. We're curating our assortment to focus on our customers' favorite brands. We're also extending the pre-shop period for our top loyalty customers. For Holiday, we're aiming to make Nordstrom more of a gift-giving destination for both new and existing customers. This includes amplifying our gifting assortment, across categories and with more accessible price points.

In closing, we own our results, and we're focused on getting our sales back on track. As always, the customer is at the center of everything we do, and through that lens, we're committed to better serving them on their terms. Now Anne will discuss our financial results and outlook.

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ANNE BRAMMAN

Thank you, Erik. I'd like to reiterate that we have taken immediate action to better serve customers, drive top-line and improve profitability. As we continue to focus on making our business more efficient and productive, we're aggressively bending the expense curve and managing our inventories.

Turning to our top-line results: total company sales were down 3.5 percent, with Full-Price down 5.1 percent and Off-Price down 0.6 percent. The drivers of our sales shortfall – loyalty, digital marketing, and merchandise – contributed to decelerating trends in our key operating metrics, which include trips and customer engagement.

Although we missed our sales expectations by several hundred basis points, we were able to offset roughly half of this miss through our merchandise margin and expense performance. In fact, the sales shortfall in Off-Price was fully offset by the team's ability to control expenses and manage inventory levels down significantly.

Moving to gross profit, our rate was down 60 basis points relative to last year due to planned markdowns and occupancy deleverage. We ended the quarter in a solid inventory position, with a positive spread of 180 basis points relative to sales. This allows us to be agile in responding to changes in customer expectations. As we continue into the second quarter, we have planned

inventory based on current sales trends, and we remain disciplined in our buys as we work to improve our merchandise offering.

From an expense standpoint, our SG&A rate increased 168 basis points relative to last year. This was entirely due to fixed cost deleverage on lower sales. We're making further structural enhancements to our operating model as we implement several efficiency initiatives related to three areas: improvements to our store operating model; productivity gains in technology and supply chain; and reduced discretionary spend.

We expect these initiatives to ramp up over the year – and we're ahead of our plans with \$35 million realized in the first quarter. This included operational changes in stores to better align with how customers are shopping. For example, we're improving services that have a direct customer impact, such as order fulfillment in full-line stores and faster checkout at the Rack. All these initiatives represent permanent reductions in our cost structure, which positions us well for strong EBIT flow-through going forward.

Another lever of improved profitability is our generational investments. Over the past decade, we invested early in our digital capabilities and new markets. This is the last year of our generational investment cycle, and we're already seeing returns. These investments are continuing to scale and are expected to deliver top-line growth and improved profitability this year.

Our financial position remains strong, enabling us to be flexible in changing business conditions. We have a healthy balance sheet and generated annual operating cash flow of more than \$1 billion over the past decade. Our consistent and balanced capital allocation approach enables us to maintain an investment grade credit rating. We also returned approximately \$250 million to shareholders through dividends and share repurchases during the first quarter.

Moving to our annual outlook, we revised EPS from a range of \$3.65 to \$3.90 to a range of \$3.25 to \$3.65. This incorporates a sales decline of 2 percent to flat growth for the year, relative to our prior outlook of a 1 to 2 percent increase. We expect it's going to take some time to see improvement as we further adjust our merchandise offering and lap the operational issues from The Nordy Club rollout. We anticipate first quarter trends to continue into the second quarter, with gradual improvement beginning in the second half of the year. For credit revenue, we're planning for a low- to mid-single-digit increase based on our current sales trends.

From a bottom-line perspective, we expect an EBIT margin range of 5.3 to 5.8 percent, compared to our prior outlook of 5.9 to 6.1 percent:

- From a gross profit and SG&A perspective, the change in our assumptions is driven by greater fixed cost deleverage from lowered sales expectations.
- We expect gross profit, at the mid-point of our outlook, to be relatively flat to last year. This reflects improved merchandise margins offset by occupancy deleverage.
- For SG&A, we expect moderate deleverage, when excluding the estimated credit charge in 2018. We've also incorporated expense savings at the high end of our original range of \$150 to \$200 million. These savings are expected to be back-half weighted as we make further progress on our various initiatives.

For the second quarter, we expect our Anniversary event to perform in-line with our current sales trends, which has been our historical experience. Our second quarter gross profit rate deleverage is planned similar to Q1, due to lower sales. We also expect SG&A to deleverage, but to a lesser extent than Q1 due to further expense savings.

Specific to Anniversary, we're making changes to improve the overall economics of the event. As a result, we expect expanded merchandise margins in the third quarter from better sell-

through of Anniversary product, which should result in lower markdowns. Please also refer to our slides for additional color on our quarterly timing assumptions.

In closing, we're making hard choices as we focus on better serving customers, driving top-line, and improving profitability. We know we must demonstrate this commitment with our results in the coming months, and look forward to updating you on our progress. I'll now turn it over to Trina for Q&A.