NORDSTROM INC
Form 10-Q
December 05, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**
**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended October 28, 2006**

**OR**

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

**For the transition period from __________ to __________**

**Commission file number 001-15059**

**NORDSTROM, INC.**

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **Washington** | **91-0515058** |
| (State or other jurisdiction of incorporation or organization) | (IRS employer Identification No.) |
| **1617 Sixth Avenue, Seattle, Washington** | **98101** |
| (Address of principal executive offices) | (Zip code) |

**206-628-2111**

(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 þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer 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 þ

Common stock outstanding as of December 1, 2006: 257,040 shares of common stock (in thousands).

**NORDSTROM, INC. AND SUBSIDIARIES**
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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements (Unaudited)

### NORDSTROM, INC. AND SUBSIDIARIES
### CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Amounts in thousands except per share amounts and percentages)
(Unaudited)

| | Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Net sales | **$ 1,872,103** | $ 1,666,130 | **$ 5,929,794** | $ 5,427,042 |
| Cost of sales and related buying and occupancy costs | **(1,160,123)** | (1,058,452) | **(3,729,759)** | (3,452,132) |
| Gross profit | **711,980** | 607,678 | **2,200,035** | 1,974,910 |
| Selling, general and administrative expenses | **(538,210)** | (481,768) | **(1,611,982)** | (1,498,386) |
| Operating income | **173,770** | 125,910 | **588,053** | 476,524 |
| Interest expense, net | **(11,419)** | (10,248) | **(34,953)** | (33,791) |
| Other income including finance charges, net | **58,819** | 47,350 | **173,508** | 135,052 |
| Earnings before income tax expense | **221,170** | 163,012 | **726,608** | 577,785 |
| Income tax expense | **(85,497)** | (55,559) | **(280,950)** | (216,876) |
| **Net earnings** | **$ 135,673** | $ 107,453 | **$ 445,658** | $ 360,909 |
| Basic earnings per share | **$ 0.53** | $ 0.40 | **$ 1.70** | $ 1.32 |
| Diluted earnings per share | **$ 0.52** | $ 0.39 | **$ 1.67** | $ 1.30 |
| Basic shares | **256,757** | 271,599 | **261,920** | 272,683 |
| Diluted shares | **261,616** | 277,293 | **266,893** | 278,399 |

| | Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **(% of Net Sales)** | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Net sales | **100.0%** | 100.0% | **100.0%** | 100.0% |
| Cost of sales and related buying and occupancy costs | **(62.0%)** | (63.5%) | **(62.9%)** | (63.6%) |
| Gross profit | **38.0%** | 36.5% | **37.1%** | 36.4% |
| Selling, general and administrative expenses | **(28.7%)** | (28.9%) | **(27.2%)** | (27.6%) |
| Operating income | **9.3%** | 7.6% | **9.9%** | 8.8% |
| Interest expense, net | **(0.6%)** | (0.6%) | **(0.6%)** | (0.6%) |
| Other income including finance charges, net | **3.1%** | 2.8% | **2.9%** | 2.5% |
| Earnings before income tax expense | **11.8%** | 9.8% | **12.3%** | 10.6% |

| | | | | |
|---|---|---|---|---|
| Income tax expense (as a % of earnings before income tax expense) | **(38.7%)** | (34.1%) | **(38.7%)** | (37.5%) |
| **Net earnings** | **7.2%** | 6.4% | **7.5%** | 6.7% |

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

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**NORDSTROM, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
(Amounts in thousands)
(Unaudited)

| | October 28, 2006 | January 28, 2006 | October 29, 2005 |
|---|---|---|---|
| **Assets** | | | |
| Current assets: | | | |
| Cash and cash equivalents | **$ 208,715** | $ 462,656 | $ 205,943 |
| Short-term investments | | 54,000 | 34,000 |
| Accounts receivable, net | **667,748** | 639,558 | 626,864 |
| Investment in asset backed securities | **313,656** | 561,136 | 509,759 |
| Merchandise inventories | **1,228,230** | 955,978 | 1,166,471 |
| Current deferred tax assets, net | **169,858** | 145,470 | 149,622 |
| Prepaid expenses and other | **65,711** | 55,359 | 53,451 |
| Total current assets | **2,653,918** | 2,874,157 | 2,746,110 |
| Land, buildings and equipment (net of accumulated depreciation of $2,733,912, $2,549,559 and $2,500,228) | **1,748,395** | 1,773,871 | 1,778,579 |
| Goodwill | **51,714** | 51,714 | 51,714 |
| Acquired tradename | **84,000** | 84,000 | 84,000 |
| Other assets | **170,355** | 137,607 | 129,130 |
| **Total assets** | **$ 4,708,382** | $ 4,921,349 | $ 4,789,533 |
| **Liabilities and Shareholders Equity** | | | |
| Current liabilities: | | | |
| Accounts payable | **$ 758,402** | $ 540,019 | $ 683,137 |
| Accrued salaries, wages and related benefits | **253,440** | 285,982 | 235,137 |
| Other current liabilities | **385,767** | 409,076 | 365,872 |
| Income taxes payable | **42,970** | 81,617 | 47,850 |
| Current portion of long-term debt | **106,572** | 306,618 | 306,967 |
| Total current liabilities | **1,547,151** | 1,623,312 | 1,638,963 |
| Long-term debt, net | **624,631** | 627,776 | 626,978 |
| Deferred property incentives, net | **351,733** | 364,382 | 367,511 |
| Other liabilities | **223,262** | 213,198 | 206,980 |
| Shareholders equity: | | | |
| Common stock, no par value: 1,000,000 shares authorized; 256,904, 269,549 and 269,690 shares issued and outstanding | **791,678** | 685,934 | 663,810 |
| Unearned stock compensation | | (327) | (438) |
| Retained earnings | **1,171,364** | 1,404,366 | 1,277,674 |
| Accumulated other comprehensive (loss) earnings | **(1,437)** | 2,708 | 8,055 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total shareholders equity | | **1,961,605** | | 2,092,681 | | 1,949,101 |
| **Total liabilities and shareholders equity** | **$** | **4,708,382** | $ | 4,921,349 | $ | 4,789,533 |

The accompanying Notes to 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 thousands except per share amounts)
(Unaudited)

| | Common Stock Shares | Common Stock Amount | Unearned Stock Compensation | Retained Earnings | Accumulated Other Comprehensive (Loss) Earnings | Total |
|---|---|---|---|---|---|---|
| **Balance at January 28, 2006** | 269,549 | $ 685,934 | $ (327) | $ 1,404,366 | $ 2,708 | $ 2,092,681 |
| Net earnings | | | | 445,658 | | 445,658 |
| Other comprehensive earnings: | | | | | | |
| Foreign currency translation adjustment | | | | | 1,131 | 1,131 |
| Fair value adjustment to investment in asset backed securities, net of tax of $3,253 | | | | | (5,276) | (5,276) |
| Comprehensive net earnings | | | | | | 441,513 |
| Cash dividends paid ($0.315 per share) | | | | (83,139) | | (83,139) |
| Issuance of common stock for: | | | | | | |
| Stock option plans | 2,909 | 68,272 | | | | 68,272 |
| Employee stock purchase plan | 446 | 16,635 | | | | 16,635 |
| Other | 17 | 257 | 327 | | | 584 |
| Stock-based compensation | | 20,580 | | | | 20,580 |
| Repurchase of common stock | (16,017) | | | (595,521) | | (595,521) |
| **Balance at October 28, 2006** | 256,904 | $ 791,678 | | $ 1,171,364 | $ (1,437) | $ 1,961,605 |

| | Common Stock Shares | Common Stock Amount | Unearned Stock Compensation | Retained Earnings | Accumulated Other Comprehensive Earnings | Total |
|---|---|---|---|---|---|---|
| **Balance at January 29, 2005** | 271,331 | $ 552,655 | $ (299) | $ 1,227,303 | $ 9,335 | $ 1,788,994 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net earnings | | | | 360,909 | | 360,909 |
| Other comprehensive earnings: | | | | | | |
| Foreign currency translation adjustment | | | | | (1,837) | (1,837) |
| Fair value adjustment to investment in asset backed securities, net of tax of $(356) | | | | | 557 | 557 |
| Comprehensive net earnings | | | | | | 359,629 |
| Cash dividends paid ($0.235 per share) | | | | (64,236) | | (64,236) |
| Issuance of common stock for: | | | | | | |
| Stock option plans | 4,870 | 91,327 | | | | 91,327 |
| Employee stock purchase plan | 757 | 16,611 | | | | 16,611 |
| Other | 127 | 3,217 | (139) | | | 3,078 |
| Repurchase of common stock | (7,395) | | | (246,302) | | (246,302) |
| **Balance at October 29, 2005** | 269,690 | $ 663,810 | $ (438) | $ 1,277,674 | $ 8,055 | $ 1,949,101 |

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

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**NORDSTROM, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Amounts in thousands)
(Unaudited)

| | Nine Months Ended | |
|---|---|---|
| | **October 28, 2006** | **October 29, 2005** |
| **Operating Activities** | | |
| Net earnings | **$ 445,658** | $ 360,909 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization of buildings and equipment | **205,816** | 204,496 |
| Amortization of deferred property incentives and other, net | **(25,255)** | (24,331) |
| Stock-based compensation expense | **25,075** | 7,672 |
| Deferred income taxes, net | **(49,755)** | 1,173 |
| Tax benefit from stock-based payments | **29,691** | 31,281 |
| Excess tax benefit from stock-based payments | **(25,384)** | |
| Provision for bad debt expense | **10,715** | 18,327 |
| Change in operating assets and liabilities: | | |
| Accounts receivable | **(38,652)** | (769) |
| Investment in asset backed securities | **242,204** | (86,786) |
| Merchandise inventories | **(235,623)** | (250,441) |
| Prepaid expenses | **(10,092)** | 855 |
| Other assets | **(4,203)** | (6,079) |
| Accounts payable | **213,294** | 190,601 |
| Accrued salaries, wages and related benefits | **(34,861)** | (56,758) |
| Other current liabilities | **(22,559)** | (2,099) |
| Income taxes payable | **(38,647)** | (67,705) |
| Deferred property incentives | **13,779** | 41,891 |
| Other liabilities | **11,328** | 14,209 |
| Net cash provided by operating activities | **712,529** | 376,446 |
| **Investing Activities** | | |
| Capital expenditures | **(187,748)** | (205,015) |
| Purchases of short-term investments | **(109,550)** | (397,500) |
| Sales of short-term investments | **163,550** | 405,325 |
| Other, net | **(6,380)** | (6,404) |
| Net cash used in investing activities | **(140,128)** | (203,594) |
| **Financing Activities** | | |
| Proceeds from long-term borrowing | **100,000** | |
| Principal payments on long-term debt | **(306,465)** | (99,769) |
| (Decrease) increase in cash book overdrafts | **(21,511)** | 4,720 |
| Proceeds from exercise of stock options | **38,917** | 61,057 |

| | | |
|---|---|---|
| Proceeds from employee stock purchase plan | **16,300** | 15,600 |
| Excess tax benefit from stock-based payments | **25,384** | |
| Cash dividends paid | **(83,139)** | (64,236) |
| Repurchase of common stock | **(595,521)** | (246,302) |
| Other, net | **(307)** | 1,398 |
| Net cash used in financing activities | **(826,342)** | (327,532) |
| Net decrease in cash and cash equivalents | **(253,941)** | (154,680) |
| Cash and cash equivalents at beginning of period | **462,656** | 360,623 |
| **Cash and cash equivalents at end of period** | **$ 208,715** | $ 205,943 |

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

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**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option 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 Annual Report on Form 10-K for the fiscal year ended January 28, 2006. 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 and the holidays in December 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.

Similar to many retailers, this fiscal year we will have an extra week a 53rd week that will be reported in the fourth quarter, which will have 14 weeks instead of the normal 13 weeks.

### 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. With the exception of our adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment* in the beginning of the first quarter of 2006, our accounting policies and methodologies in 2006 are consistent with those discussed in our Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

### Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 requires that the tax effects of a position be recognized only if it is more likely than not to be sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. The provisions of FIN 48 are effective for us as of the beginning of our 2007 fiscal year. We are currently evaluating the impact of adopting FIN 48 on our financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007. We are assessing the potential impact on our financial statements.

Also in September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 addresses the accounting for defined benefit pension plans and other postretirement benefit plans. It will require the recognition of a plan s overfunded or underfunded status as an asset or liability in the balance sheet and the recognition of changes in that funded status in the year in which the changes occur through comprehensive income. FAS 158 also requires the measurement date for plan assets and liabilities to coincide with the plan sponsor s fiscal year end. This statement is effective for fiscal years ending after December 15, 2006, except the change in measurement date provisions, which is effective for fiscal years ending after December 15, 2008. We have two benefit plans that are impacted by this standard: our Supplemental Executive Retirement Plan (SERP) and our retiree medical plan. Based on recent valuations and projections of the funded status of these plans, we expect that the effect of the adoption of FAS 158 will be to increase total liabilities and to reduce shareholders equity by approximately $14 million. The actual impact of adopting FAS 158 will depend on the valuation of our plan obligations as of our 2006 measurement date.

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**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)**

**Stock-Based Compensation**

Prior to the adoption of SFAS No. 123(R), we applied Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, to measure compensation costs for our stock-based compensation programs. Under APB No. 25, we recorded no compensation expense for stock options granted to employees and directors because the options strike price was equal to the closing market price of our common stock on the grant date. Also, through 2005 we recorded no compensation expense in connection with our Employee Stock Purchase Plan (ESPP). Through 2005, we presented the effect on net earnings and earnings per share of the fair value provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* in the Notes to Condensed Consolidated Financial Statements.

Effective January 29, 2006, we adopted SFAS No. 123(R), which requires us to measure the cost of employee and director services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The costs are recognized over the period during which an employee is required to provide services in exchange for the award.

We recognize stock-based compensation expense on a straight-line basis over the requisite service period. The following table summarizes our stock-based compensation expense (earnings):

| | Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Stock options | **$ 6,120** | | **$ 19,112** | |
| Employee Stock Purchase Plan | **400** | | **1,359** | |
| Performance share units | **4,411** | $ (110) | **3,696** | $ 6,460 |
| Other | **61** | 308 | **908** | 1,212 |
| Total stock-based compensation expense before income tax benefit | **10,992** | 198 | **25,075** | 7,672 |
| Income tax benefit | **(4,072)** | 30 | **(9,140)** | (2,877) |
| **Total stock-based compensation expense, net of income tax benefit** | **$ 6,920** | $ 228 | **$ 15,935** | $ 4,795 |

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

| | Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Cost of sales and related buying and occupancy costs | **$ 2,908** | | **$ 8,259** | |
| Selling, general and administrative expenses | **8,084** | $ 198 | **16,816** | $ 7,672 |
| **Total stock-based compensation expense before income tax benefit** | **$ 10,992** | $ 198 | **$ 25,075** | $ 7,672 |

**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)**

We adopted SFAS No. 123(R) using the modified prospective method. Under this transition method, the stock-based compensation expense recognized in the current period includes the expense for stock options granted after January 29, 2006. The stock-based compensation expense also includes the expense for options granted prior to, but not vested as of January 29, 2006 based on the grant-date fair value determined in accordance with the original provisions of SFAS No. 123. In addition, we recognized stock-based compensation expense for our ESPP, as our 10% purchase discount exceeds the amount allowed under SFAS No. 123(R) for non-compensatory treatment. As provided for under the modified prospective method, we have not restated our results for prior periods. Following the adoption of SFAS No. 123(R), we recorded incremental stock-based compensation expense of $6,520, ($4,161 net of tax), or $0.01 per basic and diluted share for the quarter ended October 28, 2006 and $20,471 ($13,105 net of tax), or $0.04 per basic and diluted share for the nine months ended October 28, 2006. We expect to record $27,103 ($17,364 net of tax) in incremental stock-based compensation expense for the year ended February 3, 2007, representing approximately $0.06 per diluted share.

Prior to the adoption of SFAS No. 123(R), we presented all tax benefits resulting from the exercise of stock options and ESPP as operating cash inflows. SFAS No. 123(R) requires the benefits of tax deductions in excess of the compensation cost recognized for those awards to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis. This amount is shown as Excess tax benefit from stock-based payments in the condensed consolidated statement of cash flows and was $25,384 for the nine months ended October 28, 2006.

The following table illustrates the effect on net earnings and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 in 2005:

| | Quarter Ended October 29, 2005 | Nine Months Ended October 29, 2005 |
|---|---|---|
| Net earnings, as reported | $ 107,453 | $ 360,909 |
| Add: stock-based compensation expense included in reported net earnings, net of tax | 228 | 4,795 |
| Deduct: stock-based compensation expense determined under fair value, net of tax | (4,525) | (18,153) |
| Pro forma net earnings | $ 103,156 | $ 347,551 |
| Earnings per share: | | |
| Basic as reported | $ 0.40 | $ 1.32 |
| Diluted as reported | $ 0.39 | $ 1.30 |
| Basic pro forma | $ 0.38 | $ 1.27 |
| Diluted pro forma | $ 0.37 | $ 1.25 |

In 2005, we used the Black-Scholes option valuation model to estimate the fair value of the stock options under SFAS No. 123. When we adopted SFAS No. 123(R), we elected to use the Binomial Lattice option valuation model. We believe that this model provides a better estimate of fair value than the Black-Scholes option valuation model, as it can accommodate variability in assumptions for expected volatility, dividends and risk-free interest rates. We used the following assumptions to estimate the fair value for stock options at grant date:

| | 2006 | 2005 |
|---|---|---|
| Risk-free interest rate | **4.9% - 5.1%** | 3.9% |
| Weighted average expected volatility | **37.0%** | 44.3% |
| Weighted average expected dividend yield | **1.0%** | 1.7% |
| Weighted average expected life in years | **5.4** | 5.0 |

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**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)**

The weighted average fair value per option at the grant date was $16 and $10 in 2006 and 2005. The following describes the significant assumptions used to estimate the fair value of options granted:

**Risk-free interest rate:** For 2006, the rate represents the yield on U.S. Treasury zero-coupon securities that mature over the 10-year life of the stock options. For 2005, the rate was the yield on the U.S. Treasury zero-coupon securities which matured near the end of the expected life of the stock options.

**Expected volatility:** For 2006, the expected volatility was based on a combination of the historical volatility of our common stock and the implied volatility of exchange traded options for our common stock. In 2005, the expected volatility was estimated using the historical volatility of our common stock.

**Expected dividend yield:** For 2006, the yield was our forecasted dividend yield for the next ten years. In 2005, the expected dividend yield was based on our historical dividend yield.

**Expected life in years:** The expected life represents the estimated period of time until option exercise. In 2006, based on our historical exercise behavior and taking into consideration the contractual term of the option and our employees expected exercise and post-vesting employment termination behavior, the expected term of options granted was derived from the output of the Binomial Lattice option valuation model. In 2005, the expected life was determined based on our historical exercise behavior.

**NOTE 2: POST-RETIREMENT BENEFITS**

The expense components of our Supplemental Executive Retirement Plan, which provides retirement benefits to certain officers and select employees, are as follows:

| | **Quarter Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Participant service cost | **$ 557** | $ 538 | **$ 1,671** | $ 1,447 |
| Interest cost | **1,308** | 1,031 | **3,924** | 3,076 |
| Amortization of net loss | **724** | 412 | **2,172** | 1,239 |
| Amortization of prior service cost | **257** | 262 | **771** | 757 |
| **Total expense** | **$ 2,846** | $ 2,243 | **$ 8,538** | $ 6,519 |

**NOTE 3: EARNINGS PER SHARE**

The computation of earnings per share is as follows:

| | **Quarter Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Net earnings | **$ 135,673** | $ 107,453 | **$ 445,658** | $ 360,909 |
| Basic shares | **256,757** | 271,599 | **261,920** | 272,683 |

| | | | | |
|---|---|---|---|---|
| Dilutive effect of stock options and performance share units | **4,859** | 5,694 | **4,973** | 5,716 |
| Diluted shares | **261,616** | 277,293 | **266,893** | 278,399 |
| Basic earnings per share | **$ 0.53** | $ 0.40 | **$ 1.70** | $ 1.32 |
| Diluted earnings per share | **$ 0.52** | $ 0.39 | **$ 1.67** | $ 1.30 |
| Antidilutive stock options and other | **1,825** | | **1,788** | |

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**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 4: ACCOUNTS RECEIVABLE**

The components of accounts receivable are as follows:

| | October 28, 2006 | January 28, 2006 | October 29, 2005 |
|---|---|---|---|
| Trade receivables | | | |
| Unrestricted | **$ 39,208** | $ 32,070 | $ 31,127 |
| Restricted | **558,354** | 552,671 | 534,252 |
| Allowance for doubtful accounts | **(15,704)** | (17,926) | (18,262) |
| Trade receivables, net | **581,858** | 566,815 | 547,117 |
| Other | **85,890** | 72,743 | 79,747 |
| **Accounts receivable, net** | **$ 667,748** | $ 639,558 | $ 626,864 |

Our restricted trade receivables are comprised of our Nordstrom private label card receivables, which back the $100,000 variable funding note due in February 2007. The unrestricted trade receivables consist primarily of our Façonnable trade 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 rebates, which are believed to be fully realizable as they are collected soon after they are earned.

**NOTE 5: INVESTMENT IN ASSET BACKED SECURITIES**

Our investment in asset backed securities and the off-balance sheet financing are described in Notes 1 and 8 of our Annual Report on Form 10-K for the fiscal year ended January 28, 2006. The following table presents the co-branded Nordstrom VISA credit card balances and the estimated fair value of our investment in asset backed securities:

| | October 28, 2006 | January 28, 2006 | October 29, 2005 |
|---|---|---|---|
| Total face value of co-branded Nordstrom VISA credit card principal receivables | **$ 844,634** | $ 738,947 | $ 692,539 |
| Debt securities issued by the VISA Trust: | | | |
| Off-balance sheet (sold to third parties): | | | |
| 2002 Class A & B notes | **$ 200,000** | $ 200,000 | $ 200,000 |
| 2004-2 Variable funding notes | **350,000** | | |
| | **$ 550,000** | $ 200,000 | $ 200,000 |
| Transferor Interest amount recorded on Nordstrom, Inc. s balance sheet: | | | |
| Investment in asset backed securities at fair value | **$ 313,656** | $ 561,136 | $ 509,759 |

In July 2006, the VISA Trust issued $300,000 for cash of variable funding notes at par; in September 2006, the VISA Trust issued $50,000 for cash of additional variable funding notes at par. The proceeds received by the VISA Trust were then sent to us in exchange for a reduction in the Transferor Interest in the VISA Trust held by Nordstrom, Inc. The reduction in the Transferor Interest was equal to a $350,000 reduction in our share of the principal balance of the underlying VISA credit card receivables since our last fiscal year end.

**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 5: INVESTMENT IN ASSET BACKED SECURITIES (CONT.)**

The following table presents the key assumptions we use to value the investment in asset backed securities:

| | **October 28, 2006** | **January 28, 2006** | **October 29, 2005** |
|---|---|---|---|
| Weighted average remaining life (in months) | 7.0 | 7.6 | 7.7 |
| Average annual credit losses | 6.0% | 4.7% | 5.9% |
| Average gross yield | 16.9% | 17.1% | 17.3% |
| Weighted average coupon on issued securities | 5.2% | 5.2% | 5.1% |
| Average monthly payment rates | 8.4% | 8.2% | 8.1% |
| Discount rate on investment in asset backed securities | 7.7% to 11.4% | 5.9% to 11.1% | 5.7% to 10.9% |

The following table summarizes the income earned by the investment in asset backed securities that is included in other income including finance charges, net on the condensed consolidated statements of earnings:

| | **Quarter Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| | **October 28, 2006** | **October 29, 2005** | **October 28, 2006** | **October 29, 2005** |
| Interest income | **$ 20,899** | $ 15,461 | **$ 65,599** | $ 48,028 |
| Gain on sales of receivables and other income | **7,744** | 8,678 | **23,775** | 22,022 |
| | **$ 28,643** | $ 24,139 | **$ 89,374** | $ 70,050 |

**NOTE 6: DEBT**

To manage our interest rate risk, we have an interest rate swap outstanding recorded in other liabilities. Our swap has a $250,000 notional amount, expires in January 2009 and is designated as a fully effective fair value hedge. Under the agreement, we receive a fixed rate of 5.63% and pay a variable rate based on LIBOR plus a margin of 2.3% set at six-month intervals (7.70% at October 28, 2006). The fair value of our interest rate swap is as follows:

| | **October 28, 2006** | **January 28, 2006** | **October 29, 2005** |
|---|---|---|---|
| Interest rate swap fair value | **$ (8,952)** | $ (11,050) | $ (12,202) |

We retired the $300,000 Private Label Securitization debt when it matured in October 2006.

In October 2006, we amended our existing variable funding facility backed by Nordstrom private label card and VISA credit card receivables to increase the capacity of this facility from $450,000 to $600,000. Borrowings under the facility will incur interest based upon the actual cost of commercial paper plus specified fees ranging from 0.075% to 0.15%. As of October 28, 2006, the facility s interest rate was 5.41%. We pay a commitment fee ranging from 0.125% to 0.15% for the note based on the amount of the commitment. Fee rates decrease if more than $50,000 is outstanding on the facility. The facility can be cancelled or not renewed if our debt ratings fall below Standard and Poor s BB+ rating or Moody s Ba1 rating. Our current rating by Standard and Poor s is A, five grades above BB+, and by Moody s is Baa1, three grades above Ba1.

In July 2006, the VISA Trust used this facility to issue $300,000 of Notes; in September 2006, the VISA Trust used this facility to issue an additional $50,000 of Notes. As the VISA Trust is a statutory business trust and the VISA credit card receivables transferred to it are accounted for as a sale under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the obligations of the VISA Trust are not recorded in our financial statements. The VISA Trust sent the proceeds from this note issuance to us in return for a reduction in our interest in the VISA Trust equal to a $350,000 decrease in our share of the principal balance of VISA credit card receivables since our last fiscal year end.

**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 7: STOCK-BASED COMPENSATION**

In 2004, our shareholders approved the 2004 Equity Incentive Plan. We currently grant stock options, performance share units and common shares under this plan.

**Stock Options**

As of October 28, 2006, we have options outstanding under three stock option plans (collectively, the Nordstrom, Inc. Plans ). Options vest over periods ranging from four to eight years, and expire ten years after the date of grant. A summary of stock option activity under the Nordstrom, Inc. Plans is presented below:

| | Nine Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | October 28, 2006 | | | October 29, 2005 | | |
| | Shares | | Weighted Average Exercise Price | Shares | | Weighted Average Exercise Price |
| Outstanding, beginning of year | **14,344** | **$** | **15** | 18,320 | $ | 13 |
| Granted | **1,940** | | **40** | 2,564 | | 26 |
| Exercised | **(2,909)** | | **13** | (4,872) | | 13 |
| Cancelled | **(518)** | | **26** | (625) | | 16 |
| Outstanding, end of period | **12,857** | **$** | **19** | 15,387 | $ | 15 |

In 2005 and 2006, stock option awards to employees were approved by the Compensation Committee of the Company s Board of Directors and their exercise price was set at the closing price of our common stock on the Committee meeting date. The stock option awards provide recipients with the opportunity for financial rewards when our stock price increases. The awards are determined based upon a percentage of the recipients base salary and the fair value of the stock options, which was estimated using an option pricing model. The fair value per stock option was $16 in 2006 (using a Binomial Lattice option valuation model) and $10 in 2005 (using the Black-Scholes option valuation model). For the nine months ended October 28, 2006, we awarded stock options to 1,235 employees compared to 1,207 employees in the same period in 2005.

The total intrinsic value of options exercised during the nine months ended October 28, 2006 and October 29, 2005 was $75,459 and $77,915. The total fair value of stock options vested during the nine months ended October 28, 2006 and October 29, 2005 was $30,087 and $26,519. As of October 28, 2006, the total unrecognized stock-based compensation expense related to nonvested stock options was $45,662, which is expected to be recognized over a weighted average period of 30 months. The aggregate intrinsic value of options outstanding as of October 28, 2006 was $357,713.

The following table summarizes information about stock options outstanding for the Nordstrom, Inc. Plans as of October 28, 2006:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| **Range of Exercise Prices** | **Shares** | **Weighted-Average Remaining Contractual Life (Years)** | **Weighted-Average Exercise Price** | **Shares** | **Weighted-Average Exercise Price** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| $8.03 - $9.00 | 3,019 | 6 | $ | 9 | 2,003 | $ | 9 |
| $9.01 - $13.00 | 2,742 | 5 | | 12 | 2,705 | | 12 |
| $13.01 - $20.00 | 3,238 | 5 | | 19 | 1,794 | | 18 |
| $20.01 - $40.27 | 3,859 | 9 | | 33 | 424 | | 26 |
| | 12,858 | 6 | $ | 19 | 6,926 | $ | 13 |

**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 7: STOCK-BASED COMPENSATION (CONT.)**

**Performance Share Units**

We grant performance share units to align certain elements of our senior management compensation with our shareholder returns. Performance share units vest after a three-year performance period only when our total shareholder return (growth in stock price and reinvestment of dividends) is positive and outperforms companies in a defined peer group of direct competitors determined by the Compensation Committee of our Board of Directors. The percentage of units that vest depends on our relative position at the end of the performance period and can range from 0% to 125% of the number of units granted. As participants may elect to exchange each unit earned for one share of stock or the cash equivalent, these units are classified as a liability award.

At the end of each period, we record the performance share unit liability based on the vesting factors described above. At the end of October 28, 2006 and October 29, 2005, our liabilities included $9,314 and $11,716 for the units. For the nine months ended October 28, 2006 and October 29, 2005, stock-based compensation expense was $3,696 and $6,460. As of October 28, 2006, the remaining unrecognized stock-based compensation expense related to nonvested performance share units was $4,160, which is expected to be recognized over a weighted average period of 18 months. At January 28, 2006, 412,648 units were unvested. During the nine months ended October 28, 2006, 68,092 units were granted, 216,865 units vested and 8,396 units cancelled, resulting in an ending balance of 255,479 unvested units as of October 28, 2006.

The following table summarizes the information for performance share units that vested during the period:

| | Nine Months Ended | |
|---|---|---|
| | October 28, 2006 | October 29, 2005 |
| Number of performance share units vested | 216,865 | 336,892 |
| Total fair value of performance share units vested | $ 11,310 | $ 10,159 |
| Total amount of performance share units settled for cash | $ 5,982 | $ 1,836 |

**Nonemployee Director Stock Incentive Plan**

The Nonemployee Director Stock Incentive Plan authorizes the grant of stock awards to our nonemployee directors. These awards may be deferred or issued in the form of restricted or unrestricted stock, nonqualified stock options or stock appreciation rights. We issued 5 shares of unrestricted stock for a total expense of $169 in 2006. An additional 15 shares were deferred for a total expense of $514. As of October 28, 2006, we had 755 remaining shares available for issuance.

**Employee Stock Purchase Plan**

We offer an Employee Stock Purchase Plan as a benefit to our employees. Employees may make payroll deductions of up to ten percent of their base and bonus compensation. At the end of each six-month offering period, participants may purchase shares of our common stock at 90% of the fair market value on the last day of each offer period. We record compensation expense over the purchase period at the fair value of the ESPP at the end of each reporting period.

We issued 446 shares under the ESPP during the nine months ended October 28, 2006. As of October 28, 2006 and October 29, 2005, we had current liabilities of $1,543 and $1,407 for future purchase of shares under the ESPP.

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

(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

### NOTE 8: SEGMENT REPORTING

The following tables set forth the information for our reportable segments and a reconciliation to the consolidated totals:

| **Quarter ended October 28, 2006** | **Retail Stores** | **Credit** | **Direct** | **Other** | **Eliminations** | **Total** |
|---|---|---|---|---|---|---|
| Net sales | $ 1,712,061 | | $ 131,367 | $ 28,675 | | $ 1,872,103 |
| Net sales increase (decrease) | 11.0% | N/A | 28.2% | 31.4% | N/A | 12.4% |
| Intersegment revenues | | $ 9,019 | | | $ (9,019) | |
| Interest expense, net | | (6,481) | | (4,938) | | (11,419) |
| Other income including finance charges, net | (1,344) | 63,397 | (197) | (3,037) | | 58,819 |
| Earnings before income tax expense | 254,258 | 15,627 | 32,238 | (80,953) | | 221,170 |
| Earnings before income tax expense as a percentage of net sales | 14.9% | N/A | 24.5% | N/A | N/A | 11.8% |

| **Quarter ended October 29, 2005** | **Retail Stores** | **Credit** | **Direct** | **Other** | **Eliminations** | **Total** |
|---|---|---|---|---|---|---|
| Net sales | $ 1,541,823 | | $ 102,484 | $ 21,823 | | $ 1,666,130 |
| Net sales increase (decrease) | 8.9% | N/A | (3.6%) | N/A | N/A | 8.0% |
| Intersegment revenues | | $ 7,836 | | | $ (7,836) | |
| Interest expense, net | | (6,270) | | (3,978) | | (10,248) |
| Other income including finance charges, net | (2,003) | 54,065 | 102 | (4,814) | | 47,350 |
| Earnings before income tax expense | 189,423 | 8,753 | 22,144 | (57,308) | | 163,012 |
| Earnings before income tax expense as a percentage of net sales | 12.3% | N/A | 21.6% | N/A | N/A | 9.8% |

| **Nine months ended October 28, 2006** | **Retail Stores** | **Credit** | **Direct** | **Other** | **Eliminations** | **Total** |
|---|---|---|---|---|---|---|
| Net sales | $ 5,494,677 | | $ 367,867 | $ 67,250 | | $ 5,929,794 |
| Net sales increase (decrease) | 8.8% | N/A | 16.6% | 6.3% | N/A | 9.3% |
| Intersegment revenues | | $ 30,069 | | | $ (30,069) | |
| Interest expense, net | | (20,665) | | (14,288) | | (34,953) |
| | (6,953) | 188,122 | (546) | (7,115) | | 173,508 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other income including finance charges, net | | | | | | |
| Earnings before income tax expense | 792,061 | 48,896 | 88,304 | (202,653) | | 726,608 |
| Earnings before income tax expense as a percentage of net sales | 14.4% | N/A | 24.0% | N/A | N/A | 12.3% |
| Total assets | 2,466,157 | 932,699 | 126,939 | 1,182,587 | | 4,708,382 |

| **Nine months ended October 29, 2005** | **Retail Stores** | **Credit** | **Direct** | **Other** | **Eliminations** | **Total** |
|---|---|---|---|---|---|---|
| Net sales | $ 5,048,371 | | $ 315,404 | $ 63,267 | | $ 5,427,042 |
| Net sales increase | 7.8% | N/A | 4.8% | N/A | N/A | 7.9% |
| Intersegment revenues | | $ 27,556 | | | $ (27,556) | |
| Interest expense, net | | (18,818) | | (14,973) | | (33,791) |
| Other income including finance charges, net | (6,609) | 162,800 | 66 | (21,205) | | 135,052 |
| Earnings before income tax expense | 666,186 | 33,754 | 61,346 | (183,501) | | 577,785 |
| Earnings before income tax expense as a percentage of net sales | 13.2% | N/A | 19.4% | N/A | N/A | 10.6% |
| Total assets | 2,509,339 | 1,089,054 | 119,453 | 1,071,687 | | 4,789,533 |

**NORDSTROM, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Dollar and share amounts in thousands except per share and per option amounts)
(Unaudited)

**NOTE 8: SEGMENT REPORTING (CONT.)**

The segment information for the quarter and the nine months ended October 29, 2005 has been adjusted from our 2005 Form 10-Q disclosures as we now reflect Façonnable, Nordstrom Product Group and the distribution network in Other. Also, beginning in September 2005, we changed our internal method for recognizing returns of Direct sales at Retail Stores. Previously, these returns were recognized in the Direct segment and now they are recognized in the Retail Stores segment.

**NOTE 9: SUPPLEMENTARY CASH FLOW INFORMATION**

| | Nine Months Ended | |
|---|---|---|
| | **October 28, 2006** | **October 29, 2005** |
| Cash paid during the year for: | | |
| Interest (net of capitalized interest) | $ 44,593 | $ 43,825 |
| Income taxes | $ 336,357 | $ 287,362 |

**NOTE 10: CONTINGENCIES**

**Gain Contingencies**

In July 2006, we received $5,586 of proceeds from the VISA Check/Master Money Antitrust Litigation. These proceeds were recorded as a gain in the second quarter of 2006 in other income including finance charges, net.

**Loss Contingencies**

We are involved in routine claims, proceedings, and litigation arising from the normal course of our business. 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 liquidity.

**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Dollar amounts in millions except per share amounts)**

The following discussion should be read in conjunction with the Management s Discussion and Analysis section of our Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

**RESULTS OF OPERATIONS**

**Overview**

| | Third Quarter | | Nine Months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Net earnings | **$135.7** | $107.5 | **$445.7** | $360.9 |
| Net earnings as a percentage of net sales | **7.2%** | 6.4% | **7.5%** | 6.7% |
| Diluted earnings per share | **$ 0.52** | $ 0.39 | **$ 1.67** | $ 1.30 |

Net earnings as a percentage of net sales improved 80 basis points for the quarter and 87 basis points for the nine months ended October 28, 2006 compared to the same periods last year. These results were driven by the combination of continued sales growth, merchandise margin rate expansion, stable selling cost rates, and leverage of general and administrative costs. Key highlights include:

Net sales increased 12.4% in the third quarter and 9.3% in the nine months ended October 28, 2006. Third quarter same-store sales increased 10.7%, our largest increase in the past ten quarters. For the nine months ended October 28, 2006, same-store sales increased 7.2%. For both periods all of our retail sales channels and geographic regions delivered positive same-store sales increases.

Gross profit as a percentage of net sales (gross profit rate) increased 156 basis points for the quarter and 71 basis points for the nine months ended October 28, 2006, delivered by merchandise margin improvement and leverage on our buying and occupancy costs.

Sales leverage on expenses resulted in a 17 basis point reduction in selling, general and administrative expenses as a percentage of net sales (SG&A rate) for the quarter and a 43 basis point reduction for the nine months ended October 28, 2006.

We repurchased 0.9 million shares of our common stock for $32.6 during the third quarter and 16.0 million shares for $595.5 during the first nine months of 2006. The resulting reduction in weighted-average shares outstanding had no material impact on diluted earnings per share for the quarter and a $0.06 impact for the nine months ended October 28, 2006.

**Net Sales**

| | Third Quarter | | Nine Months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Net sales | **$1,872.1** | $1,666.1 | **$5,929.8** | $5,427.0 |
| Net sales increase | **12.4%** | 8.0% | **9.3%** | 7.9% |
| Retail segment net sales increase | **11.0%** | 8.9% | **8.8%** | 7.8% |
| Direct segment net sales increase | **28.2%** | (3.6%) | **16.6%** | 4.8% |
| Total company same-store sales increase | **10.7%** | 5.9% | **7.2%** | 6.1% |

Retail segment net sales for the quarter and nine month periods increased over the same periods in the prior year due to same-store sales increases and new stores. Since the third quarter of 2005, net sales have benefited from the opening of two Full-Line stores and the relocation and expansion of another Full-Line store. These three stores increased our retail square footage by 2.1% compared to last year.

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**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**

All major merchandise categories achieved same-store sales growth above our overall sales plan. Key categories that performed ahead of plan were: Women s Apparel, Accessories, and Designer merchandise across all categories. During the first and second quarter of this year our women s apparel merchandise category had slight same-store sales decreases. In the third quarter, women s apparel had a mid-single digit increase; same-store sales for the category were flat to last year for the nine months ended October 28, 2006.

For the quarter, our Direct segment had a 28.2% net sales increase and a 16.6% net sales increase for the nine months ended October 28, 2006. These increases were driven by continued growth in our online sales.

**Gross Profit**

| | Third Quarter | | Nine Months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Gross profit | **$ 712.0** | $ 607.7 | **$2,200.0** | $1,974.9 |
| Gross profit rate | **38.0%** | 36.5% | **37.1%** | 36.4% |

| | Four Quarters Ended | |
|---|---|---|
| | **October 28, 2006** | **October 29, 2005** |
| Average inventory per square foot | **$54.21** | $54.08 |
| Inventory turnover rate (for the most recent four quarters) | **4.73** | 4.53 |

Compared to the same periods last year, our gross profit rate improved 156 basis points for the quarter and 71 basis points for the nine months ended October 28, 2006, driven primarily by improvements in our merchandise margin. All of our major merchandise categories delivered margin rate improvement for the quarter and all except one delivered rate improvement for the nine months ended October 28, 2006, as compared to the same periods last year. Additionally, for both periods, we experienced leverage on buying and occupancy expenses from better than planned sales.

Our buying and occupancy costs included $2.9 in the third quarter and $8.3 in the nine months ended October 28, 2006 for costs related to stock options awarded primarily to our merchant and product development groups. These costs impacted our gross profit rate by 16 basis points for the quarter and 14 basis points for the nine month period.

Our four-quarter average inventory turnover rate improved 4.6% in 2006, indicating that our merchandise planning and execution have continued to improve.

**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**
**Selling, General and Administrative Expenses (SG&A)**

| | Third Quarter | | Nine Months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Selling, general and administrative expenses | **$ 538.2** | $ 481.8 | **$ 1,612.0** | $ 1,498.4 |
| SG&A rate | **28.7%** | 28.9% | **27.2%** | 27.6% |

Compared to the same period last year, our SG&A rate improved 17 basis points for the quarter and 43 basis points for the nine months ended October 28, 2006. For both periods, the performance resulted primarily from sales growth leverage. Our variable expense rate, which consists primarily of selling labor and credit expenses, was slightly lower than last year, and we leveraged our general and administrative costs, including non-selling labor and advertising. In the third quarter, further rate improvement was held back by a rise in compensation costs linked to the price of our company s stock, which appreciated 38.4% in the quarter. This cost increase impacted our SG&A rate by 64 basis points and diluted earnings per share by $0.03 for the quarter. This increase reverses the favorable impact on SG&A that these costs had in the second quarter (due to a decline in our stock price), and for the nine months ended October 28, 2006 compensation costs that are tied to our stock s performance have decreased by $4.3 compared to the same period in the prior year.

SG&A included $3.6 in the third quarter and $12.2 in the nine months ended October 28, 2006 for costs related to stock options awarded to employees in our store operations, business units and corporate service center. These costs impacted our SG&A rate by 19 basis points for the quarter and 20 basis points for the nine month period.

**Interest Expense, net**

Interest expense, net increased by $1.2 to $11.4 for the quarter ended October 28, 2006 and $35.0 for the nine months ended October 28, 2006 compared to the same periods in 2005. We had an increase in our average interest rates and slightly lower interest income as we reduced our cash and short-term investment balances in 2006 as compared to 2005.

**Other Income Including Finance Charges, net**

| | Third Quarter | | Nine Months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Other income including finance charges, net | **$ 58.8** | $ 47.4 | **$173.5** | $135.1 |
| Other income including finance charges, net as a percentage of net sales | **3.1%** | 2.8% | **2.9%** | 2.5% |

Other income including finance charges, net increased by $11.5 for the quarter and $38.5 for the nine months ended October 28, 2006. For both periods, the increase was primarily due to growth in our co-branded Nordstrom VISA credit card program.

In July 2006, we received $5.6 of proceeds from the VISA Check/Master Money Antitrust Litigation. These proceeds were recorded as a gain in the second quarter of 2006 in other income including finance charges, net.

**Seasonality**

Our business, like that of other retailers, is subject to seasonal fluctuations. Our Anniversary Sale in July and the holidays in December 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.

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**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**
**Return on Invested Capital (ROIC) (Non-GAAP financial measure)**

In the past two years, we have incorporated Return on Invested Capital (ROIC) into our key financial metrics, and since 2005 have used it as an executive incentive measure. Overall performance as measured by ROIC correlates directly to shareholders return over the long-term. For the 12 months ended October 28, 2006, we improved our ROIC to 19.5% compared to 15.7% for the 12 months ended October 29, 2005. Our ROIC improved primarily from increased earnings before interest and taxes. See our GAAP ROIC reconciliation below. The closest GAAP measure is return on assets, which improved to 13.1% from 10.5% for the last 12 months ended October 28, 2006 compared to the 12 months ended October 29, 2005.

We define ROIC as follows:

**ROIC = Net Operating Profit after Taxes (NOPAT)**

**Average Invested Capital**

| **Numerator = NOPAT** | **Denominator = Average Invested Capital** |
|---|---|
| Net Earnings<br>+ Income tax expense<br>+ Interest expense, net | Average total assets<br>- Average non-interest-bearing current liabilities<br>- Average deferred property incentives |
| = EBIT | + Average estimated asset base of capitalized operating leases |
| + Rent expense<br>- Estimated depreciation on capitalized operating leases | **= Average invested capital** |
| = Net operating profit<br>- Estimated income tax expense | |
| **= NOPAT** | |

A reconciliation of our return on assets to ROIC is as follows:

| | **12 months ended** | |
|---|---|---|
| | **October 28, 2006** | **October 29, 2005** |
| Net earnings | $ 636.1 | $ 500.9 |
| Add: income tax expense | 398.0 | 313.4 |
| Add: interest expense, net | 46.4 | 46.9 |
| Earnings before interest and income tax expense | 1,080.5 | 861.2 |
| Add: rent expense | 45.8 | 47.0 |
| Less: estimated depreciation on capitalized operating leases[1] | (24.4) | (25.1) |
| Net operating profit | 1,101.9 | 883.1 |
| Estimated income tax expense | (423.9) | (335.2) |

| | | |
|---|---|---|
| **Net operating profit after tax** | $ 678.0 | $ 547.9 |
| | | |
| Average total assets[2] | $ 4,864.3 | $ 4,759.6 |
| Less: average non-interest-bearing current liabilities[3] | (1,390.2) | (1,307.6) |
| Less: average deferred property incentives[2] | (360.7) | (370.9) |
| Add: average estimated asset base of capitalized operating leases[4] | 360.0 | 417.4 |
| **Average invested capital** | $ 3,473.4 | $ 3,498.5 |
| | | |
| **Return on Assets** | 13.1% | 10.5% |
| **ROIC** | 19.5% | 15.7% |

1 Depreciation based upon estimated asset base of capitalized operating leases as described in Note 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, other current liabilities and income taxes payable.

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.

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**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**

## LIQUIDITY AND CAPITAL RESOURCES

In the first nine months of 2006, cash decreased by $253.9. Cash outflows of $595.5 for common stock repurchases and the retirement of the $300.0 Private Label Securitization Notes were partially offset by cash inflows from operations of $712.5, including the $350.0 reduction in our investment in asset backed securities.

### Operating Activities

In comparison to last year, net cash flow from operating activities increased by $336.1 to $712.5 in 2006, primarily due to the reduction of our investment in asset backed securities. Between July and September 2006, the VISA Trust issued a total of $350.0 for cash of variable funding notes at par. The proceeds received by the VISA Trust were then sent to us in exchange for a reduction in the Transferor Interest in the VISA Trust held by Nordstrom, Inc. (reflected as the investment in asset backed securities in our condensed consolidated balance sheets). The reduction in the Transferor Interest was equal to a $350.0 reduction in our share of the principal balance of the underlying VISA credit card receivables since our last fiscal year end.

Excluding the proceeds from the reduction of our investment in asset backed securities, our net cash flow from operating activities decreased $13.9, due partially to the timing of income tax payments.

### Investing Activities

Net cash used in investing activities decreased by $63.5 to $140.1, primarily due to a reduction in capital expenditures and sales of short-term investments. Our capital expenditures decreased in 2006 as a result of the timing of our new store openings and remodels. In the first nine months of 2006, we opened one Full-Line store in Palm Beach Gardens, Florida and relocated and expanded our existing store at the Topanga Plaza in Canoga Park, California. During the same period in 2005, we opened four new stores.

In 2006, we sold our short-term investments and primarily used the proceeds for the common stock repurchases described below.

### Financing Activities

Net cash used in financing activities increased to $826.3 in 2006 from $327.5 in 2005, due to an increase in cash outflows for common stock repurchases and the retirement of our $300.0 Private Label Securitization Notes, offset by a $100.0 borrowing under our variable funding note facility, secured by the Private Label receivables.

In the first nine months of 2006, we repurchased 16.0 million shares of our common stock for an aggregate purchase price of $595.5 (an average price per share of $37.18). In May 2006, our Board of Directors authorized $1,000.0 of share repurchases. As of October 28, 2006, the unused authorization was $617.4. The actual amount and timing of future share repurchases will be subject to market conditions and applicable SEC rules.

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**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**

In October 2006, we amended our existing variable funding note facility to increase the capacity of this facility from $450.0 to $600.0. This facility was used to borrow $100.0 in October 2006 secured by our Private Label receivables. Additionally, the VISA Trust used this facility to issue $300.0 of Notes in July 2006 and an additional $50.0 of Notes in September 2006. As the VISA Trust is a statutory business trust and the VISA credit card receivables transferred to it are accounted for as a sale under SFAS No. 140, the obligations of the VISA Trust are not recorded in our financial statements. The VISA Trust sent the proceeds from this note issuance to us in return for a reduction in our interest in the VISA Trust equal to a $350.0 decrease in our share of the principal balance of VISA credit card receivables since our last fiscal year end.

**Liquidity**

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, existing cash and available credit facilities, as well as any potential future borrowing facilities will be sufficient to fund scheduled future payments and potential long-term initiatives.

In April 2007, the $200.0 2002 Class A & B Notes issued by the VISA Trust will mature. We are evaluating alternatives to combine the Private Label and VISA credit card borrowing programs in the first half of 2007.

**CRITICAL 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 critical accounting policies and methodologies in 2006 are consistent with those discussed in our Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 requires that the tax effects of a position be recognized only if it is more likely than not to be sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. The provisions of FIN 48 are effective for us as of the beginning of our 2007 fiscal year. We are currently evaluating the impact of adopting FIN 48 on our financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007. We are assessing the potential impact on our financial statements.

Also in September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 addresses the accounting for defined benefit pension plans and other postretirement benefit plans. It will require the recognition of a plan s overfunded or underfunded status as an asset or liability in the balance sheet and the recognition of changes in that funded status in the year in which the changes occur through comprehensive income. FAS 158 also requires the measurement date for plan assets and liabilities to coincide with the plan sponsor s fiscal year end. This statement is effective for fiscal years ending after December 15, 2006, except the change in measurement date provisions, which is effective for fiscal years ending after December 15, 2008. We have two benefit plans that are impacted by this standard: our Supplemental Executive Retirement Plan (SERP) and our retiree medical plan. Based on recent valuations and projections of the funded status of these plans, we expect that the effect of the adoption of FAS 158 will be to increase total liabilities and to reduce shareholders equity by approximately $14 million. The actual impact of adopting FAS 158 will depend on the valuation of our plan obligations as of our 2006 measurement date.

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**Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations (Cont.)**
**(Dollar amounts in millions except per share amounts)**

**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, 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 economic and competitive market forces,
- the impact of terrorist activity or war on our customers and the retail industry,
- our ability to predict fashion trends,
- consumer apparel buying patterns,
- trends in personal bankruptcies and bad debt write-offs,
- changes in interest rates,
- employee relations,
- our ability to continue and control our expansion, remodel and investment plans,
- changes in government or regulatory requirements,
- our ability to control costs,
- weather conditions, and
- hazards of nature.

These and other factors 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 Condensed Consolidated Financial Statements.

**Item 3. Quantitative And Qualitative Disclosures About Market Risk**

We discussed our interest rate risk and our foreign currency exchange risk in Item 7A of our Annual Report on Form 10-K for the fiscal year ended January 28, 2006. There has been no material change 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, we performed an evaluation under the supervision and with the participation of management, including our President and Chief Financial Officer, 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 are effective in the timely recording, processing, summarizing and reporting of material financial and non-financial information.

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 1. Legal Proceedings

**Cosmetics**

We were originally named as a defendant along with other department store and specialty retailers in nine separate but virtually identical class action lawsuits filed in various Superior Courts of the State of California in May, June and July 1998 that were consolidated in Marin County Superior Court. In May 2000, plaintiffs filed an amended complaint naming a number of manufacturers of cosmetics and fragrances and two other retailers as additional defendants. Plaintiffs amended complaint alleged that the retail price of the prestige or Department Store cosmetics and fragrances sold in department and specialty stores was collusively controlled by the retailer and manufacturer defendants in violation of the Cartwright Act and the California Unfair Competition Act.

Plaintiffs sought treble damages and restitution in an unspecified amount, attorneys fees and prejudgment interest, on behalf of a class of all California residents who purchased cosmetics and fragrances for personal use from any of the defendants during the four years prior to the filing of the original complaints.

While we believe that the plaintiffs claims are without merit, we entered into a settlement agreement with the plaintiffs and the other defendants on July 13, 2003 in order to avoid the cost and distraction of protracted litigation. In furtherance of the settlement agreement, the case was re-filed in the United States District Court for the Northern District of California on behalf of a class of all persons who currently reside in the United States and who purchased Department Store cosmetics and fragrances from the defendants during the period May 29, 1994 through July 16, 2003. The Court gave preliminary approval to the settlement, and a summary notice of class certification and the terms of the settlement was disseminated to class members. On March 30, 2005, the Court entered a final judgment approving the settlement and dismissing the plaintiffs claims and the claims of all class members with prejudice, in their entirety. On April 29, 2005, two class members who had objected to the settlement filed notices of appeal from the Court s final judgment to the United States Court of Appeals for the Ninth Circuit. One of the objectors has since dropped her appeal, but the other filed her appeal brief on March 20, 2006. Plaintiffs and defendants briefs were filed on May 25, 2006. The remaining objector filed her reply brief on June 14, 2006. The Ninth Circuit has not yet scheduled oral argument on the appeal. It is uncertain when the appeal will be resolved, but the appeal process could take as much as another year or more. If the Court s final judgment approving the settlement is affirmed on appeal, or the appeal is dismissed, the defendants will provide class members with certain free products with an estimated retail value of $175 million and pay the plaintiffs attorneys fees, awarded by the Court, of $24 million. We do not believe the outcome of this matter will have a material adverse effect on our financial condition, results of operations or cash flows.

**Other**

We are involved in routine claims, proceedings, and litigation arising from the normal course of our business. 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 liquidity.

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**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 Annual Report on Form 10-K for the fiscal year ended January 28, 2006. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**(c) Repurchases**

(dollars in millions, except per share amounts)

| | Total Number of Shares (or Units Purchased) | Average Price Paid Per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) Of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs[1] |
|---|---|---|---|---|
| August 2006 (July 30, 2006 to August 26, 2006) | 210,000 | $ 34.08 | 210,000 | $ 642.8 |
| September 2006 (August 27, 2006 to September 30, 2006) | 685,800 | $ 37.10 | 685,800 | $ 617.4 |
| October 2006 (October 1, 2006 to October 28, 2006) | | | | $ 617.4 |
| Total | 895,800 | $ 36.39 | 895,800 | |

[1] In the first nine months of 2006, we repurchased 16.0 million shares of our common stock for an aggregate purchase price of $595.5 (an average price per share of $37.18). In May 2006, our Board of

Directors authorized $1,000.0 of share repurchases. As of October 28, 2006, the unused authorization was $617.4. The actual amount and timing of future share repurchases will be subject to market conditions and applicable SEC rules.

**Item 6. Exhibits**

Exhibits are incorporated herein by reference or are filed with this report as set forth in the Index to Exhibits on page 27 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 5, 2006

**NORDSTROM, INC. AND SUBSIDIARIES**
**Exhibit Index**

| | Exhibit | Method of Filing |
|---|---|---|
| 10.1 | Note Purchase Agreement dated December 4, 2001 between Nordstrom Private Label Receivables, LLC, Nordstrom fsb, Falcon Asset Securitization Corporation, and Bank One NA (incorporated by reference from Nordstrom Credit, Inc. s Annual Report on Form 10-K for the year ended January 31, 2002, Exhibit 10.25), as amended February 25, 2005, February 24, 2006, June 26, 2006, and October 10, 2006. | Filed herewith electronically |
| 10.2 | Note Purchase Agreement dated December 16, 2004 between Nordstrom Credit Card Receivables, LLC, Nordstrom fsb, Falcon Asset Securitization Corporation, and JPMorgan Chase Bank NA, as amended October 10, 2006. | Filed herewith electronically |
| 31.1 | Certification of President required by Section 302(a) of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 31.2 | Certification of Chief Financial Officer required by Section 302(a) of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 32.1 | Certification of President and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Furnished herewith electronically |