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JWN - Q1 2012 Nordstrom Earnings Conference Call

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OVERVIEW:

JWN reported 1Q12 total sales growth of 13.7% and diluted EPS of \$0.70.



CORPORATE PARTICIPANTS

Rob Campbell Nordstrom, Inc. - Treasurer and VP, IR

Blake Nordstrom Nordstrom, Inc. - President

Mike Koppel Nordstrom, Inc. - EVP and CFO

Pete Nordstrom Nordstrom, Inc. - EVP and President of Merchandising

Erik Nordstrom Nordstrom, Inc. - EVP and President of Stores

Jamie Nordstrom Nordstrom, Inc. - EVP and President, Nordstrom Direct

CONFERENCE CALL PARTICIPANTS

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Michelle Clark Morgan Stanley - Analyst

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Jennifer Black Jennifer Black & Associates - Analyst

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David Glick Buckingham Research Group - Analyst

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PRESENTATION

Operator

Hello and welcome to the Nordstrom 2012 first-quarter conference call. At the request of Nordstrom, today's conference call is being recorded. All lines will be on a listen-only mode until the question-and-answer session. (Operator Instructions) And I would now introduce Rob Campbell, Treasurer and Vice President of Investor Relations for Nordstrom. You may begin, sir.

Rob Campbell - Nordstrom, Inc. - Treasurer and VP, IR

Hello, everyone, and thank you for joining us. Today's earnings call will last 45 minutes and will include about 30 minutes for your questions. As a reminder, all forward-looking statements on this call are subject to risks and uncertainties that could cause the Company's actual results to differ materially from the expectations and assumptions discussed, due to a variety of factors that affect the Company, including the risks specified in the Company's most recently filed Forms 10-K and 10Q.



Participating in today's call are Blake Nordstrom, President of Nordstrom, Inc, and Mike Koppel, Executive Vice President and Chief Financial Officer, who will discuss the Company's first-quarter performance and outlook for fiscal 2012. During the Q&A session, we will be joined by Pete Nordstrom, President of Merchandising; Erik Nordstrom, President of Stores; and Jamie Nordstrom, President of Direct.

And now I'll introduce Blake Nordstrom.

Blake Nordstrom - Nordstrom, Inc. - President

Thank you, Rob, and good afternoon, everyone. As we shared in the earnings release, our first-quarter earnings were in line with our expectations with strong top-line performance across all channels. The consistent execution in our core business, combined with our healthy financial position, has given us the flexibility to more aggressively pursue growth opportunities, particularly in e-commerce. Having already established a solid foundation of multi-channel capabilities, which we continue to benefit from, we're accelerating our efforts to further enhance the customer experience, and increase our relevance with existing and new customers. Selection, speed, and convenience have always been important to our customers. But they are becoming even more critical going forward. Here are a few highlights.

In e-commerce, we made enhancements to our websites to improve things such as navigation, graphics, and making the checkout process faster and easier. We increased the selection of merchandise in a number of online departments, and added to the functionality of our mobile apps. We increased the speed of fulfillment and delivery, while making returns easier. These types of initiatives are ongoing. And the benefits of these efforts are reflected in the continuing strong top-line growth we're seeing in our Direct channel.

In April we announced our partnership with online men's retailer, Bonobos. Established in 2007, Bonobos quickly earned a reputation for making great-fitting pants and offering a convenient shopping experience. It's a fast-moving online retailer that has been successful in connecting and gaining relevance with a contemporary customer. We value the opportunity to expand our capabilities through an up close view of its web-driven brand, while gaining access to a great fitting, energetic clothing line to add to our men's assortment.

Recent store openings also offer examples of how we're evolving in response to our customers' want to shop. In March, we re-entered the Salt Lake City market with a successful opening of our store at City Center Creek. We provided this store with roughly 150 mobile point-of-sale devices to help make shopping faster and more convenient. This was the largest roll-out to date, with the store carrying three times as many of these devices as cash registers. We've been adding to both the functionality and number of these devices based on what we've learned since our initial roll-out during the first half of 2011. And we'll continue to build in new features that make them even more helpful to our customers.

In March, we also relocated our downtown Seattle Rack store and had a strong reopening at its new location across the street from our Nordstrom flagship store. This store, one of five Racks opened during the quarter, include 16 mobile point-of-sale devices. In the first two months of operation, we've seen a significant increase in the speed of point-of-sale, which translates into a better service experience in the Rack. Our learnings in this store will be applied to a broader roll-out of these devices in all Rack locations later this year.

During the quarter, we saw favorable response from our customers to the enhancements we made to our Fashion Rewards program. You might recall that the changes we made essentially were about convenience, giving our customers greater control over how and when to use their benefits. And to make more of the benefits more easily accessible. It's still early but in the first quarter we've seen new Fashion Reward accounts increase by nearly 50% from a year ago. We are pleased with this program that allows us to build and strengthen our relationships with customers.

Again, these are just a few examples of the meaningful growth opportunities to improve upon the customer experience in all channels. We believe strongly in our strategic direction of elevating the customer experience both in-store and online. Over the past 12 months, we've made substantial progress through our efforts in undertaking multiple initiatives, including the acquisition of HauteLook, the roll-out of mobile point-of-sale devices, free shipping and returns, enhanced Fashion Rewards, our partnership with Bonobos, growing our e-commerce capabilities, continuing expansion of the Rack, and there will be more. We are moving more quickly, we're accelerating our learning, and we're acting on our commitment to improve the customer experience.

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



Mike Koppel - Nordstrom, Inc. - EVP and CFO

Thanks, Blake. Our first quarter results continue to demonstrate our ability to drive top-line performance through our aggressive growth strategy. As we've shared previously, we are undergoing a step change in terms of the level of investments we are making to significantly enhance the customer experience, particularly in e-commerce. We're continuing our expansion of Nordstrom Racks and remain focused on increasing productivity in our full-line stores. We are firmly convinced that our strategic direction is sound. And we feel confident that the strength of our business will continue. We are moving at a fast pace.

Although our operating model is evolving, we remain disciplined in our approach to the investments we're making and in our focus on execution. Even with these additional investments, we anticipate achieving in 2012 the highest EBIT dollar performance in the history of the Company, driven by the strong sales momentum we're experiencing. And as we view the longer term outlook, we are squarely on track with our over-arching goals of achieving high single-digit top-line growth and mid teens return on invested capital.

For the first quarter, our earnings per diluted share of \$0.70 represented an increase of 8% from last year. Our earnings before interest and income taxes totaled \$280 million, an increase of 2.9% from last year. Total sales increased 13.7%, while same-store sales increased 8.5%. Nordstrom's same-store sales, which include our full-line and Direct businesses, were up 9.3%, with handbags, women's shoes and men's shoes as our top-performing merchandise categories. Same-store sales at full-line increased 5.6%, with the South and Midwest as our top-performing regions. Direct continues to be our fastest-growing business, delivering sales growth of 44.2% over last year. Nordstrom Rack total net sales grew 19.6%, with same-store sales up 6.8%.

First-quarter gross profit as a percentage of net sales decreased 31 basis points to 37.5%. Which is mostly due to our enhanced customer loyalty program and the reduction of shipping revenue associated with free shipping and returns introduced last fall. Total sales per square foot increased 10.1%, while our ending inventory per square foot increased 16%. Our inventory levels are aligned with our merchandise plans. The gap is indicative of the accelerated growth we are seeing both online and in-store. Our inventory turn of 5.4 times, down slightly from Q1 of 2011, was in line with our expectations that anticipate a year-over-year improvement for the full year. The percentage of regular price sales continued to increase compared to last year, which is attributable to the ongoing benefits from our multi-channel capabilities.

Retail SG&A expense increased \$110 million during the quarter. Roughly half was related to our e-commerce growth strategy, focused on building capabilities to improve selection, convenience, and the overall service experience online. In total, they are fueling the outsized sales increases we're achieving in this channel. The majority of the remaining increase in SG&A was attributable to the sales growth in existing and new stores. While we're accelerating the growth in e-commerce because of the rich opportunity we believe it represents, our in-store business continues to deliver incremental profits on incremental sales that are in line with our expectations and with our recent historical performance.

Next we will turn to our performance in Credit, where the positive trends continued. In addition to the early indicators Blake mentioned with respect to the enhanced Fashion Rewards program, and the growth in the number of new accounts, we again saw improving trends in our credit metrics. It was notable that the write-off rate declined to 4.7% from 7% a year ago. Combined with a review of our overall credit portfolio performance and economic outlook, we have reduced the reserve for bad debt by \$10 million. We ended the quarter with bad debt reserves as a percent of ending credit card receivables of 5.2%, down from 6.7% last year.

Our financial position remains strong with \$1.6 billion of cash and total liquidity of approximately \$2.4 billion. Our adjusted debt to EBITDAR of 2.1 times is well within the range of investment grade. In April, we retired \$500 million in securitized notes at maturity. During the quarter, we repurchased 800,000 shares at an average price of \$50.79, for a total of \$40 million. We have \$1.1 billion remaining under our current authorizations.

Our EPS outlook for fiscal year 2012 is unchanged. We increased retail SG&A guidance by \$10 million to reflect additional e-commerce opportunities that we are moving forward with. This is offset by a \$10 million reduction in credit SG&A guidance as a result of the Q1 reduction in the reserve for bad debt. We are pleased with the strength of our sales. However, we believe it makes sense at this point to maintain our existing view of 2012 earnings, given that we are only one quarter into the fiscal year.



This year's anniversary sale, our largest sale event of the year, begins one week later in July this year versus last year. As a result, an additional week of this year's event occurs in August which is in our third quarter. To better understand the estimated impact on our financial performance, we provided directional comments in the Earnings Release on the timing of sales, gross profit and SG&A over the remaining quarters of 2012.

In closing, our first-quarter's performance is on track with our long-term growth plan. We are excited about the momentum in our business, the strength of our financial position, and the multiple opportunities we see to drive growth and enhance the customer experience.

With that, I will turn the call over to Rob.

Rob Campbell - Nordstrom, Inc. - Treasurer and VP, IR

Thank you, Mike. Before taking the first question, we want to ask that each person ask just two questions, and if necessary one follow-up in order to give as many of you as possible an opportunity to ask a question. If you have additional questions, please return to the queue. Operator, we'll take the first question.

QUESTIONS AND ANSWERS

Operator

Deborah Weinswig from Citi.

Deborah Weinswig - Citigroup - Analyst

In terms of the expense side of things, Mike, with 50% of the deleverage you attributed to the stores, was that basically technology related? Can you dive into that a little bit deeper?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Sure, Deborah. I didn't say that we were delevering. I said that half of the \$110 million in expense dollars increase was due to the stores. Now, of that, we did get a percent-to-sales leverage on our store performance. Where we saw the deleverage from a percent-to-sales is from the accelerated investment in the e-commerce and technology space.

Deborah Weinswig - Citigroup - Analyst

Okay. And then in the terms of the credit card penetration, can you talk about where that is now? And how are your new Fashion Reward customers shopping you differently?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

In terms of the credit card penetration, can you give me a little more clarity on that?

Deborah Weinswig - Citigroup - Analyst

Just where are you in terms of your Nordstrom card, what percent?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Okay, thank you. We are roughly one-third-plus of our overall volume is done on our various tenders, including our debt card and our private label retail and the co-branded Visa. We continue to see really accelerated growth as a result of Fashion Rewards. One of the things that we did start this year is offering Rewards in the Rack. And so we continue to see a lot of growth there, of which over half of those are debit cards.

And of course the Rack continues to attract a relatively younger customer, and so we like that pipeline. But the overall health of folks being able to get in the program earlier, move up the various levels faster, and be able to enjoy the benefits quicker are paying off.

Operator

Michelle Clark from Morgan Stanley.

Michelle Clark - Morgan Stanley - Analyst

The first question is, your gross margin guidance for the year implies that back half gross margin performance will be better than the first half. And I'm just trying to figure out why that would be, given, my guess, is the rewards program will continue to offer the benefits it does today. And then I'm guessing that you would expect the e-commerce business would continue its strength.

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Yes, this is Mike. One of the primary reasons is that we'll be lapping over when we did free shipping and free returns, which I believe started sometime in September last year. And so, the impact of that will be neutralized after we cross that.

Michelle Clark - Morgan Stanley - Analyst

Great. Thank you. And then my second question was, what was e-commerce growth in the first quarter of last year? So, if it was up 44% this year, how much was it last year in the first quarter?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

I don't believe we disclosed it last year, first quarter, but needless to say it was a strong double-digit comp increase.

Operator

Charles Grom from Deutsche Bank.

Charles Grom - Deutsche Bank - Analyst

Mike, if I look at the 1Q performance and if I layer in the guidance that you guys gave by quarter and then the full year, it looks like your front-half margin flow-through is negative, maybe roughly 3%. And it looks like your second-half guidance implies a flow-through much higher, maybe like 18%. Just wondering if that math is correct? And should we interpret that most of your investment spend is front-end loaded here in 2012?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Sure, Charles. In terms of the math you did, I'm not going to comment on the exact math. But I think it's fair to say what we're seeing is the continuation of the accelerated investment which began in the back half of last year and will continue through the front half of this year. And in addition, the fact that we had some additional expense last year due to the free shipping, free returns. So, we definitely believe that our back half performance is going to be stronger from an earnings standpoint.

Charles Grom - Deutsche Bank - Analyst

Okay. And then a little bit of confusion still on the Street with regards to that slide you guys did in February. Can you flush out for us a little bit how you think the investment pattern is going to flow as you move from this year to 2013 and beyond?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

I think I would just clarify that the purpose of the slide was to directionally give you a sense of how we were thinking about the overall growth opportunities in front of us. And keep in mind that it was what we thought at that point in time, and we're going to continue to take advantage of every opportunity we see to grow this Business in a profitable way.

I think what we were trying to depict here is the fact that 2012 saw a step change, and an accelerating moment of investment. That we would expect that that would fuel future sales and achieve the mid-teens ROIC that we've been talking about for a while. So, the idea there was not to be an absolute depiction of exactly where we're going to be. But, I think directionally we expect that these investments are going to help us achieve our long-term goals.

Operator

Jennifer Black from Jennifer Black & Associates.

Jennifer Black - Jennifer Black & Associates - Analyst

My first question is about the Women's business. I wondered if you had given any thought to adjusting the allocation of space, but with your underperforming departments? Or if you're thinking of adding any new departments? And then I wondered where you are in hiring a GM.

Pete Nordstrom - Nordstrom, Inc. - EVP and President of Merchandising

Hi, this is Pete. Yes, I think it's appropriate for us to always be looking at space and how we can be most effective. If you look over the last 5 to 10 years, we've had really good growth in our accessory division, in the shoe division, in the cosmetic division. And even those are all on the first floor, typically, so this puts a squeeze a little bit on that floor. Women's typically is on two or three. So, it isn't super easy to adjust the space that way. But we continue to find ways to add more energy and productivity to our second and third floors.

You may have noticed that one of the things that we've done is we started a trend accessory department the last year or two. We've got those in and amongst the women's apparel department, and those have been successful. We've also had pretty growth in active apparel recently, and in lingerie. And in many cases that takes up some more space. It's just an ongoing balancing act for us to try to reconcile the space to be most efficient. So, it's nothing really new but I think the answer to your question is yes, we're continuing to work on that. What was the second part, Jennifer?

Jennifer Black - Jennifer Black & Associates - Analyst

Where are you in hiring somebody as far as to head up women's?



Pete Nordstrom - Nordstrom, Inc. - EVP and President of Merchandising

Yes, still working on that. That's been going on for a while. We've been, obviously, vetting the internal candidates that we have, and we have some really good ones. But since the job was open, it seemed like a practical thing to do for us to consider who else might be out there. And that's been really a positive experience for us. We've met a lot of interesting people that have an interest in Nordstrom. So, we're still going through that process. But certainly by our next call, we will have named a leader there, I'm confident of that.

Operator

Barbara Wyckoff from CLSA.

Barbara Wyckoff - CLSA - Analyst

Could you give us some color on the HauteLook business, where you're looking for the sales to be this year? And then could you comment on the Brooks Brothers partnership? And then just lastly quantify the impact of the 53rd week again.

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Okay. Barbara, this is Mike. I'll answer the first and third one, and then I think, Pete, you can get the second one. In terms of HauteLook, our expectations is that we have a plan to do a 50%, 60% sales increase this year. And the Company currently is on plan and continues to have very good momentum. And we continue to be very excited about the opportunities.

I will add just another piece of information there. Just recently the Company's been able to surpass the 8 million mark in terms of the number of members to the business. We continue to be really excited. In terms of the 53rd week impact, it's roughly a \$0.03 to \$0.05 impact for that period. And then I think the second question was on Brooks Brothers. Pete?

Pete Nordstrom - Nordstrom, Inc. - EVP and President of Merchandising

Yes, that's going well. They're good partners. We're still in the early part of that relationship. And I think a big part of that is them understanding more about our customer and what's going to work for us. And us having appreciation of the things that have made their brand successful over the years. We started some place, and I think, obviously, what that has shown us is that we have more to learn from each other. But it's a good collaborative partnership. I think we have every reason to be hopeful about where it's going to take us. I would say the early read has been promising.

Operator

Neely Tamminga from Piper Jaffray.

Neely Tamminga - Piper Jaffray & Co. - Analyst

I don't know if I missed this but did we talk about why we moved the anniversary sale? I'm just wondering what the strategic decision was behind that, shifting it. And maybe related to that, too, would just be how are you planning on maybe focusing on that Fashion Rewards opportunity maybe a little bit more intentionally than we even saw last year to build on the momentum that you guys have already gained on your success there?



Mike Koppel - Nordstrom, Inc. - EVP and CFO

Erik, you want to comment on the timing of the anniversary?

Erik Nordstrom - Nordstrom, Inc. - EVP and President of Stores

Sure. It's actually not anything unusual. Because we always want to start on a Friday, each year it gets a day or two days earlier depending on leap year. So, we have had this timing before. Eventually we have to drop it back a week and we did that this year. So, it causes some problems with the quarter but it is something we've done before.

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Okay. And Neely, in terms of Fashion Rewards, we still have the same program as we had last year as it relates to anniversary. And that Fashion Rewards customers have that exclusive opportunity to shop earlier. We're going to continue to find ways to expand that so more customers can shop earlier that are Rewards customers and the benefits that go along with that. So, we continue to be excited about that program. And also the fact that it is now attached to The Rack allows it to even impact more customers.

Neely Tamminga - Piper Jaffray & Co. - Analyst

Thank you.

Operator

Lorraine Hutchinson from Bank of America.

Lorraine Hutchinson - BofA Merrill Lynch - Analyst

I just wanted to follow up on the question on the Women's business. We've heard a couple of your competitors mention that Traditional or Classic Women's is starting to pick back up. Can you just talk about how that business is going for you and any initiatives you have to turn it positive?

Pete Nordstrom - Nordstrom, Inc. - EVP and President of Merchandising

This is Pete. Our Women's performance, on the whole, has been challenging but there's always been some pockets that have worked pretty well. For us, what's tending to do better is more of the modern and casual side of our offer. Again, obviously, that's relative to where we've been in the past, as well. I think there's some good pockets of success in more of the classic part. But I wouldn't characterize it as some kind of shift in the customer preference. That's not what we're seeing as much. I think most of the momentum for us is pushing us more towards modern.

Lorraine Hutchinson - BofA Merrill Lynch - Analyst

And then the gross margin guidance for the second quarter, I assume there's some moving around given the anniversary sale. Ex those shifts would it be similar to Q2?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Yes. Thanks, Lorraine.

Operator

Paul Swinand from Morningstar, Inc.

Paul Swinand - Morningstar, Inc. - Analyst

Real quick, on your prepared remarks I think you said that turns slowed slightly but would pick up in the back half of the year. With the strong pull-forward and the good weather, I thought maybe turns would even pick up a little. Could you just give us a little more color on why they maybe slowed and why they would pick up at the back half of the year?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Paul, this is Mike. That was built into our plans as it relates to the expansion, both we're seeing with the new stores that we've opened in the Rack, as well as the expansion we're experiencing in Direct. And last year at this time as we came out of the end of the previous year and to the first quarter, we were slightly under. And we recognized that. And so the combination of our position last year and the accelerating growth we're seeing right now, that was built into our plans. But our goal is for the year, as we get through this period, that we will be ahead of last year's turn by the end of the year.

Paul Swinand - Morningstar, Inc. - Analyst

Okay, great. And then just on a unit basis, are you actually a little lighter on units, but maybe up on the dollar inventory a little more?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

No, I don't think that's the case.

Paul Swinand - Morningstar, Inc. - Analyst

Okay. And then real quick, I know you guys disclose return on capital. As you do all this new investment in technology, obviously more of it is expensed than capitalized, or a portion of it is expensed. Is that maybe affecting your return on capital? And should we be, in fact, thinking about some of those as assets instead of expenses?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Actually in the short run it's affecting more of our P&L than our return -- it affects the return on capital in the sense that it depresses the P&L. But long run, you'll actually see capital on a comparative to what we used to do on building stores. The capital will grow at a slower rate but the P&L won't be as rich because more of that money goes through the P&L.

Operator

Dorothy Lakner from Caris & Company.

Dorothy Lakner - *Caris & Company - Analyst*

I just wanted to ask if you could give a little bit more color on the kinds of things you're doing with the mobile units to increase functionality. And whether for before anniversary, as you did last year, there would be a significant increase in the number of them out there or in the new functionality that you're offering. Or is that something we should see more towards year-end?

Erik Nordstrom - *Nordstrom, Inc. - EVP and President of Stores*

Sure, I'll take that. We are continuing to add functionality through the year. We're at about 75% of the functionality of our register is on our mobile devices right now. By the end of the year we will be at 100%. And next year we'll actually have additional functionality that we don't even have on the registers. We're not adding a big chunk of the mobile devices before anniversary this year. We look to test some more -- not really test but roll out more in the fourth quarter. And then, once we hit full functionality we will plan on having a big roll-out at that time.

Dorothy Lakner - *Caris & Company - Analyst*

So, that would be next year?

Erik Nordstrom - *Nordstrom, Inc. - EVP and President of Stores*

First quarter of '13, yes.

Operator

Liz Dunn from Macquarie.

Liz Dunn - *Macquarie Research - Analyst*

Just, first, a point of clarification on the guidance for Credit SG&A. So, the \$44 million in Q1, that was just because you had the \$10 million reversal? Is that correct?

Mike Koppel - *Nordstrom, Inc. - EVP and CFO*

That's correct.

Liz Dunn - *Macquarie Research - Analyst*

In terms of bad debt. Okay. So the balance of the year, a little bit higher than the run rate ex that reversal, but just some conservatism?

Mike Koppel - *Nordstrom, Inc. - EVP and CFO*

It's consistent with the -- the only difference between what we shared last quarter and this quarter is the \$10 million change in the reserve. There's no real change in the pattern of spending there than what we thought a quarter ago.



Liz Dunn - *Macquarie Research - Analyst*

Okay. And then my other question is just, I'm sure you saw this article in the New York Times the other day about Amazon's big push into fashion. And it mentioned a bunch of things, like they're going to hire three people to just try on size eight shoes so they can give customer reviews. That kind of thing. Obviously, they've got a huge amount of cash so they can do some of these things. What do you really think, as you look at yourself versus Amazon, what are the things that you have that they don't have in this category, the ways you feel like, as a brick-and-mortar retailer, you can shine that they can't?

Jamie Nordstrom - *Nordstrom, Inc. - EVP and President, Nordstrom Direct*

This is Jamie. It's a good question. I'm hesitant to talk about what competitors are doing. But I'll tell you that we're really focused on serving customers on their terms. We've been focused for a long time on our goal of improving customer service. And we realize that now and going forward that how customers define service is changing. A lot of that is going online, it's mobile, it's about, as Mike said, speed and convenience.

So we're making a lot of investments, as you see, in our capabilities around those areas. And we think that we've got a good opportunity with our team here to build some capabilities to be able to serve customers in the kind of ways that they want to be served. And we want to be known as a place that gives great service. And that's very important to us.

Operator

Paul Lejuez from Nomura.

Paul Lejuez - *Nomura Securities Intl - Analyst*

Just thinking back to Chuck's question, and sorry if I missed the answer, if it was asked this way. But should we be thinking any differently about the guidance that you gave last quarter for F13 EBIT dollars to grow faster than sales?

Mike Koppel - *Nordstrom, Inc. - EVP and CFO*

No.

Paul Lejuez - *Nomura Securities Intl - Analyst*

That's still the plan?

Mike Koppel - *Nordstrom, Inc. - EVP and CFO*

Yes.

Paul Lejuez - *Nomura Securities Intl - Analyst*

Got you. And also could you just maybe talk a little bit about the profitability of the Rack division year-over-year in the first quarter? Thanks.

Mike Koppel - Nordstrom, Inc. - EVP and CFO

We don't normally break out the profitability of the Rack. But what I will say is the Rack continues to be a terrific opportunity for us to deploy capital. We're continuing to grow at roughly 15 stores a year. We have not seen a marginal or any kind of deterioration in the incremental stores that we're opening in terms of their performance. So, we continue to be very excited about that.

Operator

Michael Benetti from UBS.

Michael Benetti - UBS - Analyst

If I look at the e-commerce growth at 44% this quarter, I have to assume that's faster than what you guys expected even in the quarter. That's a strong result. Even after the big step-up that you gave us on spending to fuel the e-commerce side of the business, if you see the e-commerce business keep growing at this pace, would anything stop you from increasing the SG&A further in 2013 or beyond to maintain this pace of growth there?

Jamie Nordstrom - Nordstrom, Inc. - EVP and President, Nordstrom Direct

Yes, in terms of what our expectations are, I think we've shared with you -- this is Jamie, by the way -- that we've got big ambitions for our online business. And so, we think we're in the very early innings of this channel still, even though we've been doing this for a while. We think that there's a lot of opportunity to capture a lot more customers and grow a lot more. So, while, yes, the number is big, we think we should be growing in that general area.

In terms of SG&A, as we've talked about, we are ramping up right now. Going back to fourth quarter, as we shared, we're acquiring a lot of talent. A lot of the capabilities that we want to add to be better in e-commerce sometimes boil down to just having people, the right people, more of them. We're adding a lot more people to the team. That's happening now. That will end. And so SG&A beyond the first half of this year should definitely be a slower growth rate than we're currently experiencing.

Michael Benetti - UBS - Analyst

I'm reflecting back on the \$1 billion in e-commerce and multi-year, five year, do you envision that as eventually including a separate Rack website, online flash sales through there like some other soft lines have been doing?

Jamie Nordstrom - Nordstrom, Inc. - EVP and President, Nordstrom Direct

There's a lot of potential there. We're really focused on listening to our customers and they're telling us where we're going to go. I think as we've gotten better at testing and trying things, we're learning a lot faster about what customers like and what they don't. And that's going to lead us where we go, both in terms of our stores and e-commerce. So, hard to speculate on what it looks like five years from now but we think the potential's pretty darn big.

Operator

Robert Drbul from Barclays.



Joan Payson - Barclays Capital - Analyst

It's Joan Payson standing in for Bob today. Just in terms of your gross margin in the first quarter, down 30 basis points, what was the contribution from the merchandise margins embedded in that?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Merchandise margin was roughly flat to last year. As I said in the remarks, it was predominantly related from Fashion Rewards and from free shipping and free returns.

Joan Payson - Barclays Capital - Analyst

Okay, thanks. And then also in terms of your second quarter comp store sales guidance, that low single-digit increase, what do you expect directionally on a monthly basis, just given the shifts in Mother's Day and anniversary sale?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

We normally don't guide on a monthly basis. Thank you.

Operator

Jacob Zitter from Robert W. Baird.

Jacob Zitter - Robert W. Baird & Co. - Analyst

Can you discuss the drivers behind the strength in comps at Rack this quarter? Have you been able to improve your buying to that channel? I know you're thinking about trying to leverage your full-line relationships a little more. Or is that acceleration more a function of the customer service enhancements?

Mike Koppel - Nordstrom, Inc. - EVP and CFO

Blake, do you want to take that, please?

Blake Nordstrom - Nordstrom, Inc. - President

I'm sorry. One more time. I didn't hear the question.

Jacob Zitter - Robert W. Baird & Co. - Analyst

Just the drivers behind the strength in comps at Rack. Have you been able to leverage some of your full-line relationships or is it more customer service enhancements at the store level?

Blake Nordstrom - Nordstrom, Inc. - President

That's a good question. There really is a synergy between the two. And that really was from our inception way back in the early '70s when we had a Rack in the basement of our downtown Seattle store. Since then, we've just continued to see a really healthy relationship.



The closer we can have a Rack to a successful full-line store is really beneficial for both. And when we relocated that downtown Seattle Rack, in addition to their great opening figures, across the street, the downtown Seattle full-line store enjoyed some really healthy gains. And so there is customer movement back and forth. There's an acquisition subject. That's also true for employees from a career path. At this point, as Mike said earlier, we're really pleased with the Rack and its growth plans and continue to support it.

Jacob Zitter - *Robert W. Baird & Co. - Analyst*

Thank you.

Operator

David Glick from Buckingham Research Group.

David Glick - *Buckingham Research Group - Analyst*

Just a follow-up on the Rack and then a merchandise question for Pete. In the past, before you started to expand the Rack a little more significantly, you used to talk about a maximum number of stores that you might consider. Now that the number of Rack stores is going to end up a bit greater than the number of full-line stores the end of this year, as you look at your multi-year plans is there a maximum number of stores that you envision? Do you reach a point where you risk cannibalization? Second question, Pete, do you still see enough innovation and strong enough trends in center core to continue those really strong trends which have been a huge driver for you and others in the industry? Or do you have to count on some other areas to drive the same kind of comps you've been driving overall? Thank you.

Blake Nordstrom - *Nordstrom, Inc. - President*

This is Blake. On the Rack question, we have, over the years, evolved our thinking about that balance of our merchandise offering. And we're very sensitive to the integrity of our pricing and to those goods. We've been very pleased with the relationship we have with our vendors to get terrific access to our top vendors and top items. What I think is important to note, though we may at the end of this year be crossing from a physical store count, our e-commerce business is so robust that when you put the two together from a percentage-wise, the Rack's staying pretty constant.

So the big driver, and it's not dissimilar to what Jamie said earlier about e-commerce, is the customer is dictating this growth and they are very supportive. And it's reflected in the results with our execution in the Rack. And so, if we're able to continue to get great product from our vendors and great locations, we're going to continue to grow this way.

David Glick - *Buckingham Research Group - Analyst*

And on the merchandise classification question, Pete?

Pete Nordstrom - *Nordstrom, Inc. - EVP and President of Merchandising*

It's actually one of the great things about work in our industry is that hope springs eternal. Regardless of what merchandise division you're talking to at any given time, they're always excited about what's coming next. The vendors obviously start that, and our buying people, they're part of that, as well. So, it's usually an issue of us trying to reel them in in terms of how much they want to spend rather than are there good things to go out there and buy.

I think if you were to a general assessment of our confidence in finding great things for our customers going forward, I think it's high. There's no reason why we shouldn't be able to continue to deliver compelling fashion for our customers.



Operator

Richard Jaffe from Stifel Nicolaus.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Quick question on inventory on hand and the inventory build we should anticipate for the summer sale -- the anniversary sale. You seem a little heavy today, just numerically. And wondering, do we need to get through that to reposition the inventory for the holiday sale? Or are you already shipping some of the anniversary product early?

Mike Koppel - *Nordstrom, Inc. - EVP and CFO*

Rich, to the point we indicated earlier, there was a couple factors there. One was just the overall acceleration of the pace of the Business on the whole, in the aggregate, and within the channels. And the second was the fact that last year we were a little light in the first quarter. So this isn't really, I don't think, a reaction or response to the upcoming sale in terms of anything that would be out of the ordinary cadence. And you should see, actually coming out of the second quarter, inventories will be slightly higher because of the fact that we had one more week of anniversary sale going into the third quarter. But in terms of our overall Business, other than those fiscal cutoffs it's pretty much in line as to where it should be.

Richard Jaffe - *Stifel Nicolaus - Analyst*

A follow-on to the e-commerce business, the opportunity, obviously, to accelerate the Rack business to reflect the growth at the full-line stores or the growth you've talked about for HauteLook. Any thoughts about an off-price venue online? A more robust off-price venue.

Jamie Nordstrom - *Nordstrom, Inc. - EVP and President, Nordstrom Direct*

This is Jamie. We do have an off-price Online business. It's HauteLook. And, as Mike mentioned earlier, it's grown about 60% this year, and we're ahead of plan there. So, we're feeling pretty good about our positioning there. We do get asked a lot, is there a more traditional off-price model that works online. We're looking for one.

And if you look across the industry of the people we compete directly with in our Rack business, there's not a lot of e-commerce going on there. And there's a reason for that. It's not obvious how you would do that. The Flash Sale business has gone from zero to almost \$2 billion now in just a few years. And we're competing there, and so far we're pretty pleased with our growth.

Rob Campbell - *Nordstrom, Inc. - Treasurer and VP, IR*

Thank you for joining us today for our first-quarter earnings call. As a reminder, a webcast replay of this call will be available for one year on the Investor Relations section of Nordstrom.com under Webcasts. Thank you for your interest in Nordstrom. Good-bye.

Operator

Thank you. This concludes today's conference. You may disconnect at this time.

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