THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

JWN - Q1 2020 Nordstrom Inc Earnings Call

EVENT DATE/TIME: MAY 28, 2020 / 8:45PM GMT

OVERVIEW:

Co. reported 1Q20 loss per share of $3.33.

THOMSON REUTERS

CORPORATE PARTICIPANTS

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

Erik B. Nordstrom *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

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

Trina Schurman *Nordstrom, Inc. - Director of IR*

CONFERENCE CALL PARTICIPANTS

Alexandra E. Walvis *Goldman Sachs Group Inc., Research Division - Research Analyst*

Damon Joseph Polistina *Deutsche Bank AG, Research Division - Research Associate*

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

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

Jay Daniel Sole *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

Kimberly Conroy Greenberger *Morgan Stanley, Research Division - MD*

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

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

Tracy Jill Kogan *Citigroup Inc, Research Division - VP*

Sarah Goldberg *Baird*

PRESENTATION

Operator

Greetings, and welcome to the Nordstrom First Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. At this time, I'll turn the call over to Trina Schurman, Director of Investor Relations for Nordstrom. You may begin.

Trina Schurman - *Nordstrom, Inc. - Director of IR*

Good afternoon, and thank you for joining us. Today's earnings call will last 45 minutes and will include approximately 30 minutes for your questions.

Before we begin, I want to mention that we'll be referring to slides, which can be viewed by going to the Investor Relations section on nordstrom.com.

Our discussion may include forward-looking statements so please refer to the slide showing our safe harbor language.

Participating in today's call are Erik Nordstrom, Chief Executive Officer; and Anne Bramman, Chief Financial Officer, who will provide a business update and discuss the company's first quarter performance for 2020. Joining during the Q&A session will be Pete Nordstrom, President of Nordstrom, Inc. and Chief Brand Officer.

With that, I'll turn the call over to Erik.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Good afternoon, and thank you for joining us today. On behalf of everyone at Nordstrom, our hearts continue to go out to all those impacted by COVID-19. The past several months have been unlike anything we've ever experienced, and we've been working hard to continue to show up in a meaningful way for our customers, employees, shareholders and communities.

With health and safety as our top priority, we temporarily closed our stores on March 17 to do our part to help limit the spread of the virus. Prior to the closures, we saw strong momentum from the second half of 2019 continue into February with positive sales growth. These closures had a meaningful impact on our financial results as stores made up 2/3 of sales in 2019. In our e-commerce business, sales grew 5% and reached more than $1 billion for the first quarter. Online demand trends were consistent with the second half of 2019. While our stores were temporarily closed, our e-commerce business had more than 50% growth in customers who are new to Nordstrom.

We successfully strengthened our financial flexibility through early actions to increase liquidity and reduce our cash burn, which Anne will discuss further. With inventory as our biggest lever of flexibility, we have reduced receipts by 30% during the first quarter, generated customer demand through increased marketing and promotions and utilized our fulfillment capabilities to clear inventory held in our stores. These actions decreased inventory levels by more than 25% from last year, putting us in a favorable position to bring in newness starting in June. As we expect a heavy promotional retail environment through July, we shifted our one-of-a-kind anniversary event to August 19 to give customers the best experience. Early access for Nordstrom card members will begin August 4 through August 13, depending on their Nordy Club status. This unique event will feature new arrivals at reduced prices for a limited time.

In Off-Price, we canceled receipts beginning in March through the second quarter, allowing us to take advantage of closeouts in the marketplace this fall. Additionally, we can leverage our Off-Price business, which makes up 1/3 of sales to help clear excess Full-Price inventory.

To sum up the quarter, we increased our liquidity through proactive steps to shore up financing and reduce our cash burn. The significant reduction in our inventory levels enhances our financial flexibility and enables us to provide customers with a relevant merchandise offering across price points, brands and key items. We're confident that we have sufficient liquidity to execute our strategy in 2020 and over the long term.

We believe these unprecedented times are only accelerating the changes that were already well underway with our customers, including how they want to engage with digital and physical experiences. The flexibility of our business model allows us to stay ahead of these changes as we serve customers through our 2 distinct brands, Nordstrom and Nordstrom Rack across stores and online. We see tremendous synergies from this model. When customers shop across more than one of these touch points, their spend increases 4 to 11x on average. Additionally, our Off-Price business continues to be our greatest source of new customers, and nearly 30% of Off-Price customers cross-shop at Full-Price.

Our unique mix of assets is a competitive advantage. In 2019, Off-Price and e-commerce accounted for nearly 60% of sales, and our U.S. mall-based full-line stores accounted for 38%, while contributing positive cash flows. As we anticipate an acceleration of these longer-term customer trends, we're taking proactive steps to move faster in executing our strategic plans, including optimizing the mix of our digital and physical assets. We're permanently closing 16 full-line stores and 3 Jeffrey specialty boutiques. In assessing customer needs, most of the impacted stores are in markets that have multiple full-line stores and are more than 20 years old. We're also accelerating the integration of our Trunk Club business into a cohesive Nordstrom styling offering across stores and online. As retail continues to evolve, our flexible model supports a continued shift from what was predominantly a mall-based business toward a more diversified model that includes digital and off-price.

Our market strategy remains our priority for gaining market share and increasing inventory efficiencies in our top markets. We're bringing greater merchandise selection and faster delivery to customers while increasing engagement through our services. Having a mix of Full-Line stores, Racks and Nordstrom Locals, and connecting these physical assets seamlessly with an online experience, gives us a distinct advantage in serving customers on their terms.

Previously, we announced plans to create a leaner and more flexible organization. To that end, we're combining our Full-Price and Off-Price teams across regions and functions to leverage our business. We're also reducing the size of our corporate teams to increase agility. Finally, we're continuing to invest in critical capabilities across technology, data analytics and supply chain. This includes scaling our end-to-end platforms to support a single view of customers, inventory and product and integrating physical and digital capabilities in Off-Price.

Earlier this month, we began taking a thoughtful, phased approach to our store reopenings. Our decisions are based on where openings are allowed by state and local governments, when we're prepared with the right safety measures and protocols, and when we believe that we can provide for the safety and well-being of our employees and customers. We currently have around 40% of our fleet open, and we offer contactless curbside pickup services in most full-line stores. We'll continue to adjust and refine our approach as we learn more about this new environment.

We've also been incorporating feedback from our customers and are humbled by their support and response throughout this process. While most of these stores have only been open for less than 2 weeks and are located in our smaller markets, we're seeing some encouraging early reads with overall sales trending slightly ahead of expectations.

Our investments to connect our digital and physical experiences continue to serve us well, and the impact of COVID-19 is only emphasizing the importance of these capabilities. In full-price, we've had store fulfillment capabilities in place for over a decade, which generally supported 20% of online units. This ramped to more than 50% while our stores were temporarily closed, contributing to our reduction in inventory.

In mid-April, we enabled store fulfillment in Off-Price, which includes a robust e-commerce business exceeding $1 billion in annual sales. This enhanced the customer experience by expanding merchandise selection to inventory located in our stores, leading to customer demand and traffic increases. Since enabling this capability, about 25% of nordstromrack.com units are being fulfilled from Rack stores.

In March, we leveraged our existing infrastructure and resources to launch a dedicated e-commerce site, serving our customers in Canada with all orders fulfilled from stores. Both customer response and sales have well exceeded expectations. Online sales are about 10x the volume we previously had under our third-party e-commerce provider.

We believe one of our most important responsibilities is supporting the people who support us, including our customers, employees and communities. We can't thank our employees enough for all they do to care for our customers. We're taking precautions to create a safe work environment and are supporting our employees who are not working at this time. For our unscheduled and furloughed employees, this includes extending medical benefits and partnering with several companies for temporary work opportunities. To support our communities, we're leveraging our alterations teams across the country to sell nearly 1 million masks for health care workers.

We believe our relentless focus on customer remains a key point of difference, and we're energized by the opportunities ahead to provide a best-in-class experience. The strength of our culture and the loyalty of our customers have sustained us through tough times. We're also grateful for the dedication and commitment of our teams who have made us nimbler and more flexible than ever before. We're confident in our ability to emerge in a stronger position to serve customers and as a leader in the market.

I'll now turn it over to Anne to provide insights on our financial results.

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

Thanks, Erik. As we discussed last quarter, we finished 2019 in a strong financial position, accelerated sales trends in the second half and demonstrated our inventory and expense discipline. This momentum continued into February, with sales tracking ahead of our guidance expectations for the month.

In March, as the impact of COVID-19 began to unfold, we took immediate steps to strengthen our financial flexibility by increasing liquidity, realigning inventory and lowering our overhead costs. The effectiveness of these collective actions adds to our confidence that we can emerge from this crisis well positioned to gain market share.

We started the year with $850 million in cash and increased our position to $1.4 billion by the end of Q1. We took early measures to increase liquidity and reduced our cash burn by more than 40% from March into April. We suspended dividends and share repurchases, amended and drew down $800 million on our revolver and issued $600 million in secured debt.

We'll continue to make reductions to our base cost structure. As a reminder, our initial plans for expense savings of $200 million to $250 million included end-to-end productivity improvements in overhead, procurement and generational investments, in addition to greater fulfillment marketing efficiencies. In response to COVID-19, we're also executing further cash savings of more than $500 million for the year. This is net of COVID-19 charges and evenly allocated across operating expenses, CapEx and working capital, which includes realigning inventory. Our total expense savings represent a reduction in nonoccupancy overhead costs of roughly 20% on an annualized basis. This includes $150 million in lower fixed labor costs for the year, resulting from our transition to a leaner and more agile organization. We're on track to deliver on our initiatives and realized approximately $100 million in gross savings in Q1.

As Erik mentioned, inventory is our largest near-term lever of flexibility. In mid-March, our teams moved quickly to realign inventory, reducing receipts by approximately 80% in April and May. We leverage data to analyze our inventory content and composition, including the seasonal nature of certain items. We ended the quarter with inventory down more than 25% from last year, which reflected a 15% reduction in units. We're planning to realign inventory by Q2, excluding the Anniversary shift.

We take our responsibilities to ensure the long-term health of our business seriously. We're keenly aware that our decisions impact all stakeholders, including our customers, employees and shareholders. We value the relationships we have with our business partners and strive to be a partner of choice for our vendors. We gave our vendor partners advanced notice of extending payment terms. Additionally, we paid rent through May, so there are no meaningful deferrals of cash payments at the end of the quarter.

While our long-term capital allocation principles are unchanged, our current financial priority as we navigate through this crisis is to preserve liquidity and maintain our investment-grade credit rating. We're committed to getting back to our adjusted debt-to-EBITDA leverage target of 1.5 to 2.5x and paying dividends over the long term. Our investments to connect our digital and physical experiences are paying off and even more so during these unprecedented times. We reduced our annual CapEx plan by roughly 30% by prioritizing technology and supply chain investments.

Now I'd like to provide additional insights into our first quarter results. Our loss per share of $3.33 and EBIT loss of $813 million included charges related to COVID-19 of $1.10 or $280 million. Roughly half of these charges related to noncash asset impairments resulting from our permanent store closures. The remainder related to premium pay and benefits and restructuring charges, which were slightly offset by credits from the CARES Act. Excluding these charges, 2/3 of the EBIT margin decline relative to last year came from deleverage on lower sales volume and 1/3 came primarily from incremental markdowns.

In the first quarter, total company sales declined 40% as our stores were temporarily closed during half of the quarter. Full-Price was down 36%, and Off-Price was down 45%. Full-Price results benefited from having a more established e-commerce business, including store fulfillment capabilities, which we enabled in Rack stores late in the quarter.

While our stores were temporary closed, online traffic and conversion trends increased notably in Full-Price and Off-Price, but were partially offset by lower average selling price. Online demand, which is an indicator of underlying trends, grew by 9% in Q1, consistent with the second half of 2019. Our online sales growth of 5% included the timing impact of unshipped orders and estimated returns. Since most online returns are done in our stores, these sales reflect higher reserves for these projected returns.

We leveraged our marketing and promotional capabilities to stimulate sales and appeal to customer interest during these times, including a series of targeted promotions to clear seasonal inventory. Our digital experience highlighted relevant categories such as wellness and comfort, which contributed to top-performing divisions in home, sleepwear and active. As we anticipated, our softest divisions were men's apparel, dresses and designer apparel.

Moving to gross profit. Our rate was 11%, down from 34% last year and reflected merchandise margins in the high 20s range. Roughly half of the gross profit decrease related to incremental markdowns included a higher reserve adjustment of around $75 million. The other half was due to deleverage on occupancy costs and planned markdowns. As stores continue to reopen throughout our industry over the next several months, we expect to see an elevated promotional environment. Our favorable inventory position enables us to bring in newness beginning in June for Full-Price. We're also able to leverage our Off-Price business to clear excess Full-Price merchandise while being opportunistic in the marketplace for fall closeouts.

In SG&A, expenses of $1.1 billion was slightly lower than last year. Excluding COVID-19 charges, SG&A decreased by roughly 25%. About 3/4 of the decrease was due to lower volume, and 1/4 was due to immediate actions to reduce overhead labor costs.

Our first quarter results reflected strategic actions that will have greater benefit on our cash burn and cost structure through the rest of the year. Based on our current outlook and the actions we took in Q1, we're currently approaching breakeven from a cash burn perspective and expect to reach this point by the end of Q2.

As we continue to navigate through this uncertainty, we're taking a cautious and thorough approach in planning our business. Our scenario plans and stress testing contemplate a slow recovery and a continued promotional environment. While around 40% of our stores are currently open, they are in relatively smaller markets. We're planning to have our full fleet reopened by the end of June, including stores in California opening over the next couple of weeks, followed by New York. While we're taking a conservative approach to planning, we expect continued improvement in underlying sales trends and merchandise margins.

Relative to Q1, excluding COVID-19 charges, earnings are expected to improve sequentially throughout the year. In Q2, the shift of the entire anniversary event into Q3 is about 10 percentage points. While we're planning improved merchandise margins and further expense savings in Q2, this will be more than offset by leverage from -- deleverage from the anniversary shift.

As we plan for the new normal environment, our model will continue to flex and evolve with the changing customer expectations. We had accelerated our long-term strategic plan by optimizing the mix of our physical and digital assets and increasing our agility through a leaner organization. As we emerge from this crisis, our focus remains on gaining market share while driving top line growth and improving profitability. We look forward to providing an update on our strategy and long-term financial outlook at our Investor Day this fall. We believe our financial flexibility, coupled with our business model to serve customers on their terms, positions us for success over the medium and long term.

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

Trina Schurman - *Nordstrom, Inc. - Director of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question comes from Ed Yruma with KeyBanc Capital Markets.

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

And I hope you and your families are staying healthy and safe in this time. I guess just a little bit more insight into the portfolio of the stores you've closed. I know you gave some age parameters around it. But kind of, I guess, what was the run rate revenue of that group, maybe profitability? And how do we expect, from a timing perspective, those closings to work through the P&L?

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

I'll take the first part of that question. So in broad terms, as you know, our portfolio had been cash flow positive coming into 2020. And we take a look at it as stores come off their operating covenants and we look at the physical presence we've got in certain markets. So as we ran our stress test and our scenarios, there was an opportunity for these particular stores to make the decision. It was a very difficult decision to close them. From a run rate perspective, I would say that it's not a meaningful and material part of the total sales for the company. And we certainly expect about 30% of those sales to be transferred either through our nordstrom.com or other stores in that market. But I would say, overall, it's less than 2% of the overall sales for the company.

It will be EBIT accretive. So it will drive incremental profitability when we close these stores. The stores have not reopened to the public. We are continuing to still do store fulfillment with those stores. And so I would say over the span of second quarter, maybe early in the third quarter, is when you would really see that starting to come through.

Operator

The next question comes from the line of Omar Saad with Evercore ISI.

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

It was great to see actually how you're able to leverage your kind of omnichannel capabilities to drive those inventory levels down. It seems like you had strong e-commerce during the kind of quarantine period. Is it fair to say that you're also -- that was also one of the reasons you're able to attract such a big increase in new digital customers? And how do you look at your omnichannel kind of inventory market capabilities, if there is this opportunity to use this pandemic or this crisis to jump at the kind of step function change and consumer adoption of BOPUS and some of the other omnichannel offerings that you guys have?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Omar, yes, I think, first, I'll have to step back. We certainly believe that the changes, drastic changes we're seeing with our business through this crisis is really an acceleration of what's been in place before. And the subject you mentioned, BOPUS leveraging store inventory is a big part of that.

When the crisis hit, our priority shifted quickly as well, and we really focused on cash and inventory levels. And being able to have store fulfill became important for -- it may be obvious, but it's really important for a couple of reasons. One was to access that inventory that would have been trapped otherwise and allowed us to reduce our inventories and we really feel good about the levels we're at right now. The other is -- it is a better customer experience. It brings a significantly bigger selection to customers, and in most cases, faster delivery. So -- and we were able to flex that up, which also allowed us to release some of the pressure on our supply chain capabilities. So being able to flex from our full-line stores, where we're normally about 20% store fulfill to over 50% since COVID hit, in our Off-Price business, we did not have store fulfill capabilities of our Rack stores going into this. Our team was quickly able to install that capability. And it's been about 20% of our orders so far have been filled from Rack stores. And it's super helpful.

And I think the bigger point is not only is it helpful in getting inventory down in a time when stores are closed, and as you know, our inventory is very perishable, but that capability, we certainly believe is going to be even more important in the future, being able to get inventory efficiency, get a bigger selection to customers with faster delivery requires leveraging this inventory that's in stores close to customers. We've invested a lot in it. And there's no doubt that the necessities of navigating this crisis has accelerated our capabilities there.

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

That's super helpful. And does it tie to the new customer growth, Erik?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

What's that? Did it tie to new customer growth?

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

Yes. Can you tell the exceptional new customer growth that you experienced in the period, does that -- is that having that inventory accessibility and availability and breadth, is that part of new customer growth? Or is it another factor?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Well, I think so. I mean it's been a very, very unusual time, and we're hesitant to draw too many predictive conclusions because of it. Having stores closed, our customers being at home, what categories they're interested in changed dramatically. And it's also been a very promotional time. Retailers are in clearance mode, there's too much inventory out in the system. And we really looked to balance things like our cash or inventory levels, certainly sales and price promotion is a big part of that. So yes, we're pleased with how many new customers came to our site. I'm just not sure how predictive that is trends moving forward.

Operator

Next question is from Oliver Chen with Cowen.

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

Nice job on the inventory agility. In the stores that you've opened, what have been some of the learnings? And how have you been -- how have you -- have you been pleased with the productivity and the ramp up? And how have you thought about planning inventory and labor in those stores? And is it helping you inform what you're going to do as the balance of the chain opens? You've also been really progressive with price matching. And as you know, we're going to face a very promotional environment. So what are the brand-appropriate strategies for you to undertake? And should we anticipate markdowns to be greater than last year?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Oliver, this is Erik. I'll take the first question. We have a -- consider today, we have about 40% of our stores open. But I think the big caveat on that is -- most of those have been opened less than 2 weeks. And we're hesitant to draw any conclusions from that. The results, while they've been about at our expectation being slightly above, it's such an unusual time. And the variance by location has been much wider than normal times. So I think it just would be -- it wouldn't be wise for us to draw conclusions and make plans going forward off of such a short sampling, especially when our big markets haven't opened up yet. We're not open in California yet, New York, here in Seattle. So we're trying to be as responsive as we can be. And we do really feel very good about our position with that. Having our inventories down 25% allows us to respond to what we see from customers.

Around the planning, inventory and labor, one of the nice aspects of having store fulfill, while our stores have been closed, we have had teams in all of our stores doing store fulfill. And now having that in Rack stores as well, we have productive use of people in store. So the amount of business coming from customers, actually coming to stores, it's easier to manage that. And it's -- we can leverage that existing labor pretty darn efficiently. So we feel pretty good about kind of the variability of our in-store labor and the inventory.

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

And Oliver, this is Pete. I'll take the part of the price matching. You're right, I mean, the likelihood of a strong promotional month or two is high. And we factored that in, and we're planning for it. I guess in our case, since you've heard about our ability to multiply and address distressed -- potentially distressed merchandise or our ability to fulfill through stores and fulfillment centers, we're actually in pretty good shape. So we're not going to be driving a bunch of price promotion because we don't really have to, to get our inventories in line. So we're going to be in a reactive position. And I think it's, again, fair to assume that, that environment is going to be highly promotional, and we're going to have to respond in kind to take competitive markdowns. So that seems like the likely scenario in June and July as stores open up. Our focus is really trying to make sure that we're getting in stock on replenishment and key items and all the things that customers would expect to want to buy from us right now. And then as we get to August, we pivot in to our anniversary sale, which this year, it seems maybe more timely than ever since the whole sale is predicated on newness, given customer's reason to buy something new, we're going to be able to tailor that assortment to be relevant to what they're interested in. And it's going to be really great value as well. We've taken a much more aggressive approach on percentage off and a lower average price point, and we've actually, in the last month, repriced some things to even make it more of a value. So we think we're going to be in a great position to be responsive to customers' interest on value and price. But I think you're right. The reactive price promotion part, particularly in June, July, I think you should be prepared for that to be significant.

Operator

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

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

As you think about the portfolio of the Off-Price stores as compared to the full-line stores, how do you think about the performance and how you're planning for Off-Price versus the full-line stores? And given the closures of the select number of full-line stores, how do you feel about the real estate portfolio of Off-Price? And is there opportunity for any pruning there given you also have online?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Hey, Dana. Yes. I think I'd start with, one, of how integrated our Off-Price and Full-Price businesses are, especially right now. We're just not in the Off-Price business. It is a vital part of our overall model. And part of that is as an exhaust of inventory from Full-Price. So we really look across Full-Price and Off-Price as our shift -- our focus shifted during the pandemic to trying to lower our inventory and how best to do that and leverage not only clearance in our Full-Price channel, but getting some of that product into Off-Price channel. So we were fairly aggressive in canceling orders in Off-Price, which frees up our ability to, one, exhaust excess product on our Full-Price channel; and two, go get what we think is going to be some terrific values in the marketplace there. So that's overall business. The store part of it, obviously, we didn't announce any store closings for Rack stores. Our Rack stores are very profitable. They're -- almost all of them are in non-mall locations. They have shorter leases. We're able to -- when those leases come up, usually move around to either invest in that building again or relocate to a better situation. So we feel really good about our Off-Price business. And again, part of it, I'd put into the banner of flexibility. In these uncertain times going forward, our Off-Price stores give us a lot of flexibility where we can -- not only do we have shorter leases, but how we use those stores. We launched in New York in the fall, some express services in our Rack stores in Manhattan where we can do Full-Price order pickup, returns and alterations in Rack stores, and that's gone really well. So we think that, that physical asset footprint is going to change. And we look at it by market, we look where we have full-line stores, where we have Rack stores. Things like our Local service hubs are part of the mix as well. And we think there's a real synergy going forward there. And again, our Off-Price stores are just a huge, huge part of our future.

Operator

The next question comes from Damon Polistina with Deutsche Bank.

Damon Joseph Polistina - *Deutsche Bank AG, Research Division - Research Associate*

I just wanted to ask on the local market strategy. Has that changed any way materially from what you outlined before moving to 10 markets kind of by the end of the year? And how are you thinking of it?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

It has not changed, so we still plan on -- we're in 5 markets right now with those enhanced capabilities, and we do plan on adding 5 more by year-end.

Operator

Our next question comes from Tracy Kogan with Citigroup.

Tracy Jill Kogan - *Citigroup Inc, Research Division - VP*

I was hoping you guys could talk a little bit more about the credit performance in the quarter. Maybe if you're seeing any changes in the payment rates or charge-offs? And then what are you expecting for credit revenues this year now?

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

Tracy, so for the credit performance, we really haven't seen a significant change in the portfolio to date, having -- from a charge-off or a collections piece to it. We have, as customers, we have offered some deferral plans or some payment plans for customers or are really good customers who've called in that for that in a particular situation. But having said that, we do -- we're planning, as we've talked about, a lot of scenario planning, we're anticipating that we're going to have a higher loss rate in the second half of the year going into 2021. And so we certainly have contemplated that as part of our scenario plans for the year.

Tracy Jill Kogan - *Citigroup Inc, Research Division - VP*

And then how about the revenue number for this year? I think you had said mid-single digits previously.

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

Yes. So I think if you recall, we pulled our guidance for the year. So we're not getting particular.

Operator

The next question comes from Alexandra Walvis with Goldman Sachs.

Alexandra E. Walvis - *Goldman Sachs Group Inc., Research Division - Research Analyst*

My question is on the e-commerce business. I wonder if you could share some more color on the cadence of e-commerce growth through the quarter and perhaps into May, if you could comment on the difference between Full-Price and Off-Price as well as any step changes in growth as you leaned into promotions or perhaps as you rolled out that incremental pickup opportunity in Off-Price that would also be particularly interesting.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Okay. We certainly have -- saw some good demand in e-commerce. But again, our top priorities were cash and lowering inventory. So there is -- again, as I mentioned earlier, it's certainly a very promotional environment out there right now. And there is -- demand can be generated quite quickly with some serious price promotion. So we do twist that dial as needed, but to really look at through the lens right now of cash and inventory levels, and we also balance it between Full-Price and Off-Price for our supply chain network. One of the dynamics with e-commerce as it is more price promotional, as average price is really for us is quite a bit lower. And so our units are way up as -- and you see that the customer number are up as well with that. So we do have more units going through the system. The dollar number is not as big. So we think it was appropriate and we're encouraged where we're at in -- again, in particular, the effects on cash or inventory levels there. But as Pete talked about with Anniversary in particular, our strength is not as a price promotional retailer. Our strength is bringing in newness and inspiring the customer to buy something new. That requires flexibility in our inventory and so it's really about setting us up for the future, and we feel really good about that.

Operator

The next question comes from Sarah Goldberg with Baird.

Sarah Goldberg - *Baird*

Given the new operating protocols in the stores to ensure health and safety, do you see any structural change to the margin profile of the stores?

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

Sarah, so we called out specific COVID expenses in the first quarter, which was basically our premium pay and some of the things that we did for employees during that time. Going forward, there are some expenses. It's not material, things like masks and cleaning and that type of thing. But we have certainly found some expense saving offsets to that. So it's not a material piece to the go-forward piece, go forward margins for the business.

Operator

The next question comes from Jay Sole with UBS.

Jay Daniel Sole - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

Great. Can you maybe just give us a little bit of help thinking about how to model gross margin, particularly the markdown pressure that you might experience in Q2 because obviously, inventory is down 25%, that's terrific. But it's likely that sales are down more. And then with the anniversary of sales shifting into third quarter, what can you tell us? I mean do you feel like the markdowns will be as much as Q1? Will it be less? If it's going to be less, how much less?

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

Yes, Jay, so I think in my comments, I talked about the fact that we felt we'd have sequential improvement from Q1. We certainly -- we took markdowns in Q1 and we got through a lot of the seasonal inventory. So as Pete talked about in his commentary earlier, we are bringing in new freshness and our replenishment items that have less of a markdown risk to it. So we do expect this to be a promotional environment, but we certainly expect to see sequential improvement, including Q2. We are starting to reopen stores. Our bigger markets will open up in the June time frame, and we still have a very strong Off-Price and omnichannel network that we're continuing to serve our customers with. So yes, the other piece that I would say is with the sale that -- we have a highly variable model, and so it's also allowing us to get a little bit more flow through on this as well.

Jay Daniel Sole - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

Got it. And maybe, Erik, just a question about how you think about promotions for next year. Obviously, Nordstrom, historically, has never been a very promotional retailer. Would you think that going forward, this is something just a regular thing that will become just part of the business model? Or would you want next year to sort of go back to a mode of doing a lot less promoting?

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

Well, we do think our strength will be in the unique merchandise mix we have and the service we provide. And that -- where we should excel is in the discovery of new products. So Pete talked about the -- safe to assume there's going to be a lot of clearance activity because there's just too much inventory in the system as an industry right now given for the demand. But we don't see that lingering into next year, at least for us, that we can get back to what our focus is. And what we hear from customers is around having great product, giving great service, and that's our focus.

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

Yes. This is Pete. The one thing I would add to that is it's -- our intention is to be a full-price retailer as much as possible. So it's not part of our strategy to become more price promotional. I mean, in fact, our strategy hasn't changed in terms of newness being -- driving in more full-priced sales. It's given us a great opportunity, I think, to have good constructive conversations with our brand partners about how that can be something that we're both working on together to the extent that we can insulate ourselves through that based on our assortments and our selection with key brands.

Trina Schurman - *Nordstrom, Inc. - Director of IR*

And now we'll take one more question.

Operator

Your last question comes from Kimberly Greenberger with Morgan Stanley.

Kimberly Conroy Greenberger - *Morgan Stanley, Research Division - MD*

Great. I wanted to ask about just understanding that the stores you've reopened are in some of the smaller markets, and they've only been open for a couple of weeks now and maybe slightly less than 2 weeks. Do you have a productivity metric you're willing to share with us in terms of the sales as a percentage of last year that are being produced by those stores? And then I just wanted to clarify one of the earlier comments and that you said on the 16 full-line stores that are closing, I think you indicated they represent less than 2% of total sales for the company. And I wanted to know, is that net of the expected 30% retention rate? Or is that the gross number before you, let's say, adjust for that 30% retention rate?

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

Yes, Kimberly, let me just answer that question really quickly, and then Erik will talk about the sales performance. So that was a gross number. So that if you net out the sales transfer, it's actually less than that.

Erik B. Nordstrom - *Nordstrom, Inc. - CEO, Principal Executive Officer & Director*

On the stores, we're not going to share any specific metrics, productivity metrics in the stores that's been open. And again, we just think it's such a small sample size, both the number of stores and time being open, and it's such an unusual time that it would be wrong to draw any conclusions from that.

I would say there's 2 general trends. Well, there has been significant variability. There are 2 trends. One, more outlying stores are performing a little better than more densely populated areas. I think that makes sense. The second part, our Off-Price -- our Rack business is outperforming expectations. Our Full-Price business is about in line with expectations.

Trina Schurman - *Nordstrom, Inc. - Director of IR*

Again, 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.
