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JWN - Q4 2016 Nordstrom Inc Earnings Call

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OVERVIEW:

Co. reported 4Q16 results. Expects 2017 total sales growth to be 3-4% and diluted EPS to be $2.75-3.00.

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PRESENTATION

Operator

Greetings and welcome to the Nordstrom fourth 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.

Trina Schurman - *Nordstrom Inc - Director of IR*

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

Before we begin, I want to mention that our speakers will be referring to slides which can be viewed by going to Nordstrom.com in the Investor Relations section. Today's 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 Mike Koppel, Chief Financial Officer, who will discuss the Company's fourth-quarter performance and the outlook for FY17. Joining during the Q&A session will be Pete and Erik Nordstrom, Co-Presidents, and Jamie Nordstrom, President of Stores. With that, I'll turn the call over to Blake.

Blake Nordstrom - *Nordstrom Inc - Co-President*

Good afternoon, everyone. With customer expectations changing faster than ever, it's important that we remain focused on the customer.

Our strong financial position has enabled us to make significant investments over the past five years. Through these investments, we have been able to strengthen our foundation and grow our business. And as we move forward, this gives us a platform for enhanced capabilities to better serve customers and increase market share. While we are mindful of the ever changing and challenging retail environment, it also presents us with many opportunities.

Our focus in 2016 was to improve both the customer experience and our productivity. We've been pleased with our team's efforts to adjust our operating model to meet the changing needs of customers. These efforts, particularly around inventory management and operating efficiencies, have contributed positively to our results.

Our fourth-quarter comp sales decreased 0.9%. While this was consistent with recent trends, it was below our plan, particularly for our full-line store business.

Early in the year, our team took aggressive steps to realign inventory in response to changes in customer demand. As a result of these efforts, fourth-quarter sales growth outpaced inventory growth by nearly 500 basis points. This enabled the flow of newness and resulted in fewer markdowns, which contributed to our gross profit increased of more than 100 basis points.

For our Nordstrom brand, inclusive of our full-line stores, Nordstrom.com and Trunk Club, comp sales decreased 2.7%. While we're not satisfied with these results, it's worth noting that we continued to see a greater share of our business shifting to regular price. Promotional sales in response to the competitive environment lessened relative to last year, demonstrating our momentum with growing relevant brands including limited-distribution product.

For our Nordstrom Rack business, inclusive of online, comp sales increased 4.3% in the fourth quarter. For the year, our increase of 4.5% exceeded our plan.

As we look ahead, we're focused on speed, convenience and personalization, culminating to our most important goal of improving service. We currently offer a number of ways to serve customers on their terms, wherever and however they shop. As an example, we began offering buy online pick up in store back in 2008. To make this a more convenient experience, we added curbside delivery in all of our US full-line stores and enhanced the overall experience. In 2016, we had an encouraging increase in buy online pick up in store sales volume of 45%.

In 2017, we're implementing several initiatives that are focused on our strategic pillars of product, as well as service and experience.

From a merchandising perspective, we strive to offer a curated selection of the best brands. This includes limited-distribution names such as Ivy Park, J.Crew, Good American as well as our Nordstrom exclusive brands. As we look for new opportunities through our vendor partnerships, we will continue to be purposeful in editing our assortment to facilitate newness and discovery.

In our full-price business, we completed a successful pilot of a mobile feature that gives customers the ability to reserve merchandise online and try on in our stores. Since the launch last fall in six Seattle area stores, we had over 10,000 customer reservations. Based on this strong response, we're planning to expand to 50 full-line stores this year.

We will also continue to enhance our digital selling tools to support new ways of serving customers seamlessly across all channels.

In our off-price business, we are further integrating the digital and store experience. For example, we recently added a feature in the mobile app that allows customers to scan an item and buy it online if the color or size is not available in the store.

In addition, last October, we tested a new store design at the Rack with improvements to the store layout and fitting room experience. This format will be Incorporated in most of our 17 new stores planned this year.

Looking over the longer term, we know that changes in retail and customer expectations will continue at an accelerated pace. We have a high-quality store portfolio, which gives us an opportunity to fully leverage our local assets -- our people, product and place -- to solve customers' unmet needs.

In that regard, last month, we asked one of our top leaders, Geevy Thomas, to head up our efforts to reimagine the customer experience. He brings over 30 years of experience in many areas of Nordstrom, including full-line stores, merchandising and most recently at the Rack. He and his team will have the ability to move quickly and boldly to find and test new solutions for serving customers into the future.

In closing, we have good momentum in place and we will continue to make changes to ensure we are best serving customers and improving our business now in into the future. I'd like to now turn it over to Mike to give additional color on our current performance and outlook for 2017.

Mike Koppel - *Nordstrom Inc - CFO*

Thanks, Blake. Our 2016 results demonstrated our team's speed and agility in responding to changes in business conditions, and in making fundamental improvements to our operating model. Throughout the year, we took aggressive actions to prioritize our resources and optimize inventory turns.

These efforts have translated into stabilized retail operating margins over the past three quarters combined. We also generated operating cash flow of $1.6 billion for the year, well surpassing our five-year historical average of $1.2 billion when excluding the sale of our credit card portfolio. This reflected working capital improvements largely driven by a 2.5% reduction in inventory. We also delivered free cash flow of $550 million for the year, which also benefited from a 20% reduction in capex from last year.

Our fourth-quarter earnings exceeded our expectations, reflecting continued momentum in our inventory and expense execution. As Blake mentioned, our gross profit expansion of over 100 basis points had a meaningful positive impact on earnings. This reflects our strategies around product differentiation, which includes our ongoing efforts to grow limited-distribution brands and private label. We believe that over the long run, these strategies support a sustainable regular price selling business which mitigates the impact of promotional activity in the marketplace.

We are encouraged that even through this current environment, we achieved record sales of $14.5 billion for the year. As we evolve with customer's changing expectations, we've made investments to fuel multiple growth areas.

Starting with our expansion into Canada. Our five full-line stores, including two which opened last fall, contributed total sales of $300 million in 2016. As we've previously shared, we believe this market represents a $1 billion opportunity consisting of 6 full-line stores and 15 to 20 Rack stores.

Second, our total online business reached over $3 billion, growing roughly 30% on an annualized basis since 2010.

Third, our off-price business reached $4.5 billion and continues to be our largest source of new customers, gaining around 6 million in 2016.

And finally, we had a strong customer response to our expanded loyalty program with 3.7 million customers joining through our non-tender offer. We ended the year with a total of 7.8 million active Nordstrom rewards customers, an increase of over 55% from last year.

Looking forward, I'd like to spend some time discussing the evolution of our business model. As we evolve with changing customer expectations, our business has shifted from a four-wall model to one that supports multiple channels. This reflected significant investments to fuel growth over the past five years in both e-commerce and new markets. E-commerce now represents nearly one-quarter of our business compared to 8% in 2010.

While we improved profitability in our core business during this time, this accelerated shift to e-commerce has impacted our overall profitability. This dynamic requires us to make fundamental changes in the way we operate. In 2016, we made significant progress in improving our productivity, particularly around technology, supply chain and marketing capabilities. Over the past five years, spending in these areas grew by 20% on average. In 2016, we were able to bend that trajectory cutting the growth in half.

This is just the beginning of our progress. As we head into 2017 and beyond, we will continue our efforts to reshape our business model to support long-term profitable growth.

The other element impacting our near-term profitability is our investments in new market opportunities such as Nordstromrack.com and HauteLook, Canada and Trunk Club. We're beginning to realize benefits from these investments.

In 2016, they collectively contributed $1.2 billion to our top line. Going forward, we expect improved operating performance as they begin to scale. In addition, 2017 includes pre-opening costs of roughly $30 million related to our Manhattan flagship store.

Now I'd like to discuss our outlook. Starting with the capital plan, we expect to invest roughly $3.4 billion over the next five years. This is approximately 4% of sales, lower than the five-year historical average of 5% due to moderating store investments. With technology and supply chain as a key enabler of delivering customer experiences, roughly 40% of our plan is allocated towards modernizing our tech platform, delivering digital and mobile enhancements and expanding our fulfillment network.

Also, as we shift to a cloud-based platform, the nature of our tech spending is transitioning from a build to a rent model. To get a holistic perspective on technology, we plan to incur in total a cash spend of roughly $540 million in 2017 or 3.5% of sales.

While this is generally consistent with our run rate over the past couple of years, our goal is to continually increase our productivity to support accelerated delivery of customer-facing features. In 2016, we were able to rollout features 3 to 4 times faster versus a couple years ago, with further opportunity for improvement.

Finally, I'd like to discuss our 2017 financial outlook. We expect earnings per diluted share of $2.75 to $3.00, which incorporates total sales growth of 3% to 4% and flat comp sales. This assumes a continuation of negative trends in our full-line stores offset by outsized online growth.

Our outlook incorporates relatively stable gross margins, while taking into account the negative mix impact from Rack's growth. As we head into 2017, we are in a clean inventory position with plans to maintain inventory growth in line with sales trends. Additionally, our focus on product differentiation, which includes limited-distribution brands and our private label, supports our ongoing efforts to strengthen our regular price selling business.

From an SG&A rate perspective, our outlook includes continued technology and fulfillment investments, supporting multi-channel growth in addition to incremental costs related to Manhattan. Please also refer to our slides for further assumptions regarding our outlook.

We are pleased with our progress in prioritizing resources, improving our productivity and increasing our speed of execution. As we position our organization for future success, we still have work to do as we realign our resources and capabilities to better serve new and existing customers consistent with the revolving expectation of the Nordstrom brand.

One more thing. As this is my last quarterly earnings call with Nordstrom, I'd like to thank both the research and investment community for their support and curiosity for our business. We've always strived to provide a differentiated experience for our customers, which also means evolving our business.

The underlying value to both customers and shareholders is the brand that has been built by our customers and supported by company leadership. As customers' expectations continue to evolve, I'm very confident that the leadership and strategy will continue to elevate the Nordstrom brand. Thank you. Now I'll turn it over to Trina for Q&A.

Trina Schurman - *Nordstrom Inc - Director of IR*

Thank you, Mike. Before we get started on Q&A, we'd like to ask you limit to one question. If you have additional questions, please return to the queue. We will now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matthew Boss, JPMorgan.

Matthew Boss - *JPMorgan - Analyst*

Thanks. Mike, congrats on your last call, first off.

Mike Koppel - *Nordstrom Inc - CFO*

Thanks, Matt.

Matthew Boss - *JPMorgan - Analyst*

My question is on the flat same-store sales guide, anything for us to consider in terms of the front end versus the back half of the year? And just on the retail EBIT guide, it implies I think 80 basis points of contraction on a flat comp in terms of margin. If comps were to come in negative this year as opposed to that flat, just what level of expense flexibility do you guys have to hold margins?

Mike Koppel - *Nordstrom Inc - CFO*

Well, Matt, let me take the first part of your question and that's the pace of sales over the year. While we don't give quarterly guidance, clearly last year in the first quarter was pretty disappointing, and that was a period of time when a lot of us changed expectations for the year. So I would expect going up against softer numbers at the beginning of the year might be a little bit helpful, but generally speaking there's no other material change other than that the Anniversary Sale will go back to its normal cadence between Q2 and Q3.

As far as the retail EBIT being down, I think that's a reflection of the soft business we continue to see in our full-line stores that's causing contraction there. Interestingly enough in 2017, we're starting to see the profitability of the online business crossover to a higher margin than the store base business, and as that continues to scale we expect to see improvement. In addition to that, there's the investments that continue to keep a little pressure on that.

In terms of the impact of any other reduced sales, most of that comp sales reduction has been coming from the full-line stores. And clearly with a commission-based model, we tend to see some positive leverage that comes from that. And I think in addition, as I mentioned in my comments, we continue to look for ways to readjust our operating model to make it more efficient.

Matthew Boss - *JPMorgan - Analyst*

Great, best of luck.

Operator

Bob Drbul, Guggenheim.

Bob Drbul - *Guggenheim Securities LLC - Analyst*

Hello, Mike, the best of luck and congratulations and thanks for everything over the years.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, Bob, thank you.

Bob Drbul - *Guggenheim Securities LLC - Analyst*

To follow Matt's question, around the full-line store when you look at the comp results in the full-line store, what are the biggest initiatives to manage the expense piece in that area of the business right now?

Jamie Nordstrom - *Nordstrom Inc - President of Stores*

Hey, Bob, this is Jamie. I will take that one.

Our full-line stores for a long time have been really productive stores, and our focus on productivity isn't changing. What is changing and it's being driven by customers is how they want to shop and the kinds of experiences that they want to have. So we've got opportunities to adjust our service model in our stores that both are more tailored to how customers want to shop, both the speed at which they want to have an experience or the type of experience they want to have as well as be more efficient with our staffing model.

So we see opportunities, we have been testing that this year. In fact in 2016, we implemented our very first labor scheduling tool, and we'll be getting mature on that this year. But also things that Blake and Mike mentioned around buy online and pick up in store growing at around 50%, rolling out store reserve.

These are low touch experiences where a customer comes in and has a great experience, buy a whole bunch of stuff in literally a few minutes without as much labor being needed. So we see opportunity in both the near and longer terms around being more efficient with our labor dollars in the stores as a percent of sales and continuing to drive productivity out of them.

Bob Drbul - *Guggenheim Securities LLC - Analyst*

Great. Thank you very much.

Operator

Lindsay Drucker Mann, Goldman Sachs.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

Thanks, good evening, everyone. I wanted to ask on Rack stores, on the new stores, could you talk about what you are seeing as far as new store productivity goes for the ones you have recently opened? And maybe if you are seeing -- and what the maturity curve looks like today? And maybe if you are seeing any difference in the comp, in the store comp trend, by vintage or you called out region for the company, so maybe just by vintage?

Blake Nordstrom - *Nordstrom Inc - Co-President*

Lindsay, this is Blake. On the newer stores, it's meeting and exceeding our expectations. There is a little bit of transfer business as we fill in some markets with our comp stores.

I think where we have seen some variability in the last couple of years is what we call non-comps. It's those stores that are moving from a new store to a fully comp store basis that they are in between. So there is a maturity curve as you just alluded to, but overall the sales productivity for our Racks have held fairly consistent.

We haven't seen a decline in that as we have added new stores. They are very productive and it's still a real good use of the shareholders' investment dollars.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

And maybe the differential by vintage, if you are seeing any difference in comp trend?

Blake Nordstrom - *Nordstrom Inc - Co-President*

We really don't break that out publicly, so I think my comments would just give you the general overtone of how we look at it.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

Okay, great. Thanks very much.

Operator

Kimberly Greenberger, Morgan Stanley.

Kimberly Greenberger - *Morgan Stanley - Analyst*

Great, thank you. I'm wondering if you can just talk about how over the last 3 to 4 years as your business has evolved to be more of a multi-channel business. I would assume that means you are getting to scale in e-commerce and the margins there are improving at the same time the stores perhaps seem to be seeing a bit of slippage in the margin rate.

Can you just give us a little bit of color on how the margin performance in each of those channels has evolved? And do you think we're likely to see some level of stabilization let's say in 2017, 2018? The guidance would seem to suggest you're still expecting some deterioration here, so I'm just wondering how we should think about it let's say on a three-year outlook. Thank you so much.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, Kimberly, this is Mike. Back the first part of your question on where we are with the margins, I mentioned a few minutes ago that we're definitely seeing those two lines crossing the margins and the e-commerce business are starting to surpass the margins in the store business. And that to your point has been about scale.

The challenge with the whole model has been having an accelerating business that has a high variable growth component, and a decelerating business that has a high fixed cost component, which both work against you. I think we made great progress in figuring out how to be more efficient on the e-commerce side, and we're starting to see that. And as Jamie mentioned, we are making some good progress on the store side.

Which leads us to the second part of your question, and that is when do you see stabilization? It's tough to answer that until you reach equilibrium, and I don't think we've reached equilibrium in terms of where store sales and e-commerce sales start to level out. And so until we reach that, I think you are going to experiencing some of this.

Fortunately, that's just a portion of our model. We have a lot of things going on in the off-price side that's driving some really good growth, and we have some new markets that we've been expanding that's driving some really good growth. So as we continue to make those adjustments going forward and the investments we have made, we continue to believe that all those collectively will put us in a position that we can grow earnings.

Kimberly Greenberger - *Morgan Stanley - Analyst*

Great, thank you.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, Kim.

Operator

Omar Saad, Evercore ISI.

Omar Saad - *Evercore ISI - Analyst*

Thank you. Wanted to get you guys to dive in a little bit on the full-line comps. I know it's -- the trends there, are what they are and it's not dissimilar to what other mall-based players are seeing. But how are you thinking about evolving that channel and the importance of that channel and strategies to get that traffic back up in the positive range again?

Jamie Nordstrom - *Nordstrom Inc - President of Stores*

Sure, Omar. This is Jamie, I will take that one.

Clearly we've got some headwinds that we have been experiencing for the last couple years. It's been well documented and reported on around other people that do what we do and mall traffic and I think our overall category. What we are encouraged by, particularly in our most recent results, is a move away from a promotional stance.

Our industry has been really promotional for the last couple years. It's been driven by higher inventories, and that's not our business. And of course we have to compete with that, but as that has cleaned up that's impacted our results pretty positively.

Our inventories are in good shape, the industry has gotten less promotional, and as a result we are selling a larger percentage of our sales at a regular price and that's when we are the healthiest. When we can be bringing in a consistent flow of new merchandise for people to see, keep that merchandise turning and selling things at full price, good things happen and we definitely felt we've turned the corner on that over the last quarter or so.

Next step is to get transactions going. Transactions is a proxy for traffic, and it's been declining for the last couple years. We see opportunities to drive traffic through new experiences.

I mentioned some of the digital experiences that we have already rolled out. We have got a number of initiatives we will be rolling out in the next year or two. Store reserve is a good example where we can use our stores to really connect our online experiences and our store businesses in a pretty profound way.

So the blending of the digital experience across the customer's entire shopping journey is a place we've been investing in for some time, and we think we are in early innings on being able to maximize the foundation and the capabilities that we have there. So we don't want to get in a lot of specifics about things we're going to be rolling out this year, but we look forward to over the next few quarters to be able to share you some results.

Omar Saad - *Evercore ISI - Analyst*

That's really helpful. And I'm sorry, I have to ask. Did you see any change in trend in your business at all around the president's tweet, whether it helped you or hurt you at all? Is that something you can comment on?

Pete Nordstrom - *Nordstrom Inc - Co-President*

This is Pete. No, that would be negligible. I think it's not really discernible one way or the other.

Omar Saad - *Evercore ISI - Analyst*

Okay, thanks. I was curious.

Mike Koppel - *Nordstrom Inc - CFO*

Thanks, Omar.

Operator

Ed Yruma, KeyBanc Capital Markets.

Ed Yruma - *KeyBanc Capital Markets - Analyst*

Hello, good afternoon. Thanks for taking my question. Mike, best of luck always for all the help.

Mike Koppel - *Nordstrom Inc - CFO*

You are welcome, Ed.

Ed Yruma - *KeyBanc Capital Markets - Analyst*

Obviously you guys have talked a lot about the full-line comp, but to further explore, do you think these are transitory issues that are causing the difficulty of traffic or the full-line business? Or are you of the thought that these are more permanent shifts and that this is the comp level that you think you're going to have to manage against going forward? And if so, how do you think about the size of the overall store footprint? Thanks.

Jamie Nordstrom - *Nordstrom Inc - President of Stores*

Ed, this is Jamie, good question. I'll take the second part first around the footprint.

We have roughly 120 full-line stores today, all of them make money, they're all cash flow positive, and we have overall a very healthy fleet of stores. We have over the last couple of years closed a few. We've have announced one closure this year. That's probably a pretty good pace as we look out over the next 5 to 10 years, that there's some stores in older centers that we think we can close that store and consolidate that business into stores nearby that we are investing in.

So the way that we are looking at our fleets, it has evolved for sure. For one thing, we look at stores that are the only store in a market and they have a huge impact on our overall ability to gain market share in that market. Because it's not just the business we do in the four walls of that store, it's also the online component.

And so if we look at a city where we've got one store, that may only be 50% 60% 70% of the business we do in that city once you add in the online component. So we think that we will be looking at those stores differently in terms of how we invest in those stores. On the flipside, the fourth or fifth or sixth store in a market, we might look at differently today than we did in the past in terms of the roll that it plays in driving business.

So you've got two sides to the coin there. We think we have an opportunity to invest in those best stores in those malls that the developers are investing in and are creating better experiences. They are doing great, and the malls that are not being invested in are not and those are some of the stores you might see close.

But overall, to the first part of your question, yes. People said there's a shift away from buying things to experiences, and I think you can see that around a lot of different parts of our industry. It's debatable whether that's a secular thing or a cyclical thing.

We are focused on having something new for the customer that they didn't know they wanted to buy. And if we think we can stick to our knitting and focus on being that place of discovery, being that place where you come to find something new, that that's a winning strategy over the long term.

Ed Yruma - *KeyBanc Capital Markets - Analyst*

Thanks so much.

Operator

Heather Balsky, Bank of America.

Heather Balsky - *BofA Merrill Lynch - Analyst*

Hello, thank you, on for Lorraine Hutchinson. I wanted to ask, first, where are you in the process of replacing promotional brands? Are there still brands that you want to exit or reduce?

Then on a different note, are you seeing any -- you've talked about seeing changes in how the customer shops and what she wants. But are you seeing changes in terms of when she shops? There have been some retailers who have come out and talked about even the high-end consumer is waiting for the newest fashions, and at the same time appointment shopping is becoming more prevalent. Thanks.

Pete Nordstrom - *Nordstrom Inc - Co-President*

This is Pete, I will try to answer those. The promotional brand thing is an ongoing dynamic that we look at. I think the arc of a brand's viability and desirability by a customer maybe has been shortened.

And so there is quick ascension for brands that are a really hot brand, but they can fall off rather quickly too. And I think it has a lot to do with the brand's decisions around distribution and how ubiquitous they are out there and in what channel.

So this is something that we look at all the time. We look at the level of promotional business that's being done at each brand, then we use that to get to the average. It's a big lever for us to not have to be taking unnecessary promotional markdowns, so we're definitely interested in doing less promotional business and in some cases that means not be doing business with some vendors.

So that's an ongoing thing. It's a big one for us. And I think the encouraging part of that is for as many brands there may be that become over promotional online, there's still new ones that come along that are super viable and have a big interest to customers. And we've got a lot of positive examples to be applying energy toward.

So I guess I would say that our merchandising group is feeling pretty optimistic about knowing where to pour on the gas, so to speak. In terms of when she shops, I don't know if I understand that question exactly. You mentioned something about appointments, can you elaborate what you mean about that?

Heather Balsky - *BofA Merrill Lynch - Analyst*

Yes, sorry. I guess we are hearing -- well there's two things. One, that the high-end consumer who used to buy a coat in the summer is now waiting till the weather turns colder. Which seems to be new, the high-end consumer tended to by earlier in the season. And the other part of it is in terms of appointment shopping, more shopping around events like a Mother's Day or maybe a sale or that sort of thing.

Pete Nordstrom - *Nordstrom Inc - Co-President*

I think it's true that customers are much more interested in buying now, wearing now. The idea that they would buy something and then put in their closet for a couple months until the weather changed is not -- that's changed a lot over the years. That's just not a great scenario for us. We talk a lot about making sure we have got the product in the store at the right time for customers.

I would also say that there is more movement around seasonless kinds of product, things that can be worn all year long. And we find, particularly since we do a lot business in southern states with warmer climates, that that's where you see that happen to a greater degree. You still have weather drive a lot of this in colder weather markets around coats and what have you, and that's fairly predictable.

In terms of the shopping happening at specific times of the year, that is true. Events, holidays, what have you drive a lot of business. And I would say a recent example of holiday and we've seen this for the last several years, it continues to get more and more contracted where we still do a lot of business over a six-week timeframe and it gets concentrated increasingly into that last week. So we might feel like well the holiday season isn't going very well, and then that last few days it's amazing how we make up for it.

So the net of all that is we're still doing the business, it's just happening in a more concentrated timeframe. So I think along the lines of what Jamie is talking about and how to service customers, it's important that we become increasingly efficient and super purposeful about how we allocate inventory when and where. And so the supply chain logistics, all of that becomes a very important part of what we're doing and we've gotten better at that over the years too.

Heather Balsky - *BofA Merrill Lynch - Analyst*

Okay, thank you so much.

Operator

Tracy Kogan, Citigroup.

Tracy Kogan - *Citigroup - Analyst*

Thanks. I was wondering what you guys are seeing on the competitive landscape for Rack? I guess both competition for compelling product and also competition for customers? I was wondering if there's any competitive factor hurting the store comps there, or do you think is it really just the online business cannibalizing the stores? Thanks.

Blake Nordstrom - *Nordstrom Inc - Co-President*

Tracy, this is Blake. It is, like all other areas of the business, a competitive area and there's been quite a bit of growth, so there is more choices for the customer in off-price and in the value segments. We don't situate or compete as much in some of the outlet malls. We find where our best success is closer to our full-line stores, there's a real synergy with our customer back and forth.

So in many cases, we are not in location wise right next to some of those competitors that you traditionally might think about. We think the challenges we have had if there's any been of any softening in comps over the years has been opportunities on our end with our execution.

And in cases with our accelerated growth where we are -- we have very productive stores and we're opening in another store in that market trade area, and so it's a win for Nordstrom Inc. and JWN. But that individual store might see a slight -- in the short-term -- reduction in some of their key metrics. So overall, yes, a competitive landscape, but we are still very encouraged by our strategy within the off-price industry both online and within the stores and we are very optimistic about the future prospects.

Mike Koppel - *Nordstrom Inc - CFO*

Tracy, I would just add one thing to Blake's comments is that keep in mind, we have grown the online portion of that business to almost 20%, it's roughly 20% of our off-price business now. We don't believe there's anybody else out there in that space that has that kind of penetration online and off-price. So I think when you look at the combined businesses, which has been averaging 4% to 5% growth, I think we are right up there in terms of taking market share.

Tracy Kogan - *Citigroup - Analyst*

Great, thank you, guys.

Operator

Bilun Boyner, RBC Capital Markets.

Bilun Boyner - *RBC Capital Markets - Analyst*

Thanks for taking the question. So just wanted to ask about the growth investment, looks like you're guiding for HauteLook Canada and Trunk Club investments to decrease by about $45 million in 2017. I just wanted to see how that compares to your internal plans a year ago, and if there is one of the growth areas that is approaching profitability or lowing expenses faster than you planned or alternatively any one of those lagging? So just wanted to see how those growth investments are tracking.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, this is Mike. In terms of what's driving that, clearly I'll start with the HauteLook and Nordstromrack.com. That business over the last several years we've seen some great growth that was really accelerated when we started to integrate it with the Rack stores, and we started taking returns in the stores and we started to bring those two brands together.

That business has moved from being an operating loss, and it's moving into 2017 slightly beyond breakeven where we are starting to make some operating profit there. So we are making very good progress in that area.

In terms of Trunk Club, we're a little bit disappointed in our sales pace there. Our earnings were better than planned for 2016 as we've made some adjustments there. So I would say in general, those businesses are roughly operating as expected.

Canada I think generally speaking, sales or there's plus or minuses by stores, but it's generally operating as expected. So what you are seeing in the improvement is not so much that we are being surprised or things are outperforming what we thought but that they are starting to scale up to where they need to be and will continue to improve over time.

Bilun Boyner - *RBC Capital Markets - Analyst*

Okay, thank you.

Mike Koppel - *Nordstrom Inc - CFO*

You are welcome.

Operator

Paul Trussell, Deutsche Bank,

Paul Trussell - *Deutsche Bank - Analyst*

Good afternoon. Mike, my best to you.

Mike Koppel - *Nordstrom Inc - CFO*

Thanks, Paul.

Paul Trussell - *Deutsche Bank - Analyst*

Wanted to ask about the credit EBIT guidance and what you are seeing there. It actually was a bit higher than I was forecasting for 2017 and just want to understand the puts and takes there.

And then second, you all had a big increase in your active customers, your reward customers. Maybe just walk us through what the spending levels are for that rewards customer versus non-reward customers, and really what you have learned from that non-tender loyalty program and what you plan to do with it in 2017? Thanks.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, Paul. I will take those. First, as far as the credit EBIT, there's two components that are driving that growth. One was that in 2016, there was some non-cash amortization due to the sale of those credit receivables. And without getting into the complexity of accounting, there are certain assets that we needed to recognize when we sold and those got amortized over a relatively short period of time. We don't have that level of amortization in 2017, so that's one piece.

The second piece is that now that we are less capital constrained and we have a great partner in TD Bank, we're able to do more things to grow that portfolio. And so what you are starting to see is some benefit of us changing that operating model and having more capital available to grow that business, and so we would expect not only in 2017 but going forward to see continued growth there.

In terms of the loyalty program, you may recall, we launched that non-tender program back in May. It's been really successful. It definitely taught us that there's a lot of folks that there that would like to have a relationship with us but don't want another credit card in their wallet, and I think that was really important to extend our relationship with our customers.

Generally speaking, loyalty customers spend 3 to 4 times more than non-loyalty customers. That is definitely true on the tender side. I think in the non-tender, we still need to learn more about that.

But I think as we go forward, some of the more significant things that we're going to be able to do is we need to integrate those two models on one platform. That will allow us to continue to offer a more seamless experience, and also continue to see some of those customers who were on the non-tender gain greater benefit moving to tender. So we are excited about that, we are less than a year into it and I think our plan is to continue to try new things to test to see how customers respond and to certainly further improve the experience for those customers.

Paul Trussell - *Deutsche Bank - Analyst*

Thanks, good luck.

Mike Koppel - *Nordstrom Inc - CFO*

Sure, thanks, Paul.

Operator

Dan Stroller, Nomura Instinet.

Dan Stroller - *Nomura Instinet - Analyst*

Hello, guys. It's Dan on for Simeon. Thanks for taking our question.

I think you've mentioned before that 15% of Rack merchandise comes from full-price stores, and that's been taken down a couple points over time. So we were wondering if it's still at that level or where you see it shaking out over time? And secondly, quickly, with transactions being down, wondering any update on transaction value or units? Thanks.

Blake Nordstrom - *Nordstrom Inc - Co-President*

Dan, this is Blake. That number has been fairly consistent of late in that zone. But I think I would emphasize that our model is a little different than many of our competitors, because we start with hopefully a very good partnership and relationship with the key vendors from a full-price point of view.

And if we do this right, we are accretive or positive to their brand if the vendors believe that whether brick and mortar or online off price is something that they would like to do. And we become their first choice. And so we believe we're able to offer our customers a trend-right product at terrific values at an advantage of many of our competitors, and I think that plays out with the results.

Jamie Nordstrom - *Nordstrom Inc - President of Stores*

This is Jamie. Your question about traffic versus ticket or item transaction numbers. Transactions are down, average selling price is up, which I think is reflective of the reduction in the promotional environment over the last quarter.

Dan Stroller - *Nomura Instinet - Analyst*

Got it. Thank you.

Trina Schurman - *Nordstrom Inc - Director of IR*

We will now take one more question.

Operator

Erinn Murphy, Piper Jaffray.

Erinn Murphy - *Piper Jaffray - Analyst*

Great, thanks for sneaking me in. Just a quick housekeeping on the fourth quarter. Were you able to isolate or compute any of the comp impact to you potentially felt from the Neiman Marcus friends and family event during the quarter?

And I guess my big question was around Geevy's role as Chief Innovation Officer. I'd love to hear more about what he's focused on and how you're allocating resources towards him, and then who is backfilling his former role as President of the Rack? Thanks.

Mike Koppel - *Nordstrom Inc - CFO*

Erinn, this is Mike. I'll take the first part. In terms of the Neiman event, no I don't think there was anything that was measurable from that. As far as Geevy's role, I'll ask Erik to comment on that.

Erik Nordstrom - *Nordstrom Inc - Co-President*

Sure. We view that role as really an addition to the efforts we have going on in full price. And we've talked to you a lot about investments, and not only growing our e-commerce business and how we are addressing our stores, but really core to our strategy of how we leverage those assets across to serve customers better. There's a lot of digital tools being rolled out to our stores, there's a lot more options of getting product for the customer, be it online pick up at the store, store reserve, same-day delivery, curbside pickup that span the channels.

And we're continuing with those, but we felt given the fast pace of change, in particular on the store side, that we need additional efforts around that. And Geevy's assignment really is to take a much more future back view of the role of stores in this digitally connected world.

We certainly view our local assets and those assets of people, product and place as being hugely important in giving us a lot of options to serve our customers better. But Geevy's assignment is really to look at regardless of channel to be super customer-focused, and really looking at by market how can we leverage the assets that we have, digital and physical, to serve the customer really where she is going. As opposed to how do we make what we do today a little better incrementally.

Blake Nordstrom - *Nordstrom Inc - Co-President*

Erinn, this is Blake. Your last question was who is taking Geevy's spot. We took one of our top leaders and someone who's been very successful in many different assignments with us, Karen McKibbin, and gave her that assignment.

Most recently, Karen has been focused the last couple of years as President of Canada. She's done a terrific job of getting that region open from scratch, now that it's up and running it's more in keeping with the regions. And so Jamie Nordstrom promoted one of his regional managers, Michelle Haggard, to take Canada, and now we are very excited about Karen both as an executive team member and head of Nordstrom Rack.

Erinn Murphy - *Piper Jaffray - Analyst*

Got it. Thank you for that.

Trina Schurman - *Nordstrom Inc - Director of IR*

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

Operator

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