NORDSTROM INC
Form 10-Q
December 08, 2009
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

## p QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 31, 2009
OR

## o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from $\qquad$ to
Commission file number 001-15059
NORDSTROM, INC.
(Exact name of Registrant as specified in its charter)

Washington<br>(State or other jurisdiction of incorporation or organization)

1617 Sixth Avenue, Seattle, Washington
(Address of principal executive offices)

91-0515058
(IRS employer
Identification No.)
(Registrant s telephone number, including area code)
Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES p NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T
( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES p NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer p
Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO p
Common stock outstanding as of November 27, 2009: 217,493,438 shares of common stock

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## PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).
NORDSTROM, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Amounts in millions except per share amounts)
(Unaudited)

|  | Quarter Ended |  |  |  | Nine Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2009 |  | 2008 |  |  | $\begin{aligned} & \text { ber 31, } \\ & 109 \end{aligned}$ | 2008 |  |
| Net sales | \$ | 1,868 | \$ | 1,805 | \$ | 5,719 | \$ | 5,971 |
| Credit card revenues |  | 95 |  | 74 |  | 268 |  | 216 |
| Total revenues |  | 1,963 |  | 1,879 |  | 5,987 |  | 6,187 |
| Cost of sales and related buying and occupancy costs |  | $(1,210)$ |  | $(1,185)$ |  | $(3,735)$ |  | $(3,852)$ |
| Selling, general and administrative expenses: |  |  |  |  |  |  |  |  |
| Retail stores, direct and other segments |  | (500) |  | (490) |  | $(1,478)$ |  | $(1,528)$ |
| Credit segment |  | (81) |  | (77) |  | (250) |  | (184) |
| Earnings before interest and income taxes |  | 172 |  | 127 |  | 524 |  | 623 |
| Interest expense, net |  | (38) |  | (33) |  | (105) |  | (98) |
| Earnings before income taxes |  | 134 |  | 94 |  | 419 |  | 525 |
| Income tax expense |  | (51) |  | (23) |  | (150) |  | (192) |
| Net earnings | \$ | 83 | \$ | 71 | \$ | 269 | \$ | 333 |
| Earnings per basic share | \$ | 0.38 | \$ | 0.33 | \$ | 1.24 | \$ | 1.54 |
| Earnings per diluted share | \$ | 0.38 | \$ | 0.33 | \$ | 1.23 | \$ | 1.52 |
| Basic shares |  | 217.1 |  | 215.6 |  | 216.5 |  | 216.9 |
| Diluted shares |  | 220.7 |  | 218.1 |  | 219.0 |  | 219.8 |

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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Commitments and contingencies
Shareholders equity:
Common stock, no par value: 1,000
shares authorized; 217.3, 215.4 and 215.4
shares issued and outstanding $\mathbf{1 , 0 5}$
Retained earnings 388
997
990

Accumulated other comprehensive loss
(9)

223
192
Acole

| Total shareholders equity | $\mathbf{1 , 4 3 0}$ | 1,210 | 1,162 |
| :--- | :---: | :---: | :---: |
| Total liabilities and shareholders <br> equity | $\mathbf{\$ 6 , 5 1 6}$ | $\$ 5,661$ | $\$ 6,064$ |

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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## NORDSTROM, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Amounts in millions except per share amounts) (Unaudited)

|  | Common Stock |  |  | AccumulatedOther |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Shares | Amount |  | Earnings | Ear | ings |  | Total |
| Balance at January 31, 2009 | 215.4 | \$ | 997 | \$ 223 | \$ | (10) | \$ | 1,210 |
| Net earnings |  |  |  | 269 |  |  |  | 269 |
| Other comprehensive earnings: |  |  |  |  |  |  |  |  |
| Amounts amortized into net periodic |  |  |  |  |  |  |  |  |
| Comprehensive net earnings |  |  |  |  |  |  |  | 270 |
| Cash dividends paid (\$0.48 per share) |  |  |  | (104) |  |  |  | (104) |
| Issuance of common stock for: |  |  |  |  |  |  |  |  |
| Stock option plans | 1.1 |  | 18 |  |  |  |  | 18 |
| Employee stock purchase plan | 0.7 |  | 13 |  |  |  |  | 13 |
| Other | 0.1 |  | 1 |  |  |  |  | 1 |
| Stock-based compensation |  |  | 22 |  |  |  |  | 22 |
| Balance at October 31, 2009 | 217.3 | \$ | 1,051 | \$ 388 | \$ | (9) | \$ | 1,430 |
|  |  |  |  | Accumulated Other |  |  |  |  |
|  | Common Stock |  |  | Retained | Comprehensive <br> (Loss) |  |  |  |
|  |  |  |  |  |  |  |  |  |
|  | Shares | Amount |  | Earnings | Earnings |  |  | Total |
| Balance at February 2, 2008 | 220.9 | \$ | 936 | \$ 201 | \$ | (22) | \$ | 1,115 |
| Net earnings |  |  |  | 333 |  |  |  | 333 |
| Other comprehensive earnings: |  |  |  |  |  |  |  |  |
| Amounts amortized into net periodic |  |  |  |  |  |  |  |  |
| Comprehensive net earnings |  |  |  |  |  |  |  | 335 |
| Cash dividends paid (\$0.48 per share) |  |  |  | (104) |  |  |  | (104) |
| Issuance of common stock for: |  |  |  |  |  |  |  |  |
| Stock option plans | 0.8 |  | 17 |  |  |  |  | 17 |
| Employee stock purchase plan | 0.6 |  | 16 |  |  |  |  | 16 |
| Stock-based compensation |  |  | 21 |  |  |  |  | 21 |

Repurchase of common stock
Balance at November 1, 2008
(6.9)
215.4 \$ 990
(238)
(238)
he accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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# NORDSTROM, INC. AND SUBSIDIARIES <br> CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS <br> (Amounts in millions) <br> (Unaudited) 

Nine Months Ended
October November 1, 31,2009 2008
Operating Activities
Net earnings\$ 269\$ 333
Adjustments to reconcile net earnings to net cash provided by operating activities:
Depreciation and amortization of buildings and equipment, net ..... 234 ..... 222
Amortization of deferred property incentives and other, net (31) ..... (30)
Stock-based compensation expense ..... 24 ..... 21
Deferred income taxes, net ..... (45) ..... (59)
Tax benefit from stock-based payments ..... 4 ..... 4
Excess tax benefit from stock-based payments ..... (5) ..... (4)
Provision for bad debt expense ..... 175 ..... 106
Change in operating assets and liabilities:
Accounts receivable ..... (119) ..... (62)
Merchandise inventories ..... (264)(301)
Prepaid expenses and other assets ..... (13) ..... 18
Accounts payable ..... 401
Accrued salaries, wages and related benefits ..... 41
Other current liabilities ..... (1)280(66)
Deferred property incentives ..... 86Other liabilities45
Net cash provided by operating activities ..... 801 ..... 454
Investing Activities
Capital expenditures ..... (281)
Change in credit card receivables originated at third parties ..... (129)
Other, net1(439)(171)
Net cash used in investing activities(409)(608)
Financing Activities
Commercial paper:
(Repayments of) proceeds from commercial paper borrowings, net ..... (135) ..... 102
Repayment of commercial paper classified as long-term ..... (140)
Proceeds from long-term borrowings, net ..... 399 ..... 150
Principal payments on long-term borrowings ..... (24)
Decrease in cash book overdrafts(8)
(45)
Proceeds from exercise of stock options ..... 15 ..... 13
Proceeds from employee stock purchase plan ..... 13 ..... 16
Excess tax benefit from stock-based payments ..... 5 ..... 4
Cash dividends paid ..... (104)(104)
Repurchase of common stock ..... (264)
Other, net ..... (9)
Net cash provided by (used in) financing activities ..... 20(136)
Net increase (decrease) in cash and cash equivalents ..... 412 ..... (290)
Cash and cash equivalents at beginning of period ..... 72 ..... 358
Cash and cash equivalents at end of period ..... \$ 484 ..... \$ 68
Supplementary Cash Flow Information
Cash paid during the period for:

| Interest (net of capitalized interest) | $\mathbf{\$ 1 8 1}$ | $\$ 81$ |
| :--- | ---: | ---: |
| Income taxes | $\mathbf{\$ 1 7 5}$ | $\$ 319$ |

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# NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

(Dollar and share amounts in millions except per share, per option and unit amounts) (Unaudited)

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Basis of Presentation

The accompanying condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in our 2008 Annual Report on Form 10-K. The same accounting policies are followed for preparing quarterly and annual financial information. All adjustments necessary for the fair presentation of the results of operations, financial position and cash flows have been included and are of a normal, recurring nature.
Our business, like that of other retailers, is subject to seasonal fluctuations. Our Anniversary Sale in July, the holidays in December, and our Half-yearly sales events typically result in higher sales in the second and fourth quarters of our fiscal years. Accordingly, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

## Accounting Policies

The preparation of our financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.
Our accounting policies in 2009 are consistent with those discussed in our 2008 Annual Report on Form 10-K.

## Reclassification

In order to improve the transparency related to our Credit segment, we have reclassified credit card revenues and expenses in our consolidated statements of earnings for the quarter and nine months ended November 1, 2008 to conform to our 2009 presentation. Credit card revenues were previously included in finance charges and other, net in our consolidated statements of earnings, and selling, general and administrative expenses for our credit segment were previously included in total selling, general and administrative expenses in our consolidated statements of earnings. These reclassifications, which were made beginning with our 2008 Annual Report on Form 10-K, did not impact our reported net earnings, earnings per share or cash flows for the quarter and nine months ended November 1, 2008.

## Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2009-01, Generally Accepted Accounting Principles (ASC 105, Generally Accepted Accounting Principles), which establishes the FASB Accounting Standards Codification ( the Codification or ASC ) as the official single source of authoritative U.S. generally accepted accounting principles ( GAAP ). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission (SEC ) guidance organized using the same topical structure in separate sections within the Codification.
Following the Codification, the FASB will no longer issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ( ASU ) which will serve to update the Codification, provide background information about the guidance and the basis for conclusions on the changes to the Codification.
The Codification is not intended to change GAAP, but is meant to organize and simplify authoritative GAAP literature. The Codification is effective for interim and annual periods ending after September 15, 2009. The impact on our consolidated financial statements is disclosure-only in nature as all references to authoritative accounting literature will be made in accordance with the Codification.
In order to ease the transition to the Codification, we are providing the Codification cross-reference alongside the references to the standards issued and adopted prior to the effective date of the Codification.

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## NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in millions except per share, per option and unit amounts) (Unaudited)

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS 160 ) (contained within ASC 810, Consolidation). SFAS 160 establishes new accounting and reporting standards for a noncontrolling interest (minority interest) in a subsidiary, provides guidance on the accounting for and reporting of the deconsolidation of a subsidiary, and increases transparency through expanded disclosures. Specifically, SFAS 160 requires the recognition of a minority interest as equity in the consolidated financial statements and separate from the parent company s equity. It also requires consolidated net earnings in the consolidated statement of earnings to include the amount of net earnings attributable to minority interest. This statement became effective for Nordstrom as of the beginning of fiscal year 2009 and did not have a material impact on our consolidated financial statements.
In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 ( SFAS 161 ) (contained within ASC 815, Derivatives and Hedging). SFAS 161 expands the disclosure requirements in SFAS 133 about an entity s derivative instruments and hedging activities. This statement became effective for Nordstrom as of the beginning of fiscal year 2009 and did not have a material impact on our consolidated financial statements.
In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB 28-1, Disclosures about Fair Value of Financial Instruments ( FSP FAS 107-1 and APB 28-1 ) (contained within ASC 825, Financial Instuments). FSP FAS 107-1 and APB 28-1, which requires disclosure about the fair value of financial instruments in interim financial statements as well as in annual financial statements, is effective for interim periods ending after June 15, 2009. We have adopted this guidance and have included the required disclosures in this Form 10-Q for the quarter ended October 31, 2009. This FSP has not impacted our consolidated financial position or results of operations, as its requirements are disclosure-only in nature.
In May 2009, the FASB issued Statement of Accounting Standards No. 165, Subsequent Events ( SFAS 165 ) (contained within ASC 855, Subsequent Events), which establishes general standards of accounting and disclosure for events that occur after the balance sheet date but before financial statements are issued. This standard is effective for reporting periods ending after June 15, 2009. We have included the required disclosures in this Form 10-Q for the quarter ended October 31, 2009. This statement did not impact our consolidated financial position or results of operations, as its requirements are disclosure-only in nature.

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## NORDSTROM, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in millions except per share, per option and unit amounts)
(Unaudited)

## NOTE 2: ACCOUNTS RECEIVABLE

The components of accounts receivable are as follows:

|  | $\begin{gathered} \text { October 31, } \\ 2009 \end{gathered}$ | $\begin{gathered} \text { January 31, } \\ 2009 \end{gathered}$ | $\begin{gathered} \text { November 1, } \\ 2008 \end{gathered}$ |
| :---: | :---: | :---: | :---: |
| Trade receivables: |  |  |  |
| Restricted | \$ 2,103 | \$ 2,005 | \$ 1,919 |
| Unrestricted | 17 | 14 | 26 |
| Allowance for doubtful accounts | (170) | (138) | (105) |
| Trade receivables, net | 1,950 | 1,881 | 1,840 |
| Other | 66 | 61 | 78 |
| Accounts receivable, net | \$ 2,016 | \$ 1,942 | \$ 1,918 |

The following table summarizes the restricted trade receivables:

|  | October 31, <br> $\mathbf{2 0 0 9}$ | January 31, <br> $\mathbf{2 0 0 9}$ | November 1, <br> $\mathbf{2 0 0 8}$ |
| :--- | :---: | :---: | :---: |
| Nordstrom VISA credit card receivables | $\mathbf{\$ 1 , 4 4 8}$ | $\$ 1,369$ | $\$ 1,304$ |
| Private label card receivables | $\mathbf{6 5 5}$ | 636 | 615 |
| Restricted trade receivables | $\$ \mathbf{2 , 1 0 3}$ | $\$ 2,005$ | $\$ 1,919$ |

The restricted trade receivables secure our Series 2007-1 Notes, the Series 2007-2 Notes and our two variable funding notes. The restricted trade receivables relate to substantially all of our Nordstrom private label card receivables and Nordstrom VISA credit card receivables.
The unrestricted trade receivables consist primarily of the remaining portion of our Nordstrom private label and Nordstrom VISA credit card receivables and accrued finance charges not yet allocated to customer accounts. Other accounts receivable consist primarily of credit card receivables due from third-party financial institutions and vendor claims.
Our Nordstrom private label cards can be used only in Nordstrom stores, while the Nordstrom VISA cards allow our customers the option of using the cards for purchases of Nordstrom merchandise and services, as well as for purchases outside of Nordstrom. We record the Nordstrom private label and Nordstrom VISA credit card receivables as trade receivables on our consolidated balance sheets at outstanding principal, net of an allowance for doubtful accounts. Cash flows from the use of both the private label cards and Nordstrom VISA credit cards for sales originating at our Nordstrom stores are treated as an operating activity in the condensed consolidated statements of cash flows as they relate to sales at Nordstrom. Cash flows arising from the use of Nordstrom VISA cards outside of Nordstrom stores are treated as an investing activity within the condensed consolidated statements of cash flows, as they represent loans made to our customers for purchases at third parties.

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## NORDSTROM, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in millions except per share, per option and unit amounts) (Unaudited)

## NOTE 3: DEBT AND CREDIT FACILITIES

We hold both secured and unsecured debt. The primary collateral for our secured debt is our Nordstrom private label card and Nordstrom VISA credit card receivables. A summary of long-term debt is as follows:

|  | October 31, <br> $\mathbf{2 0 0 9}$ | January 31, <br> $\mathbf{2 0 0 9}$ | November <br> $\mathbf{1 , 2 0 0 8}$ |  |
| :--- | :---: | :---: | :---: | :---: |
| Secured <br> Series 2007-1 Class A Notes, 4.92\%, <br> due April 2010 | $\mathbf{\$}$ | $\mathbf{3 2 6}$ | $\$$ | 326 |

As of October 31, 2009 and November 1, 2008, we had $\$ 356$ and $\$ 425$ classified as the current portion of long-term debt in our condensed consolidated balance sheets. As of October 31, 2009, this balance was primarily composed of $\$ 350$ related to our series 2007-1 notes due in April 2010. As of November 1, 2008, the current portion of long-term debt consisted primarily of $\$ 250$ related to our senior notes paid in January 2009, as well as $\$ 150$ in outstanding issuances against our Variable Funding Note facility ( 2007-A VFN ).
During the third quarter of 2009 , we entered into a new unsecured revolving credit facility with a capacity of $\$ 650$. This credit facility replaced our previously existing $\$ 650$ unsecured line of credit, which was scheduled to expire in November 2010. The new facility is available for working capital, capital expenditure and general corporate purposes, including liquidity support for our commercial paper program. Under the terms of the agreement, we pay a variable rate of interest and a facility fee based on our debt rating. Consistent with our previous unsecured revolving credit facility, the new revolving credit facility requires that we maintain a leverage ratio of not greater than four times Adjusted Debt to EBITDAR. The new facility also requires that we maintain a fixed charge coverage ratio of at least two times, defined as:

## EBITDAR less gross capital expenditures <br> Interest expense, net + rent expense

Under the new credit facility we have the option to increase the revolving commitment by up to $\$ 100$, to a total of $\$ 750$, provided that we obtain written consent from the lenders who choose to increase their commitment. We had no outstanding issuances under our $\$ 650$ commercial paper program as of October 31, 2009. The issuance of commercial paper has the effect, while it is outstanding, of reducing borrowing capacity under our unsecured revolving credit facility by an amount equal to the principal amount of commercial paper. As of October 31, 2009, we had no outstanding borrowings under our credit facility.
During the third quarter of 2009, we also repaid $\$ 19$ in liabilities related to the acquisition of Jeffrey. Other debt now consists primarily of capital lease obligations.

# NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

(Dollar and share amounts in millions except per share, per option and unit amounts) (Unaudited)

## NOTE 3: DEBT AND CREDIT FACILITIES (CONTINUED)

During the second quarter of 2009, we issued $\$ 400$ senior unsecured notes at $6.75 \%$, due June 2014. After deducting the original issue discount of $\$ 1$ and other fees and expenses of $\$ 3$, net proceeds from the offering were $\$ 396$. We used a portion of the proceeds from the issuance to repay the $\$ 140$ in outstanding issuances of commercial paper as of May 26, 2009, the date the senior notes were issued.
Additionally, we had $\$ 300$ in short-term capacity as of October 31, 2009 available under a Variable Funding Note facility ( 2007-A VFN ). As of October 31, 2009 we had no outstanding issuances against this facility. On November 13, 2009, we renewed this facility which was scheduled to mature in November 2009. The 2007-A VFN will now mature in November 2010. See further discussion of our $\$ 300$ 2007-A VFN in Note 8: Subsequent Event. As of October 31, 2009, the fair value of long-term debt, including current maturities, using quoted market prices of the same or similar issues, was $\$ 2,700$.

## NOTE 4: STOCK COMPENSATION PLANS

Stock-based compensation expense before income tax benefit was recorded in our condensed consolidated statements of earnings as follows:


## Stock Options

During the nine months ended October 31, 2009, 4.9 options were granted, 1.1 options were exercised, 0.1 options expired and 0.5 options were cancelled. During the nine months ended November 1, 2008, 2.2 options were granted, 0.8 options were exercised, and 0.5 options were cancelled. The weighted average fair values per option at the dates of grant were $\$ 7$ and $\$ 15$ in 2009 and 2008. We used the following assumptions to estimate the fair value of stock options at the date of grant:

Risk-free interest rate: Represents the yield on U.S. Treasury
0.7\%-3.3\%

2008 zero-coupon securities that mature over the 10 -year life of the stock options.

Weighted average expected volatility: Based on a
$\mathbf{6 1 . 0 \%}$
45.0\%
combination of the historical volatility of our common stock and the implied volatility of exchange traded options for our common stock.

## 1.3\%

1.3\%

Weighted average expected dividend yield: Our forecasted dividend yield for the next ten years.

Weighted average expected life in years: Represents the
5.3 estimated period of time until option exercise. The expected term of options granted was derived from the output of the Binomial Lattice option valuation model and was based on our historical exercise behavior, taking into consideration the contractual term of the option and our employees expected exercise and post-vesting employment termination behavior.

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## NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in millions except per share, per option and unit amounts) (Unaudited)
NOTE 4: STOCK COMPENSATION PLANS (CONTINUED)

## Performance Share Units

As of October 31, 2009, our liabilities included $\$ 1$ for performance share units. As of both January 31, 2009 and November 1, 2008, we had no liabilities related to performance share units. For both the nine months ended October 31, 2009 and November 1, 2008, stock-based compensation expense related to performance share units was approximately $\$ 1$. As of October 31, 2009, the remaining unrecognized stock-based compensation expense related to unvested performance share units was $\$ 3$, which is expected to be recognized over a weighted average period of 27 months. At January 31, 2009, 117,389 units were unvested. During the nine months ended October 31, 2009, 144,891 units were granted, no units vested and 8,007 units cancelled, resulting in an ending balance of 254,273 unvested units as of October 31, 2009.
NOTE 5: EARNINGS PER SHARE
The computation of earnings per share is as follows:

|  | Quarter Ended |  |  | Nine Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{aligned} & \text { October 31, } \\ & 2009 \end{aligned}$ |  | $\text { ber } 1 \text {, }$ |  | ber 31, | Nove 2008 | $\text { ber } 1 \text {, }$ |
| Net earnings | \$ 83 | \$ | 71 | \$ | 269 | \$ | 333 |
| Basic shares | 217.1 |  | 215.6 |  | 216.5 |  | 216.9 |
| Dilutive effect of stock options and performance share units | 3.6 |  | 2.5 |  | 2.5 |  | 2.9 |
| Diluted shares | 220.7 |  | 218.1 |  | 219.0 |  | 219.8 |
| Earnings per basic share | \$ 0.38 | \$ | 0.33 | \$ | 1.24 | \$ | 1.54 |
| Earnings per diluted share | \$ 0.38 | \$ | 0.33 | \$ | 1.23 | \$ | 1.52 |
| Antidilutive stock options and other | 4.7 |  | 5.1 |  | 8.0 |  | 5.1 |
|  | 12 of 31 |  |  |  |  |  |  |

# NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

(Dollar and share amounts in millions except per share, per option and unit amounts)
(Unaudited)

## NOTE 6: SEGMENT REPORTING

We aggregate our full-line, Rack and Jeffrey stores into the Retail Stores segment and report Direct as a separate segment. The Credit segment earns finance charges, interchange and late fee income through operation of the Nordstrom private label and Nordstrom VISA credit cards. The Other segment includes our product development group, which coordinates the design and production of private label merchandise sold in our retail stores, and our distribution network. This segment also includes our corporate center operations. In addition, our sales return reserve and other corporate adjustments are recorded in the Other segment. The following tables set forth the information for our reportable segments:

| Quarter ended October 31, 2009 |  | Retail Stores |  | Direct | Credit | Other |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net sales | \$ | 1,661 | \$ | 185 |  | \$ | 22 | \$ | 1,868 |
| Net sales increase |  | 1.8\% |  | 16.4\% | N/A |  | N/A |  | 3.5\% |
| Credit card revenues |  |  |  |  | 96 |  | (1) |  | 95 |
| Earnings (loss) before interest and income taxes |  | 175 |  | 58 | 3 |  | (64) |  | 172 |
| Interest expense, net |  |  |  |  | (11) |  | (27) |  | (38) |
| Earnings (loss) before income taxes |  | 175 |  | 58 | (8) |  | (91) |  | 134 |
| Earnings (loss) before income taxes as a percentage of net sales |  | 10.5\% |  | 31.8\% | N/A |  | N/A |  | 7.2\% |
| Quarter ended |  | Retail | Direct |  | Credit | Other |  | Total |  |
| November 1, 2008 |  | Stores |  |  |  |  |  |  |  |
| Net sales | \$ | 1,632 | \$ | 6.5\% |  | \$ | 15N/A | \$ | 1,805 |
| Net sales (decrease) increase |  | (8.6\%) |  |  | N/A |  |  |  | (8.4\%) |
| Credit card revenues |  |  |  |  | 74 |  |  |  | 74 |
| Earnings (loss) before interest and income taxes |  | 162 |  | 41 | (14) |  | (62) |  | 127 |
| Interest expense, net |  |  |  |  | (13) |  | (20) |  | (33) |
| Earnings (loss) before income taxes |  | 162 |  | 41 | (27) |  | (82) |  | 94 |
| Earnings (loss) before income taxes as a percentage of net sales |  | 9.9\% |  | 25.9\% | N/A |  | N/A |  | 5.2\% |
| Nine Months ended |  | Retail | Direct |  | Credit | Other |  | Total |  |
| Net sales | \$ | 5,284 | \$ | \$ 513 | N/A | \$ | (78) |  | 5,719 |
| Net sales (decrease) increase |  | (5.0\%) |  | 6.6\% |  |  | N/A |  | (4.2\%) |
| Credit card revenues |  |  |  |  | 269 |  | (1) |  | 268 |
| Earnings (loss) before interest and income taxes |  | 614 |  | 157 | (18) |  | (229) |  | 524 |
| Interest expense, net |  |  |  |  | (31) |  | (74) |  | (105) |
| Earnings (loss) before income taxes |  | 614 |  | 157 | (49) |  | (303) |  | 419 |


| Earnings (loss) before income taxes as a percentage of net sales |  | 11.6\% |  | 30.7\% | N/A |  | N/A |  | 7.3\% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total assets | \$ | 3,020 | \$ | 152 | \$ 2,053 |  | 1,291 | \$ | 6,516 |
| Nine Months ended <br> November 1, 2008 |  | Retail <br> Stores |  | Direct | Credit |  | Other |  | Total |
| Net sales | \$ | 5,563 | \$ | 481 |  | \$ | (73) | \$ | 5,971 |
| Net sales (decrease) increase |  | (4.6\%) |  | 7.9\% | N/A |  | N/A |  | (5.4\%) |
| Credit card revenues |  |  |  |  | 217 |  | (1) |  | 216 |
| Earnings (loss) before interest and income taxes |  | 702 |  | 124 | (2) |  | (201) |  | 623 |
| Interest expense, net |  |  |  |  | (39) |  | (59) |  | (98) |
| Earnings (loss) before income taxes |  | 702 |  | 124 | (41) |  | (260) |  | 525 |
| Earnings (loss) before income taxes as a percentage of net sales |  | 12.6\% |  | 25.9\% | N/A |  | N/A |  | 8.8\% |
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## NORDSTROM, INC. AND SUBSIDIARIES <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in millions except per share, per option and unit amounts)
(Unaudited)

## NOTE 7: CONTINGENT LIABILITIES

We are subject from time to time to various claims, proceedings and litigation arising from the normal course of our business including lawsuits alleging violations of state and/or federal wage and hour laws. Some of these suits purport or have been determined to be class actions and/or seek substantial damages. The results of these claims, proceedings and litigation cannot be predicted with certainty. However, we do not believe any such claim, proceeding or litigation, either alone or in aggregate, will have a material impact on our results of operations, financial position or cash flows.
NOTE 8: SUBSEQUENT EVENT
On November 13, 2009, we renewed our Variable Funding Note facility ( 2007-A VFN ) which was scheduled to mature in November 2009. The 2007-A VFN continues to have a capacity of $\$ 300$ and will now mature in November 2010. The 2007-A VFN is backed by substantially all of the Nordstrom private label card receivables and a $90 \%$ interest in the co-branded Nordstrom VISA credit card receivables. Borrowings under the 2007-A VFN incur interest based upon the cost of commercial paper issued by a third-party bank conduit plus specified fees. We pay a commitment fee for the notes based on the size of the commitment.
Under the renewed 2007-A VFN, we have the option to reduce the total capacity and provided that written consent is obtained from each of the parties to the Note Purchase Agreement, the facility contains the option to increase the total capacity.
We evaluated subsequent events through December 8, 2009, which is the date the financial statements were issued. We are not aware of any significant events, other than those identified above, which occurred subsequent to the balance sheet date but prior to December 8, 2009, that would have a material impact on our financial statements.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
(Amounts in millions except per share and per square foot amounts)
The following discussion should be read in conjunction with the Management s Discussion and Analysis section of our 2008 Annual Report on Form 10-K filed with the Commission on March 23, 2009.

## FORWARD-LOOKING INFORMATION CAUTIONARY STATEMENT

Certain statements in this Quarterly Report on Form 10-Q contain forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995) that involve risks and uncertainties, including anticipated financial results, use of cash and liquidity, growth, store openings and trends in our operations. Actual future results and trends may differ materially from historical results or current expectations depending upon various factors including, but not limited to:
the impact of deteriorating economic and market conditions and the resulting impact on consumer spending patterns
our ability to respond to the business environment and fashion trends
our ability to safeguard our brand and reputation
our ability to effectively manage inventory
efficient and proper allocation of our capital resources
successful execution of our store growth strategy including the timely completion of construction associated with newly planned stores, relocations and remodels, all of which may be impacted by the financial health of third parties
our compliance with applicable banking and related laws and regulations impacting our ability to extend credit to our customers
trends in personal bankruptcies and bad debt write-offs
availability and cost of credit
the impact of the current regulatory environment and financial system reforms
changes in interest rates
disruptions in our supply chain
our ability to maintain our relationships with vendors and developers who may be experiencing economic difficulties
the geographic location of our stores
our ability to maintain our relationships with our employees and to effectively train and develop our future leaders
our compliance with information security and privacy laws and regulations, employment laws and regulations and other laws and regulations applicable to the company
successful execution of our technology strategy
successful execution of our multi-channel strategy
risks related to fluctuations in world currencies
public health concerns and the resulting impact on consumer spending patterns, supply chain, and employee health
weather conditions and hazards of nature that affect consumer traffic and consumers purchasing patterns the effectiveness of planned advertising, marketing and promotional campaigns
our ability to control costs
the timing and amounts of share repurchases, if any
These and other factors, including those factors described in Part I, Item 1A. Risk Factors in our Form 10-K for the fiscal year ended January 31, 2009 and in Part II, Item 1A. Risk Factors on page 29 of this report, could affect our financial results and trends and cause actual results and trends to differ materially from those contained in any forward-looking statements we may provide. As a result, while we believe there is a reasonable basis for the forward-looking statements, you should not place undue reliance on those statements. We undertake no obligation to update or revise any forward-looking statements to reflect subsequent events, new information or future circumstances. This discussion and analysis should be read in conjunction with the unaudited Condensed Consolidated

Financial Statements.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)

## RESULTS OF OPERATIONS

Overview


Results for our third quarter were encouraging as we exceeded our internal sales and earnings plans. We experienced an improving trend in same-store sales in each month of the third quarter while effectively managing inventory and expenses. However, we recognize customers remain cautious given the general economic environment. We believe our continued focus on two core elements of our strategy giving our customers superior service and providing a compelling assortment of quality and trend-right merchandise will serve us well in this challenging environment.

Since the end of the third quarter of 2008 we have opened four full-line stores and thirteen
Nordstrom Rack stores, increasing retail square footage by 1.0 , or $4.5 \%$.
During the third quarter, we added incremental functionality to our inventory systems to enable online orders to be fulfilled from our stores. This allows us to share inventory across our business, provides a more in-depth online selection for our customers, and potentially increases the flow of new merchandise. Additionally, in August 2009 we implemented a new credit card processing system, which we believe will ultimately improve call center and collections automation as well as fraud and risk management, all at reduced cost.

Total net sales increased $3.5 \%$ for the quarter and declined $4.2 \%$ for the nine months ended October 31, 2009 compared to the same periods in 2008. Total company same-store sales decreased $1.2 \%$ for the quarter ended October 31, 2009 compared to an $11.1 \%$ same-store sales decrease for the same period in 2008. Same-store sales decreased $8.4 \%$ for the nine months ended October 31, 2009 compared to a $7.7 \%$ decline for the same period last year.

Our gross profit as a percentage of net sales increased 87 basis points for the quarter. The quarterly improvement in merchandise margin was partially offset by the impact of performance-related expenses within our buying and occupancy costs. For the nine months ended October 31, 2009 our gross profit declined 81 basis points primarily due to the impact of relatively fixed buying and occupancy costs as a percentage of reduced sales, partially offset by an improvement in our merchandise margin. We believe we are well-positioned for the holiday season and will be able to maintain a fresh flow of merchandise in our stores while carefully managing markdowns during the fourth quarter.

Retail selling, general and administrative expenses ( Retail SG\&A ), as a percentage of net sales, improved 37 basis points for the quarter ended October 31, 2009 compared to the quarter ended November 1, 2008. The reduction of our fixed and variable costs was partially offset by an increase in performance-related expense due to higher than planned sales and earnings results, as well as incremental new store expense of $\$ 12$ for the three months ended October 31, 2009. Our

Retail SG\&A rate for the nine months ended October 31, 2009 increased 23 basis points compared to the nine months ended November 1, 2008 driven by the increase in incentives tied to company performance and incremental new store expense $\$ 31$.

Credit selling, general and administrative expenses increased $\$ 4$ for the quarter and $\$ 66$ for the nine months ended October 31, 2009 compared to the same periods in 2008. We believe our write-off rates are correlated to trends in unemployment rates. Since the first quarter of 2009, we have projected peak unemployment rates between $10 \%$ to $10.5 \%$. While we still believe this is a reasonable range, the unemployment rate reached $10.2 \%$ in October, which was sooner than our initial projections. We have increased our bad debt reserve by $\$ 6$ for the quarter and $\$ 32$ for the nine months ended October 31, 2009.

For the 2009 fiscal year, we currently expect earnings per diluted share in the range of $\$ 1.83$ to $\$ 1.88$, increased from our previous guidance in the range of $\$ 1.50$ to $\$ 1.65$.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)

## Retail Stores, Direct and Other Segments

## Summary

Our Retail Stores segment includes our full-line, Rack and Jeffrey stores; our Direct segment includes our online store; and our Other segment includes our product development group and corporate center operations (collectively the Retail Business ). The following tables summarize the combined results of our Retail Business for the quarter and nine months ended October 31, 2009 compared with the quarter and nine months ended November 1, 2008:
Net sales
Cost of sales and related buying and


Nine Months Ended

October 31, 2009
Amount $\quad \%$ of net sales ${ }^{2}$
\$ 5,719
$(3,698)$

2,021
(1)
$(1,478)$
\$ 542
9.5
64.7
35.3

N/A
25.8

November 1, 2008
Amount $\quad \%$ of net sales ${ }^{2}$
\$ 5,971
100.0
$(3,817)$
63.9

2,154
36.1
(1)
$(1,528)$
25.6

Earnings before interest and income taxes

|  | $\begin{gathered} \text { October 31, } \\ 2009 \end{gathered}$ |  | $\begin{gathered} \text { ovember 1, } \\ 2008 \end{gathered}$ | $\begin{gathered} \text { October 31, } \\ 2009 \end{gathered}$ | November 1 2008 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net sales | \$ 1,868 | \$ | 1,805 | \$ 5,719 | \$ | 5,971 |
| Net sales increase (decrease) | 3.5\% |  | (8.4\%) | (4.2\%) |  | (5.4\%) |
| Sales (decrease) increase by channel: |  |  |  |  |  |  |
| Full-line same-store sales | (4.2\%) |  | (15.6\%) | (11.4\%) |  | (11.0\%) |
| Net sales Direct | 16.4\% |  | 6.5\% | 6.6\% |  | 7.9\% |
| Multi-channel same-store sales | (1.9\%) |  | (13.6\%) | (9.7\%) |  | (9.5\%) |
| Rack same-store sales | 3.0\% |  | 3.6\% | 1.8\% |  | 4.8\% |
| Total company same-store sales decrease | (1.2\%) |  | (11.1\%) | (8.4\%) |  | (7.7\%) |

Total net sales increased 3.5\% for the quarter and declined $4.2 \%$ for the nine months ended October 31, 2009 compared with the same periods in the prior year. The third quarter of 2008 was marked by deteriorating sales trends amid economic concerns and uncertainty. For the quarter and nine-months ended October 31, 2009, same-store sales declines at our full-line stores were partially offset by positive performance by our Direct segment and same-store sales increases at our Rack stores.
Same-store sales for our full-line stores decreased $4.2 \%$ for the quarter and $11.4 \%$ for the nine months ended October 31, 2009 compared to the same periods in 2008. Highlights for the quarter included women s better apparel, junior women sapparel and shoes, which all achieved results above the full-line same-store sales average. Sales of tops benefitted women s better apparel. Sportswear drove junior women $s$ apparel, while high-end footwear led shoes. Men s wear, particularly men sfurnishings, and cosmetics were challenging for the quarter. Examples of merchandise categories with results above the same-store sales average for the nine months ended October 31, 2009 included junior women s apparel, kids wear and women s better apparel. Junior women s apparel benefitted from increased denim sales. Girls clothing led the kids wear division and tops drove women $s$ better apparel results. Merchandise areas which continue to be challenging year-to-date include men $s$ wear and our women $s$ trendy offering. Our merchants continue to work with our vendors to provide a balanced and compelling fashion offering to our customers.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
Regionally, the Mid-Atlantic and the South were the top-performing geographic areas for full-line stores for the third quarter, with the Mid-Atlantic and Northeast achieving the largest sequential improvements over the second quarter of 2009. The South, Mid-Atlantic, and Midwest regions were the top-performing geographic areas for full-line stores for the nine months ended October 31, 2009. California and the Northwest continue to be challenging, with same-store sales below the full-line store average for both the quarter and year-to-date.
Our Rack channel delivered same-store sales increases of $3.0 \%$ for the quarter and $1.8 \%$ for the nine months ended October 31, 2009 compared to the same periods last year. For the three months ended October 31, 2009, shoes as well as accessories and cosmetics drove the increase. Shoes was led by boots and sandals while accessories and cosmetics benefitted from the performance of sunglasses and fashion jewelry. For the nine months ended October 31, 2009, shoes particularly sandals and boots and kids apparel led the Rack categories.
Sales for our Direct channel grew $16.4 \%$ for the quarter and $6.6 \%$ for the nine months ended October 31, 2009 compared with the same periods last year. During the third quarter, we updated our inventory platform to enable online orders to be fulfilled from our stores. This is part of our ongoing efforts to provide our customers with access to more of our merchandise, whenever and however they want to shop. We believe this enhancement in serving our customers had a positive impact on our Direct sales for the quarter. Merchandise categories which drove the increase for the quarter included dresses, accessories, and shoes. Dresses benefitted from special occasion. Fashion jewelry led accessories and women s high-end shoes drove the shoe category. For the nine months ended October 31, 2009, the increases were driven by dresses and women s shoes. Similar to the quarter, dresses were led by special occasion while women s shoes benefitted from high-end footwear.
We expect full year 2009 retail same-store sales to decrease in the range of $6 \%$ to $7 \%$.

## Retail Business Gross Profit

|  | Quarter Ended |  | Nine Months Ended |  |
| :--- | :---: | :---: | :---: | :---: |
|  | October | November 1, | October | November 1, |
|  | $\mathbf{3 1 , 2 0 0 9}$ | $\mathbf{2 0 0 8}$ | $\mathbf{3 1 , \mathbf { 2 0 0 9 }}$ | $\mathbf{2 0 0 8}$ |
| Gross profit | $\mathbf{\$ 6 7 0}$ | $\$ 631$ | $\mathbf{\$ 2 , 0 2 1}$ | $\$ 2,154$ |
| Gross profit rate $^{1}$ | $\mathbf{3 5 . 8 \%}$ | $34.9 \%$ | $\mathbf{3 5 . 3 \%}$ | $36.1 \%$ |

${ }^{1}$ Gross profit rate is calculated as gross profit divided by net sales.
Retail gross profit increased $\$ 39$ for the quarter while our gross profit rate improved 86 basis points compared with the same period in 2008. Retail gross profit is made up of merchandise margin offset by buying and occupancy costs. Increased sales and reduced markdowns led to the increase in gross profit dollars. The increase in our gross profit rate was the result of improvement in merchandise margin, partially offset by the impact of an increase in performance-related expense included in buying and occupancy costs.
Retail gross profit decreased $\$ 133$ for the nine months ended October 31, 2009, while our gross profit rate declined 77 basis points compared with the same period in 2008. Retail gross profit dollars declined primarily due to lower sales. The impact of our fixed buying and occupancy costs as a percentage of reduced sales and the increase in performance-related expense, discussed above, primarily drove the decrease in our gross profit rate.
We expect our retail gross profit rate for the full year 2009 to increase 10 to 20 basis points from 2008 levels of 35.1\%.

|  | Four Quarters Ended |  |
| :--- | :---: | :---: |
|  | October | November 1, |
| Average inventory per square foot | $\mathbf{3 1 , 2 0 0 9}$ | $\mathbf{2 0 0 8}$ |
| Inventory turnover rate ${ }^{1}$ | $\mathbf{\$ 4 7 . 8 0}$ | $\$ 82.88$ |
| n $^{1}$ | $\mathbf{5 . 0 0}$ | 4.88 |

${ }^{1}$ Inventory turnover rate is calculated as the trailing 12 months cost of sales and related buying and occupancy costs (for all segments) divided by 4-quarter average inventory

Our inventory turnover rate improved slightly compared to last year. The decrease in average inventory per square foot of $9.7 \%$ was slightly higher than our total company same-store sales decrease of $8.4 \%$ for the nine months ended October 31, 2009. We continue to focus on flexibility in managing inventory, which enables us to keep a fresh flow of receipts in our stores and provide customers with fashion newness.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
Retail Business Selling, General and Administrative Expenses

|  | Quarter Ended |  | Nine Months Ended |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | October | November 1, | October | November 1, |  |
|  | $\mathbf{3 1 , 2 0 0 9}$ | $\mathbf{2 0 0 8}$ | $\mathbf{3 1 , 2 0 0 9}$ | $\mathbf{2 0 0 8}$ |  |
| Selling, general and administrative expenses | $\mathbf{\$ 1 , 5 0 0}$ | $\$$ | 490 | $\mathbf{\$ 1 , 4 7 8}$ | $\$ 1,528$ |
| Selling, general and administrative rate ${ }^{1}$ | $\mathbf{2 6 . 8 \%}$ |  | $27.1 \%$ | $\mathbf{2 5 . 8 \%}$ | $25.6 \%$ |

${ }^{1}$ Selling, general and administrative rate is calculated as selling, general and administrative expenses for our Retail Business as a percentage of net sales.
SG\&A expenses for our Retail Business increased $2 \%$, or $\$ 10$ compared with last year s third quarter. Incentives tied to company performance as well as new store expenses drove the increase, partially offset by lower variable expenses and fixed cost savings. Similar to our second quarter, we increased our provision for performance related expense to reflect the improved performance of the overall business relative to our plans and our revised expectations for the year. This reflects our pay for performance approach to compensation. The third quarter of 2009 also includes $\$ 12$ in expenses for the four full-line and thirteen Rack stores opened since the third quarter of 2008. Retail square footage increased 1.0 , or $4.5 \%$ since the third quarter of 2008. Although third quarter sales improved over last year, through added focus on cost containment we were able to reduce our variable expenses. Fixed cost declines included areas such as non-selling labor and advertising. We also incurred lower depreciation due to technology assets which became fully depreciated since the third quarter of 2008. The improvement in our SG\&A rate of 37 basis points reflects a combination of improved sales and our management of fixed and variable costs. This was partially offset by the increase in performance-based incentives.
For the nine months ended October 31, 2009, our Retail SG\&A dollars decreased $\$ 50$ to $\$ 1,478$ primarily due to lower variable expenses and fixed cost savings, partially offset by performance-based incentives and $\$ 31$ of incremental expenses related to our new stores opened since October 2008. Variable expenses decreased consistent with the decrease in sales. Reductions in fixed costs encompassed many areas including advertising, services purchased, depreciation and non-selling labor. The increase in performance-based incentives was a result of better sales and earnings performance versus plan for the nine months ended October 31, 2009 compared with the same period in 2008, which reflects our pay for performance approach to compensation. This was the primary driver of the 23 basis point increase in our retail SG\&A rate for the nine months ended October 31, 2009.
We anticipate our Retail SG\&A expenses will decrease $\$ 15$ to $\$ 40$ for 2009 which is reduced from our previous range of down $\$ 100$ to $\$ 150$. The change is a result of our expectations for higher variable costs due to improved sales and additional performance-based incentives.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)

## Credit Segment

The Nordstrom credit card products are designed to strengthen customer relationships and grow retail sales by providing valuable services, loyalty benefits and payment products. We believe that owning our credit card business allows us to fully integrate our rewards program with our retail stores and provide better service to our customers, thus deepening our relationship with them and driving greater customer loyalty. Cardholders can participate in the Nordstrom Fashion Rewards ${ }^{\circledR}$ program, through which customers accumulate points based on their level of spending (two points per dollar spent at Nordstrom and one point per dollar spent outside of Nordstrom). Upon reaching two thousand points, customers receive twenty dollars in Nordstrom Notes®, which can be redeemed for goods or services in our stores. As customers increase their level of spending they receive additional benefits, including rewards such as complimentary shipping and alterations in our retail stores. We believe the Fashion Rewards program, including these additional rewards, helps drive sales in our Retail Stores and Direct segments.
The table below illustrates a detailed view of the operational results of our Credit segment, consistent with the segment disclosure provided in the notes to the condensed consolidated financial statements. In order to view the total economic contribution of our credit card program, intercompany merchant fees are included in the table below. Intercompany merchant fees represent the estimated intercompany income of our credit business from the usage of our cards in the Retail Stores and Direct segments. To encourage the use of Nordstrom cards in our stores, the Credit segment does not charge the Retail Stores and Direct segments an intercompany interchange merchant fee. On a consolidated basis, we avoid costs that would be incurred if our customers used third-party cards.
Interest expense is assigned to the Credit segment in proportion to the amount of estimated capital needed to fund our credit card receivables, which assumes a mix of $80 \%$ debt and $20 \%$ equity. The average accounts receivable investment metric included in the following table represents our best estimate of the amount of capital for our credit card program that is financed by equity. As a means of assigning comparable cost of capital for our credit card business, we believe it is important to maintain a capital structure similar to other financial institutions. Based on our research, we have found that debt as a percentage of credit card receivables for other credit card companies ranges from $70 \%$ to $90 \%$. We believe that debt equal to $80 \%$ of our credit card receivables is appropriate given our overall capital structure goals.

|  | Quarter Ended |  |  | Nine Months Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | October $\text { 31, } 2009$ | $\begin{gathered} \text { November 1, } \\ 2008 \end{gathered}$ |  | October <br> 31, 2009 | $\begin{gathered} \text { November 1, } \\ 2008 \end{gathered}$ |  |
| Finance charge revenue | \$ 68 | \$ | 52 | \$ 195 | \$ | 154 |
| Interchange third party | 18 |  | 17 | 53 |  | 51 |
| Late fees and other revenue | 10 |  | 5 | 21 |  | 12 |
| Total credit card revenues | 96 |  | 74 | 269 |  | 217 |
| Interest expense | (11) |  | (13) | (31) |  | (39) |
| Net credit card income | 85 |  | 61 | 238 |  | 178 |
| Cost of sales and related buying and occupancy costs loyalty program | (12) |  | (11) | (37) |  | (35) |
| Selling, general and administrative expenses | (81) |  | (77) | (250) |  | (184) |
| Total expense | (93) |  | (88) | (287) |  | (219) |


| Credit card charge to earnings before income taxes, as presented in segment disclosure |  | (8) |  | (27) |  | (49) |  | (41) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Intercompany merchant fees |  | 11 |  | 10 |  | 35 |  | 35 |
| Total credit card contribution (charge) | \$ | 3 | \$ | (17) | \$ | (14) | \$ | (6) |
| Average accounts receivable investment (assuming $80 \%$ of accounts receivable is funded with debt) $\square$ \$ $431 \quad$ \$ 397 <br> \$ <br> 417 \$ 377 |  |  |  |  |  |  |  |  |
| Credit card contribution (charge), net of tax, as a percentage of average accounts |  |  |  |  |  |  |  |  |
| ${ }^{1}$ Based on annualized credit card contribution (charge), net of tax for the quarter and nine months ended October 31, 2009 and November 1, 2008. |  |  |  |  |  |  |  |  |

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)

## Net Credit Card Income

Credit card revenues include finance charges, interchange fees, late and other fees. The majority of our credit accounts have finance charge rates that vary with changes in the prime rate. Interchange fees are earned from the use of Nordstrom VISA credit cards at merchants outside of Nordstrom.
Credit card revenues increased to $\$ 96$ and $\$ 269$ for the quarter and nine months ended October 31, 2009, respectively, compared with $\$ 74$ and $\$ 217$ for the quarter and nine months ended November 1, 2008. These results were due to an increase in our annual percentage rate terms implemented in the fourth quarter of 2008 and growth in our accounts receivable balance.
Interest expense decreased from $\$ 13$ and $\$ 39$ for the quarter and nine months ended November 1, 2008 to $\$ 11$ and $\$ 31$ for the quarter and nine months ended October 31, 2009, due to declining variable interest rates, partially offset by higher average borrowings.
Based on results for the nine months ended October 31, 2009 as well as the previously implemented increases in annual percentage rate terms, we expect our credit card revenues for 2009 to increase $\$ 70$ to $\$ 75$ compared to 2008.

## Cost of Sales

Cost of sales, which includes the estimated cost of Nordstrom Notes that will be issued and redeemed under our Fashion Rewards program, remained relatively constant at $\$ 12$ and $\$ 37$ for the quarter and nine months ended October 31, 2009 compared with $\$ 11$ and $\$ 35$ for the quarter and nine months ended November 1, 2008. The slight increase in cost of sales for the nine months ended October 31, 2009 compared with the nine months ended November 1, 2008 is primarily due to increased use of Nordstrom credit cards, resulting in additional expense related to the Fashion Rewards program.

## Credit Selling, General and Administrative Expenses

Selling, general and administrative expenses for our Credit segment are made up of operational and marketing expenses and bad debt. These expenses are summarized in the following table:

|  | Quarter Ended |  |  | Nine Months Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | October |  |  | October |  |  |
|  | $\begin{gathered} 31, \\ 2009 \end{gathered}$ |  | $\text { aber } 1 \text {, }$ 08 | $\begin{gathered} 31, \\ 2009 \end{gathered}$ |  | $\text { nber } \mathbf{1} \text {, }$ |
| Operational and marketing expense | \$ 25 | \$ | 27 | \$ 75 | \$ | 78 |
| Bad debt expense | 56 |  | 50 | 175 |  | 106 |
| Total credit selling, general and administrative expense | \$ 81 | \$ | 77 | \$ 250 | \$ |  |

Operational and marketing expenses, which are incurred to support and service our credit card products and the related rewards programs, remained relatively constant at $\$ 25$ and $\$ 75$ for the quarter and nine months ended October 31, 2009 compared with $\$ 27$ and $\$ 78$ for the quarter and nine months ended November 1, 2008. This reflects expenses that are mostly fixed when compared to portfolio growth and our continued focus on controlling expenses. Due to increased write-offs reflecting current consumer credit trends, as well as reserves for higher projected losses inherent in the receivables portfolio, bad debt expense increased from $\$ 50$ and $\$ 106$ for the quarter and nine months ended November 1, 2008 to $\$ 56$ and $\$ 175$ for the quarter and nine months ended October 31, 2009.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
The following table illustrates the activity in the allowance for doubtful accounts for the nine months ended October 31, 2009 and November 1, 2008:

|  | Nine Months Ended |  |  |
| :--- | :---: | :---: | :---: |
|  | October | November 1, |  |
|  | $\mathbf{3 1 , 2 0 0 9}$ | $\mathbf{2 0 0 8}$ |  |
| Allowance at beginning of period | $\$$ | $\mathbf{1 3 8}$ | $\$ 73$ |
| Bad debt provision | $\mathbf{1 7 5}$ |  | 106 |
| Net write-offs | $\mathbf{( 1 4 3 )}$ |  | $(74)$ |
| Allowance at end of period | $\$ \mathbf{1 7 0}$ | $\$$ | 105 |


|  | October | November 1, |
| :--- | :---: | :---: |
| $\mathbf{3 1 , \mathbf { 2 0 0 9 }}$ | $\mathbf{2 0 0 8}$ |  |
| Allowance as a percentage of accounts receivable | $\mathbf{8 . 0 \%}$ | $5.4 \%$ |
| Delinquent balances over thirty days as a percentage of <br> accounts receivable | $\mathbf{4 . 9 \%}$ | $3.2 \%$ |
| Bad debt provision as a percentage of average accounts <br> receivable | $\mathbf{1 0 . 4 \%}$ | $10.0 \%$ |
| Net write-offs as a percentage of average accounts receivable $^{2}$ | $\mathbf{9 . 3 \%}$ | $5.6 \%$ |

${ }^{1}$ Based upon annualized third quarter bad debt provision.
${ }^{2}$ Based upon annualized third quarter net write-offs.
As of October 31, 2009, our delinquency rate was $4.9 \%$, an increase from $3.2 \%$ as of November 1, 2008. We believe that the increase in delinquencies in the third quarter is primarily attributable to a change in customer due dates, as well as rising unemployment rates. During the third quarter, we made a change in the timing of payment due dates in response to new regulatory requirements. We believe that the change in payment due dates negatively impacted our delinquency rate at October 31, 2009, but that the impact is temporary. During the third quarter of 2009, we increased our allowance for doubtful accounts by $\$ 6$ due to our expectations around future write-offs for losses inherent in our accounts receivable balance as of October 31, 2009. Due to continued rising unemployment rates, which we believe correlate with higher delinquencies and ultimately higher write-offs, we now expect our credit selling, general and administrative expenses to increase $\$ 55$ to $\$ 60$ for 2009 compared with 2008. We continue to take actions to reduce our risk exposure by tightening underwriting and account management standards. However, additional deterioration in the overall economic environment, including worsening unemployment, could cause delinquencies to increase beyond our current expectations, resulting in additional bad debt expense.

## Total Company Results

## Interest Expense, net

Interest expense, net increased by $\$ 5$ to $\$ 38$ for the quarter ended October 31, 2009 compared to the same period in 2008. For the nine months ended October 31, 2009, interest expense, net increased $\$ 7$ to $\$ 105$. The increases were driven by higher average debt levels resulting from our $\$ 400$ debt offering during the second quarter of 2009, partially offset by the $\$ 250$ senior notes which matured in January 2009 and the impact of declining variable interest rates. We anticipate our interest expense, net for 2009 to increase by $\$ 5$ to $\$ 10$ due to higher average debt levels.

## Income Tax Expense

| Quarter Ended |  |
| :---: | :---: |
| October | November 1, |
| $\mathbf{3 1 , 2 0 0 9}$ | 2008 |


| Nine Months Ended |  |
| :---: | :---: |
| October | November 1, |
| $\mathbf{3 1 , 2 0 0 9}$ | 2008 |


| Income tax expense | $\mathbf{\$}$ | $\mathbf{5 1}$ | $\$$ | 23 | $\mathbf{1 5 0}$ | $\$$ | 192 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Effective tax rate | $\mathbf{3 8 . 0 \%}$ |  | $24.3 \%$ |  | $\mathbf{3 5 . 7 \%}$ |  | $36.6 \%$ |

The increase in the effective tax rate for the third quarter of 2009, as compared to the same period in 2008, was primarily due to a non-recurring benefit in the third quarter of 2008. This benefit related to a change in our deferred tax assets primarily driven by the closure of several tax years under audit, partially offset by a permanent item related to investment valuation. Additionally, included in our first quarter 2009 results is a benefit of approximately $\$ 0.06$ per diluted share related to the closure of our 2007 federal tax return audit. The decrease in our effective tax rate for the nine months ended October 31, 2009, as compared to the same period in 2008, was due to this benefit, as well as the impact of a permanent item related to investment valuation, partially offset by the benefit included in our third quarter 2008 results. Including the impact of the $\$ 0.06$ gain in the first quarter of 2009 , we expect our effective tax rate to be between $36.5 \%$ and $37.0 \%$ for 2009.

## Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)

## Seasonality

Our business, like that of other retailers, is subject to seasonal fluctuations. Our Anniversary Sale in July, the holidays in December, and our Half-yearly sales events typically result in higher sales in the second and fourth quarters of our fiscal years. Accordingly, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

## Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
Return on Invested Capital (ROIC) (Non-GAAP financial measure)
We define Return on Invested Capital as follows:

## ROIC $=\quad$ Net Operating Profit after Taxes (NOPAT) Average Invested Capital

We believe that ROIC is a useful financial measure for investors in evaluating our operating performance for the periods presented. When read in conjunction with our net earnings and total assets and compared to return on assets, it provides investors with a useful tool to evaluate our ongoing operations and our management of assets from period to period. ROIC is one of our key financial metrics, and we also incorporate it into our executive incentive measures. Our research has shown that, historically, overall performance as measured by ROIC correlates directly to shareholders return over the long term. For the 12 fiscal months ended October 31, 2009, our ROIC decreased to $9.9 \%$ compared to $15.1 \%$ for the 12 fiscal months ended November 1, 2008. ROIC is not a measure of financial performance under United States GAAP, should not be considered a substitute for return on assets, net earnings or total assets as determined in accordance with GAAP, and may not be comparable to similarly titled measures reported by other companies. See our ROIC reconciliation to GAAP below. The closest GAAP measure is return on assets, which decreased to $5.6 \%$ from $9.5 \%$ for the 12 fiscal months ended October 31, 2009 compared to the 12 fiscal months ended November 1, 2008. The following is a reconciliation of return on assets to ROIC:

|  | 12 months ended |  |  |
| :---: | :---: | :---: | :---: |
|  | $2009$ | Novem | er 1,2008 |
| Net earnings | \$ 337 | \$ | 545 |
| Add: income tax expense | 205 |  | 334 |
| Add: interest expense, net | 138 |  | 128 |
| Earnings before interest and income taxes | 680 |  | 1,007 |
| Add: rent expense | 40 |  | 36 |
| Less: estimated depreciation on capitalized operating leases ${ }^{1}$ | (21) |  | (19) |
| Net operating profit | 699 |  | 1,024 |
| Estimated income tax expense | (264) |  | (386) |
| Net operating profit after tax (NOPAT) | \$ 435 | \$ | 638 |
| Average total assets ${ }^{2}$ | \$ 6,043 | \$ | 5,724 |
| Less: average non-interest-bearing current liabilities ${ }^{3}$ | $(1,501)$ |  | $(1,467)$ |
| Less: average deferred property incentives ${ }^{2}$ | (451) |  | (382) |
| Add: average estimated asset base of capitalized operating leases ${ }^{4}$ | 302 |  | 344 |
| Average invested capital | \$ 4,393 | \$ | 4,219 |
| Return on Assets | 5.6\% |  | 9.5\% |
| ROIC | 9.9\% |  | 15.1\% |

${ }^{1}$ Depreciation
based upon
estimated asset
base of
capitalized
operating leases
as described in
footnote 4 below.
${ }^{2}$ Based upon the trailing 12-month average.
${ }^{3}$ Based upon the trailing 12-month average for accounts payable, accrued salaries, wages and related benefits, and other current liabilities.
${ }^{4}$ Based upon the trailing 12-month average of the monthly asset base, which is calculated as the trailing 12 months rent expense
multiplied by 8 .
Our ROIC declined primarily due to a decrease in our earnings before interest and income taxes compared to the prior year.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued)
(Amounts in millions except per share and per square foot amounts)

## LIQUIDITY AND CAPITAL RESOURCES

We maintain a level of liquidity sufficient to allow us to cover our seasonal cash needs and to maintain appropriate levels of short-term borrowings. We believe that our operating cash flows and available credit facilities are sufficient to finance our cash requirements for the next 12 months and beyond.
Over the long term, we manage our cash and capital structure to maximize shareholder return, strengthen our financial position and maintain flexibility for future strategic initiatives. We continuously assess our debt and leverage levels, capital expenditure requirements, principal debt payments, dividend payouts, potential share repurchases and future investments or acquisitions. We believe our operating cash flows, available credit facilities and potential future borrowings will be sufficient to fund these scheduled future payments and potential long-term initiatives.
For the nine months ended October 31, 2009, cash and cash equivalents increased by $\$ 412$ to $\$ 484$. Activity for the nine months ended October 31, 2009 included cash provided by operations of $\$ 801$, partially offset by capital expenditures of $\$ 281$, purchases, net of payments, made by our customers for third-party merchandise and services using Nordstrom VISA credit cards of $\$ 129$ and cash dividends paid of $\$ 104$. Additionally, we received proceeds from long-term borrowings of $\$ 399$, of which a portion was used to repay outstanding issuances of commercial paper.

## Operating Activities

The majority of our operating cash inflows are related to sales to our customers, including the collection of accounts receivable. We also receive cash payments for property incentives from developers. Our operating cash outflows generally consist of payments to our inventory vendors (net of vendor allowances), payments to our employees for wages, salaries and other employee benefits, and payments to our landlords for rent. Operating cash outflows also include payments for income taxes and interest payments on our short and long-term borrowings.
Net cash provided by operating activities increased by $\$ 347$ to $\$ 801$ for the nine months ended October 31, 2009 compared to $\$ 454$ for the same period in 2008. Although net earnings for the nine months ended October 31, 2009 declined compared to the same period in 2008, working capital initiatives and lower cash outflows resulted in higher cash provided by operating activities. The reduced cash outflows for merchandise inventories reflected our ongoing efforts to align merchandise inventories with lower demand. Additionally, lower incentive payouts tied to company performance for 2008, reductions in expenses, and lower payments for income taxes also led to a decrease in operating cash outflows.

## Investing Activities

Our investing cash flows typically consist of capital expenditures and customer purchases (net of payments) for goods and services outside of Nordstrom using the Nordstrom VISA credit cards.
Net cash used in investing activities decreased from $\$ 608$ for the nine months ended November 1, 2008 to $\$ 409$ for the nine months ended October 31, 2009, due to a decrease in capital expenditures for new stores and remodels, as well as a decrease in third-party purchases (net of payments) using the Nordstrom VISA credit cards. We opened three full-line stores, relocated one full-line store, and opened eleven Rack stores in the first nine months of 2009, compared to opening seven full-line stores, relocating one full-line store, and opening four Rack stores for the same period last year. Although we plan to continue the growth of our Rack business in 2009 and 2010, capital expenditures incurred for Rack stores are significantly less compared to our full-line stores.
Activity related to customers using their Nordstrom VISA credit cards for merchandise and services outside of Nordstrom stores decreased to $\$ 129$ for the nine months ended October 31, 2009 compared with $\$ 171$ for the nine months ended November 1, 2008. The decrease was a result of a general reduction in consumer spending.

## Financing Activities

Net cash provided by financing activities was $\$ 20$ for the nine months ended October 31, 2009 compared with net cash used in financing activities of $\$ 136$ for the nine months ended November 1, 2008. In 2009, our financing activities consisted of proceeds from long-term borrowings, net of discount, of $\$ 399$, partially offset by payments for outstanding issuances of commercial paper of $\$ 275$ and dividends paid of $\$ 104$. Of the $\$ 275$ in commercial paper issuances outstanding at the beginning of our 2009 fiscal year, we reclassified $\$ 140$ to long-term debt during the first quarter, as this amount was repaid with the proceeds of our May 2009 debt issuance. Accordingly, this portion of the
commercial paper repayments is classified as repayments of commercial paper classified as long-term in our condensed consolidated statement of cash flows for the nine months ended October 31, 2009. The remaining $\$ 135$ in commercial paper repayments made in 2009 were made using operating cash flows, and are classified as repayments of/proceeds from commercial paper borrowings, net in our condensed consolidated statement of cash flows.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
In 2008, cash used in financing activities included share repurchases of $\$ 264$ and dividends paid of $\$ 104$, partially offset by proceeds from our variable funding facility of $\$ 150$ and net commercial paper borrowings of $\$ 102$.

## Short and Long-Term Borrowing Activity

In the second quarter, we issued $\$ 400$ senior unsecured notes at $6.75 \%$ due June 2014. After deducting the original issue discount, underwriting fees and other expenses of $\$ 4$, net proceeds from the offering were $\$ 396$. A portion of these net proceeds were used to repay $\$ 140$ in commercial paper borrowings outstanding at the date of issuance. The remaining proceeds will be used for general corporate purposes.

## Credit Capacity and Commitments

As discussed above, we completed the issuance of $\$ 400,6.75 \%$ notes due 2014 during the second quarter of 2009. Our next debt maturity is a $\$ 350$ securitized note due in April 2010. Beginning in the first quarter of 2010, we will make monthly cash deposits into a restricted account until the note is due in accordance with the debt agreement. We will continue to monitor the credit markets and our potential financing needs in order to ensure we have adequate cash on hand to pay this debt when it becomes due.
On August 14,2009 , we entered into a new unsecured revolving credit facility with a capacity of $\$ 650$, which expires in August 2012. The new facility replaced our existing $\$ 650$ unsecured line of credit, which was scheduled to expire in November 2010. The new credit facility is available for working capital, capital expenditures and general corporate purposes, including liquidity support for our commercial paper program. Under the terms of the agreement, we pay a variable rate of interest and a facility fee based on our debt rating. Under the new credit facility we have the option to increase the revolving commitment by up to $\$ 100$, to a total of $\$ 750$, provided that we obtain written consent from the lenders who choose to increase their commitment.
On November 13, 2009, we renewed our 2007-A VFN which was scheduled to mature in November 2009. The 2007-A VFN continues to have a capacity of $\$ 300$ and will now mature in November 2010. Borrowings under the 2007-A VFN incur interest based upon the cost of commercial paper issued by a third-party bank conduit plus specified fees. We pay a commitment fee for the notes based on the size of the commitment. Under the renewed 2007-A VFN, we have the option to reduce the total capacity and, provided that written consent is obtained from each of the parties to the Note Purchase Agreement, the facility contains the option to increase the total capacity.

## Debt Covenants

Our $\$ 650$ unsecured line of credit contains restrictive covenants, including maintaining leverage and fixed charge coverage ratios. Consistent with our previous unsecured line of credit, the new credit facility requires that we maintain a leverage ratio of not greater than four times Adjusted Debt to EBITDAR, which we were in compliance with as of October 31, 2009. See additional disclosure of our internal calculation of Adjusted Debt to EBITDAR on the following page, which generally results in the same ratio as our debt compliance calculation. The new facility also requires that we maintain a fixed charge coverage ratio of at least two times, defined as:

## EBITDAR less gross capital expenditures

## Interest expense, net + rent expense

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued) (Amounts in millions except per share and per square foot amounts)
Adjusted Debt to EBITDAR (Non-GAAP financial measure)
We define Adjusted Debt to Earnings before Interest, Income Taxes, Depreciation, Amortization and Rent
( EBITDAR ) as follows:

## Adjusted Debt

## Adjusted Debt to EBITDAR =

## EBITDAR

Adjusted Debt to EBITDAR is one of our key financial metrics, and we believe that our debt levels are best analyzed using this measure. Our goal today is to manage debt levels at a point which we believe will help us maintain an investment grade credit rating as well as operate with an efficient capital structure for our size, growth plans and industry. Investment grade credit ratings are important to maintaining access to a variety of short-term and long-term sources of funding, and we rely on these funding sources to continue to grow our business. We believe a higher ratio, among other factors, could result in rating agency downgrades. In contrast, we believe a lower ratio would result in a higher cost of capital and could negatively impact shareholder returns. As of October 31, 2009, our Adjusted Debt to EBITDAR was 2.8 compared to 2.3 as of November 1, 2008. The increase was primarily the result of a decrease in earnings before interest and income taxes for the 12 months ended October 31, 2009 compared with the 12 months ended November 1, 2008.
Adjusted Debt to EBITDAR is not a measure of financial performance under GAAP and should not be considered a substitute for debt to net earnings, net earnings or debt as determined in accordance with GAAP. In addition, Adjusted Debt to EBITDAR does have limitations:

Adjusted Debt is our best estimate of the total company debt we would incur if we had purchased the property associated with our operating leases;

EBITDAR does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments, including leases, or the cash requirements necessary to service interest or principal payments on our debt; and

Other companies in our industry may calculate Adjusted Debt to EBITDAR differently than we do, limiting its usefulness as a comparative measure.
To compensate for these limitations, we analyze Adjusted Debt to EBITDAR in conjunction with other GAAP financial and performance measures impacting liquidity, including operating cash flows, capital spending and net earnings. The closest GAAP measure is debt to net earnings, which was 7.8 and 5.0 for the third quarter of 2009 and 2008, respectively. The following is a reconciliation of debt to net earnings to Adjusted Debt to EBITDAR:

|  | $\mathbf{2 0 0 9}$ | $\mathbf{2 0 0 8}^{1}$ |
| :--- | :---: | ---: |
| Debt $^{2}$ | $\mathbf{2 , 6 1 5}$ | $\$ 2,742$ |
| Add: rent expense x $8^{3}$ | $\mathbf{3 2 0}$ | 284 |
| Adjusted Debt | $\mathbf{\$ 2 , 9 3 5}$ | $\$ 3,026$ |
|  |  |  |
| Net earnings | $\mathbf{3 3 7}$ | 545 |
| Add: income tax expense | $\mathbf{2 0 5}$ | 334 |
| Add: interest expense, net | $\mathbf{1 3 8}$ | 128 |
| Earnings before interest and income taxes | $\mathbf{6 8 0}$ | 1,007 |

Add: depreciation and amortization of buildings and equipment ..... 314 ..... 288
Add: rent expense ..... 40 ..... 36
EBITDAR ..... \$ 1,034 ..... \$ 1,331
Debt to Net Earnings ..... 7.8 ..... 5.0
Adjusted Debt to EBITDAR ..... 2.8 ..... 2.3
${ }^{1}$ The components
of adjusted debt
are as ofOctober 31, 2009and November 1,2008, while thecomponents ofEBITDAR are forthe 12 monthsended October 31,2009 andNovember 1,2008.
${ }^{2}$ Debt included
\$102 of
commercial paper
borrowingsoutstanding as ofNovember 1,2008. There wereno outstandingcommercial paperborrowings as ofOctober 31, 2009.${ }^{3}$ The multiple ofeight times rentexpense used tocalculate adjusteddebt is our bestestimate of thedebt we wouldrecord for ourleases which areclassified asoperating if wehad purchased theproperty.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations. (Continued)
(Amounts in millions except per share and per square foot amounts)

## Contractual Obligations

There have been no material changes in our contractual obligations, other than those discussed below and those which occur in the normal course of business, as specified in Item 303(a)(5) of Regulation S-K during the quarter ended October 31, 2009. For additional information regarding our contractual obligations as of January 31, 2009, see Management s Discussion and Analysis section in our 2008 Annual Report on Form 10-K.
During the second quarter of 2009 , our contractual obligations increased by our required principal payment on the \$400 senior unsecured notes due in June 2014.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of our financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. Our critical accounting estimates and methodologies in 2009 are consistent with those discussed in our 2008 Annual Report on Form 10-K.

## RECENT ACCOUNTING PRONOUNCEMENTS

See Item 1. Financial Statements Note 1 to the unaudited Consolidated Financial Statements Recent Accounting Pronouncements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We discussed our interest rate risk and our foreign currency exchange risk in Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk in our 2008 Annual Report on Form 10-K. There have been no material changes to these risks since that time.

## Item 4. Controls and Procedures.

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company performed an evaluation under the supervision and with the participation of management, including our President and Chief Financial Officer, of the design and effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act )). Based upon that evaluation, our President and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective in the timely and accurate recording, processing, summarizing and reporting of material financial and non-financial information within the time periods specified within the Commission s rules and forms. Our President and Chief Financial Officer also concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our President and Chief Financial Officer, to allow timely decisions regarding required disclosure.
In August 2009 we implemented a new credit card processing platform, which has resulted in certain changes to business processes and internal controls impacting financial reporting. Management has taken the necessary steps to monitor and maintain appropriate internal controls during this period of change. These steps included testing before the implementation, deploying resources to mitigate internal control risks, implementing reviews to ensure the accuracy of our data and processes, and performing multiple levels of reconciliations and analysis. Other than as described above, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II - OTHER INFORMATION

## Item 1A. Risk Factors.

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2008 Annual Report on Form 10-K. We are updating our risk factors as follows:

## Regulatory Environment and Financial System Reforms

Current economic conditions, particularly in the financial markets, have resulted in increased legislative and regulatory actions.
Our wholly owned federal savings bank, Nordstrom fsb, offers our private label card, two Nordstrom VISA cards and debit cards for Nordstrom purchases, through which our Credit segment generates income. On June 17, 2009, the Obama Administration released its white paper for reform of the financial system. Proposed reforms which could materially affect our company include the elimination of the ability of our bank subsidiary to be owned by us and increased supervision and regulation of financial firms. Since that time, different forms of legislation to implement the administration s plan have been introduced in both houses of Congress. Due to the complexity and controversial nature of the proposed bills, modifications are likely and the final legislation, if any, may differ significantly from the administration s original proposal. If the final form of legislation would curtail our ability to own our bank subsidiary, we would explore and pursue alternatives as appropriate. Any such forced divestiture may materially adversely affect our business and results of operations. Additionally, compliance with potential increased regulation and scrutiny by multiple state and federal agencies may reduce our revenue and increase expenses, which would negatively impact our business.

## Impact of Public Health Concerns

Our business and operations could be materially and adversely affected by a regional or widespread pandemic, which may cause a decrease in consumer spending and would negatively impact sales. Unforeseen disruptions in operations from our vendors or developers as a result of a health pandemic could disrupt or delay production and delivery of materials and products in our supply chain, adversely affecting our business. Our brand and reputation is dependent upon our employees. A regional or widespread outbreak which affects our employees may cause staffing shortages in our stores, which could harm our business.

## Item 6. Exhibits.

Exhibits are incorporated herein by reference or are filed or furnished with this report as set forth in the Index to Exhibits on page 31 hereof.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

## NORDSTROM, INC.

(Registrant)
/s/ Michael G. Koppel
Michael G. Koppel
Executive Vice President and Chief Financial
Officer
(Principal Financial Officer)

Date: December 8, 2009
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## NORDSTROM, INC. AND SUBSIDIARIES

## Exhibit Index

| Exhibit |  |
| :--- | :--- |
| 31.1 | Certification of President required by Section 302(a) of the <br> Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer required by <br> Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of President and Chief Financial Officer pursuant to <br> 18 U.S.C. 1350, as adopted pursuant to Section 906 of the <br> Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

## Method of Filing

Filed herewith electronically

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