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CORPORATE PARTICIPANTS

Anne L. Bramman *Nordstrom, Inc. - CFO*
Blake W. Nordstrom *Nordstrom, Inc. - Co-President & Director*
Erik B. Nordstrom *Nordstrom, Inc. - Co-President & Director*
Kenneth J. Worzel *Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com*
Peter E. Nordstrom *Nordstrom, Inc. - Co-President & Director*
Trina Schurman

CONFERENCE CALL PARTICIPANTS

Adrienne Eugenia Yih-Tennant *Wolfe Research, LLC - MD and Senior Analyst Retailing, Department Stores & Specialty Softlines*
Brian Douglas Callen *BofA Merrill Lynch, Research Division - VP and Research Analyst*
Charles P. Grom *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*
Edward James Yruma *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*
Heather Nicole Balsky *BofA Merrill Lynch, Research Division - VP*
Howard Roy Gleicher *Aristotle Capital Management, LLC - CEO & CIO*
Jay Daniel Sole *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*
John Tompkins
Mark R. Altschwager *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*
Michael Charles Binetti *Crédit Suisse AG, Research Division - Research Analyst*
Oliver Chen *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*
Omar Regis Saad *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*
Kevin Foll *Gratia Capital - Analyst*

PRESENTATION

Unidentified Company Representative

Good morning, please welcome Director of Investor Relations, Trina Schurman.

Trina Schurman

Good morning, everyone. I'm Trina Schurman, Director of Investor Relations, and I'd like to welcome you as well as everyone on the webcast to the Nordstrom Investor Day event here in LA. So to quickly go over the agenda. First, we'll have Anne Bramman, Chief Financial Officer, to discuss some financial plan and commitments; second, Erik Nordstrom, Co-President on macro and customer strategy. We'll then take a quick break and then after the break, we'll have Ken Worzel, Chief Digital Officer and President of Nordstrom.com, discuss our full-price business. This will be followed by Blake Nordstrom, Co-President on off-price. And then, we'll have Pete Nordstrom, Co-President, wrap things up with some concluding remarks.

So after that, we'll move to Q&A and we will have plenty of time for questions, so if you could please reserve your questions till the end. You'll also notice that you have access to an iPad for the day, just for the day, and I'll give you a chance to view the presentation, take meeting notes as well as submit your questions online, if you prefer. For those on the webcast, you could also submit your questions throughout the day. And we'll post the full slides at the end of the day.



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So finally, I'd like to mention that our presentation may contain forward-looking statements, so please refer to our slide.

With that, we're ready to get started. So I'm pleased to introduce Anne Bramman.

Anne L. Bramman - Nordstrom, Inc. - CFO

Thanks, Trina, and welcome, everyone. Thank you for being here. We look forward to sharing our story with you and appreciate your interest in the company. As we discussed in the last few earnings calls, Nordstrom has come to a pivotal point in our business model. With 2018 as a turning point, we feel this is an appropriate time to provide further clarity on our path forward.

We believe that retail will continue to change to be more about service and experience, and we believe we're best positioned to differentiate ourselves in this changing environment. Throughout the day, you'll hear more about and see our local market strategy, a key part of our ability to win.

We're launching our efforts here in Los Angeles, our largest market, which is the reason why we're hosting today's event here. We have made meaningful investments in our digital capabilities and in key markets to support our strategies. In today's presentation, we'll lay out our financial targets and guideposts on how we're measuring outcomes and our success. We understand that for some of you this is a show-me story and that we need to demonstrate our progress. Our goal today is to provide more details and transparency on our path forward. We're confident in our ability to execute and to deliver superior return to shareholders.

As we aspire to be the best fashion retailer in a digital world, we'll discuss our key points of difference. First, our customer focus -- centered on compelling product and outstanding service; second, our approach to serving customers in a digital world; third, our local market strategy; fourth, our people and culture; and last, our best-in-class capabilities.

As our retail model continues to shift and evolve, we're targeting higher returns to shareholders based on 3 key deliverables, growing market share, improving profitability and returns and continuing a disciplined approach to capital allocation. Let me tell you more about how we'll deliver on these objectives. For market share, we plan for continued increases in our digital sales growth and penetration as well as generational investments that are coming online and maturing.

Our core business remains strong with growth coming from both full-price and off-price. For improving profitability and returns, our generational investments in digital capabilities are scaling, and we're seeing continued strength in our product margin. All of this is expected to result in EBIT growing faster than sales and an improvement in return on invested capital. We continue to be disciplined in our capital allocation approach through managing inventory, moderating CapEx as well as maintaining a strong balance sheet. As we exit this heavy investment cycle, we expect to generate accelerating free cash flow and plan to return excess cash to shareholders.

So now let's step back and get anchored on the historical context for this discussion. This slide shows the evolution of our business model based on 4 components; sales, ROIC, EBIT margin and free cash flow. If you recall, back in the early 2000s, we had a predominantly brick-and-mortar model, driven by square footage expansion. Sales grew from \$6 billion in 2002 to \$12 billion in 2012. By 2012, EBIT margin and ROIC were double digits, and we generated free cash flow of roughly \$600 million. We saw that the retail environment was changing, so for more than 5 years, we've been purposeful in accelerating our investments in digital capabilities and new markets.

Starting with digital capabilities, in 2011, we acquired HauteLook to serve customers digitally off-price. Through this acquisition, we've been able to launch Nordstromrack.com. It's been extremely successful -- and is our fastest-growing business to date. In 2014, we acquired Trunk Club to serve full-price customers in a new and relevant way. We made foundational investments in technology and marketing and began to invest in our supply chain. For new markets, in 2014, we entered Canada, and we now have 6 full-line and 3 Rack stores. We also started to invest in our full-line store presence in Manhattan. And in off-price, we accelerated growth through Rack store expansion. All of these investments have fueled top line growth, contributing to record sales of \$15 billion in 2017, but had a near-term impact on our profitability and returns.



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As we shared in this morning's release, we reaffirmed our 2018 outlook, which positions this year as an inflection point for long-term profitable growth. We're projecting EBIT growth with EBIT margin planned to expand from 6.1% in 2017 to around 6.5% to 7% by 2022. And more importantly, we plan to return to mid-teens ROIC and deliver an acceleration in our free cash flow.

Let's look at more detailed components of our economics. Pre-2012, our brick-and-mortar business model delivered above mid-single digit sales growth but was capital intensive. Thus, the model required a higher EBIT rate to drive mid-teens ROIC with free cash flow generation of approximately \$600 million in 2012. In the past 5 years, our business model evolved from brick-and-mortar to multichannel ways of serving customers.

Additionally, with the accelerated investments, EBIT and ROIC were pressured, despite delivering mid-single digit sales growth. However, even with this increased level of investments, we generated free cash flow of roughly \$600 million in 2017. As our model evolves, we have shifted the way we create value. Going forward, we're taking a local market approach to optimize customer engagement in our top markets. The most significant change to our model is increased capital efficiency, as our generational investments mature and through our local market strategy. Our plans are to deliver mid-teens ROIC and strong free cash flow with low to mid-single digit sales growth and mid- to high single-digit EBIT margin rate.

So let's talk about the first key deliverable to increasing shareholder value, which is continuing to grow market share. We're expecting to grow sales by roughly \$3 billion to approximately \$18 billion by 2022. A sales CAGR of 3% to 4% from 2017 to 2022. This reflects growth from generational investments of roughly \$2 billion as well as around \$1 billion from our core businesses with growth to be more balanced between full-price and off-price.

Two key expected outcomes from our sales plan are higher digital sales penetration as well as increased market share. We believe digital sales penetration will continue to grow from 26% in 2017 to around 40% by 2022. Over the past 5 years, we've gained market share in both our full-price and off-price businesses. Our total market share grew 70 basis points to 3.9% in 2017, and we expect to deliver around 50 basis points of improvement by 2022, assuming market growth of roughly 1%. As we track our progress on our targets, we will provide updates on these metrics annually in our earnings calls. With our business model evolving to a local market approach and our generational investments maturing, comp sales growth becomes less meaningful once we anniversary our New York City tower opening in 2020. After 2020, we expect comps and total sales growth to be roughly comparable.

Our second key deliverable is to improve profitability and returns. We're planning 50 to 80 basis points of EBIT margin improvement over the next 5 years. This reflects a steady increase of 20 to 40 basis points from 2017 to 2020. As our generational investments continue to mature, including the opening of our New York City tower in fall 2019, we expect to see 30 to 40 basis points of improvement from 2020 to 2022.

Moving now to the first driver of our EBIT inflection point, generational investments. To remind you, we consider our generational investments to be Nordstromrack.com/HauteLook, Trunk Club, Canada and Manhattan. Over the past 5 years, generational investments impacted EBIT margin by 160 basis points. At the peak of these investments, from 2015 to 2017, we've seen a drag to EBIT of roughly \$140 million to \$160 million each year.

By 2020, we expect less of a drag with the New York City tower opening and generational investment scaling. By 2022, we expect to break even for the combined impact of generational investments. This represents an improvement of more than \$160 million in EBIT relative to 2017 or roughly 40 basis points in EBIT margin. And we expect further improvement beyond our target period, as they continue to scale.

The second driver for EBIT margin improvement is to leverage our digital capabilities. We recognized early on the need to serve customers in a digital world. This shifted our focus from a four-wall view to one that leverages digital and physical assets. We began these accelerated investments more than 5 years ago in marketing, technology and supply chain, resulting in outsized expense growth. For these areas, expense grew at around 20% CAGR from 2010 to 2015.

We've made good progress in bending the curve, cutting this expense growth in half in 2016 and 2017. We anticipate that going forward, expense growth for these areas will moderate to a mid-single-digit range over the next 5 years, relatively in line with sales growth. Here's how we're going to get there. Beginning with marketing, we're planning to hold our expense rate to sales, leveraging our foundational investments in data analytics and increased personalization capabilities. In technology, while we're continuing to invest, we are seeing productivity and benefits from our early investments to modernize our platform. This has enabled us to move with increased speed and flexibility as we continue to invest in the customer



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experience. Going forward, our total cash spend is expected to increase at a rate lower than sales. The nature of our technology projects continued to shift from largely capitalized projects to cloud-based solutions, which are mostly expensed.

And finally, supply chain continues to be a critical enabler of the customer experience as we shift our focus from a cost center to a competitive advantage. Our goal is to drive speed with faster delivery for customers. We are at an earlier stage of our journey but over time, expect leverage in our investments as they mature to learn what we've seen in the other capabilities. Our focus in the next 2 years is expanding our West Coast supply chain capabilities to support our local market strategy. These investments are already included in our plans.

To wrap up, we're seeing the benefit from these investments, including doubling our digital sales penetration over the past 5 years. Achieving a market-leading digital presence, we are now among the top 10 largest e-commerce retailers in the U.S., and building a solid foundation for a local market strategy, which you will hear more about later today.

Providing more color on the impact these drivers have on our P&L, from a gross profit perspective, the majority of our improvements is from generational investments maturing. Additionally, our merchandise strategies support the strength in our product margin through continued inventory discipline and increasing penetration of strategic brand sales.

For SG&A, we're planning growth in line with sales and continue to find ways to achieve productivity and efficiencies. Overall, of the 50 to 80 basis points of EBIT margin improvement, from 2017 to 2022, generational investments and core business are each contributing roughly half of the improvement.

Our key investment strategies focus on our top markets to serve customers across both physical and digital experiences. As we move past generational investments, we continue to shift our focus toward tech and supply chain. We expect to invest roughly \$3.2 billion over the next 5 years, approximately 4% of sales, which is more of a normal historical level. However, we expect 2019 CapEx levels to be relatively higher at approximately 5%, due to the buildout of our New York City tower and West Coast supply chain capabilities. In the back half of our plan, we expect CapEx to be around 3% of sales as generational investments near completion.

Moving to our capital allocation strategy, our philosophy is to maintain a consistent and balanced approach between reinvesting in the business and returning cash to shareholders while maintaining strong balance sheet and an investment grade rating. We continue to target a leverage ratio of adjusted debt to EBITDAR of 1.5x to 2.5x. While we were at the higher end of our leverage ratio in 2017, we believe that our improving EBIT margins will bring us back in line with our ratios in the near term. We have consistently returned cash to shareholders through dividends and share repurchase. Over the last 5 years, we have returned \$5 billion directly to shareholders and expect to return roughly the same amount over the next 5 years. We will do this through a targeted dividend payout of 30% to 40% of earnings with excess cash applied towards share repurchase.

So that's a look at the next 3 to 5 years from a financial perspective. We believe we are uniquely positioned in the industry to win with customers. We're targeting higher shareholder returns through the execution of 3 key deliverables: growing market share, improving profitability in returns and continuing a disciplined approach to capital allocation.

We provided a roadmap to improving value creation and laid out our financial targets. Our financial commitments over the next 5 years position us for EBIT CAGR of 5% to 6% outpacing our sales CAGR of 3% to 4%. We expect EBIT margin improvement of 50 to 80 basis points from 2017 to 2022.

The completion of our heavy investment cycle as well as improving EBIT margins are planned to return our ROIC to mid-teens. And our free cash flow is expected to grow to \$800 million by 2020 and \$1 billion by 2022. As we track our progress, we will give updates on the following operating metrics on an annual basis: Market share, customer count, digital sales penetration and strategic brand penetration. We're confident in our ability to achieve these plans. Throughout the day, our team will focus on how we implement our strategies and how they link to our expected financial outcomes.

I'll now turn it over to Erik, who will discuss the macro environment and our customer strategy.



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Erik B. Nordstrom - Nordstrom, Inc. - Co-President & Director

Well, good morning. First of all, I just want to thank you all for coming today. It's -- like a lot of you traveled quite a bit. We greatly appreciate having an opportunity to share a little bit more about our story. And as Anne alluded to, we get it that it's a time for a little more transparency, as we're at this inflection point on where we're moving ahead.

My section, this morning, I want to talk a bit about the macro environment we find ourselves in and our strategies to win within. And when we talk about winning, hopefully, with us we've focused our strategies, first and foremost, it's rooted in the customer. We always start with the customer strategy. We need to win with the customer to have any success. But we're in a position now, both given the macro environment we're in but mainly, with investments that we've been making over the last number of years, aggressively against these changes, to not only win with the customer but to have a win with the investors as well.

So let's get into that. There's a lot of discussion in retail these days. I don't think I have to tell you that. We're well aware of a lot of the comments out there. I thought it would be best to take some actual headlines to share them with you, address them -- these issues head-on and dispel some of the myths, at least, how they apply to us.

So start the first one, retail apocalypse continues at department stores. We don't like seeing that, but I get it. It's -- macro environment is changing. There's forces that seem to be accelerating that put a lot of challenges to our sector. For us, we're in a different place. Again, mainly we've been not only investing in adding capabilities against these changes for a number of years now, those capabilities are starting to gain traction and have us in a much different position. We're also in a different position because we've been at this for quite some time. I think we got a little earlier start against these changes than some others. We have more learnings from those and more clarity on what our position is and how we can win with the customers, and we'll get into this more specifically.

All right. One of my favorite ones, retail wreck. Over 1,000 stores close in a single week. I don't think it's a surprise to any of us here that the U.S. is over-stored. We understand that. I think that's been the case for quite some time. It's not the case with us. We are in a different position with our store portfolio. And specifically around the quantity of stores we have and the quality of those locations. In the quantity, we have 122 full-line stores. We believe that's about the right number to serve customers where we have and want to have. Those stores are in the best markets, most strategic markets across the country and in Canada. We have 239 Rack stores mainly in power centers that are most convenient for customers in shopping off-price. And let me just add a point to on that is the fact that all of our stores are cash flow positive. And while we do constantly reevaluate our portfolio and things can change, that fact of having all of our stores cash flow positive has us in a position where we're not looking to close dozens and dozens of stores over the next several years.

All right, next headline. The inconvenient truth about e-commerce: it's largely unprofitable. This is probably the question we get the most. And I get it, the logic is for retailers that were historically bricks-and-mortar as they add e-commerce business, e-commerce is less profitable because especially when you have free shipping and it's a much higher return rate. And as your portion of business shifts to e-commerce, inevitably, the company's profitability declines from that. That is not the case for us, and we want to give you a little more transparency into that. We've taken for our full-price just an illustrative order, \$100 sale that happens both in our full-line stores and in Nordstrom.com. So you start with \$100 sale, we'll go first to gross margin. We have shared inventory across those 2 channels. Our gross margins are essentially the same in those 2 channels, and you get down to the expenses to make that sale.

In stores, our major expenses is the selling cost. Online, our major expense is the shipping. Those about equal each other and our contribution margin from selling in our full-line stores and selling at Nordstrom.com is essentially the same. What's that mean for us? That means we are largely indifferent of when our -- where our next sale comes from. And that's important because that allows us to focus clearly on the customer and go where the customer wants to go. There is a lot of discussion about channels and boy, how do you invest customers in the channel you want them in. I got to tell you, channel coercion, we don't think is a winning strategy. Customers want to shop where they want to shop. And having this parity in contribution margin between our channels allows us to go where the customer wants to go.

All right. Wall Streets bets Amazon will doom department stores and retailers. Amazon gets a lot of attention. Truly no news to us; we share our hometown with them. Look outside my window every day, I see a lot of cranes that they're building. And there is no doubt their growth rate is



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incredible. But it's important to put that in context. Number one, much of their strength comes from transactional efficiencies, comes from price points, comes from convenience and around product that in particular is commodities. Product where brand value is not as important. Product where the customer knows exactly what they want and can go and get it there. That's not the business we're in. I'll have some contrasts here between the marketplace. We're not a marketplace. We're not looking to be the everything store. We have a curated assortment. We're in the fashion business. And in particular, where we participate in fashion, it is about newness. Our model is not a price-promotion model. Our business is always been best when we're able to invest in newness and expose customers to a product that they didn't know they wanted.

One of the best experiences we can provide a customer, and it happens all the time, so a customer comes to us either in a store or online, and they don't know exactly what they want, but they know they want something new. They know they want something current. And they come in and they end up leaving with something that they know they wouldn't have found on their own and that ends up being their favorite thing in the closet. That is a place we should excel at. We think the position we're in, we have opportunity to do that. And in particular, the product overlap between us and Amazon is pretty small. We look at customer choices, only 15% of our customer choices are also on Amazon and of that 15%, only 16% of them are in our top 100 brands. So our best items and our best brands aren't found on Amazon and that differentiation is super important for us.

All right, retailers be aware, more companies now selling direct. It's no doubt for brands that the traditional wholesale models are being disrupted greatly. Especially, brands that are born online, digitally native brands do sell more directly to customers. That actually fits well with us. We are a place for cross-brand discovery and while brands, especially emerging brands, can, do and should sell directly to customers, they need a bigger platform for that. We can provide customers that platform.

The example we have on screen here of these products from Zella to Nike, Reformation, Gucci, those are all products we sell. Those are all products that are either exclusive or have very limited distribution, and it is how customers shop. A modern customer puts these items together. A modern customer does not settle on one brand and go 24/7 that brand. I don't believe that we're going to be here 5 years from now and all of us are going to be wearing 1 of 5 brands. Part of fashion is there is newness, there is innovation, and customers enjoy that exploration and being exposed to different brands. And for brand partners, we have the ability to expose their brand to customers in a very relevant way and it makes us a partner of choice for these brands.

All right. Cramer says, department stores are in real trouble and Nordstrom is cannibalizing themselves. Yes. No. And we get this question a lot, and we have for years. We've been in the off-price business for many decades, and we learned long ago that it works best for our company, overall, not any individual channel but works best for us overall when our Rack stores were across the street from our best full-line stores, there is a synergy with customers there, and that has continued to apply as we've added digital business. And in particular, we go deep on this subject. And we've been able to track customers -- full-line customers, we open a Rack store, they start shopping the Rack, what happens to their spend? And what happens to their spend is not only does their spend for JWN increase, their spend in our full-line stores increases. The more we can engage customers, the better our business is and the better it is in every channel. It works for our customer who starts with us online and starts doing business in the store. Their business -- our business with them increases online as well as a store and it works the other way around. Customers who start in a store gets introduced to our e-commerce business, that engagement lifts all of our channel business.

You can see some examples here, hopefully, you've heard us talk about our 4-box model. When we talk about our 4-box model what we mean is, we have a full-price business, we have an off-price business, we have a store business and we have e-commerce business. The more we can engage customers -- and by the way, this is engaging customers on their terms, how they want to be served -- the better our business is all over. It increases engagement, increases trips, most importantly, increases spends. And you can see here when we engage with a customer, going from 1 channel to 2, their trips increase 3x, their spend increases 4x. When we're able to get customers in all 4 of our businesses, trips increase 13x, spend increases 11x. This engagement absolutely is synergistic. We study this year after year, and it has proved more and more true and it's something that we think is a big advantage for us.

So what are advantage of this One Nordstrom model with the 4 boxes? With customers and we're serving them how they want to shop, serving them on their terms. Competitively, it allows us to cover much more of the market from off-price all the way to Designer and allows us much more differentiation between us and our competitors.



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Financially, there are significant financial efficiencies as well as resilience by having a wider breadth and more diversified business. A couple of examples provide you on that. As we sell product at our full-line stores, our exhaust for that is our Rack business, both online and in-stores. That exhaust, it allows us, in our full-price business, to have more newness. It frees up inventory dollars that is consumed by odds and ends of clearance merchandise and allows us to replace that with new merchandise and full-size runs. Again, that is what drives our business. We are not a price-promotional retailer. We are a full-price retailer and that newness is essential for us. What does that do for our off-price business? It provides a treasure hunt, point of differentiation that is really important, that drives a lot of trips to both Rack.com and our Rack stores. And part of it is we have very, very high crossover of brands between our off-price business and our full-price business. Almost every brand of our top brands in full-price is carried in our off-price business as well. And again, there is a big synergy with it. There is certainly a financial synergy, as we meet with brands, almost all the brands. We're their biggest full-price partner and I think it makes sense for them to invest their off-price business with their biggest full-price partner.

There's also synergy with customers, as customers oftentimes come to us in a Rack and get exposed to brands that they end up falling in love with and have interest in having the newer versions of that. So having the same product brands in off-price helps our movement of customers to full-price as well.

Okay, our aspiration is to be the best fashion retailer in a digital world. How we get there is -- main focus on 3 separate pillars. Service and experience, fashion authority and brand. We'll get into those.

Okay, service. Service, as I hope you know, long been our foundation. I think if customers have heard of us, we have some reputation with our customers, it's first and foremost around service. What's changed is how customers define service, and we've had to change accordingly. There's no doubt that the customer is in more control today than ever before. They are less willing to compromise how and where they want to be served. Our response, again, we don't think is to try to coerce them into channels we want them -- to serve them in, but it's to be where the customer wants to be and to provide the control for the customer. And a way of thinking about that is from low touch to high touch. Customers -- even the same customers, even on the same journey, may want portions of that journey to be low touch and portions of that journey to be high touch. One of the things we've added over the last couple of years is store reserve. And when I first thought about store reserve and picking up and trying on in-store, so reserving online, trying on in the store, I thought, okay, well, why is that beneficial to a customer? And I thought of it as more of like reserving products so we're not running out of it and the customer knows it's there. And I guess, that's part of it. But what really clicked for me is -- in talking to customers and seeing customers as they use it and their high level of satisfaction, it's really about control. It's about that discovery phase of selecting merchandise, they want to be -- do that digitally. They don't want people involved with that. They want to do that however they are in control of that. But they want to try on before they actually make the buy.

So it is in the same journey, one area that's low touch high control, another area that has some assistance to it, ends up in the same buying trip. And the capabilities we've invested in over the last number of years allows us to do these things.

One of the questions we sometimes get is, okay, yes, you guys are about service, don't you invest too much in service, does the customer really care? We certainly don't believe that's the case. Our investment in service and services drives real values for our customers. This shows the incremental spend as customers engage with our services from store reserve, Buy Online, Pick Up in Store, alterations, style boards and having a personal stylist.

The point is customers value this, and it drives real financial value for us. An example I like is alterations. Alterations is -- I don't know if there's a more analog activity that we can provide. It's long been a big part of our business. We are the biggest employer of tailors in North America, but it's increasingly an important point of difference. And I will say, historically, we used to look at -- as a store manager, we looked at alterations as this back-office function and they would emerge in a dressing room and hem a pant or something. It is a real point of difference and a very value-driving service that we can leverage even more.

Customers engage in alteration spend, you see there, 3x our customers who don't. So here is an asset we've already invested in. We have great clarity on the value that drives and can leverage that even more going forward.

Okay, I'd like to shift to product. We talk about leading with product, having fashion authority. One of the changes over the last number of years is, it's been more important for us to be more purposeful in having strategic relationships with brands. In my day as a buyer, we would go to market



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and buy the best stuff and whoever -- I used to buy shoes. Whatever shoes looked the best, we would buy. There is still some of that, but there is -- it's more and more important that we start upfront with strategic partnership with our brands, and we put them into 4 buckets. You can see here, preferred brands, Designer, emerging brands, a lot of these emerging brands are digitally native brands, and our own Nordstrom product, our own label. Having these strategic relationships are not only more important for us, it's more important for brands as well.

I think it's true that brands don't need as many retail partners as they used to, but they need at least one. And increasingly, we are that partner of choice. Our model allows these brands, especially emerging brands, to be exposed to our customer base, which is very attractive for them, allows their brand to have much more exposure on a bigger platform both the store -- physical store platform and online. I can't think of a brand that isn't subscribed in pursuing a physical location strategy along with the digital strategy to grow their brand. And for physical locations, brands don't need 800 locations but they need more than 20 and that's where we talk about where we think they have the right number of stores there. I'd bring 122 stores, full-line stores is about the right number and is very appealing to brands to give them the platform and national coverage across most important markets that they're looking for.

Our model is complementary and additive for brands. Again, we think it's great our brand sells directly to our customers. It's not cannibalistic. It doesn't shift business over. It's the same thing we have found as brands open stores, their own boutiques near our own stores. It tends to lift our business for both. Their business gets better in their boutique, our business gets better with them in our stores where we have it. These strategic partners -- partnerships then result of it is it makes our product mix more differentiated. It also makes a very important defense against margin erosion for us.

One of the questions we get a lot is, boy, how do you maintain margins in this promotional environment. Well, ubiquity is, a lot of times, the enemy of fashion. The more ubiquitous a certain product or brand is out there, the more pressure on price promotion is out there. And having these strategic relationships sometimes are exclusive. They don't always have to be exclusive. But they need to have some limited distribution there that helps us a lot.

And for these brands, as you can imagine, the fact that we are a regular price, a full-price retailer, that we're not price promotional, is a very important element for them.

So it's easy enough for us to talk about, as you can imagine, how -- what a great partner we are for a brand. But we have a video to share with you. We'll let some of our strategic brand partners talk about it in their own words.

(presentation)

To tell you about our strategic brands why is it important for us financially. From what our growth and strategic brands is growing 30% faster than our nonstrategic brands and delivers a much higher margin, 240 basis points higher margin with that. We have been very purposeful in expanding the proportion of our mix that is with these strategic brands, and we will continue to do that. You can see the proportions from 2015 to 2017, it's went from 31% to 40%. Our plan is by 2022 to have half of our business done with these strategic brands.

Okay. When we talk about our brand -- and our brand is -- and always has been really built by our customers. We have been a word-of-mouth brand. We have invested in customer experiences, unique products that -- and provide experiences that customers talk about. And that's -- well, that's always been the case. It is a little different -- much different time we're in now. You can see, some of our customer demographics. Our customer tends to be a little younger. We have a young, affluent, engaged customer who, again, likes newness and is aware of fashion. But this word-of-mouth is amplified these days. It is through digital means, through social media and that lends itself to our brand in particular.

One of the things that's been very successful for us is partnering with social influencers who have launched some brands. Things like Something Navy, Gal Meets Glam, those 2 launches were some of our biggest launches. I think it was \$1.8 million the first week for Something Navy and \$1.6 million for Gal Meets Glam. Big, big launches for us and really leverages these social influencers, their customer base they have, their follower base they have, and it's really a terrific fit for us.



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We're talking about our brands. Really, our loyalty programs is a key part of our brand. And it's something that's been vital to us for quite some time. And it's something we've been investing in. 5 years ago, 35% of our business was done through our loyalty program. It is now at 55% and growing rapidly. One of the big changes and investments we made a couple of years ago was to have a nontender portion of our loyalty program. That proved to be very additive, did not cannibalize our cardholders and create a much bigger tent for customers to participate in our loyalty program. We're up to 10 million customers who have -- we have -- we're very excited. A lot of plans to continue to strengthen that program. We'll share it with you as it's ready. We're not quite ready to launch all these things now. But you will see us continue to strengthen our loyalty program.

Okay. Lastly, I want to come back just with some context through all this. So yes, our world's changing and there is disruption. But these important context to know that we have been growing market share in our -- both our off-price business and full-price business through this disruption. This has been a result of our focus and a result of the investments we've made and getting traction from those investments. We certainly expect that to continue. There is nothing we see that doesn't give us confidence that not only can we continue this trend, but as some of these investments start to mature that we can build upon them and continue to grow our market share.

And with that, that's the end. We're going to go to a break. Right? Trina, you're coming up here. Okay.

Trina Schurman

Okay, so we're going to take a quick 10-minute break, and we'll get started at around 9:30, so see you back soon.

(Break)

Trina Schurman

Hi, everyone, if you can get seated, we're ready to get started. Everyone's very chatty this morning.

So I'm pleased to introduce Ken Worzel, our Chief Digital Officer and President of Nordstrom.com.

Kenneth J. Worzel - *Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com*

Good morning, and thanks for joining us. And for everyone on the webcast, thanks for dialing in. So I have the pleasure of spending the next few minutes talking about where we are in our journey on our full-price strategy and delivering to customers. And I think as you guys know, we've been on a journey, and Erik referenced this, and it's been a journey really that's extended for quite a long time. And what we're excited about and hopefully, we'll have a chance to share with you is, we're now at a point where a lot of these pieces that we've been working on for a long time are coming together in front of customers. So as Erik referenced, a lot of activity in terms of the last 10 and even 20 years in terms of our journey to become even more relevant to customers as their expectations change. And Erik said this, and I think it's important to underscore it, our heritage is about service and it continues to be about service and being customer-centric. That hasn't changed. What has changed is how customers define that, what they expect from us, what they expect from other retailers. And I think, we've shown and shown you, and I think, hopefully, have shown our customers that we're going to invest to stay ahead of them, to stay relevant for them. So as an example of that, I think some of you in the room will know this, we were early in e-commerce. So this year October will be the 20th anniversary of launching Nordstrom.com. So this has been a journey we've been on for a long time. But now the focus is on bringing it all together. And really our focus is on continuing to move, and Erik again referenced this, we're not channel-centric, we're customer centric, and that has evolved over time to mean different things. So how do we feel about that in terms of where we are today? We feel like we're positioned to win, and we're confident about our path forward. Part of it is because we continue to innovate, and I know some of you guys have had a question about how do you continue to invest enough to stay relevant? And I think part of it is, we feel like we have the advantage of having invested early in things that matter to customers. And really, we think about our full-price business as having 3 components to it that make us confident: one is our core business, strong core business; two, that Anne referenced a lot, is the maturation of our generational investments; and three, which I'm going to have an opportunity talk to a lot about, is our local market strategy, which is the reason we're here in LA. So we'll come onto that as well.



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So first of all, if you look at our full-price business, it's large, it's healthy, and it's growing. About a \$10 billion full-price business, it continues to grow. As you saw earlier, we've continued to gain market share throughout the last 5 years, and we'll continue to gain market share in the next 5 years. But we're also continuing to invest to evolve our business to serve customers on their terms. You see some of the stats up here, and this was referenced as well, we're now a top-10 U.S. e-commerce retailer, do over \$1 billion in mobile sales. We've had over 800 million unique daily visitors to our website, and our mobile experiences for full price. So we really are seeing the benefits of knitting these experiences together to serve customers whenever, wherever and however they want to be served. And from our perspective, that enables us to not only win with customers, but deliver financial results while we continue to drive innovation and increasingly -- and we're going to come onto this focus on a reality, which is a lot of our business has done in our key markets. So this local market strategy is how do we continue to invest in our best customers, in our best markets and bring them the best product and experience.

So let me talk a little bit about generational investments. Canada, as you guys know, we entered Canada in 2014, and we're early in our journey there, but we have seen a great response from customers. The reality is, we opened Canada with a strong offer in one of our 4 boxes, we talk about our 4-box model. If you've been to Canada and had the opportunity to visit our stores, you'll know that we have some of the most amazing stores in our fleet in Canada. We have a -- there's an example up here on the slide of Pac Centre up in Vancouver. It's a top-5 store for us, it has amazing product, has amazing experiences and store design, has a great team. The same is true of our other stores in Canada, and we have seen the customer response to that. But where we are now on our journey in Canada is adding to that experience, building out the rest of the 4 boxes for us to serve customers in Canada. And that started with us opening 6 Rack stores by the end of this year in Canada. So our entrée into off-price in Canada. And as Erik referenced, that's important for a number of reasons, and Blake will get into this as well. But our off-price business is additive to our full-price business. And it's additive in a couple different ways. One, which Erik referenced is, from a product perspective, it gives us the opportunity to keep freshness in our full-price business and to keep our inventory moving, because we are a full-price retailer, a fashion retailer where our business is based on newness. And so having our off-price business grow in Canada is an essential way to make our offer in our full-price stores in Canada more relevant. The other thing is, from a customer perspective, off-price is an essential part of how we acquire new customers and grow our brand. You've heard us reference this statistic before, but off price is not only the largest source of new customers for Nordstrom, about 1/3 of the customers that come to Nordstrom via the Rack and our off-price business will become full-price customers over time. So as we build out our off-price presence in Canada, it's also building out the pipeline of new customers for our full-price business in Canada. So in addition to having our Rack stores opening in Canada, you'll also see us, over the next 18 months, really enhance our digital experience in Canada. We currently sell to customers in Canada via our website but it's via third-party fulfillment cross-border experience. But what that means for customers is a lot of the omni experiences that you value and that we see that customers value are not yet available to our full-price customers in Canada. Things like Buy Online, Pick Up in Store, store reserve, Style Boards. These experiences which we have shown and demonstrated build great engagement and sales with customers aren't yet available to our Canadian customers. So we are now building the capability to turn those experiences on over the next 12 to 18 months, which we think will as well will enhance our Canadian experience for customers. So we have great confidence that we're on the right track in Canada and still believe that we're going to deliver \$1 billion-plus market opportunity through our Canadian business. So that's the first of our generational investments.

The second one I wanted to just speak to is Manhattan. I think most of you, many of you are from New York, so you may be aware, we're coming. We've opened our men's store this spring in Manhattan, and then the main women's tower will open next fall, the fall of 2019 in Manhattan. And we're excited about the market as you can imagine, but we're also realistic. As we've said a number of times, New York doesn't need another store. So it is incumbent upon us to create a product and service experience for customers in New York, which is compelling and provides a reason to do their business with us. And we're really excited about the early results. Hopefully, many of you have been able to visit our men's store. That's our first foray into serving the New York customer, our full-price business, and it's been exciting, it reflects, we think, what we do well. It reflects a unique product offering of high-low curated fashion, but also complemented by a service and experience wrapper that is at the very core of our brand. So we are very excited about it and focused on delivering, first, with our men's store, and now with the opening of the tower. But it's also really important to know, from our perspective, we have a total market approach for New York. It's not just about what happens in the 4 walls. New York is already our #1 market for online sales, New York City. But we also know from experience that when we add to a digital-only experience, a flagship store experience, it not only generates 4-wall sales, it generates a big lift in our digital business with customers. So we have a lot of confidence that New York remains on track to be a \$700 million-plus market opportunity as we go forward with the maturation of our New York strategy.

And then finally, I want to talk about Trunk Club as a third generational investment for full price. We haven't talked to you guys about this for a while, and there is a reason for that. 2017 for us was really a year of stepping back. We acquired Trunk Club in 2014, and we realized that we needed



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to step back and rethink some aspects of the business in order to make it scalable. We wanted to be able to profitably grow that business to serve customers. One thing that never changed was our belief that this was an important way to serve customers. Customers have demonstrated, to us and in the marketplace with competing offers, that they are interested in this kind of an offer, an offer that provides them with the benefits of a stylist experience in the comfort of their home and brings all that together in a really convenient way. That was the reason we acquired Trunk Club. We believe that, that full-price, full-service kind of offering was right in our wheelhouse with customers. So what did we do last year? Last year, we stepped back and tested a lot of things and learned a lot of things in the business. Just a couple that I'll call out. We realized that the market opportunity for us with Trunk Club was actually much bigger with women than with men. It started as a men's-focused business. We shifted to focus a lot of energy on how do we serve women customers with that offer. The result of that is that we went from, in 2016, women's representing about 1/3 of the business to now representing over 2/3 of the business.

We also realized that we had an opportunity to do a better job of serving customers on their terms with what they really expected and wanted. So a big example of that is we supplemented our commission stylist model at Trunk Club with a big focus on scheduled sales force. So why is that important? Well, for customers, it's important because we realized what they wanted was to know that somebody was going to respond very quickly at whatever point in time they reached out to us for stylist advice and for a trunk. Why does it matter to us? Well, it matters to us because we've been able to see a big uptick in the operating metrics as we've done that. So our conversion with customers and new leads has gone up significantly as we've executed on net new sales force model. Our take rate has gone up significantly. And from an operating and cost perspective, not only did it provide a better experience to customers, that structured sales force enables us to take about 500 basis points out of our labor cost. So it's a win for customers in getting what they wanted from the service model, and a win for us. Now we still have commission stylists, we still have clubhouses experiences, but we realized that we had an opportunity to really focus down on what worked with customers, and it's working. So the business is growing quite significantly. Now our trunk growth, which is where the focus in the business has been, went from about 33% year-on-year in fiscal year 2016, to 78% year-to-date through May this year. So the business has now got a profitable foundation with a customer offer that's resonating, and it's growing quite rapidly. So we're very excited about this.

The last thing I should just mention about Trunk Club is, a big component of this, for this part of the business as well as for the rest of our business has been the application of data science. There is an opportunity that we are in the early stages of, but have invested aggressively against to build out data science and analytics to serve customers, and it's paying big dividends for us.

So now I want to switch gears a little bit and talk about the third component of our full-price strategy, which we've referenced a few times now, which is this notion of a local market strategy. What do we mean by local market strategy? And why do we think it's important? Well, I'll get into a little bit more of this in a bit, but the fact is that we have done a great job of building a lot of individual capabilities and experiences to serve customers. The opportunity we have now and where our focus is now is how to stitch all of that together to serve customers in a really seamless way. And that opportunity is most pronounced when you look at our top markets. We're here in LA because it is our top market and it's where we're starting this journey of really focusing on local markets. If you look at the combination of LA and New York, with the opening of the tower in New York, those 2 markets combined will represent over 25% of our full-price business. Our top-10 markets represent over 60% of our business. So our business is highly concentrated in our top markets; it's highly concentrated with our best customers. And so our local market strategy is taking a focus on that and a realization of that and saying, how do we bring the best of Nordstrom to these customers in these local markets by orienting ourselves differently. And that's important because we think if we do this well, and we believe we can do it really well, early signs are really encouraging, is that we can not only win with customers, it will help us win financially. For customers, what we're really doing is helping them be able to leverage our local market assets, our local market assets of people, product and place to serve them better. Sometimes our people are what they want, high-touch service is something that a lot of our customers want in some of their customer journeys. Our product, as we've talked about already, is differentiated, and our stores and physical touch points, existing stores and new concepts like Nordstrom Local are a way to connect the digital and physical journeys for customers in a way that provides real value to them. But it's also true, as Erik referenced, that it provides real value for us. When we get customers to engage beyond one of our channels, their spend goes up dramatically. Their retention rates go up dramatically, their satisfaction goes up dramatically. The result of that is that we get 5x the amount of spend for customers shopping both stores and online versus one channel. And in markets where we have stores and not just a digital presence, our profitability per customer is 2x where we only have a digital presence. And that's because we sell more per customer, the cost to serve those customers are lower on things like returns, but mostly, it's the engagement model with customers.



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So we're excited about this, but it also requires some investment. As Anne referenced, one of the big places we're investing, and we're not unique in this, we recognize that, but is in our supply chain, in our fulfillment capabilities. This is in our plan, so this is not additive to the plans you've seen, but it is a shift in focus. If you look at the supply chain we've historically had in our fulfillment network, we -- from a legacy perspective, we really built 2 parallel supply chains. One was a 50-year-old model to serve -- to get inventory from brands into our stores. That was largely done through fulfillment centers called distribution centers, which took cases of product from brands and immediately got it out into stores, because that was the only way you could sell it. And then along came e-commerce 20 years ago, and we and others started to build dedicated fulfillment centers to send direct to consumer, to send onesies and twosies directly to your home. Where we now are as we realize we have a big opportunity to bring those 2 supply chains together. And the reason is because it's the same product and it's the same customers. And as we bring them together, we can do a couple of things: one is, we can go from a push model to our stores to a pull model. So we can hold back some of that initial inventory and we can see what stores need it and allocate it out as they sell inventory more efficiently. That increases asset efficiency, so it increases our turn on the inventory. It also is a better customer experience. We can make sure the product is where the customer needs and wants it. And then, we can also take the opportunity to serve a local market very differently. So we were always going to need a West Coast fulfillment center to grow -- to serve from a capacity perspective to serve our growing business. What's changed is now it's going to be very close to LA, it's going to be in the heart of this metro area, so that it gives us the opportunity to get inventory to customers much, much faster than they've previously gotten. So there is some continuity, and we're going to continue to invest in supply chain, but it's different. Now we're investing in a way that really focuses on serving local markets differently and better.

So I mentioned that we're on a journey and this is about bringing it all together. Why do I say that? Well, because you guys know we talked a lot over the last 5 years about investments we've been making in individual capabilities. We've invested a lot in fashion authority, and Erik spoke about our focus on strategic brands. We've invested a lot in the individual experiences in service and experience via technology. So things like store reserve, things like Style Boards, Buy Online, Pick Up in Store. All of these experiences that you've seen us roll out. In many cases though, to date, we've rolled them out as individual experiences, and that has a couple limitations. One is, if you're a customer, it means the Style Board and the store reserve experience aren't really integrated. So you get a Style Board today but what you really want to do is still try the product on. We hadn't yet integrated those experiences together. It also means, from an awareness and marketing perspective, we haven't been able to shout out to a market that we have all of these things and here's how they all come together. So this year in LA, this is what we're doing. We've been integrating these experiences for customers largely through an app, that's largely how the digital connection happens with customers. And we've already built a lot of this, not only the individual pieces but the integration of it. We've been working for the last 4, 5 months now with a beta group of about 800 customers with a very agile co-development and co-creation process with them. And so some of the experiences I'm going to show you, they were already been playing with for the last couple of months, and now they're going to scale, we're going to scale those and make those available to the rest of our customers in the back half of this year in LA. So that's why we focused on bringing the pieces together in LA. Mentioned it's our biggest market. We do over \$1 billion in full-price sales. Just in this market, we have 4 million customers, and we have a lot of assets. We have a lot of full-line stores. We have a lot of Rack stores, and we have a lot of fulfillment assets here, and we will have more as we build out our supply chain.

The other aspect of this, and I want to define this a little bit, because I know there is some confusion around, "You guys, talk about your local market strategy and talk about Nordstrom Local." Just you'll -- hopefully, many of you will have the opportunity to take the opportunity with us to tour our Nordstrom Local on Melrose Avenue later today. But just to define terms a little bit, Nordstrom Local is the branded hyper local service touch points we're creating. And we have one right now, we announced, we're opening 2 more opening in LA this year. And what these are, are the opportunity to bring Nordstrom closer to the customer. In a market like LA where drivability is a big issue, it's given us the opportunity to bring our brand in a small footprint very cost-effectively to our customers to let them engage with our services and have product ready for them there if they order it, Buy Online, Pick Up in Store, they do a store reserve, a stylist appointment. And while it's early days, we're measuring this very closely. It has already resulted in a very big increase in the engagement of customers, customers that engage with that Nordstrom Local experience, their spend is a lot higher, their frequency of engagement with our brand goes up. So we're excited about that, and -- but I did want to just make it clear that Nordstrom Local is just one piece of the local market strategy. The supply chain change is another piece, how we leverage our existing stores and people is another piece. It's an important piece of the puzzle, and it's one piece of the puzzle. So with that, I wanted to take a pause and run a video, which bring some of this to life through the eyes of a customer journey. So let me run that and come back afterwards and explain a little bit.

(presentation)



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Those of you in the back of the room in particular might not have been able to see the puzzle pieces popping up in that video. So just to explain that a little bit. That was a customer journey that happened like a lot of our customer journeys. Started online, customer discovering product online, that leveraged then a capability we've already built, which was the puzzle piece that popped up called Style Boards, which is the opportunity to connect with the sales person or stylist and request some personalized styling advice. That's what you saw come up. Then was the creation message goes to one of our folks who then creates a personalized shoppable Style Board for the customer.

I mentioned data science earlier and analytics. When the Style Board came up, there was a sort of reference there to something called dynamic looks. And you might ask, what's that? Well, that's another capability that we've been building in the background, which is, when it's available on our website but also with the Style Boards is when that Style Board gets created, a human, a stylist will create a look, but then we want to be able to offer alternative looks, and so we have a machine learning data science approach which builds on the human expertise but then allows you to see alternative looks if the look that shows up on the board is not exactly what you wanted, or if we sell out of that item and we need to replace it with something else. We have a data science driven approach now to dynamically repopulate those recommendations. Then you saw the customer go to a store and get the benefit of our store reserve experience, including the benefit of using geolocation proximity services on their phone. So we know they're coming. So they don't have to schedule an appointment, we know they're on their way, we get the dressing room set up with them -- for them with their name on it. And then in the dressing room, you saw connected dressing room experience. Lot of what happens when someone's in the dressing room is, I like it, it's not quite the right size but I don't want to get dressed again to go out and ask for some help. We now have made that possible from the dressing room with the connected dressing room experience, and with that device you saw the salesperson had to notify them so that they can get engaged with it. The reason this video I think is so powerful from our perspective is this isn't Vaporware, this isn't some ambition of something we're going to deliver somewhere in the future, it's stitching together those 8, 9 different components that we've been building, have invested in and have put in front of customers in different fashions over the last 18 months. We're now connecting all of those things for the first time for our customers in a very seamless way so that all of those experiences are connected. And again, that's already -- 80%, 90% of what you saw in that video has already been tested with our 800 beta customers in LA over the last couple of months. And we're now going to roll that forward at scale and put it in front of all of our LA customers later this year. So we will be live at scale in half 2. The supply chain component of this is also coming on board in LA over the next 18 months or so. And that is an important part of this experience. If you think about what's changing for customers, a lot of the experiences we have today that are very powerful individually, like Buy Online, Pick Up in Store and store reserve, to date, we've limited customers in those experiences the inventory available in a specific store, which dramatically narrows what that selection is. In LA, over the next 6 months, what we are doing is linking the inventory of all of our stores and therefore, making that inventory available to customers in any -- one of those experiences to be delivered to any store or any Nordstrom Local by the next day.

In addition, when we light up our West Coast fulfillment center, we'll be doing the same thing with the inventory that's in this local fulfillment center. The net result of that is for a store -- for a customer who wants one of those experiences, the amount of selection available to them for those experiences goes up 4x to 7x. So these are already very powerful engaging experiences with our customers. But the biggest complaint we have is, sometimes I have to go to a different store to get the product I want versus you having the product available from I want to engage with it. So we're going to be able to deliver, in our local market approach, all the inventory in the market to a customer in any location they want, a store, a local or their own home, and do it very quickly. Today, if you are a customer here in our largest market in LA, most of your Nordstrom.com orders will take 4, 5 days to get to you because they're coming from a fulfillment center in the Midwest or the East Coast. 18 months from now, 90% to 95% of everything an LA customer will order will be available to get delivered to them same or next day. So a dramatic difference in the speed of the experience -- fulfillment experience to customers. We know that has a dramatic impact on the conversion for our customers, but it also has a big financial benefit for us. It's actually less expensive, it will be less expensive for us to get product to customers in LA 18 months from now that it is today even though we're getting it to them a lot faster. The other benefit is, the faster we get product to customers, the more likely that they keep it. The return rate is materially impacted by how quickly we get product to customers. And if they are going to return it, our product margin is materially impacted by how quickly we get it back and can resell it because we are selling perishable goods.

So this local market strategy is good for customers, gives them much more selection, gives them many more fulfillment options with faster speed, and also gives them the connection to our people and our high-touch services, but it's also good for us. Much more assets efficiency, lower cost to serve and higher engagement, as you've heard us say it several times today, leads to higher sales. So we're very excited about this, not just for L.A. obviously, but for other -- our other top markets as well. 2018, by design, we've made to be the year of L.A. We wanted to focus and operationalize this at scale in our largest market first and get the learnings from that. 2019, we're intending to focus the same local market strategy approach on New York, as we open the tower. There'll be some differences, New York is a different market, the customer expectations are different. But we will



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learn from L.A. and then tailor these experiences for our New York customer to take advantage of that, and then we'll roll out beyond that to our other large markets as well. The net result of that, we think, is we will gain market share faster. As I mentioned, we can leverage our biggest investment and our biggest asset, which is our inventory, more efficiently. And as a result, we're going to be able to grow top line and bottom line faster in these top markets.

So that's our plan, and that's our commitment. And I look forward to see many of you at Nordstrom Local later today. You can see some of that aspect of our local market strategy come to life.

So with that, I'll turn it over to Blake to talk about off-price.

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

Good morning. I'm pleased to have the opportunity to talk to you about our off-price business and to give you some insight about our strategy, the elements that make our off-price business a little different than many of our off-price brethren. And most importantly, the value contributors to Nordstrom Inc. and how it helps drive these results that you're hearing about today.

We did, just in the last couple of years, decide with off-price being a hot sector, we might want to get into that business. I want to remind everyone that we started in 1973 with the Nordstrom Rack. And as a little kid, I remember working in the stockroom in that first location, we've come a long way. And as we should, for the needs of the customer, this chart here shows our growth. We just ended the year there approximately \$5 billion in off-price. It's 1/3 of the company's sales and 1/3 of the company's EBIT. From 2012 to 2017, we doubled our market share. And so we look at it as an off-price business, and we're focused on not only what's happening in the off-price sector, but how is it contributing to Nordstrom Inc.

Okay. We've had a long track record of success in the off-price business. Again, we just didn't wake up yesterday and jump into this business, we have a really strong team that's super knowledgeable about this business, and our results have shown that. Over the last 21 quarters, 20 we've exceeded the market's average. But no question, this last quarter Q1 of 2018, we fell short of our expectations. We know we fell short of yours and our shareholders, and I want to talk about that a little bit. I alluded to in the Q1 earnings call that predominantly this miss happened within our Women's Apparel division in Nordstrom Rack stores. So again, we look at the business how the customer views it as an off-price business. But I want to assure you that we work on all aspects and all details of the business, and we're highly attuned to what's happening within the Rack stores. Women's Apparel is a meaningful part of the total business within the Rack stores. And when it underperformed, it pulled us down. So our Nordstromrack.com and HauteLook business, our online off-price business continue to have robust results, but because of the Women's Apparel business, we had a 4.9% decrease for Q1 in the Nordstrom Rack stores. We know what those issues are and we're getting after it. Our team made some bets on some fashion-related items and some seasonal-related items that the customer wasn't particularly enthusiastic about it. And so we saw that and we've reacted accordingly. We're really anxious to demonstrate starting with August 16, our Q2 earnings call and going forward on future quarters, that we are taking the appropriate steps in addressing this. We don't view this as something out of our control, that it's something secular, there's something going with off-price. Our model's wrong. The ball's in our court. We need to execute better. And again, we think we're getting after that.

In 2017, we talked about throughout the year where our sales fell short of our plans, and so -- and hence, our inventories were too high. And so retail in general but particularly off-price. It's important to have Open-To-Buy to be able to be fluid, to be able to take the information that we get daily from the customer and really chase the business. And throughout all of 2017, our hands were tied in our ability to do that, and it has a negative impact with more touches and more expense and with markdowns really affecting our gross margins. Geevy Thomas, who's here today, is the President of our Nordstrom Rack store division. He's been really championing inventory management. And what we mean by inventory management is making sure that we have the appropriate balance and mix of flow and brands and great values that our customers are looking for. And so he and I were raised in the business that when you have a business like this, that's that productive, you got to make sure you got the inventory. And when you've got a uneven supply chain in the past, then we would load up in the back of our stores more inventory. What that would do is, again, it would create more touches, more expense, and it would slow down our return and hurt markdowns. Geevy's been able to, with the merchandising team, surgically reduce some of that inventory. So at the end of Q1 when I articulated that I felt our inventories are in good shape, I want to give you some specifics on that. On a comp-store basis within the Rack division, we had \$80 million less at the end of Q1 than we did in 2017 on a comparable basis. But I challenge you to visit any of those stores and see material difference front of the house how a customer experiences that



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was inventory in the back. And so we're trying to do a better job that every day when the truck comes in, it's going straight to the floor. There's fewer touches, it's more current, it helps our initial pricing and it allows us to, kind of, be on the offense and work in the marketplace and react to what's going on. And so we're in a much stronger position, not only for Women's Apparel, but for all of our merchandising divisions.

Next, in addition to the racks, really #1 goal of getting merchandise in an efficient way out of the full-line stores so that they can have Open-To-Buy and respond to newness for the customers. The second thing that Nordstrom Rack does for Nordstrom Inc. JWN is, it's our #1 source of new customers, the very aspirational customer that we are aspiring to attract and retain as well as our vendor partners is what's coming from off-price. Erik had a slide up, I believe, that showed our average age at JWN is 42 years old. For off-price, it's 39 years old. This is an affluent customer that their first foray into Nordstrom many times is through off-price and experiencing many of these coveted brands. And we show and we talked about this, the facts show that the customer then migrates to full price. We had 6.5 million customers in the last year come to Nordstrom Inc. (Rack), 1/3 of those moved to full price. And those customers that go to full price have an over 2x lift in their spend. We also talked about earlier the importance of the vendor and the brand and having the right merchandise. A unique advantage for our off-price business is the partnership and access we have to the most highly coveted brands. We are the #1 or #2 or #3 account for these brands. And it was mentioned earlier, having that robust full-price business allows our merchants from an end-to-end point of view to partner with these vendors. It's positive for the vendors' brand, it's positive in attracting new customers and it's accretive to their results. And when they have to clear their goods, they think of Nordstrom first for their off-price merchandise. So 90% of the top 200 brands are actively involved in our off-price business.

I want to talk about our store footprint. We ended the year last year with 232 stores, again, approximately \$4 billion in sales. As of today, we have 239 stores. We're particularly excited about finally getting some Racks open in Canada. This picture here is Bloor Street in Toronto. We have 3 stores now in Canada and they are well ahead of our plans. We've got 3 more opening in the balance of this year as well as 3 more here in the U.S. We believe we're in the best locations. We're in 75% of the top 20 markets. We're able to best serve our customers with this footprint. So my first slide I showed, in 2007, we only had 50 stores. In 2008, '09 and '10, we put the effort and the foundation together to expand that store footprint in off-mall locations that are convenient for our customers and how they want to shop. And today coupled with our online off-price business, we really think we can best serve the customer. And so we're going to be opportunistic going forward. There is always opportunities with changes in the marketplace. Many years ago, businesses like Linens 'n Things and Circuit City, when they went out of business, opened up key locations. We talked about earlier the closures that are taking place, it's a pretty dynamic thing, but we're in a position of strength here on this. The key thing is, these stores are productive. Our average sales per square foot is \$500; that's double our competition. The IRR on these stores is in excess of 20%. It's a great use of the shareholders' money, and it really works in the ecosystem of JWN.

Now let's talk about our online off-price business, which is Nordstromrack.com and HauteLook, and that's led and supported by Terry Boyle, who is also here today, and that's based down here in L.A. We bought this business in 2011. It's a 10-year old business. It is the fastest business in the history of this company to get to \$1 billion. We ended last year just over \$900 million. This year, we're crossing the \$1 billion mark. There aren't many businesses that in 10 years scale to \$1 billion as -- are as successful as this business is. So in addition to my comments earlier about the need to expand our footprint with stores to best service the customer, the customer wants to shop digitally and in an omnichannel and multichannel way. Most of our off-price competitors have no digital or online presence, and the few that do just have their toe in the water. We've done the heavy lifting work, we have a \$1 billion business that married with our store business is exactly how the customer wants to shop with us.

So when we look at that -- the synergy of how that customer's shopping between both physical stores and online, there's a pretty small overlap. And so we think there's a real opportunity because when that customer does, whether they are online going to a store or store to online, they spend 55% to 70% more. I want to give you an example of the type of integration that we're doing and this may sound really simple, but trust me, the execution is a little more difficult. And that has to do with how the customer when they purchase merchandise online, when they want to make a return. We take back over 80% of those returns in our stores. The customer views that as the most simplest, most efficient and best way to make that return. That will be 12 million units this year in our Rack stores. It creates, again, foot traffic in our stores and a chance they would sell them something else, but it's how the customer wants to shop. And it's bringing those 2 elements together in off-price. The vast majority of our off-price competitors don't have that ability to serve the customer in that way.

Okay. So what's all this mean? Well, Anne talked about some results that we feel confident in talking to today about over the next 5 years, off-price is a key component of that growth. For us, for JWN to win, off-price has to be successful. There'll be times over the years where 1 quarter full price is better than off-price or off-price is better than full price, but over the long haul, we need a strong and robust off-price business. And we couldn't



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be more pleased and more confident about that area of our business and what that's going to bring, both to our customer and to Nordstrom Inc. I mentioned its ability to move merchandise and create newness, both at full price and what we're doing in off-price. Secondly, I mentioned how it's our #1 source of new customers. Third, it's great on the vendor partnership. It creates a vendor partnership that no other retailer really can offer the customer, both in a young fashionable aspirational customer and an efficient way to clear goods. And what we don't talk about, it's a little bit more granular, has to do with talent. We were 12,000 people in the Nordstrom Rack stores. Many people that started Nordstrom started the Rack. Most of our department managers, their first management role was at the Rack. Most of our full-line store managers started as a store manager at the Rack. So the leadership development, the career path that happens by utilizing off-price is a huge lift for Nordstrom Inc. Again, we're really excited about what's possible, and we hope that you share that enthusiasm. We want to give you the information as we go forward with each quarter that you have the roadmap and you can follow along with our numbers, and we can demonstrate through our outcomes in our result why we're so bullish about this business.

So with that, I'd like to turn it over to Pete.

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

Okay. So only things that stands between this presentation and your questions is me.

So I'm going to try to be succinct here if I can. Put a bow on this thing. As you heard from Anne earlier, I want to talk about our main financial themes. Our financial commitment over the next 5 years positions EBIT growth of 5% to 6%, outpacing sales growth of 3% to 4%. We're committing to EBIT margin improvement of 50 to 80 basis point from 2017 to 2022. Exiting a heavy investment cycle will drive an inflection in ROIC to mid-teens and free cash flow of \$1 billion by 2022. So we believe Nordstrom is defining the future of retail. Our ambition is to be the best fashion retailer in a digital world, and we have concrete plans to get there.

I want to talk a little bit about how we do that, as you've heard a lot of this already today from Ken and Erik, in particular, but I want to go a little bit deeper. I want to start with the fashion authority part of it; that is the stuff that I work on most directly as the leader of our merchandising group. And I'll give you a little color how this works when we interact with the different vendors. Probably the #1 thing about the fashion authority, I think, in terms of its appeal for customers is our breadth of offer. It's probably our #1 differentiator. We talk a lot about Vans to Valentino, Clinique to CHANEL, Topshop to YSL. Those aren't just platitudes that exist in some kind of academic way, and it is actually a reflection of how people like to shop and getting that breadth of offer and being able to pull together looks that work for them rather than head to toe brand offers. And this is something that our competition does not do. Period. We have a distinct and unique offer in terms of how we -- what our merchandise offer is.

In terms of what is exciting and interesting to the vendors that we work with. First of all, they want a lot of control about how their brand shows up, whether it's on a website or store, they want to ensure that it happens in a quality way. They appreciate that we have a real focus on service and that we invest in all our customer touch points, not at least of which stores. They really appreciate that we're a full-price retailer, that all our goals, all our strategies, all our interactions centered around how we can do more full-price selling. That's something that's really, again, a big differentiator for us. So when we think about fashion authority in the brands, we break them up in really 4 distinctive ways. So first is the preferred group and that represents everyone from a Topshop or a Madewell to someone like a Nike or Levi's, some of the bigger, more-established brands that you might expect to see. I think the interesting part about something like a Nike or a Levi's is, these are brands that sell a lot of different people, and you may wonder how that works for us. They also have a very broad product range. And what we've been able to do over time, I'll use Nike as a specific example, they wanted to be more important to female customers. They thought that we had a lot of female customers that they would like to have. We said, "Well, that's great. We'd like to have access to your product that is rare and hard to get." And -- so we have that now. We sell -- like Nike 2 years ago, was our biggest vendor. It's going to be in the top 2 or 3 again this year. It's a very big business, but we were able to grow it quite a bit because we layered on a lot of additional product that is not found in malls anywhere. It's the kind of stuff you may see at a Colette when that existed and some of these boutique stores. And that has been the icing on the cake that's been really successful for us. We've, in particular, been able to execute in some of that product in our new store in New York. It's been super successful. Designer part of the business is the fastest growing part of our business. You hear me talk about it every single quarter on the conference calls, and it's been that way for a few years. We're growing at a double-digit rate in Designer and that's across all categories and classifications, apparel, accessories and shoes. I think a lot of that is because we haven't quite met the demand from our customers on that. It's been completely accretive situation.



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The inventory that we've added there is just only layered on to the business that we already have done. We are a much more prominent designer, stellar, retailer now than we were 20 years ago, and that's been through a lot of really purposeful effort on our part. The emerging brands, you heard Erik talked about that a little bit, largely those -- we defined those by the -- some of these digitally native brands or perhaps stores -- or brands that exist in a vertical way. They're looking for a platform to be able to expose the brand to more people. They like who our customer is. We offer a lot of transparency about who our customer is, and why that might be appealing to them and it's a great story. And we attract a lot of really wonderful opportunities, and you saw the ALLBIRDS and the Reformation and a brand like the GREATS and these come up all the time. And our goal is to leverage them and make them big in our ecosystem and then, kind of, move on and see if we can take on other ones. We will continue to do business with these people as long as the performance is good. But what you see when you catch a brand early -- in that early stage is in the growth trajectory, it's a big deal, and it can grow very quickly in our system. We've learned over the years how to really get a brand to maximum potential in a much shorter time. A brand like Topshop, it took us 4, 5 years. And a brand like Madewell, it took us 1 or 2 years. We'll see how it takes for Reformation in that. Maybe that's going to be about 1 year. So we're getting better at this. And the opportunities that come our way and the calls that we get from brands that are looking for this opportunity, this exposure and this partnership, has really been a great thing for us. And lastly, NPG and that's our own product label group. It's a \$1 billion business. 11% of our sales, we're good at this. We participate in every classification and category except Designer and Beauty. We drive really good value there. The products are outstanding. They got to stand on their own. We're not obligated to -- buyers aren't obligated to buy much stuff they don't think is going to sell. We carry this product because it performs. We get a significantly higher gross margin out of it because we're good at designing it, we're good at producing it and we're good at selling it. Customers love it. And we think we can continue to expand and grow that part of the business. Service and experience is another part of how we win. And again, you've heard a lot about that. I guess what I would say is, what we've had to learn how to do over the last 10 years or so is evolve from what has strictly been kind of a very high touch part of the business. We think about Nordstrom and a lot of it's about these stores, about super high-touch services that we provided for customers. That's still a big part of what we do. But if you would have served a customer 10, 15, 20 years ago and ask them to define service, they would talk about things like that. But there was this tipping point about 10 years ago, when online business really created a dynamic shift. And also when they started talking about speed and convenience. And so we had to learn how to pivot and do that too. So we have to be able to in our stores be prepared to have this dressing room experience that may last for 4 hours and bring in something to their house and all the super high-touch stuff. But we also got the customer coming in says, "Look, I only got 5 minutes; I just need to pick this up. Can I just get it and go?" And we've gotten good at that. And with something that we talk about all the time, how we can serve the customers on their terms. And again, let's be clear, customers define what good service is, not us. And it's important that we stay humble and attentive at the point of sale across all of our touch points that we can continue to evolve the tactics ...

(technical difficulty)

of how we serve customers.

Next, local market strategy, Ken did a great job talking about that. I guess what I would tell you most is, it's a great idea, but it's difficult to execute, and it depends heavily on a really good supply chain strategy and execution. We think we've got that capability. We've been working and thinking about this for a long time. But I think that's where you'll see supply chain as you've seen some of these investments and how it breaks out SG&A, why investing more in supply chain. It's so who we can deliver these experiences for customers. And then we want to be able to make sure, as Erik talked about, really a channel agnostic thing. If someone things about Nordstrom, we want to be able to give them all the qualitative things they like about us. These high-touch services and customer service amenities across all touch points. And again, through technology and really looking at through the local market strategy, we think we can do that in a better way and grow our business.

People and culture, this is something that doesn't get talked about often enough. Blake mentioned a little bit in terms of what happens at the Rack. I can tell you we've always benefited by having a really good leadership team around us, but none of those teams are better than what we have today. We have an outstanding group of leaders that are highly dedicated to doing a great job, and we're really fortunate to be working with them. One of the things that's evolved and changed over the years is, for me, a very kind of inbred promote from within culture, which I benefited from; that and a little nepotism didn't hurt me at all. But what we've been able to do is surround a lot of this institutional knowledge and this legacy that pulls our culture through to a next generation by people that are seasoned Nordstrom employees, people that started in the stockroom and all that kind of stuff. But we also now have brought in people that are from different industries, subject matter experts that bring an objectivity and a point of view to what we do that helps break through some of these paradigms and allows us to evolve really and define how the future of retail



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is going to go. You heard from a couple of those people already, from Anne and Ken and our leadership team who's here today. Several of them had a career and a life before Nordstrom, and again, we benefit greatly from that.

And lastly, the investment in best-in-class capabilities. We're at an inflection point here, we talked about these investments and they need to start paying off. Ken likes to say, we're going to go from writing checks to cashing checks and that's certainly our intention here. We are really focused on being in the execution phase. In our business, we have the capability and the people and the infrastructure to do that. But it takes focus and discipline, and we're committed to be able to bring that through. The investments, you heard about a lot of things we do that are foundational in nature from the technology, the supply chain. A lot of it isn't necessarily the most sexy part of the business. But we also invest in stores, and I know that might seem controversial to some in the business. But again, if we look at from the perspective of the customer and their touch points, there's a giant disconnect if we have the super whizbang, great step that happens from the technology point of view and only online, they go into the store and seems tired and not relevant and not up to speed and not connected with the different channels that we're doing business in. And so we invest a lot in that. Again, that's super important to the brands that we work with. They want to know that all these touch points are elevating their brand presence in our stores, and we're proud of the way our stores look. You got a chance to see Century City last night, and that was an example of basically moving what was it, a half mile from Westside Pavilion to Century City, we like this market. We thought we could improve our box. We thought we can improve the physical presence, and we think it's going to improve our business in its entirety and in terms of the market share for the L.A. market and so far, so good there.

So we have a lot of confidence in our path forward. I guess I would define this by saying this is not an outline for survival, kind of getting back to Erik's headline stuff about the doom and gloom that may be happening around our industry. That's not what we talk about, is how we can survive all these things that are happening to us. We don't want to be in that reaction business we want to get in front of it, we want to be linked closely to our customers and understand what's important to them keeps us moving all the time. So what we really have here is a blueprint for success. We have great confidence in our ability to be able to deliver this. We hope that, that's come through for you all today.

We're anxious to take your questions, and we will move on to that. So Trina, come on up.

QUESTIONS AND ANSWERS

Trina Schurman

Thanks, Pete. Before we get started with Q&A, so I am one last barrier. We're going to take a quick 15-minute break, so that way you can take little bit of relief and we'll get started again. Thank you.

(Break)

Trina Schurman

Okay, if everyone could get seated.

Okay, I'd like everyone -- the speakers to come back on stage. Give you guys about a minute to get situated.

So here's how we're going to do it. We'll have several mics out in the audience. So if you could please wait until you get the mic, you want to make sure everybody on the webcast can hear. I'd like you to state your name and your firm and then proceed with your question. We'll also fill in with any questions that we've received along the way. And we actually wanted to kick it off with the first question. We've been hearing this a lot. So I'm going to throw it to Anne, on our credit revenue assumptions and what that means in terms of our targets that we gave?



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Anne L. Bramman - Nordstrom, Inc. - CFO

Thanks, Trina. So I wanted to clarify on the sales target. So sales target does not include credit revenue. As you look at our P&L, we split out credit revenue separate from sales. Everything we've talked about today is net sales, it does not include credit revenue. The end of 2017, credit revenue was roughly \$340 million. We gave guidance in our '18 range that it's mid-teens growth, and I would assume going forward, it's going to be in line with our sales CAGR of 3% to 4%.

Trina Schurman

Great. Okay. So first question, I'll -- right over here in second row.

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

Oliver Chen, Cowen and Company. The pull-inventory model sounds quite unique. What are your thoughts in terms of making that work with respect to vendors as well as speed and how inventory versus sales will trend in order to execute on pull? The second question was just about customer engagement at large and customer count. How are you thinking about retention versus acquisition and CAC versus LTV? Will customer acquisition costs -- are they growing? And what are your thoughts about how the count will evolve and your analysis there?

Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

I can take those questions. On the push versus pull-inventory model of the flow model that we talked about. First, I would say, I wouldn't characterize it as completely unique. There's certainly other retailers who've come to the same realization, which is localizing inventory and changing the balance between push versus pull has some benefit, not necessarily in our direct space, but there's other retailers who've announced similar kind of investments recently. For us, the big realization is that we can -- but when we do this well and this is certainly our focus in L.A., there's an opportunity to both serve customers better in the sense of giving them more selection a lot of these fulfillment experiences, but also be able to get them product faster, while also making us more efficient on our biggest investment, which is inventory. With respect to vendors, I would say, right now our focus is very much on doing this well with the owned inventory we have, which is our model. Our model is largely focused on owning the inventory. So there will be certainly opportunities over time, I think increasing opportunities to work with our vendors as well to figure out how to leverage that capability more effectively in partnership with them. But right now our focus is very much on how do we take what we already own and use the model to address customers' needs around selection and around speed and convenience of their experience. And at the same time, reduce costs for us and increase the asset efficiency in our biggest investment, which is inventory.

On the second question, I can start but on the customer engagement question, we'd say that it's a -- we look at it a lot. I mean, we -- as you guys saw, we have a lot of data around what happens at an individual customer level when 2 customers look the same and something changes. Something changes in the sense one of them starts shopping at channel they didn't use to or they engage

(technical difficulty)

with the service that they didn't. So we know a lot about what the touch points are that drive a change in the value of individual customers. We also, and we've -- Anne reference this, we're going to provide more transparency on an ongoing basis of what's happening with our customer counts and our engagement with those customers. So we look at those metrics quite closely. And on the acquisition costs, what I would say on that is the combination of the analytics and data that we've applied in our marketing organization and some of the benefits we get for things like acquisition out of our off-price business and our Rack-store business, we've actually seen an ability to acquire customers at a consistent and very economic rate and produce a good returns off of that. Now not all of that -- from a digital marketing perspective, we use the analytics all the time to tune that and balance that. When you look at something like our stores, we don't directly control all the time how much traffic's going to hit a store, but we do measure how much of our acquisition is coming through those channels, and it has a big impact on where we put our marketing investment.



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Trina Schurman

Okay, there's a question in the third row.

Heather Nicole Balsky - *BofA Merrill Lynch, Research Division - VP*

Heather Balsky on Lorraine Hutchinson's team at BofA. Can you talk about your appetite for doing another acquisition like a Trunk Club or a HauteLook? And if you are interested, what you might want to do? And then as a separate question, is 300 still the target for your Rack stores?

Kenneth J. Worzel - *Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com*

Who elected the acquisition?

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

You're going to take the acquisition.

Kenneth J. Worzel - *Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com*

Yes. I'll take it. The -- I guess a couple of points. One is we're always looking for ways to better serve customers and certainly that hasn't changed. And we're obviously not going to comment at any given point in time or speculate about what we might do in the future if an opportunity came our direction. The same time, what I would say is we continue to look for opportunities to leverage all different ways to partner with folks on the outside and make investments that help serve customers. So more recently, we've done that more in the sphere of investing in capabilities with third parties investing in companies that add capabilities for our customers. We've been public about some of those, so an example is dropship.com or Dsco as an example of a strategic partner we have. We have a very strong relationship with. We've also made a small investment to help them scale to serve us. We have other small investments aligned with serving customer better in things like how to use robotics in our supply chain network. So if it makes sense in terms of scaling the strategic relationship and serving customers, we look for ways to tighten those partnerships externally, and we'll continue to do that. We also, as part of our effort to continue to be on the forefront of seeing where customers are going and where technology or other opportunities to serve them are going, we have relationships with some of the best investors in the venture community that invest in the commerce space. We have, as an example where -- we have been, for a long time and continue to be partnered with investors like Kirsten Green at Forerunner Ventures, who's an amazing investor in this space, and Aileen Lee at Cowboy Ventures, who similarly has a lot of focus on where retail is going. We're also in L.P., a new fund that Natalie Massenet, Nick Brown have started, that's focused on this space. So we try to use a broad approach to keep on the radar screen things that could help serve customers better and to help us innovate.

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

Heather, your question was about the Rack, and you talked about roughly 300 stores. And we were asked -- I was asked many years ago as we were starting to embark on a Rack store growth plan, how many stores we thought we could have. And at that time we thought approximately 300. For the last couple of years when I've been asked on the earnings calls, I've said it's been something less than that, inclusive of Canada. We'll end this year just shy of 250 stores. We don't have a store-count strategy. We have a customer strategy. And when we were embarking on that and talked about again approximately 300 stores, it was really absent of a very robust online business as well. And so we really think about both our full-price business and off-price business in that manner with both of those channels together integrated. We see growth opportunities, but there isn't a specific store count growth.



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Trina Schurman

Next question. I see one towards the end and then I'll get to you next.

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

Mark Altschwager from Baird. First I wanted to ask about the local market strategy. So how is the store labor model changing? Are there more hours moving towards fulfillment-type activities versus the traditional commissioned sales role? And how does this change the fixed versus variable mix of SG&A? And then separately on local market, just to the extent you like the results in LA, how quickly can you roll this out to additional markets, what would be the next couple on the list? And then separately for Anne, just bigger picture on the financial targets, what do you see as the biggest risks to the margin numbers you put out there today?

Erik B. Nordstrom - *Nordstrom, Inc. - Co-President & Director*

Yes. I'll take the labor model piece. Not just the local store. We'll talk about that. We have one of them so far, and it's small and we're learning a lot there. But it is true that there is more fulfillment activity in our stores in general. And that we do have more hourly people as a critical portion than we used to. We were experimenting some different labor models to incent our people the best and to have their time as productive as possible. My guess is where it's going to go is that we will have commissioned sales people, but we will have some more hourly people too. And their activities need to be fluid, it's -- we can't -- I don't think have people who are just for a pure fulfillment people and then people who are just purely can deal with a customer. It's -- we need to have that flexibility to be able to serve customers and to do the fulfillment activities that come out of the stores as well. I think the net result of all that is, our selling cost in our stores have not been growing, as we've had some decline in our sales in the last number of years. We're able to manage that pretty darn well. So whether it's an hourly rate or a commission rate, our stores have that portion of our labors variables to store to the sales and we see that continuing.

Kenneth J. Worzel - *Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com*

And on the scaling of our local market strategy, as I referenced, our focus has been first on getting it operationalized. I think Pete referenced this. The complexity here isn't the idea necessarily it's operationalizing it. Anytime, and it's certainly been our experience, anytime we've introduced things that connect digital and physical, the key is to get it executed really well at every touch point. And so that's why we've started with one market, a big market, our biggest market, but enabling us to focus our energy on getting the operationalizing of all those components proven. And then from a scaling perspective where we go next, I mean I think, our focus is very much next year on how to bring relevant parts of that experience and new experiences to New York as our next top market to really focus on. And I think the combination of what we're learning this year, what we learned in the front half of next year with New York, will then inform how quickly we can scale to other top markets like Chicago and the Bay Area and Seattle and others. So we'll see, but that our plan right now is very much focused on prove it and you get the kinks out here in L.A., bring it next to New York with the modifications to localize it for the New York customer and then move on from there.

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

As far as the question on the overall model, I just want to reemphasize, we are very confident in hitting these targets that we laid out for 2020 and 2022. If you look at the range that we've given for the EBIT components with the 50 to 80 basis points, it really depends on how quickly we can scale and mature the generational investments and how quickly they come online. But other than that, we're feeling very confident about the targets we've given out to you. As far as risks to it, I mean from a macro perspective, there's always the macroenvironment risks. I would tell you, though, the part of where we think we have strength is that we have a very healthy balance sheet that can weather a lot of storms out there. So we think we're really well positioned if anything like that were to happen. The other piece that we're very sensitive of, and you've heard it from Pete and Ken, is making sure that we're driving with speed to meet the customer needs. I mean, that's something we're constantly looking at to make sure that we can deliver on that.



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Trina Schurman

Great. And then a question in the front row, please.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Chuck Grom from Gordon Haskett. Anne, just on the margin, you touched on it just briefly, the 50 to 80 basis points. At first blush, it looks conservative, but then when we dig into the generational investments coming offline, which I think the math would come out to about 80 to 90 basis points of a benefit. The strategic brands going from 40% penetration to 50% is, say, 25 basis points of benefits. So it seems like you got some cushion in there. So I guess, the question is, is that the right way to look at it or what are the offsets to that margin cut.

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

Yes. So again, the one thing to keep in mind is the EBIT targets we laid out really drives superior returns to shareholders. So what we've laid out does not rely on significant top line growth as 3% to 4% CAGR. We're delivering an EBIT that gives us mid-teens ROIC and really strong healthy cash flow. So I think that's something to keep in mind. The model has changed, and it's much more capital efficient.

Having said that about the margins, we do -- if you look at what's baked into there, as I mentioned, it really depends on how quickly the generational investments come online. We talked about the fact that we're continuing to invest in our supply chain, you heard about this in Ken's section, and that's going to take some time to ramp up to get to maturity, which you're seeing a little bit of piece of that in the SG&A component, which we gave guidance that we think that we're roughly in line with the sales CAGR of 3% to 4%.

As far as opportunities, we're still early stages with local market. We've baked in the investments in the expense and modest improvement based on outcomes from this.

As I mentioned, we're early-stage and there's an opportunity as this comes on line to really come in and help from the market share perspective as well as the investments from an inventory perspective in our margins.

The other piece to it is when we get the generational investments to come in even more quickly, that's also some upside for us. And as I mentioned, we're always looking for opportunities to drive more productivity and scale out of our fixed cost and SG&A. So we're really focused on that as well.

Trina Schurman

Okay, question over there, see a microphone heading over?

Unidentified Analyst

Yes, just a question on the slide of -- the economic slide. There was about...

Trina Schurman

Oh sorry, before you can start, can you just state your name and...

Kevin Foll - *Gratia Capital - Analyst*

Yes. It's Kevin with Gratia Capital. In terms of the unit economic slide, there's a line item about 10% shipping cost for the online portion of the unit economics, and as I think about other retailers I follow, distribution cost, warehousing cost, et cetera, that fall in that line item, tend to be around



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mid-single-digit percentage of sales. And so I'm trying to reconcile, maybe the cost of a return where that is within that line item? Because I imagine that there's a \$5 or \$6 charge to ship it to somebody online and then to return it. If they decided to ship it back to the store, that might be another \$5. So where are the return cost in the unit economic slide? Or where are the distribution costs in that line item, because it's only adds up to 10% of sales. I'm trying to reconcile how it can only be that small, I guess?

Erik B. Nordstrom - Nordstrom, Inc. - Co-President & Director

Yes. I think it's important on that, that chart was not a percent of sales. That was an illustrative \$100 sale. Our average sale was higher than \$100. So to flip the math percentage of sales is going to be a little inaccurate. So our supply chain cost a little different in full price than off price. We have free shipping in full price, but it's -- that flow-through, that contribution margin is accurate.

Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

I think the other part of the answer, which I think we talked about a little bit at the break is, that was on a net \$100 order. It is inclusive of returns and the cost associated with handling all those returns that is in part of that supply chain of fulfillment line item you saw there. But it is important to recognize, and Blake referenced in off-price, that over 80% of our online returns get walked back into a store by a customer. I think full price, it's over 60% and so that has a material impact on the cost of dealing with the reverse logistics. That is a much more efficient process for us.

We don't -- to Erik's point, we have free shipping and free returns so we're not coercing customers to do that. They do it because it's a better experience for them and more convenient. But that has a big financial benefit with respect to how our shipping and fulfillment costs look relative to some other folks. And to Erik's point, our average order value given what we sell and the price points we sell it at tends to be quite a bit higher than a lot of other e-commerce retailers, which also has a material impact on how that supply-chain cost looks for online orders.

Erik B. Nordstrom - Nordstrom, Inc. - Co-President & Director

Yes. I think -- I don't think I touched on this. There's -- a part of -- again, the economics are the e-commerce business and again, we get this question a lot and keep wanting to isolate those economics, but what's helped us a lot is higher order value, having a mature digital platform. We've been at this for quite a while. And the synergy of their stores and Ken's example is a powerful one. It is simply more cost efficient for us to take returns back through a store. We get them -- not only is it more cost-efficient to get it back to us, we get it faster and the margin recovery is higher. So those things come together, make our e-commerce economics better than if we were a standalone e-commerce company.

Trina Schurman

Great, I'm just going to pass, yes, right next door.

Unidentified Analyst

You put up some interesting slides in the service continuum of high-to-low touch and the transaction values, the more involved the Nordstrom staff is in the sale alterations, personal shopping, et cetera. As the business moves increasingly online, that personalization and maintaining personalization as the people are coming into the store less becomes more important. Can you talk about where you think you are on achieving your potential with that recognizing that it's fluid, right? This is going to continue to change, but reaching out to the customer creatively, inspiring them when they're not coming into the stores potentially as much? Where are you technologically to be able to get where you want to go? With that local market strategy and what you showed us in the video being very powerful, but highly specialized.



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

Yes, I'll take that one. What I'd say is the high-touch and low-touch service is certainly component of this. But some of the examples that you've seen are, from the customer's perspective, feel very low touch and on their terms. Example of Style Board is a good example. That's an experience that has some of the highest CSAT and NPS scores. So customer satisfaction and net promoter scores of any experience we've ever provided to a customer. And I think it's because it provides the best of what they're looking for from us, which is inspiration from a person in this case but supplemented by data and analytics, but it's delivered to their phone, they get to engage with it on their terms. And that experience doesn't have to -- the video showed that experience leading to an in-store fulfillment experience, but the Style Boards experience can also shop off the board, send it to my house. So what we're seeing is that there are lots of digital opportunities to engage with customers and inspire customers that customers respond to, and it's not for us to choose which journey they are going to be on. And the same thing is true if you look at our app. Not surprisingly, customers that engage with our app, engage often. They spend a lot of money. A lot of the time that they are on our app, though, is about discovery and inspiration. I think that is what's different about the business we're in. We're not selling commodity consumables. We're selling stuff that people are looking for. They don't need it, they want it, because they are inspired and they discover it in some fashion. From a marketing perspective, the example of influencers and fashion affiliates and bloggers is a really important example, which is, it's a way to get our brand and our experience in front of customers in the natural way that they are interacting every day digitally, which is out in the ecosystem. Sometime in the ecosystem that extends well beyond our walls.

So we're partnering with folks to do that. I think where we have a lot more opportunity and are making a lot of investment and are in the early innings is how to continue to personalize all of those experiences digitally, so that it becomes obvious that Nordstrom knows you on the basis of your interactions with us and your engagement with us, whether they happen in store, with a person or happen digitally. And we're pretty excited about some early examples of this. I mentioned dynamic looks. That's something that is getting a lot of traction with customers as well. They are like, "This is great. When I look at a product, you show me how to style it with other product," and we think there's a lot of application of that kind of engagement and personalization for customers and the early signs are, that's the digital equivalent of the high-touch experiences we've historically provided in stores and it has the same kind of result, which is that it results in higher engagement and higher spend. So we'll continue to roll those out and invest in those.

Trina Schurman

Great. The next question and I'm going to go back to the submitted questions. As we begin to view financial performance more holistically, rather than by channel, how do you evaluate whether to keep or sell assets, for example stores, on valuable real estate?

Anne L. Bramman - Nordstrom, Inc. - CFO

So I think the thing to think about, I'll take the first one. You guys may want to supplement, but the first, maybe, think about really looking at this on a market basis. So we're evaluating both our digital and physical assets in that market, driving market share and getting the return on that in those markets as well. So that's part of the evaluation process. As Ken talked about, we were investing in the supply chain, for example, in Los Angeles for the West Coast. So that's a piece of what we've looked at as far as how do we make sure that the economics hold together the total market component to it. That's the way that we're focusing on it. As far as the real estate component, you think you heard today, we feel like we've got a really good, healthy store portfolio versus what you may see from some others in the marketplace. And as far as store closures and that type of thing, you will -- we look at this every time a store comes up on its commitments. We'll look at what the investments are in that mall. We look at what investments are in that market, and we assess whether or not we move it like we did here with Century City or we close it or we remodel it. So it's kind of part of the process we go at making sure that we're delivering on that total market experience.

Erik B. Nordstrom - Nordstrom, Inc. - Co-President & Director

Yes, I would just add stores -- we do regularly evaluate our store portfolio and there is the basis that share that all our stores are cash flow positive, but that's not dollar criteria. Number one, we have to look at our lease obligation and when our lease obligations come to an end, it is at an actionable point for us.



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So we not only look at the profitability of those 4-walls. Mainly we look at the contribution of that store to the market and we can -- we have insight into the role that the store plays into the market profitability that we have there. So it's just not the 4-wall sales. The other factor that is very real is the investment that is starting. It's -- if it's a low profit store, low contribution store, but still profitable, but it's in need of an investment and we cannot make a good business case to put an investment in there, that's where you've seen us close up stores. So we've closed, I think, we've averaged around 2 a year for the last number of years. I think that's a decent sign of our pace going forward as stores come up. There'll be a few that fit in there, but again, nothing at a real large scale.

Trina Schurman

Wonderful. We'll go to this question, front row.

John Tompkins

John Tompkins from Tyvor Capital. My question is about Canada. When do you expect to break even in Canada? And then what do you think the ultimate margin opportunity is in Canada relative to the United States?

Anne L. Bramman - Nordstrom, Inc. - CFO

Ah. So we haven't specifically called out specific markets or territories. We talk about this in general from a generational investment. We knew going into Canada, it was going to take time to scale and leverage some of the investments we needed to make from an overhead cost perspective. And we're continuing to see traction. Opening of the Rack stores this year is really a great way to continue to build out that business model, because it introduces the concepts to more people in that market and also provides exhaust for the full price store to allow more freshness coming through. So as part of the total generational investments, that scale and maturity is included in that improvement in EBIT.

John Tompkins

So maybe a different tact or hit on it. So when you went into Canada, I remember, you were going to do I think it was 6 full-line stores. You signed these commitments, you had a lot of the rent payments just running through without any offsetting revenue. And so now, you have all those stores open and surprised to hear, or not surprised but various -- it sounds like the Vancouver store is very successful. So has the financial performance improved relative to what it was, just because they're running and you're not paying dead rent?

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes.

John Tompkins

And now you're just opening these Racks. So those are...

Anne L. Bramman - Nordstrom, Inc. - CFO

Again, so again, it's going back to the One Nordstrom concept, right? So with the full-line stores have come online, that certainly helped the economics. As Rack is opened up, it's absolutely helped the economics. Because it's also leveraging some of the overhead investments we've made in that country, in that market. And then, as Ken talked about, some of the digital components really helps complete the total journey from a One Nordstrom perspective. So as we continue to add some of this on it, it keeps getting the business case even better from a maturity perspective.

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John Tompkins

And then the final thing would be just like longer term, is there any reason why Canada wouldn't be as profitable for you as the United States? Is there any structural reason why that would not be the case?

Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

I think Canada is -- there are structural differences. So -- that are both on the plus column and the minus column. So stores -- Canada, we talked about the reality of U.S. retail being over-stored in the macro sense, that's much less true in Canada. Productivity in physical locations from retail, in general, in Canada tends to be higher as a result. So there's some pluses around that. But there is complexities on things like product margin relative to the size of that market, the cost of getting product into that market. I think from our perspective, we still have some road to travel as we continue to build out the business there on things like the Rack stores, which are significantly ahead of our expectations and plans so far. But what's the impact of that on the overall margin? So I don't know that we would commit to exactly where all of that comes out relative side-by-side with the U.S. business other than to say that there are differences on the pluses and the minus column and on balance, we're very comfortable that it's a -- going to be a sizable and profitable business for us.

Trina Schurman

Okay. I think there's a question right here in the fourth row.

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

Jay Sole of UBS. First, I just want to say thank you for a great day and also, thank you for all the numbers. It's a really great level of detail, it's really helpful. I want to ask you about fashion. Because you mentioned a couple of times during the presentation that fashion is core to what Nordstrom does. And if think about the last decade, technology has excited consumers, the iPhone, things like that. There may be even some other categories outside of traditional soft lines have been more exciting. What does your data tell you about consumer's willingness to come back to fashion or at least, make it a priority compared to what we've seen maybe over the last 10 years?

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

You want me to take that.

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes.

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

We don't really dive into it that deeply in terms of trying to change our source based on those vagaries that happened. The fact is, people are still buying a lot of clothes out there, and our market share is not so great that we can't do any more. I mean, this is not Coca-Cola or something. So I think, we just look at it in terms of there's a lot of apparel and shoes and accessories being bought. There might be some classifications that are complementary. For example, we got into the Anthropologie Home business. We've always had a kind of a small home business. So dipping our toe in the water there, going to see what's possible relative to that. In things like, for example, baby gear has been a superhot category for us and talk about strollers and car seats and stuff. And it's a logical extension of what we sell and it's a sizable business. So we try to stay open minded on it, but I think, ultimately, to the point that we are a curator, I think we can't be an aggregator of everything. I think we've got to be really good at a subset of what happens out there. For us, we're in the fashion business. Trends come and go, but if you just kind of drew a straight line through



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time, you could see hit at business continues to chug along. So I think the better way for us to look at is in terms of what's our market share like and how we're doing relatively in the classifications we participate.

Trina Schurman

The question.

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

Way back there.

Trina Schurman

Yes, in the way back.

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

You've been very patient back there.

Michael Charles Binetti - Crédit Suisse AG, Research Division - Research Analyst

Michael Binetti with Crédit Suisse. Thanks for all the detail today. So I guess, since we're thinking about the business through a different lens today with the generational investments versus non-generational, I want to dig in there a little bit and just think we can help what's the profitability ramp there as you're going from \$1.5 billion in revenues from those assets to about \$3.5 billion by 2022. So a fairly big CAGR. But it only breaking even by 2022. I'm wondering why there is not more corporate leverage on that kind of an incremental sales volume, and is there 1 or 2 components in there that are holding it back more than others?

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes, so we're still -- these things take time to ramp and so we've got Manhattan coming online, '19 to '20. We are continuing to invest expand in the Canadian market and then, we're continuing to get scale on leverage out of the digital businesses we've acquired and built between nordstromrack.com, HauteLook and Trunk Club. So again, this all takes time. We're scaling, we're getting leverage. We are getting improvement in profitability, which is what you're seeing and that piece of it, not only -- as Ken likes to say that we are cashing checks now versus writing the checks, but we're also continuing to get that out -- the overhead component leverage to it.

So what your -- so that's part of what's flowing through the EBIT component to it. How fast we get there on the different points is really going to be kind of the spread that we're getting on the EBIT component to it. What you're seeing is -- as you mentioned, is that top line is about 70% growth from generational and it's less of a flow-through at this point. We're continuing to see how we can get improvement in that flow-through because the core businesses -- it has a higher proportion of flow-through to cover the EBIT margins.

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

Can I follow that up? Maybe you could help us think about the expected profitability ramp from Manhattan. Because you now you have your dead rent diminishing, you said rack.com, inflecting the profitability. Canada will be largely built out and I think Trunk Club stabilizing. So it seems like, you're kind of implicitly isolating the Manhattan ramp that you want to give yourself a little bit of room for, is that fair?



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Anne L. Bramman - Nordstrom, Inc. - CFO

I think it's beyond Manhattan. So as we continue to see growth in the digital components -- digital businesses, we're continuing to see how we improve profitability and drive scale in that. Again, Manhattan is a component to it and then, we've also talked about Canada being a journey in the maturity of that market as well. So it's kind of a combo of all things. Now Manhattan, clearly, the big component to the '19-'20 and while you're seeing a little bit more of inflection past '20 on the EBIT margin improvement.

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

Okay, if I could just finalize one last one. I think you said earlier that you approximate in the second half of the plan that comp growth will approximate total revenue growth in the out years. I think, everybody in this room spends a lot of time thinking about where the market's going to be for not just you guys but your competitors at that point. So how do you -- maybe, you could help us think about how you built up to 3 to 4 comp in the out years. What your -- and I think it implies gross margin expansion as well. How you thought about the marketplace as you get beyond 2020 and thereabouts?

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes. So we assumed and what we've seen pretty consistently from a market growth perspective if you step back and look at the total market is around a 1% market growth. So when we layered in the market share pieces to it, we just assume that current trajectory of about 1% overall for the market.

As we think about the generational investments component to it or the top line piece to it, what we've laid out was that we are seeing about 70% of the top line coming from generational investments, Manhattan coming online as well as continuing growth in those pieces of the business. And then, really, if you look back, it's pretty much current course on trend on the current core business. So if you -- just to remind you that 2017 had a 53rd week. So once you kind of adjust for that -- correct for that, it's really very consistent top line growth for the core business that we've seen in the last year or 2.

Trina Schurman

Take another question back, but towards the front, yes, right there.

Adrienne Eugenia Yih-Tennant - Wolfe Research, LLC - MD and Senior Analyst Retailing, Department Stores & Specialty Softlines

Adrienne Yih, Wolfe Research. Anne, I wanted to go back to that slide. It's not -- it was contribution. I think you said contribution margin? And I want to know, how do you define that? Does that include fixed cost? It didn't seem like it did when we compared the 2 channels. Then secondly, if you can talk about where the breakeven comp was during this investment phase, historically? And then lastly, maybe, for each of you, this is more a competitive question. Can you give an example of a new world retail model, be at Stitch Fix or Amazon Wardrobe or boohoo.com that impresses you? Why and what components of that can you adapt to the model?

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes, thanks. So, sorry, the first part of your question was?

Adrienne Eugenia Yih-Tennant - Wolfe Research, LLC - MD and Senior Analyst Retailing, Department Stores & Specialty Softlines

Just define the margins.



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Anne L. Bramman - Nordstrom, Inc. - CFO

So a lot of that really is more variable cost. So in the piece of it between contribution margin and EBIT, there is a fixed component for some of the things investment like generational investments, capability investments like in technology and marketing, that's more infrastructure related, that's not part of that, that gets kind of spread across everything. So that's a piece of it and as I mentioned in my comments on SG&A, we're always looking for ways to drive more scale and more productivity out of our infrastructure and overhead components to it.

As far as the breakeven, I can't really -- you guys can do the math on the historical. I think if you look at the roadmap that we gave you going forward, you can pretty much back into what it would take from a top line perspective to be at a parity from an EBIT for margin rate. And I want to pivot back to the fact that the model has changed. It's a much more capital efficient model. It doesn't require the historical 11%, 12% EBIT margin and it's going to generate really strong returns for shareholders and free cash flow.

The model we're comfortable with and very confident in, actually, doesn't rely on a significant top line in order to get to that EBIT margin improvement in the terms.

Trina Schurman

Get that question back there.

Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

Yes, there was the second part to that question and I'm happy to lead and other people can chime in. I think your examples are good examples, but we could give you 20 examples as we look around of retailers who are doing interesting things that are either variants of things we thought about, or things we haven't thought about that we look at and say, "Is there an application of that for our customers and in our customer journeys?" But most of where we start from is from our customers. We start from looking at what our customer is asking for.

So you mentioned Stitch Fix. We have Trunk Club; it's an offer that in many ways looks very similar. In some ways, it's quite different in terms of the product that we're able to offer and the type of product that ends up going to the customer. It's quite a different price point and selection of customer choice than what they are able to do. But that team's obviously done a great job in serving customers. And we have learned things from how they serve customers that we have a variant of that we have applied in our Trunk Club business. And that would go, I think, across a lot of competitors. But we start and finish with customer obsession. We start and finish with what are our customers asking for that we are not providing in the best way we could and where do we change our model to be better at that. I think other folks are going to have different plays because they're in a different business. In many cases, selling different things, serving customers' different needs. So we want to be externally curious but I also think we want to stay true to the dimensions at which we think we win with our customers.

Trina Schurman

Great. How about towards the back in the center, gentleman in the blazer, yes, right. Okay, I'll get you next.

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

It's Omar Saad from Evercore ISI. 2 questions. The first one, it seems you're telling us we were once a 13%, 14% operating margin business. We were 6% last year, we're going to claw a little bit of that back over the next 5 years. But you keep telling us the model's changed, the asset turns are improving, the capital efficiency is improving. It's an interesting story that you're telling here. What gives you confidence in the consistency of the business that's going to allow you to run that level of profitability and consistency behind the returns? What has changed about the business? Are there insights into fashion predictability? It feels to me like the industry used historically to be a higher margin industry because of the more feast-or-famine nature of fashion. So is something changed on that front that allows you to be confident in the consistency of the business?



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Anne L. Bramman - Nordstrom, Inc. - CFO

You want to take the fashion? I can take the model.

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

I'm not sure how to answer that relative to the fashion. I don't really know how to answer that.

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

I do think on that subject, you mentioned margin and fashion and you talked about historical. We're at historical highs or close to it from a gross margin. The models changed. So the margin per se, is pretty robust for the number of things you guys have been working on.

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

Yes. Well, I mean, the big catalyst that we had is we went to shared inventory, that made a big difference in terms of the efficiency of the inventory in reducing markdowns. So really technology in a lot of ways has helped enable just efficiency of inventory and margins. Then, I guess, I'd say really beyond that, as there's more ongoing strategy, we have to try to partner with brands to solve for common issues and how we can do business together in a way that ensures full-price business. Although the slippery slope for us would be being engaged in products and brands that are highly promotional, which is really corrosive to the margin. So we spend a lot of time looking at that and seeing what we can begin partnering with people that are committed to full-price selling.

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

But the drivers or contributors of the model have changed. So whether that's technology, marketing, supply chain, some of the capital investments, we have for about 20 years now really been focused on ROIC. We've seen the closest correlation to share price and shareholder value with ROIC improvement. And so the whole ROIC model has changed in this new world and that's what you've been advocating is that we can have a robust ROIC with different elements contributing to it than the old model.

Anne L. Bramman - Nordstrom, Inc. - CFO

Right. As far as the confidence, when you look at the leverage in the business, we don't need to get back to an 11% EBIT margin to get to those returns, the ROIC returns and the free cash flow. What we're showing is that it's a less -- it's more capital efficient. Some of the things you may be putting in your capital expenditures in the past are actually coming through on the P&L when you think about things like technology. So 5 years ago, 2/3 of our technology expenses were capitalizing big projects. Today, it's only about 1/3. So even as we migrate more and more to cloud and to agile technology. So that's just a different piece and where it lands, and that's why we're really focused on cash flow as well.

In the top line components to it, it's a pretty consistent trend as what we've seen in the business from both off-price and full price. The only -- the biggest contributor to that is the generational investments coming online and continuing to mature. And quite frankly, we've seen that growth already and we're continuing to drive that growth, that scale in those investments.

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

And then if I could just ask one quick follow-up. Is there any update on the go-private thought process with the family? Is there any insight you could provide in how the family was thinking about the opportunities there? Is it really just more of a valuation? You're seeing the valuation of the



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company and an opportunity taking advantage of that? Are there other factors that would have provided a better landscape for the company to operate under private ownership?

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

We are not here today to talk about that subject. We're excited about our strategy. We're excited about encourage our ability to grow the business and to return meaningful value to the shareholder. The special committee of our board in spring announced that this process was concluding. We support and abide by that, and we're 100% focused on being the best public company we can be.

Trina Schurman

Great. I am going to take one question, right, the next fellow, please. The gentleman in the suit jacket. Yes, you.

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

This is Ed Yruma from KeyBanc. Just 2 quick ones for me. First, there's been some hesitation by vendors to allow off-price online at least, maybe, in a very explicit way. So kind of, is growth in Rack predicated on some of that mindset changing? And then 2, I appreciate you said that all your full line stores are cash flow positive. Could you talk a little bit about some of these smaller market stores that maybe haven't gotten the capital or attention that some of these large urban stores got?

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

You want to take the first on the product.

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

Yes, the thing about the off-price part is a reality for everybody that makes themselves product, because it doesn't all sell equally well. And so there is distress exhaust that exists out there and I think Erik brought it up. For many of these brands, we're their biggest full-price customer. And so if they're going to have off-price distressed product out there, often times, they'll exhaust that through their own means, their own outlet centers, what have you, but we're kind of the logical place for them to go.

So we have access to a lot of this stuff. There's some, thinking very few, what would it like, say, 90% of our top 200 brands sell us directly. And -- so we -- there's plenty of supply out there. That has not been an issue and I get -- I suppose, it could be at a certain point. But it really hasn't at this point. I mean, you heard like the Madewell example. We don't do off-price any -- business with anyone, but we do with you. So there is this level of confidence and trust and when people understand the ecosystem, the 4-box part of it. The most successful big brands at Nordstrom are the ones that participate with us in every box and all these guys are competitive. When we use that information all time, if we say, "Hey, what brand you compare yourself out there?" And they'll say, "Brands, they will -- this is what they do at Nordstrom." "Oh, maybe, we should try that too." So I mean, it's all part of the ongoing journey and we don't get 100% of what we want but again, I think, that there -- these are practical realities that we can partner on together upfront and it really just benefits the whole.

Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

One thing that I would add, Pete, is the other thing that's been super valuable in those conversations is, we can show very tangibly evidence to the brands of what happens when a brand sells us online, off-price. There was a much bigger barrier 3 or 4 years ago for us. But now that we have a track record of having brought brands into that fourth box, and we have been able to show brands that it lifts all the boats for their brand and for us, that it actually improves not only their Rack store business, but also, their full-price business with us. To Pete's point, brands are competitive



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and they want good outcome. So when we are able to give them data to say this is how it works, and this is how it's worked with other brands in terms of why it's a benefit, it's unlocked a lot of doors. So we haven't -- that's it not been a big problem recently in terms of having enough selection for our off-price customers.

Erik B. Nordstrom - Nordstrom, Inc. - Co-President & Director

To your small market stores, when we look at our stores on a store-by-store basis, there's a high level of variability. We have some one-market -- one-store market, small-market stores that are very successful and some you've seen us close those stores over the years so. There's not a big generalization to make there.

Trina Schurman

Great. We're approaching the end of the Q&A. So any last questions out there that feels urgent? Okay, I'll take that one.

Brian Douglas Callen - BofA Merrill Lynch, Research Division - VP and Research Analyst

A lot of pressure here. Brian Callen from Bank of America Merrill Lynch. I just really come back to the long-term shareholder return plan relative to managing that healthy balance sheet and sort of moving leverage inside of 2.5x. Looking at the sort of pacing of free cash flow and then CapEx in 2019, I guess, the question is, is the buyback more -- in the figure that was provided around the buyback, is it more 2021, 2022 loaded? It seemed to imply based on the cash flow that there's still some incremental debt that's needed to fund the buyback, obviously, EBITDA should be growing. But it seems like maybe, the ongoing leverage target is more like 2.25 on the math or to fund the buyback is maybe in the low 2s versus sort of the 1.5x to 2.5x. So just some clarity around that and sort of the long-term return plan.

Anne L. Bramman - Nordstrom, Inc. - CFO

Sure. So I think the thing to remember is that we were out of the market for share buyback for about a year. And so at the end of the year of '17, we had a decent amount of cash already built up on the balance sheet, about \$1 billion worth -- \$1 billion to \$1.2 billion. So we already had started with a pretty strong cash flow position. As we're thinking through, as you mentioned, our free cash flow from '19, we do have some headwinds on CapEx but we still have a lot -- we are seeing improvement in the EBIT in the profit component to it as well. So it will be a ramp. Having said that, we're looking to be very consistent in the market as far as share buyback. So we're not looking to do anything super big or we just want to be very consistent out there. Now having said that, if we see the price drop down, we're going to be opportunistic about it. But in general, the way we're approaching our capital allocation is to be pretty consistent out there.

Trina Schurman

Great. We have one last question.

Howard Roy Gleicher - Aristotle Capital Management, LLC - CEO & CIO

Thank you very much for hosting, particularly in Los Angeles. It's Howard Gleicher from Aristotle Capital. You talked about your inflection this year, next year, soon. I understand it in terms of some of the physical assets that you're building in Canada and New York. I'm not quite understanding it in terms of the technology investments. It seems to me if anything, your need to invest in technology to maintain relevance and compete with -- is going to increase, not decrease. Just, you put touchscreens in your dressing rooms and all that. It seems like you could have put a button, but you put a touch screen. That tells me you have much grander aspirations for what that's going to do and how much that's going to cost. Can you help me understand that a little better?



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Kenneth J. Worzel - Nordstrom, Inc. - Chief Digital Officer & President of Nordstrom.com

Yes, what I'd say is built into the plan that you have seen here is not a -- we're not taking the foot off the gas in terms of investment in technology, in particular, to fuel our customer experience. There is a shift, as Anne's referenced, and where it shows up, how much is capitalized, how much comes through the income statement. But the other aspect of it is, we have gone through a lot of effort over the last 3 or 4 years, and we'll continue to do this, to modernize our architecture and our approach. And one of the benefits of that is we're seeing much better throughput and output on our technology spend. So we're simply able to get more done for the same dollars than we were 2 or 3 years ago, in large part, because of very clear things about moving from enterprise, legacy, tightly coupled on premise software to agile cloud-based service-oriented architecture that we've continued to advance on across our stack. And so we will continue to invest a significant amount of money in technology, both for purely digital experiences as well as experiences that show up in store, and that's built into this plan. I don't think that there is any lack of ambition around that or lack of investments to fuel that. But we are getting more quality and quantity of outcome for those investments as we've modernized large parts and portions of our architecture and change our development approach. And so part of what we're seeing is just the throughput, the shots on goal we're able to take and the number of things we're able to put in front of customers is increasing relative to the amount of money we're spending. Now it's still going to be a lot of spend; that's the reality. Technology is at the center of most of the customer experiences that we're creating and that we're linking across digital and physical and that's not going to change, but that's contemplated in here.

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

But that's also -- there is a difference between what's being expensed and capitalized as well.

Anne L. Bramman - Nordstrom, Inc. - CFO

Yes. Total cash, as Ken mentioned, we're investing or increasing the amount of cash we're spending but not the same rate the sales are going -- or increasing. So when getting some leverage out of that just based on the fact that we're being more productive with the investments we're making. But we are not going around slashing costs on our investments in this at all.

Trina Schurman

Okay. Well, thank you for your questions. If we did not get to you, please feel free to reach out, and this concludes the management presentation portion of our event. So for those of you on the webcast, we appreciate your interest in Nordstrom. Thank you.

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