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PRESENTATION

Operator

Greetings, and welcome to the Nordstrom First Quarter 2023 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

At this time, I'd like to turn the call over to Sara Penner, Manager of Investor Relations for Nordstrom. You may now begin.

Sara Penner - *Nordstrom, Inc. - Manager, Investor Relations*

Good afternoon, and thank you for joining us. Before we begin, I want to mention that we'll 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. As a reminder, we are here today to discuss our business and first quarter performance, and we will not be taking questions on other matters.

Participating in today's call are Erik Nordstrom, Chief Executive Officer; Pete Nordstrom, President and Chief Brand Officer; and Michael Maher, Chief Accounting Officer, who will provide a business update and discuss the company's first quarter performance.

And now I'll turn the call over to Erik.

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

Thank you, Sara. Good afternoon, everyone. For the first quarter, we delivered net sales of $3.1 billion, a loss per share of $1.27 and adjusted earnings per share of $0.07. Adjusted earnings were higher than the first quarter of last year despite lower sales, reflecting the progress we are making against the priorities we laid out at the beginning of the year: improving Nordstrom Rack performance, increasing inventory productivity, and optimizing our supply chain.

As we've seen since June of last year, customer demand continued to be pressured given the current macroeconomic backdrop, which impacted our top line results across both banners. By comparison, the first quarter of 2022 benefited from a strong pent-up demand for a return to occasions as the pandemic receded. As a result, our year-over-year sales comparisons for Q1 were difficult, but those comparisons get progressively easier as we proceed through the year.

Given the uncertain macro environment, we remain focused on executing with agility. Our 3 key priorities position us for improved profitability in 2023 and a return to long-term profitable growth. I'd now like to talk about our progress against those priorities during the first quarter.

Our first priority is to improve the performance of Nordstrom Rack. We're pleased with the progress our teams are making across multiple fronts. Consistent with our customer promise to deliver great brands at great prices, we've increased the penetration of our top-performing strategic brands. As strategic brand penetration increases, we're seeing Rack sales trends improve. April was our best month of the quarter, and we have continued to see trends improve in May.

We also continue to expand our reach and convenience for customers by opening 2 new stores during the quarter, which, together with the 2 stores we opened last year, have performed well so far, with sales productivity exceeding the fleet average. Rack stores are a great investment with returns that exceed our cost of capital and a short payback period. They also represent the largest source of new customers for Nordstrom. We are excited to roll out to more markets as we expand our Rack footprint. We opened 6 more stores in May, and plan to open 13 additional new stores later this year. With an improved assortment and more new stores, we expect Rack performance to sequentially improve throughout 2023.

Moving to our second priority of increasing inventory productivity, we are managing with leaner and more current inventories, improved sell-through and faster churn across most of our categories, resulting in a 110-basis-point increase in our gross profit margin over the first quarter of last year. Overall inventory levels were 8% lower than last year, with non-designer inventory down 11%. Pete will talk more about the performance of our designer business and the actions we're taking to rightsize our designer inventory.

We continue to make significant progress on our third priority, optimizing our supply chain. For the third consecutive quarter, variable supply chain costs fell by over 100 basis points as a rate of sales versus the prior year, helping to mitigate overall SG&A deleverage on lower sales. We are continuing to increase productivity throughout our network, reduce transportation costs and shorten delivery time to customers.

To illustrate our progress, we made double-digit improvements in productivity and throughput in our distribution and fulfillment centers. In addition, we are delivering better service to our customers through faster delivery, with overall delivery speed up 9% from last year. Supply chain is the largest component of our SG&A expenses, and we believe there is more opportunity to improve our efficiency and drive overall expense leverage as sales improve.

I'm also thrilled we added new leaders to help us advance our strategic priorities. We welcome Cathy Smith as our Chief Financial Officer; and Jason Morris as Chief Technology and Information Officer. They will play a critical role as we continue to advance our Closer to You strategy. Cathy has a long track record as CFO with many well-known brands and brings deep expertise in retail. I look forward to having her join our next earnings call. In addition, we welcomed Atticus Tysen and Eric Sprunk to our Board of Directors this year. Together, they bring a wealth of expertise in retail, including in technology, cybersecurity and operational excellence.

In summary, we are delivering on our priorities to improve profitability against what remains an uncertain macro environment. We believe continued focus and execution will drive incremental improvement over the balance of the year and will position us well to create long-term shareholder value. We look forward to sharing our continued progress in the quarters ahead.

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

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

Thanks, and good afternoon, everyone. Erik discussed the progress we're making against our key priorities. So I'll focus my remarks on our category performance and our approach to agile inventory management.

Starting with category performance. Most categories had tough comparisons to last year's strong double-digit increases from pent-up demand coming out of the pandemic. Still, this quarter, both Men's and Women's Active apparel and sneakers performed well. Beauty and Men's Apparel performed better than average, with men's dresswear continuing to be strong.

Within Active, customers responded well to our fresh offerings from powerhouse brand partners like Nike, as well as newer brands like Vuori, On and HOKA. Our ability to partner with up-and-coming brands and scale them highlights the important role we play in helping customers discover new and exciting products. Designer was our toughest category, continuing the trend we saw last quarter.

Moving to inventory management. Our focus on improving inventory productivity helped us deliver more than 100 basis points of gross profit margin improvement in the first quarter.

During our Q2 earnings call last August, we talked about our work to rightsize inventory in 4 areas: first, unproductive regular priced merchandise primarily in the Nordstrom banner, which require deeper markdowns to clear through the back half of the year; second, our private brands product, which had soft performance last year; third, lower price point items at Nordstrom Rack, which did not resonate with our customer; and fourth, designer, where trends decelerated after exceptionally strong growth during the pandemic.

We took additional markdowns in the second half of '22 as we prioritized finishing the year with leaner and healthier inventory levels. In '23, we are managing with conservative plans and targeting faster turns. At the Rack banner, we've increased the penetration of strategic brands, which had strong sell-through during the first quarter and are contributing to our faster inventory turn. At both banners, we're encouraged to see improved performance in our private brands product, which contributed meaningfully to sales in men's dresswear and was also the #1 volume driver at Nordstrom Rack.

As a result of these efforts, we are now well positioned in 3 of the 4 areas of excess inventory we discussed last year, and we are actively working to address designer.

Designer has a longer buying cycle and takes more time to clear excess product. The category had a strong run up during the pandemic, and we're now seeing demand normalize. We are working to rightsize our designer inventory, which will include incremental markdowns over the balance of this year. The potential impact is already reflected in our financial outlook for the year. It's important to note that designer sales in Q1 remained above pre-pandemic levels. Overall, the category continues to be a strong contributor to our core offering and a key differentiator to our unique breadth of selection.

In addition to managing our merchandise mix with greater precision across our banners, we are also enhancing our capabilities to manage inventory with higher accuracy at the unit level through investments in RFID and the shift to cost accounting for internal merchandising. We completed the internal shift to cost accounting in Q1 and began to launch RFID. These capabilities will improve our ability to buy, allocate and track merchandise across our network, provide us greater visibility into profitability at the unit level, increase efficiency and reduce shrinkage.

Looking forward, we are excited to serve our customers during our upcoming Anniversary Sale. Our event offers a uniquely curated and diverse assortment of new products from our best brands that will inspire customers across all categories and occasions. This year, we are enhancing our Anniversary experience based on customer feedback, providing more ways to participate and delivering the right product while also driving higher profitability. We are focused on engaging and rewarding our best customers through targeted in-store and digital experiences, and our print catalog is backed by popular demand. We have optimized our inventory mix to include more product from the most highly coveted brands, including some exciting new first-time brands. We are excited about our approach to Anniversary, which is highly anticipated by our customers and has an outsized impact on our second quarter and fiscal year results.

In closing, we're encouraged to see the early results of the disciplined execution of our operational priorities. We're delivering a better customer experience and improving financial outcomes through these ongoing efforts.

I'll now turn it back over to Erik to say a few words before Michael discusses our financial results.

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

Before I turn it over to Michael, I would like to thank him, not only for serving as a great partner in his expanded role as interim CFO during this important transition, but also for his dedication to our customers, our employees and our shareholders. Michael, you have made significant contributions to our business over the past 13 years, including guiding many strategic initiatives during and after the pandemic, and you have been an integral part in building an outstanding finance organization. Many of you know Michael, and I know you would agree that not only is he an outstanding finance executive and a tremendous leader, I'll tell you he's an even better person. Thank you for your leadership over the years. We wish you all the best in your next chapter.

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Thanks, Erik. It's been a privilege to be part of such a great organization. I'll talk now about our first quarter results and then discuss our outlook for the remainder of 2023.

For the first quarter, we reported a loss per share of $1.27. After excluding the charges from the wind-down of Canadian operations, adjusted earnings per share was $0.07 compared to an adjusted loss per share of $0.06 in the prior year. Net sales as well as gross merchandise value, or GMV, decreased 12% in Q1. Net sales included a negative impact of 175 basis points from the wind-down of Canadian operations. During the quarter, sales trends softened in March, but recovered in April, with the most pronounced improvement at Rack.

Nordstrom banner sales decreased 11% and GMV decreased 12% versus last year. The wind-down of Canadian operations had a negative impact on Nordstrom banner net sales of 270 basis points.

Nordstrom Rack sales decreased 12%, with approximately 600 basis points of this decline attributable to the elimination of store fulfillment of Rack digital orders starting in the third quarter of 2022.

Digital sales decreased 17% in the first quarter, including an estimated 800-basis-point negative impact from eliminating store fulfillment of Rack digital orders in the third quarter of 2022 and sunsetting Trunk Club earlier in 2022.

Gross profit as a percentage of net sales increased 110 basis points, reflecting our focus on improving inventory productivity. Ending inventory decreased 8% versus last year compared to a 12% decrease in sales. Inventory levels for categories outside of designer are in line with our sales trend. We remain committed to a disciplined approach to inventory management with a goal of improving turns by at least 10% this year.

Total SG&A as a percentage of net sales increased 240 basis points in the first quarter. Half of the increase was due to the comparison to one-time items in the first quarter of last year, with the remainder driven by deleverage from lower sales. Our ongoing initiatives to improve our supply chain delivered improvements in variable costs which helped to partially offset the deleverage impact. This marks the third consecutive quarter where we've delivered at least 100 basis points of improvement in our variable costs as a percentage of sales reflecting our team's focus on improving the efficiency of our operations. We are pleased with the momentum in our supply chain initiatives and expect additional benefits from these efforts throughout the year.

The wind-down of our Canadian operations is on track with all stores expected to be closed by the end of June. We recorded $309 million in pretax expenses related to the wind-down in the first quarter, toward the low end of our previous estimate range of $300 million to $350 million.

EBIT margin was negative 8.5% for the first quarter. After excluding the charges from the wind-down of Canadian operations this year, adjusted EBIT margin was positive 1.6% versus an adjusted EBIT margin of 0.9% in the first quarter of last year. Adjusted EBIT increased $18 million over last year despite $403 million lower sales, reflecting progress on our profit improvement initiatives.

We continue to maintain a solid balance sheet and financial position, ending the first quarter with $1.4 billion in available liquidity, including the full $800 million available on our revolving line of credit.

Turning to our outlook for the remainder of 2023, I'll first cover the backdrop and related assumptions underlying our guidance. We expect elevated inflation and interest rates will continue to pressure consumer spending throughout the year. We also expect to make continued progress on our key priorities, which will help improve our profitability and mitigate inflationary cost pressures.

Taking these factors into consideration, we are reaffirming our outlook for revenue, adjusted EBIT and adjusted earnings per share. We are updating our outlook to reflect the charge related to the wind-down of Canadian operations and related tax impacts.

I'll highlight a few factors that shape our outlook in the first and second half of the year for revenue and EBIT margin, starting with revenue. We continue to expect revenue to decline 4% to 6% versus 2022. This outlook includes an approximately 2.5 percentage point negative impact from the wind-down of our Canadian operations, which delivered sales of approximately $400 million in 2022. It also includes an approximately 1.3 percentage point positive impact from the 53rd week in fiscal 2023, which we expect will add approximately $200 million in sales to the fourth quarter.

Year-over-year sales comparisons will be more difficult in the first half against our stronger first half in 2022, with more favorable comparisons expected in the second half.

We expect sequential improvements in our business in the second quarter and building into the second half, especially in the Rack as our merchandise assortment continues to improve and we open new stores. We will also lap the impact of discontinuing Rack store fulfillment of online orders beginning in the third quarter.

As a reminder, one week of the Anniversary Sale will shift from the second quarter into the third quarter this year. This will negatively impact second quarter sales and positively impact third quarter sales by approximately 200 basis points.

As a result of these factors, we expect a slight sequential improvement in our top line trend in the second quarter, resulting in a low double-digit decrease in total revenue for the first half, followed by a low single-digit percentage increase in the second half versus the prior year.

Turning to EBIT. We remain on track to deliver on our previous outlook for an adjusted EBIT margin of approximately 3.7% to 4.2% for the full year versus 3.3% in 2022. Our forecast assumes that adjusted EBIT margin expansion will be driven primarily by gross margin improvements from our focus on inventory productivity, especially in the second half of the year when compared to the elevated markdowns we took in 2022. We do not expect gross profit margin expansion in the second quarter as we will lap our best gross profit margin of 2022, which was approximately 200 basis points higher than the second half of the year.

We expect SG&A expenses will continue to deleverage in the second quarter on lower sales, partially mitigated by continued progress on our supply chain optimization efforts. We expect more favorable SG&A expense rate comparisons in the second half of the year as sales trends improve.

Given these revenue, gross margin and expense assumptions, we continue to expect adjusted EBIT margin to decrease slightly in the first half of the year and to increase in the second half of the year relative to 2022.

We are also reaffirming our outlook for adjusted EPS for the full year. On a GAAP basis, we updated estimates for the Canadian wind-down charges and related tax impact. Our revised GAAP earnings per share outlook is now $0.60 to $1 for the full year. Excluding the impact of these charges, we continue to expect adjusted earnings per share of $1.80 to $2.20 for the full year. Our EPS projections exclude the impact of share repurchases, if any.

Shifting to capital allocation, our priorities remain unchanged. Our first priority, as always, is investing in the business to better serve our customers and support long-term growth. We continue to plan for capital expenditures of 3% to 4% of net sales.

Our second priority is reducing our leverage. We remain committed to an investment-grade credit rating through a combination of earnings improvement and debt reduction. We continue to target a leverage ratio below 2.5x.

Our third priority is returning cash to shareholders. Earlier this month, our Board of Directors declared a quarterly cash dividend of $0.19 per share. We repurchased a very small number of shares during the first quarter. We will continue to take a measured approach to share repurchases as we also take into account the macroeconomic environment and market conditions.

As you've heard from our call today, we continue to execute with agility given uncertainty in the macroeconomic environment. We are making progress in our focus areas, which will continue to drive greater profitability through improving the performance of Rack, increasing inventory productivity and optimizing our supply chain initiatives. We are confident in our ability to navigate through the near-term challenges and remain excited about the future of Nordstrom and our ability to deliver significant shareholder value over time.

With that, we're ready for questions.

Sara Penner - *Nordstrom, Inc. - Manager, Investor Relations*

Thank you, Michael. Before we get started with Q&A, we ask that participants please limit themselves to one question and one follow-up. We'll now move to the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Ed Yruma with Piper Sandler.

Edward James Yruma - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

I guess, first, a housekeeping question. On the 110 basis points in gross margin improvement, what would that look like if you had stripped Canada out of the comparison? And then just kind of a bigger picture question on the softness in designer, is this driven by a higher-end consumer that's weakening? Or is it a trade-up consumer that maybe during the pandemic bought designer and is maybe normalizing now?

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Ed, it's Michael. I'll take the housekeeping question first and let Pete dive in on designer. So the gross margin expansion is really primarily about the U.S. Our -- the Canada impact is mostly on buying and occupancy costs. It's about 20 basis points or so. And so the vast majority of that improvement is from merchandise margin expansion.

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

Yes, it's Pete. Relative to the designer subject, I think we would categorize it more like normalizing. As you know, there was a big run up over the last few years in the designer business and a lot of that was just with more people, new customers in that space than had been in there previously. I think particularly when you look at more of the entry price points of where we participate in designer, that's where we saw, and particularly around items and what have you, we saw quite a bit of growth that has kind of normalized.

And so it's important that we mention that relative to where we were pre-pandemic, it's ahead of that. It's still a very big robust part of it, but it is off its peak of what was in the last couple of years during the pandemic time.

Operator

Our next question is from Ashley Helgans with Jefferies.

Ashley Elizabeth Helgans - *Jefferies LLC, Research Division - Equity Analyst*

Kind of a follow-up to Ed's question. Just anything you can tell us broadly on the high-end consumer. And then your thoughts around the promotional environment overall?

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

Yes. With the high-end customer, I guess we would say they're pretty resilient, but they're also cautious. And we're seeing that really across the board, that caution. So we've been really well served to have conservative sales plans and inventory plans so that we have the ability to flow through and sell through. And the good news is that for 1 quarter, we've got momentum and progress on that front. And our plans going forward bodes well, I think, for our ability to continue to improve. I'm sorry, the second question was what? On promotional environment.

Ashley Elizabeth Helgans - *Jefferies LLC, Research Division - Equity Analyst*

Is any color you can give us there, yes.

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

Yes. So on the promotional environment, the most telling sign of that is just inventory position that our competitors are in. We tend to respond to what's happening around us in terms of price. And you've seen, I think, with -- at least as we've been paying attention to the different companies reporting, it seems like almost everyone is down in their year-over-year inventory level. So I think that probably bodes pretty well for the promotional pressures we might find. But again, it's early days. We'll see how this all plays out. We're anticipating, use that normalized word again, but that we've kind of reached a more expected level, more predictability around where the price promotion is going to come, and we're prepared for that.

Operator

Our next question is from Chuck Grom with Gordon Haskett.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

I'm just curious within both banners, any changes in basket composition or basket size since last quarter, are you seeing any incremental trade down at the Rack over the past couple of months? And maybe that helped the business since April?

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

Chuck, this is Erik. Really not seeing signs of trade down. Traffic remains fairly soft. Our spend per trip is up. It -- if it comparisons to last year, last year's first quarter was unusual on several dimensions. One was we had a lot more clearance business last year. So part of what we're seeing is a bigger percentage of our sales is being done at regular price, which helps that spend per trip.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Okay. Great. And then my follow-up would be on Anniversary, you talked about bringing back catalog. Any other changes that you guys are bringing back this year to help the business?

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

This is Pete. What we do is we try to iterate on learnings every year and find ways where we can make improvements. I think what we've learned over the years is that it's important to keep in mind, this is a scarcity event based on new product coming in, and when we can create a compelling reason for people to come in and buy something new that, that always works well for us.

And then it's really tapping into our existing loyal customer base. There's a lot of anticipation for this event, it's a unique event. We have a lot of loyalty around that. And so our communications with customers is important. That's why you've seen us with the print catalog, doing more of that, because that's probably the #1 thing we heard from customers that they wanted more of.

Operator

Our next question is from Brooke Roach with Goldman Sachs.

Brooke Siler Roach - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Can you contextualize with a little bit more detail, the recent improvement that you are seeing at Nordstrom Rack, how much of a sequential improvement in trend did you see at quarter end? And were there any particular categories driving the growth? Was it new consumers coming into the brand or higher spend among your existing customers? Any additional detail would be helpful.

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

Brooke, I'll start and others can fill in. What we mostly see, cause and effect, is as we increase our percentage of strategic brands to our overall inventory mix, our business continues to get better. That happened throughout the quarter. April was our best month of the quarter, and that has continued into May. But we have a ways to go. We're not there yet, but we're laser-focused on that subject in particular.

And I just bring you back to what we know about our customers at the Rack and where we really compete well is having great brands at great prices. And great brands for the most part are brands that they see in our Nordstrom banner. And again, we're seeing good traction on that. So I wouldn't point to any categories in particular that stood out. It's fairly across the board where we get those great brands and higher penetration, we're seeing good traction.

Operator

Our next question is from Noah Zatzkin with KeyBanc.

Ashley Anne Owens - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Ashley on for Noah. Just one for me on Anniversary. Given the tighter buying you guys have called out this year, has anything changed in terms of your planned approach?

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

Well, our approach is the same. What we try to do is give customers a compelling reason to buy something new. It's why we talk about new brands. That's why the sale is really different. It's about new products. It's not about old clearance products. And customers clearly like to see their favorite brands, but that's when we partner with the different brand partners that we have to see how we can bring some newness in around the stuff that they also expect. So it's a pretty collaborative effort. It's really a year-round effort. We plan this thing out. I mean literally once the sale starts, stops I mean, we start planning the next year, and we buy it a solid 6 to 8 months out.

Operator

Our next question is from Matthew Boss with JPMorgan.

Matthew Robert Boss - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

Great. So 2 questions. Could you speak to the cadence of sales as the quarter progressed at full line? And then here in May, what you're seeing? Maybe just elaborate on the change in category trends that you cited between active or casual relative to dressy and occasion wear? And then, Michael, on gross margin, could you just expand on the inventory productivity initiative that was a key driver of gross margin in the first quarter? And then how best to think about the duration of those initiatives as we think about the balance of the year?

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Yes, Matt, I can take both of those. So first of all, on the cadence of sales during the quarter. Directionally, it was consistent in that we started off with a decent February. We saw softness in March in both banners. And we saw a pretty meaningful recovery in April. As Erik said, April was our best month. We saw improvement in both banners and most pronounced at the Rack. We've seen continued sequential improvement in May also, again, both banners, but more pronounced at Rack. I wouldn't say huge differences in terms of category mix across that time. So it was more or less kind of the tide that lifted or lowered the boats as we went through.

As far as gross margins, so we talked about one of our big key priorities this year around inventory productivity was first and foremost, starting the year with cleaner and more current inventories and we did that. As you'll recall, we took some meaningful excess markdowns in the third and fourth quarters of last year to get ourselves in a cleaner and healthier position. And that just put us in a better position to start the quarter.

Secondly, we're managing with conservative sales plans as we go through the year, and that includes use of reserves and other measures to hold back some of our buying until we get closer into season. And then we're targeting faster turns. We've set a target for ourselves of a 10% increase in turn for the year.

And so just collectively, what that means is that we're operating on leaner inventory levels, more current inventory levels, with less to markdown, less susceptible to shrink, and you just get better margins and better productivity out of that. We would expect, as we hold to those disciplines throughout the year, that those benefits should continue.

But as you look at the year-over-year comparisons, where we have the biggest opportunity for improvement over last year is the second half because, again, that's when we took really elevated levels of markdowns last year. And if we can just get back to something more in keeping with sort of historical trend, we've got a lot of upside in the second half of the year.

Operator

Our next question is from Dana Telsey with Telsey Advisory Group.

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

Just wanted to follow up on you mentioned about the penetration of strategic brands was increasing at Rack. Where are you relative to where you were, where you want to be and what benefit to margin does come from that? And the other thing you mentioned in terms of brands and margin is the expansion of the private brand performance. Where is that? Where is it going? And how do you see the margin impact there, too?

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

Dana, I'll take the first part. Pete can take the private brand question. We're still somewhat early innings on the strategic brands. And to Michael's point he's made of starting the year clean, that put us in a position to be more aggressive and get after the strategic brands. And again, we're seeing good traction there.

Just for context, it's a means to an end. It's a way of driving profitable sales. We get higher sell-through in the strategic brands, so it does drive top line, but also is more sell-through at regular price. We do get higher margins from the increased penetration of these strategic brands. So exactly what those brands are can and should evolve as we move through the year and customers respond differently. So we need to stay nimble, which is even more important.

But I think the -- what Michael pointed out of having -- starting the year clean and having dollars available and planning for faster turns, I think that is most impactful on our Rack business. To be opportunistic, to be aggressive of what's available out there in the off-price market and be able to really see the brands that are most resonating with our customers is super important. So we expect to continue to have improvement. We expect continued sequential improvement in Rack performance as we go through the year, again, because we still see upside on that strategic brand initiative.

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

Yes, it's Pete. With the private brands, and you've heard us talk about this a bit. I mean we had poor performance in '21 and '22. We took a lot of efforts to clean up all inventory that was not working for us at the end of '22, and that's put us in a good position in '23 and going forward. Now with private brands, the lead times are a lot longer. We're designing it and producing it and bringing it in, what have you. And that just takes more time. So it's not a switch we can flip all at once.

I can tell you that, for example, in the Rack division, private brands was the #1 volume brand for us was the Nordstrom brand, which is very encouraging. In terms of the Nordstrom banner, we've got some green shoots around some of the new product that's been coming in, and we expect to see incremental improvement throughout this year. And hopefully, as we get into next year, you'll start seeing some more outsized growth improvement. It's a big area of opportunity for us, and we are counting on sizable improvements over the next couple of years in our private brands.

Operator

Our next question is from Alex Straton with Morgan Stanley.

Alexandra Ann Straton - *Morgan Stanley, Research Division - Research Associate*

I've got 2 for you. First, it sounds like some of the supply chain initiatives are certainly shining through in SG&A. So can you just give some examples of the success there and how you're thinking about it going forward? And then second, just the reiterated profitability guide on the back of the first quarter beat, seems to imply you've got a more conservative 2Q onwards outlook. Can you just walk us through what's driving that? Is it gross margin, SG&A? Or how do we think about that?

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Alex, it's Michael. Yes, I'll take those. First of all, on supply chain. I'll just give you a couple of examples there. So we started talking about this last year as well, and we just continue to kind of build on all of them in different areas. But there's unit flow, optimizing that with better inbound processes. There's velocity and throughput in the centers, we improved that by over 20% with better scheduling and training. There's click to delivery speed, getting the number of orders under 4 days, for example, that's up over 40% from last year.

So we just continue to see a lot of opportunities across productivity and efficiency in our network, return transportation efficiencies, scaling our West Coast omnichannel center. As you heard Erik say, it's our largest component of SG&A, and there's a lot of opportunity there, and we're really pleased with how much progress we've made, but we think there's still more to come. Now we will start lapping the third quarter of last year when we really started to see that reach critical mass. So the year-over-year improvement will not be quite as robust then, but we do believe there's continued opportunity.

As far as the guidance and holding that for the year, yes, we were pleased with the first quarter performance on our profitability. But for context, it's a small quarter. Anniversary is a big driver in Q2. And of course, then there's the holidays in Q4, and it remains an uncertain environment. So while we're happy with the way we're starting off Q2, it remains early days in the year.

Operator

Our next question is from Simeon Siegel with BMO Capital Markets.

Simeon Avram Siegel - *BMO Capital Markets Equity Research - MD and Senior Retail & Services Analyst*

Is there any way to characterize what percent of the increased penetration of strategic brands at Rack came from buys specifically for Rack versus maybe product that came from the full-price banner? And then can you just maybe elaborate a little bit on the GMV versus revenues? I know the GMV is, I think, trending slightly below revenues. So just how to think about that as initiative given the context before?

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

Okay. I'll take the Rack. It's mostly product we're buying for the Rack. As we entered the year in a clean inventory position, so we haven't had a lot of cleanup to do in the Nordstrom banner of transferring goods for the Rack. So it's mostly been our dedicated Rack buying team focusing on these strategic brands.

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Yes, Simeon, this is Michael. As far as the sales versus GMV dynamics, as you indicated, GMV is slightly below sales performance. The designer is a category where we are more likely to have concession-type models and unowned inventory models where the volume, the totality of the volume will show up in GMV and only the commission revenue, if you will, will show up in sales. So to the extent the designer has softened recently, that's going to play out in that dynamic.

Operator

Our next question is from Lorraine Hutchinson with Bank of America.

Lorraine Corrine Maikis Hutchinson - *BofA Securities, Research Division - MD in Equity Research*

It sounds like your outlook for improvement through the year at Rack includes better product and the benefit of new stores. How are you thinking about full line progression through the year if we exclude some of the timing shifts around the Anniversary Sale and the Canadian exit? And then what are the key drivers to improving full-line sales this year?

Michael W. Maher - *Nordstrom, Inc. - Senior VP & CAO*

Lorraine, it's Michael. I can talk a little bit about the assumptions and Erik, or Pete can talk about just some of the things we got going on in our Nordstrom banner. So yes, we do expect sequential improvement. As you indicated, we'll continue to see the Canada impact of roughly 250 basis points every quarter weigh on us there. You'll see some timing shift between Q2 and Q3 around Anniversary.

But other than that, I think we would just expect kind of continued sequential improvement in the business. And part of that is also a reflection of, again, last year's comparisons. We had a much tougher second half of the year in 2022. So those comparisons will be easier. We did have some excess inventories to clean up there as well, but -- and that negatively impacted our business. So you should see that come through in terms of the Nordstrom performance as well.

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

Yes. When I call out in the Nordstrom banner, first of all stores continue to recover from the pandemic. And there's -- as we talked about previously, there's been some geographic difference that we had during the pandemic, more urban stores, in particular, being slower to recover. So we're seeing that recovery in stores being much more across the board at Nordstrom banner and for that to continue.

Digitally, we continue to look for ways to bring more selection to our customers and that especially through alternative inventory models, drop-ship being one, having ways of bringing selection to our customers from the brands that they really love and finding different ways to work with our partners to do that. And then connecting all that is the omnichannel capabilities we've been investing in for a number of years. We're continuing to see a lot of goodness come from that, and that's goodness in both sales, but that's also a goodness in engagement, customer engagement, things like taking returns more convenient, with stylists and having digital capability for our stylists to connect with customers without them coming into the store. Things like alterations capabilities, being able to do a Buy Online, Pick Up In-Store of a nordstrom.com order in a Rack store, things like that, that are fairly unique or mature for us. We continue to see a lot of opportunities and get feedback from Nordstrom banner customers, in particular, that those capabilities are really resonating with them.

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

I'm going to pile on here, it's Pete. The one thing that we probably don't talk about enough on these calls is the way the customer service impacts our business. And that is most played out really in the physical store environment. It matters everywhere, but it really is a sharp focus that happens there in stores.

And we've spent a lot of time in our different stores across the country over the last several months, and it's very heartening for us to see the spirit is alive and well in terms of people feeling that accountability, that ownership and that empowerment to take care of the customer in front of them. And as we have more coming in the door these days, I think it gives a lot of momentum and purpose and intention to what we're doing there. So I just want to give a shout out to our teams in the stores. They're doing a really nice job. And you can see the way customers appreciate that. And it is no doubt that it pays dividends in our business results.

Operator

Our last question comes from Janet Kloppenburg with JJK.

Janet Joseph Kloppenburg - *JJK Research Associates, Inc. - President*

I just wondered on the Rack, where you think you are in terms of planned content improvement, I've noticed the change and the elevation. And I'm wondering if the outlook is for the content to further improve and if that means that higher price points will come to the Rack as you bring in more elevated products? And on the designer matrix at the full-line stores, I'm just wondering where you are in that improvement. Do you understand what designers you want to have, when will you achieve the right balance and mix of designers? And when do you expect that the clearance of the problematic designer product will be behind you?

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

Yes, this is Pete. I wish I had a perfect answer for all that but it's a little bit the crystal ball of retailing. I'll start with the Rack part of it. We've been on this journey to really transform our business there and be very focused about our strategy. So -- but I'd still say it's relatively early innings. And we've known what we wanted to do, but it's hard to flip the switch all once there as well. We've got the green shoots. We've got the momentum. We know we've got a proof of concept that's worth continuing to invest in. And what we would hope to be able to do here is to fill you in our progress every quarter and how that's going, and we fully expect that, that will continue to improve for us.

So I guess we view that as early innings that we've got more to accomplish there. Erik mentioned it in terms of our strategic brand penetration, what have you. It's pretty good. It needs to be better, and it will be. And we'll keep you informed as, again, what he said is, this is all the means to an end, and that's how to improve sales and productivity in the stores.

Related to designer, what works and what doesn't work. Again, that's just the fickle nature of fashion to some degree. I mean, we're lucky that we've got a relationship with all of the biggest designer brands and we have access to a lot of it. We have to partner with them to figure out the best, most effective distribution strategies but I hope you get the impression, it's an important part -- foundational part of our end-to-end offer that has kind of a unique breadth to it.

We have a lot of customers that want the best the world has to offer, and we take that responsibility seriously and working with our brand partners to deliver. So we think designer is going to continue to be an important part of our future. We need the remainder of this year to clean up the relatively unproductive inventory. Michael talked about that. That is all contemplated and baked into the forecast that we have. But we continue on and we, again, have a lot of confidence that designer will continue to be an important part of our mix.

Sara Penner - *Nordstrom, Inc. - Manager, Investor Relations*

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 conference. You may disconnect your lines at this time, and we thank you for your participation.