J.P.Morgan

North America Equity Research
23 February 2009

Nordstrom, Inc.

Turning Down a Free Pass = Neutral; 4Q Wrap

Neutral

JWN, JWN US

Price: $11.33

Price Target: $10.00

Summary: After the close, Nordstrom printed 4Q results and provided, at first blush, what appears to be very conservative 2009 guidance. On the positive side, the company's SSS and GPM outlooks look reasonable relative to recent trends – see below. However, the company's SG&A deleverage assumption (40-70 bps) relative to its absolute dollar decline estimate ($100.0-$175.0 million) suggests a sizeable improvement in new store productivity YOY – an aggressive assumption, in our view. Also, after experiencing a substantial YOY spike in bad debt expense (up $66 million, or 58.9%) in 2008, we're surprised that JWN expects this line item flat in 2009 with an internal 9.0%+ unemployment assumption and recently raised APR fees. <u>All in, provided expectations for a much lower EPS range by the buy-side (say $0.80-$1.00), we would have preferred if Nordstrom management had taken the free pass that was in front of them. Instead, the bar, while low, may still need to come down further.</u> Accordingly, we're staying Neutral the stock and prefer both Macy's and Kohl's as better risk/reward scenarios in 1H09.

- **4Q EPS misses our estimate – quality less than satisfactory.** Nordstrom reported 4Q08 EPS of $0.31 or $0.019 below our estimate, although a penny ahead of the Street. As a reminder, in conjunction with its December sales, JWN downwardly revised its outlook to "below the previous range of $0.35-$0.45" citing higher-than-expected competitive markdown pressure. The downside relative to our model came from (1) higher than expected SG&A expense (29.1%A vs. 28.5%E), which was a $0.04 drag versus our forecast, and (2) a higher than expected tax rate (44.7%A vs. 38.5%E) that reduced EPS by $0.035. Partially offsetting the downside was (1) lower than expected interest expense, which contributed $0.03, (2) finance charges rising more than expected ($0.014), and (3) GPM slightly ahead of our estimate by 20 bps (32.0%A vs. 31.8%E) for a penny benefit – netting out to the company's $0.02 miss from our forecast.

Broadlines & Food Retailing

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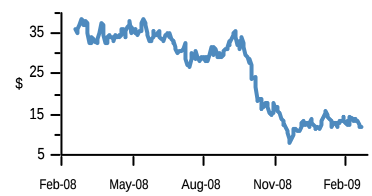
Price Performance



	YTD	1m	3m	12m
Abs	-10.7%	-1.0%	41.5%	-66.9%

Nordstrom, Inc. (JWN;JWN US)

	2007A	2008E *(Old)*	2008A *(New)*	2009E
EPS (Operating) ($)				
Q1 (Apr)	0.60	0.54A	0.54A	0.18
Q2 (Jul)	0.71	0.65A	0.65A	0.36
Q3 (Oct)	0.59	0.30A	0.30A	0.18
Q4 (Jan)	0.91	0.33	0.31A	0.39
FY	2.80	1.82	1.80A	1.10
P/E (Operating) FY	4.0	6.2	6.3A	10.3

Source: Company data, Reuters, J.P. Morgan estimates. EPS excludes one-time items.

Company Data	
Price ($)	11.33
Date Of Price	23 Feb 09
52-week Range ($)	39.52 - 6.62
Mkt Cap ($ mn)	2,486.94
Fiscal Year End	Jan
Shares O/S (mn)	220
Price Target ($)	10.00
Price Target End Date	31 Dec 09

See page 5 for analyst certification and important disclosures.

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- **FY09 guidance looks "OK" . . .** Overall, we credit JWN management for providing a respectable earnings outlook for FY09, particularly on the top-line where JWN guided to a negative 10%-15% annual comp, including 300-500bps more deterioration in 1H than 2H (indicative of current trends, according to management). Moreover, on a 2-year stacked basis, JWN guidance is prudent as it implies a negative ~20% comp in both the 2H09 and 1H09, which compares favorably to its 13.2% decline in 4Q. For GPM, we believe 150-250 bps of erosion modeled for FY09 on top of the 289 bps decline in FY08 is feasible. Finally, on SG&A dollars, we see a $100-$175 million decrease YOY as attainable provided roughly 50% is from variable selling costs, although we would have liked to have heard more granularity on the other 50% (overhead reductions, particularly in areas of labor, marketing, and distribution).

- **. . . except for two important line items.** Continuing on expenses, we note that JWN's planned $100-$175 million dollar decrease is suggested to result in SG&A de-leverage (as a % of sales) of 40-70bps, which we have a hard time arriving at. Taking the provided SSS range into account (JPM modeling -12.0%), total sales are implied to be down only 6%-7% YOY by the guidance, which would require new store productivity (NSP) of ~90% to arrive at this much SG&A deleverage. As a comparison, NSP in FY08 totaled a mere 41.8%. Second, considering an expected rise in credit card receivables (guidance of ~19% increase in finance charges) and a rise in unemployment to 9%+, we were surprised to hear that bad debt expense/reserves are expected to be flat year-over-year in FY09 following a ~$70 million increase in FY08. We note that charge-offs in 4Q were up 240 bps YOY to 6.8% and monthly trust data indicates write-offs of 7.4% in January. Net, we are maintaining our FY09 EPS estimate of $1.10 which implies a 38.8% earnings decline YOY and is at the low-end of the company's range of $1.10-$1.40.

- **3 items we liked in the quarter . . .** (1) solid inventory management – down 12% YOY on a per square foot basis and future receipts are also planned to be down "low-double digits," (2) prudent top-line guidance as aforementioned, implying a deceleration of roughly ~700 bps from 4Q trends, and (3) a respectable adjusted debt to EBITDAR of 2.6x (although up from 1.9x in 4Q07) and a slight decline in debt/cap YOY to 67.5% from 69.1% in 4Q07.

- **. . . and 3 items we did not:** (1) forecast for bad debt to remain flat YOY despite rising charge-offs (6.8% in 4Q08 vs. 4.4% in 4Q07) and robust receivables growth (+8.6% in 4Q), (2) California comps (~30% of store base) continue to trend below company average in-line with spread seen over past ~18 months, and (3) more aggressive EPS guidance ($1.10-$1.40) than necessary, in our view, considering the company had a free pass to lower the bar (consensus at $1.22 and Street low at $0.90 for FY09).

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Valuation and Price Target Analysis

We rate Nordstrom Neutral and our $10.00 December 2009 price target is predicated on a weighted, blended (50/50) P/E and EV/EBITDA multiple build. On P/E valuation, Nordstrom currently trades at 10.3x our 2009E EPS, representing a 55.1% discount to its 5-year average. Our best case scenario (20%) for the stock assigns a forward P/E multiple of 10.0x and 7.5x EV/EBITDA. Conversely, our worst case scenario (30%) implies a 7.0x forward P/E multiple and 3.5x EV/EBITDA.

Risks to Our Rating

Potential downside risks to our rating and price target include: (1) in the past, the company has encountered issues moving into new markets, most notably its entrance into Florida in 2000, which presents a risk given JWN's plans for over 25 new stores over the next five years; and (2) Nordstrom's unfavorable geographic diversification (51.9% of operations in the West; 30.1% in California alone) provides some reason for concern particularly given unfavorable housing trends in these exposed regions. Conversely, if JWN's results in its women's segment exceed expectations – our gross profit margin assumptions could be materially understated leaving, room for upside to our existing EPS estimates.

Company Description

Nordstrom Inc., headquartered in Seattle, WA, is an upscale department store selling apparel, footwear, accessories, home products, and jewelry. The company was founded in 1901 as a shoe retailer and began selling apparel with the acquisition of Best Apparel in 1968. In 2007, the company reported sales totaling $8.8 billion, representing year-over-year growth of 3.1%.

As of November 1, 2008, the company operated 166 stores, including 108 full-line stores and 58 Nordstom Rack outlets. The company's product mix is as follows: (1) Women's – 34.6%; (2) Women's Accessories and Cosmetics – 20.9%; (3) Shoes – 20.2%; (4) Men's – 18.2%; (5) Children's – 3.3%; and (6) Other – 2.7%.

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Nordstrom, Inc.: Summary of Financials

Income Statement - Annual	FY08A	FY09E	FY10E	Income Statement - Quarterly	1Q09E	2Q09E	3Q09E	4Q09E
Revenues	8,272	7,555	-	Revenues	1,646	2,063	1,693	2,153
COGS	5,417	5,101	-	COGS	1,114	1,409	1,139	1,438
Gross profit	2,855	2,454	-	Gross profit	532	654	554	715
SG&A	2,386	2,270	-	SG&A	518	574	539	640
Operating income	779	552	-	Operating income	100	169	103	180
EBITDA	1,081	872	-	EBITDA	190	(77)	179	260
Interest, net	131	153	-	Interest, net	36	40	38	38
Other Income	-	-	-	Other Income	-	-	-	-
Pretax income	648	399	-	Pretax income	64	129	65	141
Income taxes	247	158	-	Income taxes	25	51	26	56
Tax rate	38.1%	39.5%	-	Tax rate	39.5%	39.5%	39.5%	39.5%
Net income - reported (GAAP)	401	241	-	Net income - reported (GAAP)	39	78	39	85
Diluted shares outstanding	219	219	-	Diluted shares outstanding	219	219	219	219
EPS - operating	1.80	1.10	-	EPS - operating	0.18	0.36	0.18	0.39
EPS - reported (GAAP)	1.83	1.10	-	EPS - reported (GAAP)	0.18	0.36	0.18	0.39

Balance Sheet and Cash Flow Data	FY08A	FY09E	FY10E	Ratio Analysis	FY08A	FY09E	FY10E
Cash and cash equivalents	72	224	-	Sales growth	(6.3%)	(8.7%)	-
Accounts receivable	1,942	2,059	-	Same store sales growth	-	-	-
Current assets	3,217	3,423	-	EBITDA growth	(27.0%)	(19.3%)	-
				EBIT growth	(37.5%)	(29.1%)	-
PP&E	2,221	2,251	-				
Goodwill	53	53	-	EPS growth - operating	(35.7%)	(38.8%)	-
Total assets	5,661	5,883	-	Gross margin	34.5%	32.5%	-
				EBIT margin	9.4%	7.3%	-
Short-term Debt	-	-	-	EBITDA margin	13.1%	11.5%	-
Current liabilities	1,601	1,503	-				
Long-term Debt	2,450	0	-	Inventory growth	-	-	-
Total liabilities	4,451	4,572	-				
Shareholders' equity	1,210	1,311	-	Debt / EBITDA	2.3	0.0	-
D&A	302	320	-				
Change in working capital	(130)	(149)	-	Enterprise value / Revenues	0.6	0.3	-
Cash flow from operations	544	430	-	Enterprise value / EBITDA	10.1	-	-
Capex	(563)	(350)	-	P / E	6.2	10.3	-
Free cash flow	10	62	-				
Free cash flow / share	(0.59)	(0.36)	-				
Dividends	-	-	-				

Source: Company reports and J.P. Morgan estimates.
Note: $ in millions (except per-share data). Fiscal year ends Jan

Other Companies Recommended in This Report (all prices in this report as of market close on 23 February 2009)
Kohl's Corporation (KSS/$33.96/Overweight), Macy's Inc. (M/$7.40/Overweight)

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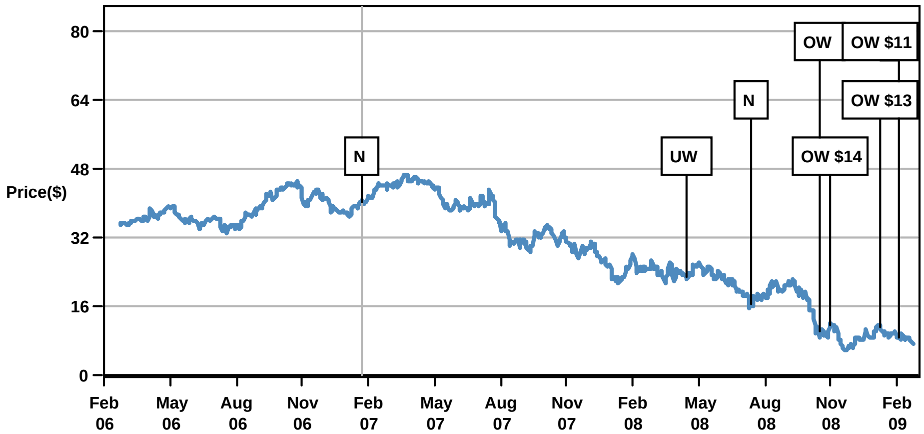
Kohl's Corporation (KSS) Price Chart

Date	Rating	Share Price ($)	Price Target ($)
29-Sep-06	N	66.45	--
03-Mar-08	OW	44.44	--
02-Jul-08	OW	41.01	50.00
12-Aug-08	OW	51.00	--
31-Oct-08	OW	33.86	43.00
10-Nov-08	OW	33.08	40.00
14-Nov-08	OW	30.57	34.00
29-Jan-09	OW	38.75	44.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Oct 10, 2005 - Sep 29, 2006. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

Macy's Inc. (M) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
22-Jan-07	N	40.22	--
16-Apr-08	UW	22.98	--
14-Jul-08	N	16.28	--
17-Oct-08	OW	10.05	--
31-Oct-08	OW	11.66	14.00
08-Jan-09	OW	11.31	13.00
03-Feb-09	OW	8.59	11.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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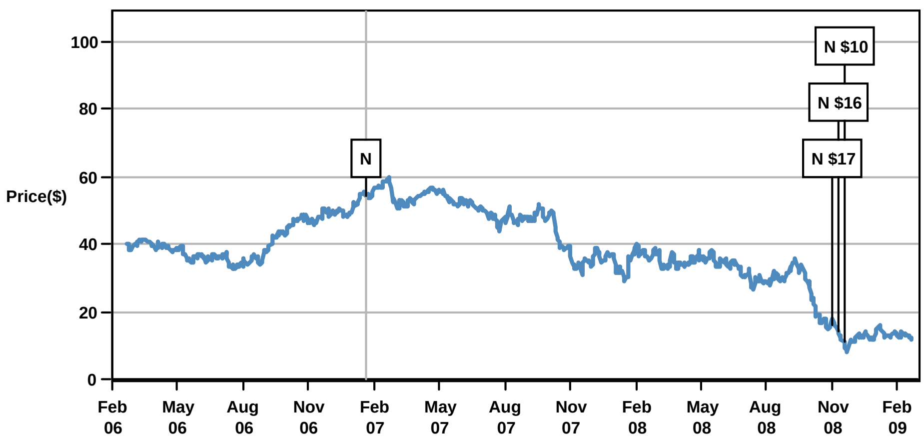
Nordstrom, Inc. (JWN) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
22-Jan-07	N	54.22	-
31-Oct-08	N	15.99	17.00
10-Nov-08	N	14.04	16.00
18-Nov-08	N	10.82	10.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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