

NORDSTROM Q4 2016 EARNINGS

Prepared Remarks - Blake Nordstrom, Co-President, Nordstrom, Inc.

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've 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're 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 percent. 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 increase 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 percent. While we are 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 percent in the fourth quarter. For the year, our increase of 4.5 percent exceeded our plan.

As we look ahead, we are 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 U.S. 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 percent.

In 2017, we are 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 are 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 re-imagine 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 will continue to make changes to ensure we are best serving customers and improving our business now and 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.

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Prepared Remarks - Mike Koppel, CFO, Nordstrom, Inc.

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 2½ percent reduction in inventory. We also delivered free cash flow of \$550 million for the year, which also benefited from a 20 percent 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 customers' 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 six full-line stores and 15 to 20 Rack stores.
- Second, our total online business reached over \$3 billion, growing roughly 30 percent 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 percent 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 4-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 percent 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 our technology, supply chain, and marketing capabilities. Over the past five years, spending in these areas grew by 20 percent 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 re-shape 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 are 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 percent of sales, lower than the five year-historical average of 5 percent due to moderating store investments. With technology and supply chain as a key enabler of delivering customer experiences, roughly 40 percent 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 percent 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 roll out features 3 to 4 times faster versus a couple of 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 percent 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're 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 their evolving 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 have 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.