VCA INC
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

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

Commission File Number: 001-16783

VCA Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-4097995 (I.R.S. Employer Identification No.)

12401 West Olympic Boulevard
Los Angeles, California 90064-1022
(Address of principal executive offices)
(310) 571-6500
(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 [X] No [ ].

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ].

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.:

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X].

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: common stock, $0.001 par value, 84,124,955 shares as of November 3, 2014.

VCA Inc. and Subsidiaries
Form 10-Q
September 30, 2014
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VCA Inc. and Subsidiaries
Condensed, Consolidated Balance Sheets
(Unaudited)
(In thousands, except par value)

	September 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$126,507	$125,029
Trade accounts receivable, less allowance for uncollectible accounts of $18,292 and $17,702 at September 30, 2014 and December 31, 2013, respectively	65,603	59,900
Inventory	50,325	55,067
Prepaid expenses and other	32,830	25,417
Deferred income taxes	28,921	28,907
Prepaid income taxes	—	15,434
Total current assets	304,186	309,754
Property and equipment, net	450,617	448,366
Goodwill	1,368,230	1,330,917
Other intangible assets, net	78,611	86,671
Notes receivable	3,016	3,454
Deferred financing costs, net	8,308	2,987
Other	59,517	55,632
Total assets	$2,272,485	$2,237,781
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt	$11,687	$51,087
Accounts payable	38,858	36,962
Accrued payroll and related liabilities	72,221	57,337
Income tax payable	3,078	—
Other accrued liabilities	64,414	58,762
Total current liabilities	190,258	204,148
Long-term debt, less current portion	648,723	568,558
Deferred income taxes	90,428	100,099
Other liabilities	35,811	36,758
Total liabilities	965,220	909,563
Commitments and contingencies		
Redeemable noncontrolling interests	11,014	10,678
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding	—	—
VCA Inc. stockholders’ equity:		
Common stock, par value $0.001, 175,000 shares authorized, 85,292 and 88,508 shares outstanding as of September 30, 2014 and December 31, 2013, respectively	85	89
Additional paid-in capital	261,812	384,721
Retained earnings	1,035,799	928,720
Accumulated other comprehensive loss	(12,581)	(6,190)
Total VCA Inc. stockholders’ equity	1,285,115	1,307,340
Noncontrolling interests	11,136	10,200

Total equity	1,296,251	1,317,540
Total liabilities and equity	$2,272,485	$2,237,781

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Condensed, Consolidated Income Statements
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$499,577	$464,055	$1,438,556	$1,367,916
Direct costs	375,820	353,378	1,092,933	1,046,022
Gross profit	123,757	110,677	345,623	321,894
Selling, general and administrative expense	42,792	38,747	124,163	117,616
Impairment of goodwill and other long-lived assets	27,019	—	27,019	—
Net loss (gain) on sale or disposal of assets	470	(109)	(173)	1,187
Operating income	53,476	72,039	194,614	203,091
Interest expense, net	4,367	4,474	12,564	14,439
Debt retirement costs	1,709	—	1,709	—
Other expense (income)	188	(86)	178	(113)
Income before provision for income taxes	47,212	67,651	180,163	188,765
Provision for income taxes	18,261	25,740	69,389	71,571
Net income	28,951	41,911	110,774	117,194
Net income attributable to noncontrolling interests	1,499	1,264	3,695	4,400
Net income attributable to VCA Inc.	$27,452	$40,647	$107,079	$112,794
Basic earnings per share	$0.32	$0.46	$1.22	$1.27
Diluted earnings per share	$0.31	$0.45	$1.21	$1.26
Weighted-average shares outstanding for basic earnings per share	86,274	88,834	87,543	88,583
Weighted-average shares outstanding for diluted earnings per share	87,360	89,845	88,665	89,659

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Condensed, Consolidated Statements of Comprehensive Income
(Unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income[1]	$28,951	$41,911	$110,774	$117,194
Other comprehensive income:				
Foreign currency translation adjustments	(6,207)	2,633	(6,919)	(3,708)
Other comprehensive (loss) income	(6,207)	2,633	(6,919)	(3,708)
Total comprehensive income	22,744	44,544	103,855	113,486
Comprehensive income attributable to noncontrolling interests[1]	1,021	1,264	3,167	4,400
Comprehensive income attributable to VCA Inc.	$21,723	$43,280	$100,688	$109,086

(1) Includes approximately $1.9 million and $2.6 million of net income related to redeemable and mandatorily redeemable noncontrolling interests combined for the nine months ended September 30, 2014 and 2013, respectively.

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Condensed, Consolidated Statements of Equity
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
	Shares	Amount					
Balances, December 31, 2012	88,372	$ 88	$ 390,359	$ 791,209	$ 1,847	$ 10,890	$ 1,194,393
Net income (excludes $1,152 and $1,475 related to redeemable and mandatorily redeemable noncontrolling interests, respectively).	—	—	—	112,794	—	1,773	114,567
Other comprehensive loss	—	—	—	—	(3,708)	—	(3,708)
Formation of noncontrolling interests	—	—	—	—	—	1,806	1,806
Distribution to noncontrolling interests	—	—	—	—	—	(1,175)	(1,175)
Purchase of noncontrolling interests	—	—	(976)	—	—	(4,309)	(5,285)
Share-based compensation	—	—	10,340	—	—	—	10,340
Issuance of common stock under stock incentive plans	1,313	1	15,110	—	—	—	15,111
Stock repurchases	(737)	—	(19,384)	—	—	—	(19,384)
Excess tax benefit from stock options	—	—	2,654	—	—	—	2,654
Tax benefit and other from stock options and awards	—	—	(4)	—	—	—	(4)
Other	—	—	—	—	—	163	163
Balances, September 30, 2013	88,948	89	398,099	904,003	(1,861)	9,148	1,309,478
Balances, December 31, 2013	88,508	$ 89	$ 384,721	$ 928,720	$ (6,190)	$ 10,200	$ 1,317,540
Net income (excludes $723 and $1,172 related to redeemable and mandatorily redeemable noncontrolling interests, respectively).	—	—	—	107,079	—	1,800	108,879
Other comprehensive loss (excludes $358 related to mandatorily redeemable noncontrolling interests).	—	—	—	—	(6,391)	(170)	(6,561)
Formation of noncontrolling interests	—	—	—	—	—	933	933
Distribution to noncontrolling interests	—	—	—	—	—	(1,627)	(1,627)
Purchase of noncontrolling interests	—	—	29	—	—	—	29

Share-based compensation	—	—	12,234	—	—	—	12,234
Issuance of common stock under stock incentive plans	614	—	926	—	—	—	926
Stock repurchases	(3,830)	(4)	(139,906)	—	—	—	(139,910)
Excess tax benefit from stock options	—	—	3,808	—	—	—	3,808
Balances, September 30, 2014	85,292	$ 85	$ 261,812	$ 1,035,799	$ (12,581)	$ 11,136	$ 1,296,251

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Condensed, Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	$110,774	$117,194
Adjustments to reconcile net income to net cash provided by operating activities:		
Impairment of goodwill and other long-lived assets	27,019	—
Depreciation and amortization	59,659	57,783
Amortization of debt issue costs	957	937
Provision for uncollectible accounts	4,388	5,380
Debt retirement costs	1,709	—
Net (gain) loss on sale or disposal of assets	(173)	1,187
Share-based compensation	12,234	10,340
Deferred income taxes	—	2,868
Excess tax benefit from exercise of stock options	(3,808)	(2,654)
Other	381	(251)
Changes in operating assets and liabilities:		
Trade accounts receivable	(9,678)	(9,986)
Inventory, prepaid expense and other assets	(8,233)	(1,634)
Accounts payable and other accrued liabilities	2,920	4,941
Accrued payroll and related liabilities	14,761	11,408
Income taxes	12,137	21,492
Net cash provided by operating activities	225,047	219,005
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(62,122)	(39,640)
Real estate acquired in connection with business acquisitions	(3,293)	(1,208)
Capital expenditures	(50,093)	(52,682)
Proceeds from sale or disposal of assets	4,464	905
Other	(202)	(1,738)
Net cash used in investing activities	(111,246)	(94,363)
Cash flows from financing activities:		
Repayment of debt	(563,976)	(28,507)
Proceeds from issuance of long-term debt	600,000	—
Payment of financing costs	(7,987)	—
Distributions to noncontrolling interest partners	(3,577)	(3,324)
Purchase of existing noncontrolling interests	(326)	(5,727)
Proceeds from issuance of common stock under stock option plans	926	15,111
Excess tax benefit from exercise of stock options	3,808	2,654
Repurchase of common stock	(139,910)	(19,384)
Other	(838)	(160)
Net cash used in financing activities	(111,880)	(39,337)
Effect of currency exchange rate changes on cash and cash equivalents	(443)	(566)
Increase in cash and cash equivalents	1,478	84,739
Cash and cash equivalents at beginning of period	125,029	68,435
Cash and cash equivalents at end of period	$126,507	$153,174

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Condensed, Consolidated Statements of Cash Flows - Continued
(Unaudited)
(In thousands)

	Nine Months Ended September 30, 2014	2013
Supplemental disclosures of cash flow information:		
Interest paid	$10,633	$9,487
Income taxes paid	$57,108	$47,305
Supplemental schedule of noncash investing and financing activities:		
Detail of acquisitions:		
Fair value of assets acquired	$76,686	$58,825
Fair value of pre-existing investment	(2,014)	—
Noncontrolling interest	(1,705)	(5,406)
Cash paid for acquisitions, net of acquired cash	(62,122)	(39,640)
Assumed debt	(4,483)	(2,360)
Contingent consideration	(2,531)	(1,120)
Holdbacks	(2,900)	(892)
Other liabilities assumed	$931	$9,407
Other noncash items:		
Capital lease additions	$—	$21,668

The accompanying notes are an integral part of these condensed, consolidated financial statements.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements
September 30, 2014
(Unaudited)

1. Nature of Operations

Our company, VCA Inc. ("VCA") is a Delaware corporation formed in 1986 and is based in Los Angeles, California. We are an animal healthcare company with the following five operating segments: animal hospitals ("Animal Hospital"), veterinary diagnostic laboratories ("Laboratory"), veterinary medical technology ("Medical Technology"), Vetstreet, and Camp Bow Wow Franchising, Inc. (f/k/a D.O.G. Enterprises, LLC) ("Camp Bow Wow"). Our operating segments are aggregated into two reportable segments "Animal Hospital" and "Laboratory." Our Medical Technology, Vetstreet and Camp Bow Wow operating segments are combined in our "All Other" category. See Footnote 9, "Lines of Business" within these notes to unaudited condensed, consolidated financial statements.

Our animal hospitals offer a full range of general medical and surgical services for companion animals. Our animal hospitals treat diseases and injuries, provide pharmaceutical products and perform a variety of pet-wellness programs, including health examinations, diagnostic testing, vaccinations, spaying, neutering and dental care. At September 30, 2014, we operated or managed 622 animal hospitals throughout 41 states and four Canadian provinces.

We operate a full-service veterinary diagnostic laboratory network serving all 50 states and certain areas in Canada. Our laboratory network provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At September 30, 2014, we operated 59 laboratories of various sizes located strategically throughout the United States and Canada.

Our Medical Technology business sells digital radiography and ultrasound imaging equipment, provides education and training on the use of that equipment, provides consulting and mobile imaging services, and sells software and ancillary services to the veterinary market.

Our Vetstreet business provides several different services to the veterinary community including, online communications, professional education, marketing solutions and a home delivery platform for independent animal hospitals.

Our Camp Bow Wow business operates and franchises a premier provider of pet services including dog day care, overnight boarding, grooming and other ancillary services at specially designed pet care facilities, principally under the trademark Camp Bow Wow®. As of September 30, 2014, there were 125 Camp Bow Wow® franchise locations operating in 37 states and one Canadian province.

The practice of veterinary medicine is subject to seasonal fluctuation. In particular, demand for veterinary services is significantly higher during the warmer months because pets spend a greater amount of time outdoors where they are more likely to be injured and are more susceptible to disease and parasites. In addition, use of veterinary services may be affected by levels of flea infestation, heartworms and ticks, and the number of daylight hours.

2. Basis of Presentation

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements as permitted under applicable rules and regulations. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for the full year ending December 31, 2014. For further information, refer to our audited consolidated financial statements and notes thereto included in our 2013 Annual Report on Form 10-K.

The preparation of our condensed, consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in our condensed, consolidated financial statements and notes thereto. Actual results could differ from those estimates.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2014
(Unaudited)

3. Goodwill and Other Long-Lived Assets
Goodwill
The following table presents the changes in the carrying amount of our goodwill for the nine months ended September 30, 2014 (in thousands):

	Animal Hospital	Laboratory	All Other	Total
Balance as of December 31, 2013				
Goodwill	$1,216,581	$96,871	$138,276	$1,451,728
Accumulated impairment losses	—	—	(120,811)	(120,811)
Subtotal	1,216,581	96,871	17,465	1,330,917
Goodwill acquired	46,475	27	6,669	53,171
Goodwill impairment	—	—	(9,246)	(9,246)
Foreign translation adjustment	(5,176)	(28)	—	(5,204)
Other [(1)]	(1,408)	—	—	(1,408)
Balance as of September 30, 2014				
Goodwill	1,256,472	96,870	144,945	1,498,287
Accumulated impairment losses	—	—	(130,057)	(130,057)
Subtotal	$1,256,472	$96,870	$14,888	$1,368,230

(1) "Other" primarily includes immaterial measurement period adjustments and an immaterial write-off related to the sale of an animal hospital.

Vetstreet Goodwill Impairment Charge

Impairment testing for goodwill is performed at least annually at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment (also known as a component). We perform our annual impairment test as of October 31st. Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

With respect to our Vetstreet reporting unit, during 2013 we established a Fiscal 2014 Operating and Financial Performance - Turnaround Plan. The Plan anticipated the launch of numerous product enhancements designed to restore our competitive advantage in the marketplace. Although certain of these product enhancements were delivered in a timely fashion, others were not. In addition, increasing competition created the need for additional product enhancements to those already planned. Given the less than anticipated impact of new product offerings combined with the the impact of increased competition, we determined that a triggering event had occurred with respect to goodwill and long-lived assets of our Vetstreet reporting unit. Accordingly, we established revised multi-year projections and performed an interim test of Vetstreet’s recorded goodwill and long-lived assets for impairment in the third quarter of 2014, prior to our annual October 31, 2014 test. As a result of our review, we determined that goodwill related to our Vetstreet reporting unit was impaired.

The impairment test for goodwill uses a two-step approach. Step one compares the fair value of the reporting unit to its carrying value including goodwill. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., the fair value of the reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is recorded as an impairment.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2014
(Unaudited)

3. Goodwill and Other Long-Lived Assets, continued

We calculate the implied fair value of the reporting unit utilizing the income approach. The income approach is based on a discounted cash flow analysis and calculates the fair value of the reporting unit by estimating the after-tax cash flows attributable to the reporting unit and then discounting the after-tax cash flows to a present value, using a weighted average cost of capital ("WACC"). The WACC utilized in our analysis using the income approach was 14.0%. The WACC is an estimate of the overall after-tax rate of return required for equity and debt holders of a business enterprise. The reporting unit's cost of equity and debt was developed based on data and factors relevant to the economy, the industry and the reporting unit. The cost of equity was estimated using the capital asset pricing model ("CAPM"). The CAPM uses a risk-free rate of return and an appropriate market risk premium for equity investments and the specific risks of the investment. The analysis also included comparisons to a group of guideline companies engaged in the same or similar businesses. The cost of debt was estimated using the current after-tax average borrowing cost that a market participant would expect to pay to obtain its debt financing assuming a target capital structure.

Based on the above analysis, it was determined that the carrying value of the Vetstreet reporting unit including goodwill exceeded the fair value of the reporting unit, requiring us to perform step two of the goodwill impairment test to measure the amount of impairment loss, if any.

In performing step two of the goodwill impairment test, we compared the implied fair value of the reporting unit's goodwill to its carrying value. As the carrying value of Vetstreet's goodwill exceeded its implied fair value we recognized a non-cash, goodwill impairment charge of $9.2 million, representing the entire balance of Vetstreet's goodwill. The impairment charge was recognized during the quarter ended September 30, 2014.

The fair value estimates used in the goodwill impairment analysis required significant judgment. The Company's fair value estimates for purposes of determining the goodwill impairment charge are considered Level 3 fair value measurements.

Other Intangible Assets
Our acquisition related amortizable intangible assets at September 30, 2014 and December 31, 2013 are as follows (in thousands):

	As of September 30, 2014			As of December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Non-contractual customer relationships	$98,904	$(50,033)	$48,871	$109,842	$(41,895)	$67,947
Covenants not-to-compete	9,170	(4,383)	4,787	8,843	(4,661)	4,182
Favorable lease assets	9,591	(4,844)	4,747	7,458	(4,373)	3,085
Trademarks	13,104	(4,608)	8,496	13,115	(4,194)	8,921
Contracts	460	(363)	97	608	(305)	303
Technology	2,913	(1,613)	1,300	5,240	(3,015)	2,225
Client lists	—	—	—	50	(42)	8

Franchise rights	10,400	(87)	10,313	—	—	3,127
Less: current portion	(9)	(8)	(8)			
Total due beyond one year	$2,800	$3,123	$3,119			

Credit Facilities

As of October 31, 2015, we had total short-term borrowing capacity available for general corporate purposes of $800. In April 2015, we terminated our $800 senior unsecured revolving credit facility that was scheduled to expire in March 2018. We replaced this with a five-year $800 senior unsecured revolving credit facility ("revolver") that expires in April 2020, with an option to extend for an additional two years. Under the terms of our revolver, we pay a variable rate of interest and a commitment fee based on our debt rating. The revolver is available for working capital, capital expenditures and other general corporate purposes. As of October 31, 2015, we had no issuances outstanding under our commercial paper program and no borrowings outstanding under our revolver.

The revolver requires that we maintain an adjusted debt to earnings before interest, income taxes, depreciation, amortization and rent ("EBITDAR") leverage ratio of less than four times. As of October 31, 2015, we were in compliance with this covenant.

As a condition of closing the credit card receivable transaction (see Note 2: Credit Card Receivable Transaction), we defeased the $325 secured Series 2011-1 Class A Notes in order to provide the receivables to TD free and clear.

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NORDSTROM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar and share amounts in millions except per share, per option and per unit amounts)
(Unaudited)

NOTE 6: FAIR VALUE MEASUREMENTS
We disclose our financial assets and liabilities that are measured at fair value in our Condensed Consolidated Balance Sheets by level within the fair value hierarchy as defined by applicable accounting standards:
Level 1: Quoted market prices in active markets for identical assets or liabilities
Level 2: Other observable market-based inputs or unobservable inputs that are corroborated by market data
Level 3: Unobservable inputs that cannot be corroborated by market data that reflect the reporting entity's own assumptions
Financial Instruments Measured at Fair Value on a Recurring Basis
We recorded a beneficial interest asset when we completed the sale of substantially all of our U.S. Visa and private label credit card portfolio (see Note 2: Credit Card Receivable Transaction). We determined the fair value of the beneficial interest asset based on a discounted cash flow model using Level 3 inputs in the fair value hierarchy regarding future credit card portfolio performance. Inputs and assumptions include the discount rate, payment rate, credit losses, revenues and expenses. Based on comparable market participant capital structures in the banking and credit card industries, we used a 12% discount rate. Based on historical and expected portfolio performance, we used a monthly payment rate ranging from approximately 6% to 33%, an annual credit loss rate ranging from approximately 1% to 4%, annual revenues ranging from approximately 6% to 18% of credit card receivables and annual expenses ranging from approximately 2% to 9% of credit card receivables. Amortization was the only significant change in value during the quarter and primarily reflects payments received on the receivables sold.
We did not have any financial assets or liabilities that were measured at fair value on a recurring basis as of January 31, 2015 and November 1, 2014.
Financial Instruments Not Measured at Fair Value
Financial instruments not measured at fair value include cash and cash equivalents, accounts payable and long-term debt. Cash and cash equivalents and accounts payable approximate fair value due to their short-term nature.
We estimate the fair value of our long-term debt using quoted market prices of the same or similar issues and, as such, this is considered a Level 2 fair value measurement. The following table summarizes the carrying value and fair value estimate of our long-term debt, including current maturities:

	October 31, 2015	January 31, 2015	November 1, 2014
Carrying value of long-term debt[1]	$2,809	$3,131	$3,127
Fair value of long-term debt	3,177	3,693	3,566

[1] The carrying value of long-term debt includes the remaining unamortized adjustment from our previous effective fair value hedge.
Non-financial Assets Measured at Fair Value on a Nonrecurring Basis
We measure certain non-financial assets at fair value on a nonrecurring basis, primarily goodwill, investment in contract asset and long-lived tangible and intangible assets, in connection with periodic evaluations for potential impairment. There were no material impairment charges for these assets for the nine months ended October 31, 2015 and November 1, 2014. We estimate the fair value of goodwill, investment in contract asset and long-lived tangible and intangible assets using primarily unobservable inputs and, as such, these are considered Level 3 fair value measurements.

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NORDSTROM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar and share amounts in millions except per share, per option and per unit amounts)
(Unaudited)

NOTE 7: COMMITMENTS AND CONTINGENT LIABILITIES
Plans for our Manhattan full-line store ultimately include owning a condominium interest in a mixed-use tower and leasing certain nearby properties. As of October 31, 2015, we had approximately $176 of fee interest in land, which is expected to convert to a condominium interest once the store is constructed. We have committed to make future installment payments based on the developer meeting pre-established construction and development milestones. In the unlikely event that this project is not completed, the opening may be delayed and we may potentially be subject to future losses or capital commitments in order to complete construction or to monetize our investment in the land.
NOTE 8: SHAREHOLDERS' EQUITY
In February 2013, our Board of Directors authorized a program to repurchase up to $800 of our outstanding common stock, through March 1, 2015. There was $73 of unused capacity upon program expiration. In September 2014, our Board of Directors authorized a program to repurchase up to $1,000 of our outstanding common stock, through March 1, 2016. On October 1, 2015, our Board of Directors authorized a program to repurchase up to $1,000 of our outstanding common stock, through March 1, 2017. During the nine months ended October 31, 2015, we repurchased 7.0 shares of our common stock for an aggregate purchase price of $517 and had $1,486 remaining in share repurchase capacity as of October 31, 2015. The actual number, price, manner and timing of future share repurchases, if any, will be subject to market and economic conditions and applicable Securities and Exchange Commission ("Commission") rules.
On October 1, 2015, our Board of Directors authorized a special cash dividend of $4.85 per share of outstanding common stock, using proceeds from the sale of our credit card receivables (see Note 2: Credit Card Receivable Transaction), payable to shareholders of record at the close of business on October 12, 2015. The special cash dividend was in addition to our recurring quarterly dividend of $0.37 per share, paid in September 2015.
Our accumulated deficit was $1,047 as of October 31, 2015, compared with retained earnings of $29 as of November 1, 2014, primarily resulting from the special cash dividend, our recurring quarterly dividends and increased share repurchases.
In November 2015, subsequent to quarter end, we declared a quarterly dividend of $0.37 per share, payable in December 2015.
NOTE 9: STOCK-BASED COMPENSATION
The following table summarizes our stock-based compensation expense:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Stock options	$7	$8	$26	$29
Acquisition-related stock compensation	5	4	14	4
Restricted stock units	4	3	14	9
Performance share units	(1)	—	(1)	1
Other	1	2	4	5
Total stock-based compensation expense, before income tax benefit	16	17	57	48
Income tax benefit	(5)	(6)	(18)	(17)
Total stock-based compensation expense, net of income tax benefit	$11	$11	$39	$31

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The following table summarizes our grants:

	Nine Months Ended			
	October 31, 2015		November 1, 2014	
	Granted	Weighted-average grant-date fair value per unit	Granted	Weighted-average grant-date fair value per unit
Stock options	1.8	$21	1.9	$16
Stock options special dividend adjustment	0.9	N/A	—	N/A
Restricted stock units	0.5	77	0.5	63
Restricted stock units special dividend adjustment	0.1	N/A	—	N/A

Special Dividend Adjustment

In connection with the closing of our credit card receivable transaction on October 1, 2015, our board of directors authorized a special cash dividend of $4.85 per share (see Note 8: Shareholders Equity). As required by our equity incentive plans, an adjustment was made to outstanding awards to prevent dilution of their value resulting from the special cash dividend. The adjustments to awards included increasing the number of outstanding restricted shares, stock options and performance shares, as well as reducing the exercise prices of outstanding stock options. These adjustments did not result in incremental stock-based compensation expense as the anti-dilutive adjustments are required by our equity incentive plans.

NOTE 10: EARNINGS PER SHARE

The computation of earnings per share is as follows:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net earnings	$81	$142	$420	$465
Basic shares	187.2	190.7	189.1	190.0
Dilutive effect of stock options and other	4.1	4.0	4.1	3.4
Diluted shares	191.3	194.7	193.2	193.4
Earnings per basic share	$0.43	$0.74	$2.22	$2.45
Earnings per diluted share	$0.42	$0.73	$2.17	$2.40
Anti-dilutive stock options and other	1.9	1.6	1.8	2.8

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NOTE 11: SEGMENT REPORTING
The following tables set forth information for our reportable segments:

	Retail	Corporate/Other	Retail Business[1]	Credit	Total
Quarter Ended October 31, 2015					
Net sales	$3,169	$ 70	$3,239	$—	$3,239
Credit card revenues, net	—	—	—	89	89
Earnings (loss) before interest and income taxes	185	(37)	148	7	155
Interest expense, net	—	(27)	(27)	(3)	(30)
Earnings (loss) before income taxes	185	(64)	121	4	125
Assets[2]	6,140	1,869	8,009	577	8,586
Quarter Ended November 1, 2014					
Net sales	$2,991	$ 49	$3,040	$—	$3,040
Credit card revenues, net	—	—	—	100	100
Earnings (loss) before interest and income taxes	254	(49)	205	57	262
Interest expense, net	—	(29)	(29)	(5)	(34)
Earnings (loss) before income taxes	254	(78)	176	52	228
Assets[2]	5,165	1,788	6,953	2,316	9,269
Nine Months Ended October 31, 2015					
Net sales	$10,135	$ (182)	$9,953	$—	$9,953
Credit card revenues, net	—	—	—	291	291
Earnings (loss) before interest and income taxes	855	(246)	609	168	777
Interest expense, net	—	(82)	(82)	(12)	(94)
Earnings (loss) before income taxes	855	(328)	527	156	683
Assets[2]	6,140	1,869	8,009	577	8,586
Nine Months Ended November 1, 2014					
Net sales	$9,339	$ (167)	$9,172	$—	$9,172
Credit card revenues, net	—	—	—	291	291
Earnings (loss) before interest and income taxes	931	(224)	707	151	858
Interest expense, net	—	(90)	(90)	(14)	(104)
Earnings (loss) before income taxes	931	(314)	617	137	754
Assets[2]	5,165	1,788	6,953	2,316	9,269

[1] Retail Business is not a reportable segment, but represents a subtotal of the Retail segment and Corporate/Other, and is consistent with our presentation in Management's Discussion and Analysis of Financial Condition and Results of Operations.
[2] Assets in Corporate/Other include unallocated assets in corporate headquarters, consisting primarily of cash, land, property and equipment and deferred tax assets.

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The following table summarizes net sales within our reportable segments:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Nordstrom full-line stores - U.S.	$1,634	$1,666	$5,431	$5,423
Nordstrom.com	414	371	1,518	1,291
Nordstrom	2,048	2,037	6,949	6,714
Nordstrom Rack	885	816	2,573	2,316
Nordstromrack.com/HauteLook	129	93	363	249
Other retail[1]	107	45	250	60
Total Retail segment	3,169	2,991	10,135	9,339
Corporate/Other	70	49	(182)	(167)
Total net sales	$3,239	$3,040	$9,953	$9,172

[1] Other retail includes Trunk Club, Nordstrom Canada full-line stores and Jeffrey boutiques.

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CAUTIONARY STATEMENT

Certain statements in this Quarterly Report on Form 10-Q contain or may suggest "forward-looking" information (as defined in the Private Securities Litigation Reform Act of 1995) that involve risks and uncertainties, including, but not limited to, anticipated financial outlook for the fiscal year ending January 30, 2016, anticipated annual total and comparable sales rates, anticipated new store openings in existing, new and international markets, anticipated Return on Invested Capital and trends in our operations. Such statements are based upon the current beliefs and expectations of the Company's management and are subject to significant risks and uncertainties. Actual future results may differ materially from historical results or current expectations depending upon factors including, but not limited to:

- successful execution of our customer strategy, including expansion into new domestic and international markets, acquisitions, investments in our stores and online, our ability to realize the anticipated benefits from growth initiatives and our ability to provide a seamless experience across all channels,
- 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 ability to manage the investment opportunities in our online business and our ability to manage related organizational changes,
- our ability to maintain relationships with our employees and to effectively attract, develop and retain our future leaders,
- effective inventory management, disruptions in our supply chain and our ability to control costs,
- the impact of any systems failures, cybersecurity and/or security breaches, including any security breach of our systems or those of a third-party provider that results in the theft, transfer or unauthorized disclosure of customer, employee or Company information or compliance with information security and privacy laws and regulations in the event of such an incident,
- successful execution of our information technology strategy,
- our ability to effectively utilize data in strategic planning and decision making,
- efficient and proper allocation of our capital resources,
- our ability to realize the expected benefits, respond to potential risks and appropriately manage potential costs associated with the program agreement with TD,
- our ability to safeguard our reputation and maintain our vendor relationships,
- the impact of economic and market conditions and the resultant impact on consumer spending patterns,
- our ability to respond to the business environment, fashion trends and consumer preferences, including changing expectations of service and experience in stores and online,
- the effectiveness of planned advertising, marketing and promotional campaigns in the highly competitive retail industry,
- weather conditions, natural disasters, health hazards, national security or other market disruptions, or the prospects of these events and the resulting impact on consumer spending patterns,
- our compliance with applicable banking-related laws and regulations, employment laws and regulations, certain international laws and regulations, other laws and regulations applicable to us, including the outcome of claims and litigation and resolution of tax matters, and ethical standards,
- impact of the current regulatory environment and financial system and health care reforms,
- compliance with debt covenants, availability and cost of credit, changes in interest rates, debt repayment patterns, personal bankruptcies, and
- the timing, price, manner and amounts of share repurchases by the Company, if any, or any share issuances by the Company, including issuances associated with option exercises or other matters.

These and other factors, including those factors described in Part I, "Item 1A. Risk Factors" in our 2014 Annual Report on Form 10-K could affect our financial results and cause actual results to differ materially from any forward-looking information we may provide. We undertake no obligation to update or revise any forward-looking statements to reflect subsequent events, new information or future circumstances.

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OVERVIEW

We continue to execute our strategy to enhance the customer experience and serve more customers through our growth initiatives. While we experienced lower growth than expected during the quarter, we are still confident in achieving our long-term plans. For the third quarter our total net sales increased 6.6%, comparable sales increased 0.9% and we achieved the following milestones towards our growth initiatives:

- We opened our first international flagship full-line store in Vancouver, British Columbia.
- We opened two new U.S. full-line stores and 16 Nordstrom Rack stores.
- We increased our fulfillment capacity by over 50% with the opening of our new East coast fulfillment center.

On September 18th, we opened our first international flagship store in Vancouver, B.C. Not only was it the most successful opening in our company's history, it is a major step forward in store experience and services. We believe our continued expansion in Canada represents a $1 billion sales opportunity by 2020 with six announced full-line stores and the potential for approximately 15 Nordstrom Rack stores.

In our Nordstrom business, we opened two full-line stores, including our first in Milwaukee and second in Minneapolis, and relocated a store in Los Angeles. These stores reflect our latest store design, which is now featured in nine locations. At Nordstrom.com, we made ongoing progress on our strategic priorities around selection, convenience and experience. This included expanded selection of approximately 20% and increased capacity with our new East coast fulfillment center.

Our Nordstrom Rack off-price business gives us access to new markets and a pipeline of new and younger customers. We are serving more customers with 16 additional stores, taking our total Rack store count to 194. Additionally, our online business had a significant gain in new customers to Nordstrom over the last year. Net sales at Nordstromrack.com/HauteLook increased 39%. Similar to our full-price business, we see meaningful synergies for customers to engage with us across stores and online.

Lastly, on October 1st, we completed the sale of our credit portfolio to TD Bank, a premiere global financial institution and experienced credit card partner. Our mutual commitment to having Nordstrom employees serve our customers directly was paramount to this partnership. We are able to retain all aspects of customer-facing activities, aligning with our strategy of enhancing the customer experience while allowing for improvement in capital efficiency. We are returning $1.8 billion net proceeds directly to our shareholders, including a special cash dividend of $905 paid on October 27th, with the remaining proceeds to be applied towards share repurchase.

We are well-positioned through our customer strategy while remaining focused on our current execution, and believe we are on track to achieve our sales ambition of over $20 billion by 2020. We are confident that the execution of our strategy will deliver long-term profitable growth and top-quartile shareholder return.

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RESULTS OF OPERATIONS
Our reportable segments are Retail and Credit. Our Retail segment includes our Nordstrom branded full-line stores and online store, Nordstrom Rack stores, Nordstromrack.com/HauteLook, Trunk Club, Jeffrey and our Last Chance clearance store. For purposes of discussion and analysis of our results of operations of our Retail Business, we combine our Retail segment results with revenues and expenses in the "Corporate/Other" column of Note 11: Segment Reporting (collectively, the "Retail Business"). We analyze our results of operations through earnings before interest and income taxes for our Retail Business and Credit, while interest expense and income taxes are discussed on a total company basis.
Retail Business
Summary
The following table summarizes the results of our Retail Business:

	Quarter Ended							
	October 31, 2015				November 1, 2014			
	Amount		% of net sales[1]		Amount		% of net sales[1]	
Net sales	$3,239		100.0	%	$3,040		100.0	%
Cost of sales and related buying and occupancy costs	(2,140	)	(66.1	%)	(1,960	)	(64.5	%)
Gross profit	1,099		33.9	%	1,080		35.5	%
Selling, general and administrative expenses	(951	)	(29.3	%)	(875	)	(28.8	%)
Earnings before interest and income taxes	$148		4.6	%	$205		6.8	%

	Nine Months Ended							
	October 31, 2015				November 1, 2014			
	Amount		% of net sales[1]		Amount		% of net sales[1]	
Net sales	$9,953		100.0	%	$9,172		100.0	%
Cost of sales and related buying and occupancy costs	(6,463	)	(64.9	%)	(5,908	)	(64.4	%)
Gross profit	3,490		35.1	%	3,264		35.6	%
Selling, general and administrative expenses	(2,871	)	(28.8	%)	(2,557	)	(27.9	%)
Other loss	(10	)	(0.1	%)	—		—	
Earnings before interest and income taxes	$609		6.1	%	$707		7.7	%

[1] Subtotals and totals may not foot due to rounding.

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Retail Business Net Sales

In our ongoing effort to enhance the customer experience, we are focused on providing customers with a seamless experience across our channels. While our customers may engage with us through multiple channels, we know they value the overall Nordstrom brand experience and view us simply as Nordstrom, which is ultimately how we view our business. To provide additional transparency into our net sales by channel, we present the following summary of our Retail Business:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net sales by channel:				
Nordstrom full-line stores - U.S.	$1,634	$1,666	$5,431	$5,423
Nordstrom.com	414	371	1,518	1,291
Nordstrom	2,048	2,037	6,949	6,714
Nordstrom Rack	885	816	2,573	2,316
Nordstromrack.com/HauteLook	129	93	363	249
Other retail[1]	107	45	250	60
Retail segment	3,169	2,991	10,135	9,339
Corporate/Other	70	49	(182)	(167)
Total net sales	$3,239	$3,040	$9,953	$9,172
Net sales increase	6.6%	8.9%	8.5%	7.3%
Comparable sales increase (decrease) by channel:[2]				
Nordstrom full-line stores - U.S.	(2.2%)	0.0%	(0.2%)	(1.0%)
Nordstrom.com	11.4%	21.8%	17.6%	25.2%
Nordstrom	0.3%	3.4%	3.2%	3.2%
Nordstrom Rack	(2.2%)	1.7%	(0.2%)	4.0%
Nordstromrack.com/HauteLook	38.8%	33.8%	46.1%	19.7%
Total company	0.9%	3.9%	3.5%	3.8%
Sales per square foot:[3]				
Total sales per square foot	$116	$114	$361	$347
4-wall sales per square foot	93	94	296	295
U.S. full-line sales per square foot	79	81	264	262
Nordstrom Rack sales per square foot	130	138	389	408

[1] Other retail includes Trunk Club, Nordstrom Canada full-line stores and Jeffrey boutiques.

[2] Comparable sales include sales from stores that have been open at least one full year at the beginning of the year. We also include sales from our online channels (Nordstrom.com and Nordstromrack.com/HauteLook) in comparable sales because of the integration with our stores.

[3] Sales per square foot is calculated as net sales divided by weighted-average square footage. Weighted-average square footage includes a percentage of year-end square footage for new stores equal to the percentage of the year during which they were open. 4-wall sales per square foot is calculated as sales for our Nordstrom U.S. full-line stores, Nordstrom Rack stores, Jeffrey boutiques, Nordstrom Canada full-line stores, Last Chance and Trunk Club clubhouses divided by their weighted-average square footage.

Total company net sales increased 6.6% for the quarter and 8.5% for the nine months ended October 31, 2015, compared with the same periods in 2014. During the nine months ended October 31, 2015, we opened five full-line stores, relocated one full-line store and opened 27 Nordstrom Rack stores. Overall comparable sales increased 0.9%

for the quarter and 3.5% for the nine months ended October 31, 2015.

(Continued) (Dollar and share amounts in millions except per share and per square foot amounts)

Nordstrom net sales, which consists of U.S. full-line and Nordstrom.com businesses, increased to $2,048, or 0.5%, for the third quarter of 2015 and to $6,949, or 3.5%, for the nine months ended October 31, 2015, compared with the same periods in 2014. These increases were driven by growth at Nordstrom.com and new store openings. Although both the number of items sold and the average selling price increased on a comparable basis for the quarter and nine months ended October 31, 2015, the growth in number of transactions decelerated relative to the first half of the year. The top-performing merchandise category for the quarter ended October 31, 2015 was Cosmetics and for the nine months ended October 31, 2015 were Cosmetics and Women's Apparel.

U.S. full-line stores' comparable sales decreased 2.2% for the quarter and 0.2% for the nine months ended October 31, 2015, compared with the same periods in 2014. The top-performing geographic regions for full-line stores for the quarter ended October 31, 2015 were the Northwest and Southern California, while the top-performing geographic regions for the nine months ended October 31, 2015 were the Northwest and Southwest.

Both of our online channels' net sales increased in the quarter and nine months ended October 31, 2015, driven by increased merchandise selection. Nordstrom.com net sales increased 11.4% in the quarter and 18% in the nine months ended October 31, 2015. Nordstromrack.com/HauteLook net sales increased 39% in the third quarter of 2015 and 46% in the nine months ended October 31, 2015.

Nordstrom Rack net sales increased $69, or 8.5%, for the quarter and $257, or 11.1%, for the nine months ended October 31, 2015, compared with the same periods in 2014. Nordstrom Rack comparable sales decreased 2.2% for the quarter and 0.2% for the nine months ended October 31, 2015. The average selling price increased, while the number of items sold decreased on a comparable basis for the quarter and nine months ended October 31, 2015. Nordstrom Rack sales per square foot decreased 6.4% for the third quarter and 4.7% for the nine months ended October 31, 2015 primarily due to new store openings.

Retail Business Gross Profit

The following table summarizes the Retail Business gross profit:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Retail gross profit[1]	$1,099	$1,080	$3,490	$3,264
Retail gross profit as a % of net sales	33.9 %	35.5 %	35.1 %	35.6 %

	October 31, 2015	November 1, 2014
Ending inventory per square foot	$83.98	$81.69
Inventory turnover rate[2]	4.32	4.52

[1] Retailers do not uniformly record the costs of buying and occupancy and supply chain operations (freight, purchasing, receiving, distribution, fulfillment, etc.) between gross profit and selling, general and administrative expenses. As such, our gross profit and selling, general and administrative expenses and rates may not be comparable to other retailers' expenses and rates.

[2] Inventory turnover rate is calculated as the trailing 12-months' cost of sales and related buying and occupancy costs (for all segments) divided by the trailing 4-quarter average inventory. Retailers do not uniformly calculate inventory turnover as buying and occupancy costs may be included in selling, general and administrative expenses. As such, our inventory turnover rates may not be comparable to other retailers' rates.

Our Retail gross profit rate decreased 162 basis points for the quarter primarily due to higher markdowns in addition to Nordstrom Rack's continued store expansion. For the nine months ended October 31, 2015, our Retail gross profit rate decreased 53 basis points primarily due to higher markdowns. Our Retail gross profit increased $19 for the third quarter of 2015 primarily due to increased sales, partially offset by higher markdowns and Nordstrom Rack's continued store expansion. Retail gross profit increased $226 for the nine months ended October 31, 2015, compared with the same period in 2014, primarily due to increased sales, partially offset by Nordstrom Rack's continued store expansion.

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Our inventory turnover rate of 4.32 times decreased for the period ended October 31, 2015, compared with the same period in 2014, due to softer sales trends experienced during the quarter. Though our ending inventory per square foot of $83.98 increased for the period ended October 31, 2015, our ending inventory increase of 8.0% was in-line with the increase in net sales.

Ending inventory includes pack and hold inventory of $162 and $169 on October 31, 2015 and November 1, 2014, which represents strategic purchases of merchandise for upcoming selling seasons.

Retail Business Selling, General and Administrative Expenses

Retail Business selling, general and administrative expenses ("Retail SG&A") are summarized in the following table:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Selling, general and administrative expenses	$951	$875	$2,871	$2,557
Selling, general and administrative expenses as a % of net sales	29.3 %	28.8 %	28.8 %	27.9 %

Our Retail SG&A rate increased 58 basis points for the quarter and 97 basis points for the nine months ended October 31, 2015 due to planned growth initiatives related to Trunk Club and Canada, and higher fulfillment costs associated with online growth. Retail SG&A increased $76 for the quarter and $314 for the nine months ended October 31, 2015 primarily due to planned growth initiatives related to Trunk Club and Canada and an increase in sales.

Other Loss

Other loss of $10 for the nine months ended October 31, 2015 was due to impairment of an equity method investment as we determined it was no longer recoverable.

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Credit Segment
Summary
The table below provides a detailed view of the operational results of our Credit segment, consistent with Note 11: Segment Reporting. In order to better reflect the economic contribution of our credit and debit card program, intercompany merchant fees are also included in the table below, which represent the estimated costs that would be incurred if cardholders used third-party cards instead of ours in our stores or on our websites.
On October 1, 2015, we completed the sale of substantially all of our U.S. Visa and private label credit card portfolio to TD (see Note 2: Credit Card Receivable Transaction).
Prior to October 1, 2015, interest expense at the Credit segment was equal to the amount of interest related to securitized debt plus an amount assigned to the Credit segment in proportion to the estimated debt and equity needed to fund our credit card receivables. Based on our research, debt as a percentage of credit card receivables for other credit card companies ranged from 70% to 90%. As such, we considered a mix of 80% debt and 20% equity appropriate, and therefore assigned interest expense to the Credit segment as if it carried debt of up to 80% of the credit card receivables. Subsequent to the sale, we no longer allocate interest expense to the Credit segment as we do not fund the accounts receivable now owned by TD.

	Quarter Ended	
	October 31, 2015	November 1, 2014
Credit card revenues, net	$89	$100
Credit expenses	(50)	(43)
Credit transaction, net	(32)	—
Earnings before interest and income taxes[1]	7	57
Interest expense	(3)	(5)
Intercompany merchant fees	24	23
Credit segment contribution, before income taxes	$28	$75
Credit and debit card volume[2]:		
Outside	$1,059	$1,074
Inside	1,243	1,160
Total volume	$2,302	$2,234

	Nine Months Ended	
	October 31, 2015	November 1, 2014
Credit card revenues, net	$291	$291
Credit expenses	(152)	(140)
Credit transaction, net	29	—
Earnings before interest and income taxes[1]	168	151
Interest expense	(12)	(14)
Intercompany merchant fees	83	77
Credit segment contribution, before income taxes	$239	$214
Credit and debit card volume[2]:		
Outside	$3,209	$3,220
Inside	4,242	3,879
Total volume	$7,451	$7,099

[1] As presented in Note 11: Segment Reporting.
[2] Volume represents sales plus applicable taxes on all Nordstrom branded credit and debit cards, including those owned by TD.

(Continued) (Dollar and share amounts in millions except per share and per square foot amounts)

Credit Card Revenues, net
The following is a summary of our credit card revenues, net:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Finance charge revenue	$45	$64	$173	$186
Interchange	15	22	60	66
Late fees and other	14	14	43	39
Credit program revenues, net	15	—	15	—
Total credit card revenues, net	$89	$100	$291	$291

Prior to the close of the credit card receivable transaction on October 1, 2015, credit card revenues included finance charges, interchange fees, late fees and other revenue, recorded net of estimated uncollectible finance charges and fees. Finance charges represent interest earned on unpaid balances while interchange fees are earned from the use of Nordstrom Visa credit cards at merchants outside of Nordstrom. Late fees are assessed when a credit card account becomes past due. We continue to recognize revenue in this manner for the credit card receivables retained subsequent to the close of the credit card receivable transaction.
Following the close of the credit card receivable transaction and pursuant to the new program agreement with TD, we receive our portion of the ongoing credit card revenue, net of credit losses, from both the sold and newly generated credit card receivables, and is recorded in credit program revenues, net. Asset amortization and deferred revenue recognition associated with the assets and liabilities recorded as part of the transaction are also recorded in credit program revenues, net.
Credit card revenues, net decreased $11 for the quarter ended October 31, 2015, compared with the same period in the prior year, primarily due to amortization and the impact of the program agreement with TD.
Credit Expenses
Credit expenses are summarized in the following table:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Operational expenses	$42	$36	$121	$108
Bad debt expense	6	6	26	28
Occupancy expenses	2	1	5	4
Total credit expenses	$50	$43	$152	$140

Total credit expenses increased $7 for the quarter and $12 for the nine months ended October 31, 2015, compared with the same periods in the prior year, due to higher operational costs related to increased credit volume.
Credit Transaction, net
Credit transaction, net of $(32) for the quarter ended October 31, 2015 represents transaction costs associated with the sale. Credit transaction, net of $29 for the nine months ended October 31, 2015 is due to the reversal of the allowance for credit losses on receivables reclassified as "held for sale" during the second quarter, partially offset by transaction related costs related to the sale of these receivables.
Allowance for Credit Losses and Credit Trends
We considered a credit card account delinquent if the minimum payment was not received by the payment due date. Our aging method was based on the number of completed billing cycles during which the customer failed to make a minimum payment. During the third quarter of 2014, we modified our write-off policy from 150 days past due to 180 days past due to better align with industry practice.

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

Substantially all of our U.S. Visa and private label receivables were reclassified as "held for sale" during the second quarter of 2015, and resulted in the reversal of the allowance for credit losses on those receivables. Activity in the allowance for credit losses is as follows:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Allowance at beginning of period	$1	$80	$75	$80
Bad debt expense	6	6	26	28
Write-offs	(11)	(14)	(49)	(52)
Recoveries	5	3	13	19
Reversal of allowance for credit losses	—	—	(64)	—
Allowance at end of period	$1	$75	$1	$75

Intercompany Merchant Fees

Intercompany merchant fees represent the estimated costs that would be incurred if Nordstrom cardholders used third-party cards in our Nordstrom stores and online. This estimate increased to $24 for the quarter ended October 31, 2015 from $23 for the same period in 2014, and increased to $83 for the nine months ended October 31, 2015 from $77 for the same period in 2014. These changes were primarily driven by the increased use of Nordstrom branded credit and debit cards in store and online.

Total Company Results

Interest Expense, net

Interest expense, net was $30 for the third quarter and $94 for the nine months ended October 31, 2015, compared with $34 for the third quarter and $104 for the nine months ended November 1, 2014. The decreases are primarily due to increased capitalized interest resulting from growth-related initiatives.

Income Tax Expense

Income tax expense is summarized in the following table:

	Quarter Ended		Nine Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Income tax expense	$44	$86	$263	$289
Effective tax rate	35.2%	37.9%	38.5%	38.3%

The effective tax rate decreased for the quarter ended October 31, 2015, compared with the same period in 2014, primarily due to the benefit of income tax credits in 2015, and changes in non-deductible expenses and estimated tax reserves. The effective tax rate was flat for the nine months ended October 31, 2015, compared with the same period in 2014.

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

Fiscal Year 2015 Outlook
The Company updated its annual earnings per diluted share expectations, incorporating third quarter results. Our expectations for fiscal 2015 are as follows:

	Prior Outlook	Current Outlook
Net sales increase (percent)	8.5 to 9.5	7.5 to 8.0
Comparable sales increase (percent)	3.5 to 4.5	2.5 to 3.0
Gross profit % (basis points)	5 decrease to 5 increase	50 to 60 decrease
Selling, general and administrative expenses % (basis points)	65 to 75 increase	70 to 75 increase
Earnings per diluted share (excluding the impact of the credit transaction and other, and impact of any future share repurchases)[1]	\$3.70 to \$3.80	\$3.40 to \$3.50
Impact of credit transaction and other[1]	\$51 million EBIT increase	\$38 million EBIT decrease
Earnings per diluted share (excluding the impact of any future share repurchases)	\$3.85 to \$3.95	\$3.30 to \$3.40

[1] The impact of the credit transaction and other primarily represents credit program revenues related to the program agreement, transaction costs, non-cash accounting adjustments and other loss.

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

Return on Invested Capital ("ROIC") (Non-GAAP financial measure)
We believe ROIC is a useful financial measure for investors in evaluating the efficiency and effectiveness of our use of capital and believe ROIC is an important component of shareholders' return over the long term. In addition, we incorporate ROIC in our executive incentive compensation measures. For the 12 fiscal months ended October 31, 2015, our ROIC decreased to 11.4% compared with 13.1% for the 12 fiscal months ended November 1, 2014, primarily due to ongoing store expansion and increased technology investments in addition to the acquisition of Trunk Club.
ROIC is not a measure of financial performance under generally accepted accounting principles ("GAAP") and should be considered in addition to, and not as a substitute for, return on assets, net earnings, total assets or other financial measures prepared in accordance with GAAP. Our method of determining non-GAAP financial measures may differ from other companies' methods and therefore may not be comparable to those used by other companies. The financial measure calculated under GAAP which is most directly comparable to ROIC is return on assets. The following is a reconciliation of the components of ROIC and return on assets:

	12 Fiscal months ended	
	October 31, 2015	November 1, 2014
Net earnings	$675	$732
Add: income tax expense	438	458
Add: interest expense	129	155
Earnings before interest and income tax expense	1,242	1,345
Add: rent expense	165	133
Less: estimated depreciation on capitalized operating leases[1]	(88)	(70)
Net operating profit	1,319	1,408
Less: estimated income tax expense[2]	(519)	(542)
Net operating profit after tax	$800	$866
Average total assets[3]	$9,362	$8,733
Less: average non-interest-bearing current liabilities[4]	(2,965)	(2,658)
Less: average deferred property incentives[3]	(536)	(498)
Add: average estimated asset base of capitalized operating leases[5]	1,171	1,035
Average invested capital	$7,032	$6,612
Return on assets	7.2%	8.4%
ROIC	11.4%	13.1%

[1] Capitalized operating leases is our best estimate of the asset base we would record for our leases that are classified as operating if they had met the criteria for a capital lease or we had purchased the property. Asset base is calculated as described in footnote 5 below.
[2] Based upon our effective tax rate multiplied by the net operating profit for the 12 fiscal months ended October 31, 2015 and November 1, 2014.
[3] Based upon the trailing 12-month average.
[4] Based upon the trailing 12-month average for accounts payable, accrued salaries, wages and related benefits and other current liabilities.
[5] Based upon the trailing 12-month average of the monthly asset base. The asset base for each month is calculated as the trailing 12 months of rent expense multiplied by eight. The multiple of eight times rent expense is a commonly used method of estimating the asset base we would record for our capitalized operating leases described in footnote 1.

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

LIQUIDITY AND CAPITAL RESOURCES

We strive to 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, available credit facilities and potential future borrowings 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, maintain our financial position, manage refinancing risk and allow flexibility for strategic initiatives. We regularly assess our debt and leverage levels, capital expenditure requirements, debt service payments, dividend payouts, potential share repurchases and other future investments. We believe that as of October 31, 2015, our existing cash and cash equivalents on-hand of $821, available credit facilities of $800 and potential future operating cash flows and borrowings will be sufficient to fund these scheduled future payments and potential long-term initiatives. Further, upon the closing of our credit card receivable transaction, we received net proceeds of approximately $1.8 billion, after $325 in debt reduction and transaction costs. On October 27, 2015, the Company paid a special cash dividend of $905, or $4.85 per share of outstanding common stock, using the proceeds from the sale of our credit card receivables. In addition, the Company expects to initiate share repurchase with the remaining net proceeds beginning in the fourth quarter of this year.

For the nine months ended October 31, 2015, cash and cash equivalents decreased by $6 to $821, due to payments for cash dividends of $1,116 and capital expenditures of $857, offset by net proceeds from the sale of our credit card receivables of $1,848.

Operating Activities

Net cash provided by operating activities increased $1,229 for the nine months ended October 31, 2015, compared with the same period in 2014, primarily due to proceeds from the sale of credit card receivables originated at Nordstrom of $1,297.

Investing Activities

Net cash provided by investing activities was $69 for the nine months ended October 31, 2015, compared with net cash used of $638 for the same period in 2014. The increase relates to proceeds from the sale of the credit card receivables originated at third parties of $890, offset by capital expenditures of $857.

Financing Activities

Net cash used in financing activities was $1,820 for the nine months ended October 31, 2015, compared with $639 for the same period in 2014, primarily due to an increase in cash dividends paid. The nine months ended October 31, 2015 included a special cash dividend of $905.

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

Free Cash Flow (Non-GAAP financial measure)

Free Cash Flow is one of our key liquidity measures, and when used in conjunction with GAAP measures, provides investors with a meaningful analysis of our ability to generate cash from our business. For the nine months ended October 31, 2015, Free Cash Flow increased to $702 compared with $(357) for the nine months ended November 1, 2014, primarily due to an increase in cash provided by operating activities as a result of proceeds from the sale of our credit card receivables, partially offset by cash dividends paid.

Free Cash Flow is not a measure of financial performance under GAAP and should be considered in addition to, and not as a substitute for, operating cash flows or other financial measures prepared in accordance with GAAP. Our method of determining non-GAAP financial measures may differ from other companies' methods and therefore may not be comparable to those used by other companies. The financial measure calculated under GAAP which is most directly comparable to Free Cash Flow is net cash provided by operating activities. The following is a reconciliation of net cash provided by operating activities to Free Cash Flow:

	Nine Months Ended	
	October 31, 2015	November 1, 2014
Net cash provided by operating activities	$1,745	$516
Less: capital expenditures	(857)	(616)
Less: cash dividends paid	(1,116)	(189)
Add: proceeds from sale of credit card receivables originated at third parties	890	—
Add (Less): change in credit card receivables originated at third parties	33	(10)
Add (Less): change in cash book overdrafts	7	(58)
Free Cash Flow	$702	$(357)
Net cash provided by (used in) investing activities	$69	$(638)
Net cash used in financing activities	(1,820)	(639)

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

Credit Capacity and Commitments
As of October 31, 2015, we had total short-term borrowing capacity available for general corporate purposes of $800. In April 2015, we terminated our $800 senior unsecured revolving credit facility that was scheduled to expire in March 2018. We replaced this with a five-year $800 senior unsecured revolving credit facility ("revolver") that expires in April 2020, with an option to extend for an additional two years. Under the terms of our revolver, we pay a variable rate of interest and a commitment fee based on our debt rating. The revolver is available for working capital, capital expenditures and other general corporate purposes. As of October 31, 2015, we had no issuances outstanding under our commercial paper program and no borrowings outstanding under our revolver.
As a condition of closing the credit card receivable transaction (see Note 2: Credit Card Receivable Transaction), we defeased the $325 secured Series 2011-1 Class A Notes to provide the receivables to TD free and clear.
Impact of Credit Ratings
Under the terms of our revolver, any borrowings we may enter into will accrue interest for Euro-Dollar Rate Loans at a floating base rate tied to LIBOR, for Canadian Dealer Offer Rate Loans at a floating rate tied to CDOR, and for Base Rate Loans at the highest of: (i) the Euro-Dollar rate plus 100 basis points, (ii) the federal funds rate plus 50 basis points and (iii) the prime rate.
The rate depends upon the type of borrowing incurred, plus in each case an applicable margin. This applicable margin varies depending upon the credit ratings assigned to our long-term unsecured debt. At the time of this report, our long-term unsecured debt ratings, outlook and resulting applicable margin were as follows:

	Credit Ratings	Outlook
Moody's	Baa1	Stable
Standard & Poor's	A-	Stable
	Base Interest Rate	Applicable Margin
Euro-Dollar Rate Loan	LIBOR	0.91%
Canadian Dealer Offer Rate Loan	CDOR	0.91%
Base Rate Loan	various	—

Should the ratings assigned to our long-term unsecured debt improve, the applicable margin associated with any such borrowings may decrease, resulting in a slightly lower borrowing cost under this facility. Should the ratings assigned to our long-term unsecured debt worsen, the applicable margin associated with our borrowings may increase, resulting in a slightly higher borrowing cost under this facility.
Debt Covenant
The revolver requires that we maintain an adjusted debt to earnings before interest, income taxes, depreciation, amortization and rent ("EBITDAR") leverage ratio of less than four times (see the following additional discussion of Adjusted Debt to EBITDAR). As of October 31, 2015, we were in compliance with this covenant.

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

Adjusted Debt to EBITDAR (Non-GAAP financial measure)

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 is to manage debt levels to maintain an investment-grade credit rating and operate with an efficient capital structure. In evaluating our debt levels, this measure provides a reflection of our credit worthiness that could impact our credit rating and borrowing costs. We also have a debt covenant that requires an adjusted debt to EBITDAR leverage ratio of less than four times. As of October 31, 2015 and November 1, 2014, our Adjusted Debt to EBITDAR was 2.1.

Adjusted Debt to EBITDAR is not a measure of financial performance under GAAP and should be considered in addition to, and not as a substitute for, debt to net earnings, net earnings, debt or other financial measures prepared in accordance with GAAP. Our method of determining non-GAAP financial measures may differ from other companies' methods and therefore may not be comparable to those used by other companies. The financial measure calculated under GAAP which is most directly comparable to Adjusted Debt to EBITDAR is debt to net earnings. The following is a reconciliation of the components of Adjusted Debt to EBITDAR and debt to net earnings:

	2015[1]	2014[1]
Debt	$2,809	$3,127
Add: estimated capitalized operating lease liability[2]	1,320	1,068
Less: fair value hedge adjustment included in long-term debt	(26)	(39)
Adjusted Debt	$4,103	$4,156
Net earnings	$675	$732
Add: income tax expense	438	458
Add: interest expense, net	129	155
Earnings before interest and income taxes	1,242	1,345
Add: depreciation and amortization expenses	557	498
Add: rent expense	165	133
Add: non-cash acquisition-related charges	13	8
EBITDAR	$1,977	$1,984
Debt to Net Earnings	4.2	4.3
Adjusted Debt to EBITDAR	2.1	2.1

[1] The components of Adjusted Debt are as of October 31, 2015 and November 1, 2014, while the components of EBITDAR are for the 12 months ended October 31, 2015 and November 1, 2014.

[2] Based upon the estimated lease liability as of the end of the period, calculated as the trailing 12 months of rent expense multiplied by eight. The multiple of eight times rent expense is a commonly used method of estimating the debt we would record for our leases that are classified as operating if they had met the criteria for a capital lease or we had purchased the property.

Off-Balance Sheet Arrangements

On October 1, 2015, we completed the sale of substantially all of our U.S. Visa and private label credit card portfolio to TD (see Note 2: Credit Card Receivable Transaction). This transaction represents an off-balance sheet arrangement and credit card receivables serviced under this contract are $2,199 as of October 31, 2015.

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 2014 Annual Report on Form 10-K filed with the Commission on March 16, 2015. There have been no material changes to these risks since that time.
Item 4. Controls and Procedures.
Disclosure Controls and Procedures
On May 4, 2015, the Company filed a Form 8-K announcing the appointment of Blake Nordstrom, Pete Nordstrom and Erik Nordstrom as co-presidents of Nordstrom, Inc. The three executives retained their current roles and responsibilities following that appointment. In light of those individual responsibilities, Blake Nordstrom continues to serve as the Company's principal executive officer for purposes of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company's Executive Vice President and Chief Financial Officer is the Company's principal financial officer for purposes of the Exchange Act.

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 principal executive officer and principal 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 Exchange Act). Based upon that evaluation, our principal executive officer and principal 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 principal executive officer and principal 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 principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.
Changes in Internal Control over Financial Reporting
There have been no changes 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 have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are subject from time to time to various claims and lawsuits arising in the ordinary course of business, including lawsuits alleging violations of state and/or federal wage and hour and other employment laws, privacy and other consumer-based claims. Some of these lawsuits include certified classes of litigants, or purport or may be determined to be class or collective actions and seek substantial damages or injunctive relief, or both, and some may remain unresolved for several years. We believe the recorded reserves in our Condensed Consolidated Financial Statements are adequate in light of the probable and estimable liabilities. As of the date of this report, we do not believe any currently identified claim, proceeding or litigation, either alone or in the aggregate, will have a material impact on our results of operations, financial position or cash flows. Since these matters are subject to inherent uncertainties, our view of them may change in the future.

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

(c) Repurchases

(Dollar and share amounts in millions, except per share amounts)

The following is a summary of our third quarter share repurchases:

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs[1]
August 2015 (August 2, 2015 to August 29, 2015)	0.2	$73.10	0.2	$ 718
September 2015 (August 30, 2015 to October 3, 2015)	1.9	73.08	1.9	1,579
October 2015 (October 4, 2015 to October 31, 2015)	1.4	68.77	1.4	1,486
Total	3.5	$71.42	3.5	

[1] In September 2014, our Board of Directors authorized a program to repurchase up to $1,000 of our outstanding common stock, through March 1, 2016. On October 1, 2015, our Board of Directors authorized a program to repurchase up to $1,000 of our outstanding common stock, through March 1, 2017. The actual number, price, manner and timing of future share repurchases, if any, will be subject to market and economic conditions and applicable Commission rules.

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 35 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 1, 2015

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NORDSTROM, INC.
Index to Exhibits

Exhibit		Method of Filing
10.1	Credit Card Program Agreement by and among Nordstrom, Inc., Nordstrom fsb and TD Bank USA, N.A. dated May 25, 2015	Filed herewith electronically
31.1	Certification of Co-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 Co-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
101.INS	XBRL Instance Document	Filed herewith electronically
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith electronically
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith electronically
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document	Filed herewith electronically
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith electronically
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith electronically