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JWN.N - Q3 2021 Nordstrom Inc Earnings Call

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OVERVIEW:

Co. reported 3Q21 net sales decline vs. 3Q19 of 1%. Expects FY21 revenue growth to be more than 35% vs. FY20.

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PRESENTATION

Operator

Greetings and welcome to the Nordstrom Third Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

At this time, I'll turn the call over to Heather Hollander, Head of Investor Relations for Nordstrom. You may begin.

Heather Hollander - *Nordstrom, Inc. - Head of Investor Relations*

Good afternoon and thank you for joining us. Before we begin, I want to mention that we will be referring to slides, which can be viewed in the Investor Relations section on nordstrom.com. Our discussion may include forward-looking statements. So please refer to the slide with our safe harbor language.

Participating in today's call are Erik Nordstrom, Chief Executive Officer; Pete Nordstrom, President and Chief Brand Officer; and Anne Bramman, Chief Financial Officer, who will provide a business update and discuss the company's third quarter performance. And now I'll turn the call over to Erik.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO & Director*

Good afternoon and thank you for joining us. We have long benefited from a commitment to customer service, interconnected digital and physical assets and innovative brand partnerships. However, we need to move faster and more aggressively to better capitalize on those strengths.

While our quarterly results were in line with our stated plans and we are on track to deliver on the financial commitments we made at our Investor Day in February, when we look across the landscape, we need to deliver more. We need to grow market share and deliver greater profitability, and we are acting with a sense of urgency to do so.

We've taken a comprehensive look at opportunities to improve our business, engaging external consultants with function-specific expertise across 3 key areas: improving Nordstrom Rack performance, increasing profitability and optimizing our supply chain and inventory flow. We are not satisfied at all with our Rack business as clearly our recovery is lagging what we think it should be. However, we are encouraged with the clear path to improvement that we see in front of us and have identified clear actions we are taking to improve performance and accelerate profitable growth.

First, Nordstrom Rack has been challenged by low inventory levels in premium brands in key categories such as women's apparel and shoes. Customers are drawn to Nordstrom Rack to purchase premium brands at a terrific price. In fact, 90% of the top brands at Nordstrom are also sold at the Rack. These brands are more highly penetrated in our Rack business than they are at other off-price retailers.

While many retailers are dealing with macro-related supply chain disruptions, Rack faces a unique challenge as off-price procurement of the same top brands we carry at Nordstrom is particularly difficult in an environment with production constraints and lower levels of clearance product. Rack's top 50 brands represented approximately 50% of sales in 2019. Year-to-date, these brands represented only 42% of sales, highlighting the outsized gap in the merchandise availability.

In response, we are undertaking a comprehensive set of actions to increase our inventory levels and improve merchandise flow for the Rack. In particular, we are executing a multilayered plan to both grow our offer of the most coveted brands we carry as well as source from new vendors to ensure we have the selection our customers want.

To minimize supply gaps, we are increasing our opportunistic use of pack and hold inventory, allowing us to buy larger quantities of relevant items when available then hold a portion of it to deploy in periods with high demand, tight supply or system constraints.

Given that we expect macro-related supply chain disruptions to continue into next year, we're strategically evaluating our assortment and increasing our use of pack and hold inventory by a factor of 2 to 3x. We expect that action in these areas will not only yield benefits as we deal with macro-related supply chain disruptions, but also deliver sustainable benefits that will enhance our long-term performance as well. While we are in the early days of these efforts, preliminary results show sales responding positively in Rack stores with improving inventory positions.

Second, our mix has skewed too far to lower prices at the Rack with AURs declining 4% versus 2019. This sharper-than-expected decline results from a couple of factors. First, customers come to the Rack for coveted premium brands at a great value. This is a strength of ours as much of this product is scarce in the off-price channel. However, we haven't had adequate supply of those brands, as I just described.

Next, as we adjusted our assortment over the last year to add more product at lower price points, we found that we went too far in certain categories. We are now rebalancing our assortment to increase the breadth of selection in premium brands, improve average selling price and better align with customer expectations.

Third, we are acting to strengthen Rack's brand awareness and drive traffic. As part of this effort, we launched a new "More Reasons to Rack" marketing campaign in September. We are encouraged by our early consumer research read, which showed a meaningful increase in future purchase intent.

By improving inventory levels, expanding our selection in top brands and increasing awareness and traffic, we expect to grow market share and improve profitability at Nordstrom Rack. With the actions we're taking, we anticipate improvement in Q4 with more significant improvement to follow in the first half of fiscal 2022.

Turning to profitability, we are committed to delivering significant improvement in merchandise margins and EBIT margin across the business. We launched a comprehensive study of the factors driving our merchandise margin and found meaningful opportunities for improvement in pricing, category management and private label brands. Pete will take you through the detailed plans behind those workstreams in a moment.

Within SG&A, we remain focused on managing fixed expenses. In 2020, we rebased our overhead cost structure, and we remain committed to sustaining a substantial portion of that reduction. And while we've seen significant macro-related pressure in fulfillment and labor costs, we're concentrated on mitigating our overall impact from those pressures.

Improving our supply chain and inventory flow is also a priority. In response to macro-related supply chain challenges, we have identified various ways to improve our internal network and processes by diversifying our carrier capacity, gaining better end-to-end visibility of inventory as it moves through our supply chain, increasing velocity and throughput in our distribution and fulfillment centers and better positioning our inventory to get it closer to the customer. We expect that these initiatives will enhance the customer experience and drive topline growth at both Nordstrom and Nordstrom Rack by increasing delivery speed and expanding the selection for in-store shopping as well as same-day and next-day pickup while also driving efficiencies in labor and fulfillment. We expect to see benefits from these actions beginning in the first half of fiscal 2022.

Turning to third quarter performance, we continued to see improvement in our Nordstrom stores, strong digital growth and benefits provided by the interconnected capabilities of our market strategy. Nordstrom banner sales returned to 2019 levels in the third quarter. In the Southern portion of the U.S., where 44% of our stores are located, Nordstrom comparable store sales grew 8% over the third quarter of 2019.

Our geographic footprint has been a source of strength for us historically with stores located in highly desirable real estate in the country's top markets. However, urban areas have been disproportionately impacted by the effects of the pandemic. As a result, our suburban Nordstrom locations outperformed our urban locations by 1,300 basis points in the third quarter.

As discussed at our investor event, winning in our most important markets and increasing our digital velocity are key strategic priorities for us, and we are making progress in these areas. The convenience and connection delivered by our market strategy continues to be a powerful enabler for the business. We are leveraging a strong store fleet that positions us physically closer to the customer and drives value across the business. As a result, we are able to better serve customers and provide greater access to products by linking our assets at the market level.

Our market strategy delivers incredible convenience that provides customers with 4x more product available for next-day pickup, a 1-day reduction in average shipping time and the ability to pick up orders at the Nordstrom, Nordstrom Local or Nordstrom Rack location of their choice. This quarter, 1/3 of next-day Nordstrom.com orders were picked up at Rack stores, showing continued evidence of the power of integrating capabilities across our 2 brands and across our digital and physical platforms.

In our top 20 markets where our market strategy continues to gain traction, order pickup accounted for 12% of digital demand versus 4% in other markets. Since we launched order pickup at the Rack last year, we have seen 70% growth in the program. As we head into the holiday season, we are encouraged to see steady increases in order pickup demand each month, which is evidence that customers are taking advantage of our integrated touch points. This trend is also advantageous because Buy Online, Pick Up In-Store provides our highest satisfaction customer experience, which in turn drives more return visits. It is also our most profitable customer journey.

The value of our interconnected model is evident as customers dramatically increase their spend when engaging across multiple channels, banners and services. For example, the average customer that shops across both banners, in-store and online, spends over 12x more than a customer utilizing a single channel. The quality and convenience of the services we offer such as alterations and personal styling drive connection and engagement, increasing customer spend by a factor of 5 to 7x versus customers who don't utilize those value-added services.

We also continue to increase our digital velocity across Nordstrom and Nordstrom Rack. This quarter, digital sales increased 20% over the third quarter of 2019. Digital sales represented 40% of our business in Q3, and we continue to drive growth over 2019, while store traffic improved sequentially.

Before I turn the call over to Pete, we'd like to express our thanks to our exceptional team, their dedication and efforts in serving our customers and transforming our company to drive our optimism about the future of the business. Nordstrom has a strong foundation and unique competitive differentiators, and we are working diligently to accelerate our strategic transformation and build on our core advantages.

To be clear, we recognize the need to move faster and more aggressively. We are taking decisive steps to improve Rack performance, increase profitability, transform our supply chain and create value for our shareholders. All said, we remain confident in our ability to achieve the top and bottom-line commitments we set forth at our investor event and continue to build capabilities to profitably grow our market share.

With that, I'll turn it over to Pete.

Peter E. Nordstrom - *Nordstrom, Inc. - President, Director & Chief Brand Officer*

Thanks, Erik, and good afternoon, everyone. As Erik said, we've taken a deep look at our business and identified areas of improvement in pricing, category management and private label brands that are expected to drive a better customer experience as well as sales and margin improvements.

Through decades of experience, we've learned that when you make things better for the customer, you make things better for the business overall. I'd like to first discuss these specific areas of opportunity before getting into our category performance and customer trends in the third quarter and, finally, our plans for the fourth quarter.

First, we are using dynamic pricing analytics to optimize our promotional effectiveness and improve the pace and depth of markdowns to move product profitably at the end of each season. We expect to see initial benefits from this work beginning in Q4.

Next, we are working to improve our category management process. We are using a data-driven, customer-centric approach to define the role of each category at Nordstrom and Nordstrom Rack and then optimize our assortment for the role each category plays. We benefit by attracting new customers and expanding engagement and share of wallet with existing customers. We also gain efficiency by focusing on the most productive items, eliminating redundancy and editing out our poor performers as a result.

As we shared during our investor event earlier this year, we also have a meaningful opportunity with our private label business, Nordstrom Product Group. We see the significant value that Nordstrom-made brands represent, delivering expanded options and better value for our customers while also giving us more control over our merchandise selection.

Notably, the gross margins of our private label brands are on average 500 basis points higher than our third-party brand product. We recognize the opportunity and need to accelerate our efforts to increase our private label penetration. We look forward to sharing our progress with you in the coming quarters.

Turning to category performance. This quarter, we continued to see strength in pandemic-related categories, particularly home and active, where our sales increased 95% and 57%, respectively, compared to 2019 levels. Our designer category continues to perform well with a strong double-digit sales increase over '19 led by strength in designer shoes, handbags and designer men's apparel.

We saw signs of travel returning with sunglasses and swimwear posting double-digit increases over 2019. We are also encouraged with the sequential trend improvement in occasion-based categories during the third quarter, a promising signal that customers are beginning to return to social and work events. Dresses, men's suiting and dress shirts, dress shoes and makeup all showed sequential improvement during the third quarter, and we are closing the gap to '19 sales levels.

However, we experienced inventory shortages in the quarter, especially in certain core categories such as women's apparel and shoes where demand came back stronger and faster than we expected. We responded by trying to increase supply as quickly as possible but weren't able to land as much product as we needed in certain core categories and missed an opportunity to capture incremental sales as a result.

We are working to better align inventory levels and customer needs and have pulled inventory receipts forward in anticipation of holiday demand. We are confident that we are in a much improved position for the holiday season, both in terms of quantity and balance of categories.

As we look at customer trends, our Nordy Club loyalty program remains a powerful engagement driver, and we are encouraged by positive trends within the program. Q3 loyalty sales grew 5% versus 2019, and loyalty penetration increased 2 percentage points to 65% of sales. We also saw increases in spend and trips per customer compared to prepandemic levels.

As we look to Q4, we are excited about our plans to continue transforming the business. We are scaling our Nordstrom Media Network, which allows our brand partners to advertise directly to customers on Nordstrom.com and Nordstromrack.com and drive traffic and sales for their brands. Having successfully piloted the platform in Q3, we are expanding it in Q4 and expect to see more meaningful financial benefit in '22.

As we evolve our merchandising approach, our alternative partnership models have gained approximately 3 percentage points of total sales share since 2019 to nearly 8% today. Building on that progress, I'm pleased to announce our new partnership with Fanatics. Nordstrom.com customers will now have access to Fanatics' industry-leading assortment of high-quality licensed sports products. This partnership demonstrates our ability to increase choice count quickly and at scale. With Fanatics, we'll scale to 90,000 new customer choices on Nordstrom.com, an increase of over 20% in our total choice count without a corresponding increase in owned inventory or labor.

We're also excited to advance our partnership with ASOS and offer a broader assortment to better meet the needs of 20-something customers. We launched select ASOS brands on Nordstrom.com and in 2 pilot stores this month. Though we are in the early days, preliminary reads are very promising. We'll expand our in-store ASOS offering with a market rollout launch this spring. Nordstrom stores will be the only physical locations in the world where customers can buy ASOS product, and we are excited about our opportunities to build on this partnership.

As you heard at our investor event in February, we are expanding our choice count to both gain greater wallet share with our existing customers and attract new customers. We entered Q4 with record-high choice count, and we'll continue to significantly expand our selection using customer insights and enhanced analytics to present a curated, relevant assortment.

For the holiday season, we are excited about our plans to use our integrated network of stores and digital platforms to showcase holiday dressing, decor and gift offerings and provide festive experiences and convenient services that make shopping easy and enjoyable for our customers. To drive holiday performance, we're leveraging analytics as well as learnings from our Anniversary Sale, where we combined the art of merchandising with data-driven insights to put the right assortment in the right place at the right time. Through our customer analytics work, we learned that we have a lot of opportunity to expand holiday gifting. And in response, we significantly expanded our gifting assortment and featured gift shops, both in-store and online.

In closing, we're excited to drive sales and delight customers with our compelling holiday offering and the newness and choice count expansion from innovative partnerships with Fanatics and ASOS.

With that, I'll turn it over to Anne to discuss our financial results.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Thanks, Pete. I'd like to begin with a review of our third quarter results then take you through our approach to Q4. Overall, net sales decreased 1% in the quarter compared to the same period in fiscal 2019. The timing shift of the Anniversary Sale, with roughly 1 week falling into the third quarter of 2021, positively impacted third quarter sales by approximately 200 basis points.

Nordstrom banner sales returned to 2019 levels driven by improving store trends, sequential store traffic improvement and increasing spend per customer. Nordstrom Rack sales declined 8% as inventory procurement and flow challenges negatively impacted performance. And as Erik mentioned, the team is taking specific actions to improve Rack's performance and capture market share in the off-price sector.

On the digital front, we continue to serve our customers' desire for online shopping experiences, with strong digital growth even as Nordstrom store traffic and sales continue to recover. For the third quarter, digital sales increased 20% over 2019 and 16% after adjusting for the timing of the Anniversary Sale, reaching $1.4 billion.

Gross profit as a percentage of net sales increased 80 basis points compared with the same period in fiscal 2019 primarily due to leverage in buying and occupancy costs and higher merchandise margins. Ending inventory increased 13% compared with the same period in fiscal 2019. In-transit product represented the majority of our inventory increase in the quarter as we pulled receipts forward to address continuing supply chain backlogs and support the anticipated earlier holiday demand.

Entering the fourth quarter, our inventory is current with new exciting product for the holidays. Looking ahead, we anticipate elevated inventory levels through the end of the fiscal year as we position product to meet customer demand and invest in pack and hold inventory for the Rack.

Total SG&A as a percentage of net sales increased 260 basis points compared to the same period in fiscal 2019 as a result of continued macro-related fulfillment and labor cost pressures, partially offset by continued benefit from resetting the cost structure in 2020.

Now turning to our outlook for the remainder of the year. As you've heard today, we're excited about our plans for the fourth quarter with a great selection of compelling products and experiences to serve holiday demand, both in-store and online. Our outlook for the remainder of the year assumes that economic improvement and increasing mobility will continue to drive consumer spending.

Given third quarter performance in-line with our expectations and plans for continued progress in the fourth quarter, we are reaffirming our guidance for fiscal 2021. We expect revenue growth of more than 35% versus fiscal 2020, and we are still projecting slight sequential topline improvement from Q3 to Q4. We expect to deliver EBIT margin of approximately 3% to 3.5% for the full year.

I'd like to provide a bit of color on our fourth quarter forecast compared to 2019. For the fourth quarter, we are forecasting significant gross margin improvement versus the fourth quarter of 2019, reflecting the benefits of lower promotional activity and higher regular price sell-through this year. We expect that SG&A pressures primarily related to fulfillment and labor costs will continue in Q4, resulting in SG&A deleverage similar to what we experienced this quarter after excluding an impairment charge that we recorded in the fourth quarter of 2019.

Turning now to capital allocation. We remain committed to our ongoing priorities with our first priority being investment in the business. We're planning capital expenditures at normalized levels of 3% to 4% with an emphasis on supporting supply chain and technology capabilities.

Our second priority is reducing our leverage. We are committed to an investment-grade credit rating and remain on track to decrease our leverage ratio to approximately 3x by the end of this year and approximately 2.5x by the end of 2022 through a combination of earnings improvement and debt reduction.

Our third priority is returning cash to shareholders, and we continue to expect to be in a position to do so by the end of the year. As you've heard today, our third quarter results show some pockets of strength as well as several areas for improvement. We made progress toward our goals with strong digital growth and improving trends in our Nordstrom banner stores and remain on track to deliver our fiscal 2021 targets and the commitments we set forth at our investor event: delivering EBIT margins greater than 6% and annual operating cash flow greater than $1 billion.

As Erik said earlier, we recognize that we need to deliver more, and we are acting with a sense of urgency. These medium-term targets are a step on the way to delivering greater profitability and cash flow as we grow share, optimize across platforms and drive scale. We are confident in our path forward and excited about the future of our business.

I'd like to now turn it over to Heather for Q&A.

Heather Hollander - *Nordstrom, Inc. - Head of Investor Relations*

Thank you, Anne. (Operator Instructions) We'll now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Omar Saad with Evercore ISI.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

I'd love for you to dive in deeper on the Rack -- challenges and opportunities in the Rack business. Maybe talk about -- try to weigh it between external factors impacting that business versus merchandising, better merchandising and other things you guys can do internally to improve that business.

And could you also maybe talk about -- you built this great digital platform, omnichannel platform, the market -- local market model. Maybe you could help us understand why all the data and analytics that comes out of that ecosystem isn't helping you to be better at placing the inventory and buying the inventory and getting it where it needs to be -- the right inventory where it needs to be. It's a little bit surprising. It sounds like maybe you didn't have enough premium brands.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO & Director*

Thanks, Omar. This is Erik. With Rack, I mean, certainly, there's external headwinds, but everyone is dealing with those. I'd put it on internally. We have not responded as quickly and as aggressively as we need to. With Rack in particular, it really starts with our source of goods. Our source of goods got disrupted with the pandemic, and it resulted in both just flat-out shortage of inventory.

We've been significantly under inventory plans all year. We've had lots of fallout of our on-order. But it's also resulted in a mix issue, which we talked about in the prepared remarks of not having the quantity of our top premium brands, the brands that are -- our top brands in our Nordstrom banner, which tend to be our higher price point brands in Rack and really is the juice that gets customers excited to come to Rack. These great brands they know at great prices, we haven't had enough of that.

Added to that, we've been, I think, just too slow to adjust to that. And adjustments, which are underway, is both working with these top brands to get the flow of product we need. And oftentimes, that is making commitments a little further in advance. But it's also if there's key categories and price points that our customers are asking for and we can't get it from brand A, we got to go to brand B. So we're working on that.

Another issue, which is related, is our AUR, our average price being down 4%. Not only does that put a lot of pressure on our operations, it just isn't what the customer wants. Again, the customer wants these top premium brands. And so our mix has skewed a little more lower price than our customer wants, and that's put a lot of pressure on our operations as well.

So yes, there's external factors that start a lot of this, but these things are within our control. We have a plan to address these things. We're absolutely determined to get this on the right path and get this fixed, and we will do that.

To your second question, the data from our omni capabilities at the market strategy driving inventory placement, the -- I think from your question -- we've talked about our inventory issues. It has been most pronounced for our Rack banner, and market strategy is much more about our Nordstrom banner than the Rack banner. So the data that we have is helping us in our Nordstrom banner. As we've started to link our Rack stores to market strategy, and it's really been as a pickup point for Nordstrom.com orders, we do have that multichannel data set for customers, which is helpful.

So we are using -- we've been seeing some benefit from it, but we see a lot of benefit coming ahead, both as our sources of goods become a little more stable and more predictable and also as we continue to leverage out our data set and apply analytics to get the quantity and inventory we want and need, our customers want, the content and the location that serves our business best.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Omar, this is Anne. I just wanted to add on that, and Erik talked about some of his opening comments about the Rack business, is we've been flowing through some of the improvements in the inventory and key areas with some of the key brands. We're seeing some early reads on this in the quarter that give us optimism on the progress on this and the momentum going forward. So while still very early, we're actually seeing some positive impact from that.

Operator

Next is Edward Yruma with KeyBanc Capital Markets.

Edward James Yruma - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

I wanted to ask about SG&A. I understand you guys did the repositioning and took out a lot of SG&A last year. And I know there's been some rebuild and some of it's been due to higher cost pressures. But I guess, as you guys think about the medium term, are there incremental layers of SG&A you can remove? Or will leverage really be reliant on just driving higher topline? And then as just a follow-up to that, as you think about Rack repositioning, do you think this is an area where incremental investment from an SG&A perspective is needed?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

I'm going to take the first one on SG&A, and then I can talk a little bit about the Rack piece and then Erik, I think maybe you want to talk a little bit about that as well. So just in general, on the fixed cost expenses, we did take out a significant portion of expenses in 2020. We are actually on track to slightly ahead of our target of the permanent reduction of over $300 million this year, and we believe that will continue to be the short- and medium-term takeout of cost going forward in the structure.

The add-back to SG&A has really been on the -- what I would say our variable cost line. So it's some of the wage pressures that we're seeing in stores as well as our distribution center supply chain and then on top of that, it's really about freight costs and shipping costs. And so we're actively working to offset some of those, not just through topline but really through a number of levers that we've been pulling.

And let me give you a couple of examples or some context around that. As Pete and Erik both talked about, there are a number of levers that we're pulling in our merchandise margin pricing, getting the most profit out of the end-of-season product on the markdown component to its sell-through as well as really looking at private label brands.

In supply chain, we're making a number of improvements that we expect to start seeing some results in 2022, and it's really about improving the processes in our network, really diversifying our carrier capacity, which we're already doing right now, and then gaining really better end-to-end visibility on the inventory to ensure that we have fewer touches as we go through our ecosystem.

We're scaling some of our supply chain investments that we've made on the West Coast. We're reducing a lot of cost around order pickup and getting just general scale in our platforms. Those are all offsets to the variable headwinds that we're seeing in the 2 areas that we've called out. So we're very optimistic about how we're progressing on this.

As you've heard in the opening comments, we've got a lot of work streams underway to get after this and believe that it will not only help us achieve our Investor Day targets but that go beyond that as well as we can think about the long-term future. So Erik, are you going to talk about the investments in SG&A for Rack?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO & Director*

Yes. For Rack, we have our 2 channels. We have a really big digital channel in Rack.com. We've been making investments there. And Rack.com, in particular, is to improve our contribution margin there. We know there's a lot of demand, and there's not much competition for online off-price product there. So we've been making investments there that are paying off, and some of that has been integrating on the back-end. We got Rack.com on our Nordstrom.com platform earlier this year, and we're starting to see the benefits from that.

On the store side, we do think there's opportunity to add stores, to have some store growth. But our short-term focus right now is to get our comp stores going. We see a lot of opportunity there. We know what our issues are. We know how to fix them, but we need to get after that before we invest a lot of money in that channel.

Operator

Next is Dana Telsey with Telsey Advisory Group.

Dana Lauren Telsey - *Telsey Advisory Group LLC - CEO & Chief Research Officer*

As you look at the puts and takes of enhancing the supply chain and optimization, what should we be looking for as the guidepost as we look -- as we move through 2021 into 2022? How do you see this optimization of inventory and being able to get the different elements of supply chain where you want, both for the full line and for the Rack businesses?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

So inventory -- Dana, thanks for the question. As we think through '21 to '22, as I mentioned, we're -- there are a number of things that we measure, not just on the cost side, but also on the time to serve customers, how quickly we can get inventory available for customers and how we can enhance the customer experience as far as getting their purchases as quickly as possible. One of the things we're looking at is really the market strategy and increasing things like order pickup and using our assets in each of the markets to -- in order to enhance that piece to it.

So we're going to continue to talk about that. We're going to continue to optimize that, but also really reducing some of the headwinds we see on the cost side as well. And from the puts and takes, we do expect to get some leverage in our overall platform for supply chain. And we also expect to see improvements going forward on the SG&A piece of that as well.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO & Director*

Yes. Dana, this is Erik. I would just add, we're several years into our market strategy. We scaled it to our top 20 markets, which is 75% of our sales. And I think, as you know, a big part of that is leveraging the product that we have as close to our customers and be able to leverage the product as a market. And we're seeing real good results from that, continue to.

Adding to Rack, our Rack stores is a pickup point for Nordstrom.com orders. We're now seeing 1/3 of our next-day Buy Online, Pick Up In-Store orders being picked up at the Rack. And our market strategy is delivering 4x more selection for next-day pickup to customers. Our average shipping time is -- had a 1-day reduction already. And in our top 20 markets, order pickup is accounting for 12% of our digital demand versus 4% in our other markets.

So the point there is we're seeing a lot of proof points, but those are the type of proof points that you should continue to see as we optimize not only our market strategy, but in particular, optimize our inventory placement.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

And then Dana, I will just finish it up with the conversation on our investments in inventories as we talked about in some of the opening comments. I just want to give a little bit of context. We do believe there's still going to continue to be some headwinds as far as flow of inventory coming in. So we're taking efforts to make sure that we pull forward inventory to ensure that we've got the right product at the right time for our customers. An example of that is for holiday, we did pull forward to Q3 some of the holiday receipts, and we'll expect to do that again for spring receipts as we exit Q4 into Q1.

Additionally, and particularly, in the Rack space, we are investing in pack and hold. We believe (inaudible). So it will be a onetime investment and then hold it through. But it's really making sure we've got great seasonal products that we can pull out for the customers to smooth out that supply chain disruption.

Operator

Next is Oliver Chen with Cowen.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

Regarding Rack and what's happening ahead, how would you contrast this relative to the price store strategy you had earlier? And as you think about pack and hold, which sounds prudent, why is it prudent now versus using this less so in the past? I would also love your thoughts on promo effectiveness. I know you called it out in your prepared remarks, but what are the aspects where you see opportunity? I do think you have a pretty advanced digital analytics platform. So what happened with promo effectiveness and/or where is the lower-hanging fruit?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO & Director*

Yes. Oliver, I'll start with the Rack question, first question there on the price store strategy. Yes, we've -- at the end of the year shared that we saw opportunity to in particular grow share of wallet of customers who are in our Rack stores and buying premium product from us, but going to other off-price retailers for a lower-priced product.

So we did bring and have brought more lower-priced product in over the year. Frankly, we went too far. We brought some lower-priced product in categories that we've heard from customers is not what they're looking for. Now overall, we have seen good performance from our price stores, particularly in customer acquisition, but we also know that the hot stuff is kind of hot everywhere.

So an example I use would be handbags. The $20, $30 handbag market is not our sweet spot, having access to really coveted brands. And brands mean a lot in that category. We should have that in all our stores and we can sell it in all our stores. So it's not -- it's really not surprising to us that we've had to adjust a merchandising strategy that was a new effort. What's been kind of added to the difficulty there was the lack of receiving the premium brand product that we normally have.

So going too much with the price strategy product and not getting the flow that we ordered on the premium brand product compounded the situation to where we ended up having a lower AUR than we should have, which kind of somewhat relate to your question on pack and hold. We've done pack and hold before. In particular, we did quite a bit of it when we were more aggressively opening Rack stores. It really helped us have the right flow of goods for these store openings.

And when we pulled back on our store openings a couple of years ago, we pulled back on pack and hold, which was fine at the time. Our source of goods, particularly from these premium brands that are the same brands that we work with in the full-price channel, they had at-once product. They had short-term product where we could adjust our buys. And that's just gone away during the pandemic. These brands do not have the supply of goods in the short term that we normally have.

And given that and given the disruptions in the supply chain, it seems pretty obvious to us that what we can do to react to that is to have more product that we're packing and holding and -- because we do believe we're going to continue to have some level of these disruptions going into next year, and this pack and hold will really smooth out our inventory flow.

Anne L. Bramman - *Nordstrom, Inc. - CFO*

And Pete, do you want to answer the question on promotion?

Peter E. Nordstrom - *Nordstrom, Inc. - President, Director & Chief Brand Officer*

Yes, sure. So I mean relative to our approach there on how to do a better job with markdowns, I mean, it really feeds into what you've heard us talk about before, and that's a digital, kind of a data-first approach in how we're doing this. And I think what you're going to see from us is more of a surgical effort to leverage that data to make markdowns, both related to timing and depth of markdowns, in a way that maximizes the profitability.

I know that sounds obvious, and we've always done a version of that. But I think taking kind of the extra step to take a more analytical approach to that is something that we think will bear fruit and something we piloted and worked on in the past. But I think we can apply that methodology more broadly, and we believe that there's a lot of goodness that can come from that, that will affect our profitability positively.

Operator

Our last question comes from Mark Altschwager with Baird.

Mark R. Altschwager - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess, first, following up on the Rack investments. As you look to broaden the product availability at Rack, and it sounds like increase in flexibility with brands and price points, are there incremental investments needed in merchant teams or supply chain beyond what's already contemplated in the market strategy? I guess is this just about rebuilding and rebalancing? Or are there some broader changes needed to drive the type of consistent growth you want longer term?

Peter E. Nordstrom - *Nordstrom, Inc. - President, Director & Chief Brand Officer*

Yes. This is Pete. I think the biggest thing with the Rack is everything that happened in the pandemic really affected our model, as we've known it for a lot of years, and Erik mentioned that. Having the great relationships we do with these premium brands has allowed us to be in a good position to be able to do a lot of at-once, just-in-time type of inventory planning.

And what we learned unfortunately through the pandemic is that if you didn't make those buys up front, it was hard to react in a really short time to be able to do that. So I think we've had to learn from that, and we've got to be better at planning that out and making sure we have a more balanced approach to flowing the inventory in. You heard that with pack and hold. That's a mitigating strategy that will be good for us. And the same is true with our own label brands, which there's an application for in the Rack as well.

So I think that we'd rocked along and had done our playbook really well for a long time, and the landscape has changed and evolved. We got to change with it. So it's with a great sense of determination that we're taking this on and urgency, and we expect to start having improvement, well, pretty much right away, and we look forward to better days ahead for sure.

Mark R. Altschwager - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And if I could ask a quick follow-up for Anne. And I think the Analyst Day targets implied a roughly mid-single-digit type of growth trajectory after 2021. Is that a fair baseline to be thinking about as we model out next year? Are there other factors we should be considering?

Anne L. Bramman - *Nordstrom, Inc. - CFO*

Yes. So as you know, we're not really giving 2022 guidance at this stage. What I will say to give a little bit more context to this is that the Investor Day topline particular targets were once we got to 2019 levels. I think in general, when you look at where we are for -- if you look at the range of guidance that we have for the rest of this year, it would certainly -- if you back into the different points to it, it will get you back to pretty close to a flat with '19 topline. And it would also imply that we're getting back to that 6% target that we've also given as -- in our Investor Day goals as well.

So I think if you look at Q4, you look at the progress we're making, it certainly would have implied those medium-term goals and commitments that we made out there. We're well on that path to getting that. And we'll provide you a lot more color and commentary when we have our next earnings call.

Heather Hollander - *Nordstrom, Inc. - Head of Investor Relations*

Okay. We want to thank you for joining today's call. A replay, along with the slide presentation and prepared remarks, will be available for 1 year on our website. Thank you for your interest in Nordstrom.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.
