REFINITIV STREETEVENTS

EDITED TRANSCRIPT

JWN.N - Q1 2021 Nordstrom Inc Earnings Call

EVENT DATE/TIME: MAY 25, 2021 / 8:45PM GMT

OVERVIEW:

JWN reported 1Q21 results. Expects 2021 revenue growth to be more than 25%.

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

Lorraine Corrine Maikis Hutchinson *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

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

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

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*

Simeon Avram Siegel *BMO Capital Markets Equity Research - Analyst*

Stephanie Marie Schiller Wissink *Jefferies LLC, Research Division - Equity Analyst and MD*

PRESENTATION

Operator

Greetings, and welcome to the Nordstrom First 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 Michael Maher, Chief Accounting Officer for Nordstrom. You may begin.

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

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 in the Investor Relations section on nordstrom.com. Our discussion may include forward-looking statements. So please refer to the slides with 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. Joining during the Q&A session will be Pete Nordstrom, President of Nordstrom, Inc. and Chief Brand Officer.

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 today. We're pleased with our results in the first quarter, which were marked by improving sales momentum and continued progress in our transformation as we work to unlock the full potential of our digital-first platform.

As demand continues to recover, our unique product offering and connection to our customers place us in a strong position to capitalize on this opportunity, and we are confident in our ability to capture market share and drive profitable growth as consumers resume activities, including social events, travel and return to work.

Our top line trends increased sequentially for the third quarter in a row with improvements in both Nordstrom and Nordstrom Rack, supported by recovery in stores as COVID restrictions were lifted, and continued growth in digital. Sales trends reflected broad-based improvement across businesses, regions and merchandise categories, both in-store and online.

Stores in markets that have opened up earlier outperformed other markets by 7 to 10 percentage points, giving us increasing optimism about the pace of recovery as we look to the remainder of the year. Our performance in the quarter reflects solid execution toward the growth priorities we laid out at our Investor Day in February: win in our most important markets, broaden the reach of Nordstrom Rack and increase our digital velocity.

Starting with our priority to win in our most important markets. Our market strategy helps us engage with customers through better service and greater access to product no matter how they choose to shop. We successfully expanded the rollout to 10 new markets, including Atlanta, Houston, Detroit and Minneapolis over the last 3 months.

Market strategy is now in place in all of our top 20 markets, bringing an unmatched level of convenience and connection to customers who make up about 75% of our sales. We continued to scale the enhanced capabilities we launched in 2020, like the expansion of order pickup and ship-to-store to all Nordstrom Rack stores, with order pickup more than doubling compared to the first quarter of 2019. In addition, nearly 1/3 of next-day order pickup volume for Nordstrom.com in our top 20 markets was picked up at Rack stores since launch as we continue to integrate our capabilities across our 2 powerful brands.

We also continued to evolve our approach to get closer to our customers than ever before. This quarter, we made significant progress expanding our personalized styling programs, with new tools deployed in the first quarter to allow our salespeople to offer our customers highly relevant recommendations, both in-store and digitally. More than 50% of our salespeople are now utilizing these remote styling tools, a 10 percentage point increase compared to just a quarter ago.

We also introduced new Livestream Shopping events featuring some of our best brands. We delivered significant growth from these initiatives in the quarter and are on pace to meet our milestones for the year.

Our second growth priority is broadening the reach of Nordstrom Rack. In the quarter, total Rack sales declined 13% to 2019, a 10 percentage point sequential improvement from the fourth quarter. Importantly, the merchandise repositioning across price, hybrid and brand doors is progressing in spite of some challenges matching slower-than-anticipated inbound inventory flow. We remain in the early innings in these initiatives, and our progress is encouraging. Increased customer choice of price-oriented offerings in Kids, Home and Active supported a 37% increase in sales compared to 2019 in these categories.

With respect to our priority to increase our digital velocity, we maintained strong growth at Nordstrom.com and Nordstromrack.com in the first quarter, even as store traffic and sales rebounded with increased mobility. Digital sales increased 23% over the last year and 28% over the first quarter of 2019. With continued growth in digital, our total penetration has increased by 15 percentage points over the past 2 years to 46%.

Our Nordstrom and Nordstrom Rack apps continue to be powerful drivers of customer engagement. During the quarter, we generated over 1 million downloads of our apps, a more than 50% increase over the first quarter of 2019. Mobile customers, including app users, represented approximately 75% of total digital traffic and 2/3 of total digital sales for the quarter.

Looking ahead, we continue to enhance our digital capabilities to improve the customer experience across the shopping journey. One of the key opportunities we see is to offer our customers more choices, with plans to increase choice count to approximately 1.5 million over the next several years. This quarter, we saw ramping benefits from this initiative with choice count increasing approximately 20% versus 2019, primarily driven by an expanded dropship assortment in both our core categories and in-demand categories like Home, Active and Kids. This allowed us to drive strong sales growth in our digital business without a corresponding increase in our inventory investment.

We've also seen continued strong improvement in conversion, which was up more than 15% compared to 2019. We continue to deliver exciting product for our customers with some of the brands that matter the most to them through launches like our pop-in with Skims and New Concepts shop featuring Fear of God.

As we look ahead to the second quarter, we believe that our Anniversary Sale will be well timed to benefit from customers' increasing confidence and return to pre-pandemic activities. The event will also mark a significant step forward in the transformation of our approach to getting "closer to you." Our goal is to have an event that rewards and engages our best customers with a superior shopping experience.

We are building on last year's launch of a digital catalog with personalized editorial content and product recommendations while adding new virtual and in-store events. We will also significantly increase selection for Anniversary this year, with total customer choices up double digits compared to 2019, supported by an expansion of alternative partnership models with our vendors. To ensure that we are best positioned to support our Anniversary Sale, we are also working with our vendors to accelerate product receipts, which Anne will talk about shortly.

Overall, we are very excited about our offering and our approach to Anniversary, which remains an important opportunity for us to provide a one-of-a-kind experience for our loyalty customers while introducing new customers to Nordstrom.

In closing, coming out of the first quarter, our focus on accelerating our strategic priorities to serve customers in new and differentiated ways is gaining momentum. We are in a stronger position than ever to capitalize on our market share opportunity as customer demand recovers. We're confident in our direction and look forward to sharing our continued progress in the quarters ahead.

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

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

Thanks, Erik. Our first quarter results represented a strong start to the year with sequential improvement in sales trends that have continued into the beginning of the second quarter, strengthening of our inventory position and continued progress restoring our balance sheet. Our performance in the first quarter leaves us increasingly confident in our ability to deliver on our financial targets for the year despite cost headwinds.

Total sales were down 13% in the first quarter compared to the same period in fiscal 2019, representing a sequential improvement of 7 percentage points from the fourth quarter. Sales trends reflected broad-based improvement across both Nordstrom and Nordstrom Rack, with Nordstrom sales improving 6 percentage points sequentially, and Nordstrom Rack sales improving 10 percentage points sequentially. Demand recovery benefited from increased vaccinations, lifting of COVID restrictions in many of our markets and government stimulus payments.

Encouragingly, pent-up demand also accelerated throughout the quarter as back-to-normal activities are resuming, including social events, travel and return-to-office. These activities are driving accelerating momentum in some of our biggest categories.

We continue to satisfy our customers' desire for online shopping experiences, delivering solid growth in digital even as our store traffic and sales continue to recover. Our digital business grew 23% year-over-year and 28% compared with the same period in fiscal 2019 as we continue to benefit from our efforts to unlock the full potential of our digital-first platform.

From a merchandise perspective, we saw broad-based improvement across our product offering. We continue to see strength in categories that led during COVID-19, particularly Active and Home, where our sales are up 58% compared to 2019 levels. And our penetration has increased by 5 percentage points since the start of the pandemic.

We saw customers responding well to designer brands, spring classifications like sunglasses, swim, shorts and dresses as well as recovery categories like denim, dresswear, makeup and handbags. Taken as a group, these recovery categories returned to growth compared to 2019 in March and April, with strength continuing early into the second quarter.

Our sales performance was supported by improvements in inventory flow, allowing us to exit the quarter with inventory decreasing 2% compared with the same period in fiscal 2019 versus a 13% decrease in sales. This includes approximately $120 million of spring and summer in-season inventory that was pulled forward into the first quarter, a roughly 7 percentage point impact as we made the decision to accelerate vendor shipments to support sales trends and mitigate potential supply chain backlog in the second quarter. This reflects significant progress addressing seasonal and underperforming category inventory from the fourth quarter at both Nordstrom and Nordstrom Rack.

At Nordstrom Rack, our sales outpaced inventory growth for the first time since the start of the pandemic. Across both Nordstrom and Nordstrom Rack, our inventory is current and well-positioned in key categories as we prepare for the Anniversary Sale.

Our teams are operating with continued agility and flexibility in what remains a challenging supply chain environment, ensuring we can appropriately distort inventories into high-demand categories and provide our customers with the exceptional product assortment they expect from us.

Looking ahead, the company is balancing inventory levels with sales while managing receipt flows to mitigate potential supply chain disruptions as the year progresses.

Gross profit as a percentage of net sales decreased 260 basis points compared with the same period in fiscal 2019, primarily due to deleverage on lower sales and lower merchandise margins as we took action to reduce elevated inventories coming into the quarter, partially offset by permanent reductions in buying and occupancy costs.

While COVID-19-related demand impacts are clearly moderating, the underlying cost environment remains volatile with elevated labor and shipping costs as well as apparel industry supply constraints, creating continued pressure.

Total SG&A as a percentage of net sales increased 280 basis points compared to the same period in fiscal 2019. Freight and labor challenges were partially offset by continued benefit from the permanent reductions in overhead expense of approximately 15%.

We continue to make progress restoring our balance sheet, closing $675 million in senior unsecured notes during the quarter at highly favorable interest rates between 2.3% and 4.25%. Proceeds were used to redeem in full the $600 million outstanding at 8.75% secured notes, which were issued in April 2020 during the onset of the COVID-19 pandemic. This allowed us to return our bond portfolio to being entirely unsecured, fully unencumbering the real estate used to secure the prior notes.

The transaction also reduces our annualized interest expense by approximately $30 million while creating additional flexibility for continued debt paydown with a par call feature beginning in April 2022.

Based on our first quarter results, we continue to expect to deliver revenue growth of more than 25% in 2021 with digital representing approximately 50% of sales. Digital penetration is expected to vary over the course of the year depending on the pace of store recovery. We are responding with speed to manage external cost pressures and remain on track to deliver on our guidance for breakeven EBIT in the first half and 3% operating margin for the full year. And we continue to see a path to an operating margin of approximately 3.5% depending on how the demand recovery and cost headwinds play out.

Our income tax rate is expected to be around 27% for the year. From a capital allocation perspective, we're planning CapEx at normalized levels of 3% to 4% of sales, primarily to support investments in technology and supply chain capabilities. We continue to expect to reduce our leverage ratio to approximately 3x and to be in position to return cash to shareholders by the end of the year.

Overall, we have seen strong customer response to our initiatives to evolve our operating model, positioning us well to drive market share gains while improving profitability, returns and cash flow generation.

While there is still considerable uncertainty with respect to COVID-19, we remain confident in our ability to deliver on our targets for 2021 and generate profitable sales growth as demand recovers.

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

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

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 Oliver Chen with Cowen.

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

The opportunity to increase choice count sounds quite innovative. What should we know about how this will impact your margin profile and also as you think about inventory versus sales, as you look to these alternative arrangements and flexibility, especially amidst the Anniversary Sale?

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

Oliver, thanks. I'm going to let Pete talk a little bit about how we're thinking about the choice counts from an assortment offering perspective, and then I'll come back in at the end and address some of the questions about inventory, sales and margin.

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

Yes. I think the main thing here is the dropship model, in particular, allows us to expand choice count in a way that creates a lot of leverage for us in terms of all the work that goes with bringing inventory in. If it was in a traditional wholesale model, that's -- obviously, there's a lot of manual effort that goes with that. So it's a great way for us to expand choice count. I think you're seeing that play out.

If we had to pick an example is in the Home category, where we've expanded quite significantly over the last 18 months or so, and dropship has been a really important part of that. So you'll continue to see that. And it is true as we move into Anniversary, it creates more flexibility for us with our Open-To-Buy too as we have a decent percentage of that offering is going to be available in dropship.

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

And to your question about the flow-through on the P&L. The one thing I would highlight is that we added 20% more choice count versus 2019. But our inventory investment, we were down 2%. And so I think that just gives you a flavor that when you don't own the inventory, you're sharing the economics with the vendor and it really is responding to customer demand as well. So I think for all of us involved, it's really a great solution.

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 focus a little bit on gross margin. I know that in the first quarter, as you guys had anticipated, you were clearing out of some of the excess fourth quarter merchandise. I guess any comments on the current industry inventory situation, the promotional environment seems to be in check and how that might portend as sales start to improve or accelerate for your gross margin going forward?

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

I'm going to let Pete talk a little bit what's going on in the industry, give some context, and then I will circle back and talk about what we're thinking about for the rest of the year.

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

Yes. In terms of the pressure that gets put on gross margin for promotional activity, that's been relatively low compared to recent times. And I think given the position everyone was in with the positive momentum around sales trends, and I think we would expect that promotional activity would not be what it was, for example, say, in '19. It would be less than that.

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

And as we think about Q1, we are really pleased with where we landed from an inventory position heading into Q2 and the rest of the year. We progressed faster than we thought a few months ago as far as clearing through inventory. And so we feel like we've got a really strong offering for our customers that's relevant and seasonal.

The pieces just to remind you on our Q1 deleverage was it was really related to 2 things. One, if you look at against '19, it was the sales deleverage component to it and the other was the markdown piece. So our -- we anticipate that we'll continue to see favorability in the merchandise margin component starting in Q2 and going forward.

Operator

Our next 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 wanted to dive in -- ask if you could dive in a little bit deeper on the 7-point sales acceleration, focusing on that kind of pickup in business. Is it -- kind of compare and contrast the stores and traffic in stores versus e-commerce. Is it the older customer coming back versus younger consumers? Can you discern any difference between stimulus and vaccine reopening as a driver there and then categories? Maybe there's some interesting takeaways there, whether it's kind of categories like return-to-work and return-to-social versus the COVID pandemic wear, if you will. So dive in deeper in that acceleration, I think, would be really helpful.

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

Okay. Thanks, Omar. This is Erik. Yes, it's -- basically, our Southern regions from east to west performed 7 to 10 percentage points greater than our Northern regions. And we find a lot of encouragement in that. I mean those Southern stores have opened up, some from mandates and some from just customers getting out more. And we see that in traffic. We see some of it in conversion as well, but there is a difference in traffic. And so we anticipate our Northern stores will get to the same spot. And we're starting to see that.

You mentioned categories as well. We've definitely seen a shift in categories. Categories that were really out of favor during the pandemic -- or many of those are starting to come back. And one of the ways that I think you should -- in looking at us, we're a bit unique in our mix and also our geographic footprint. And our big markets and many of our big categories really had a disproportionate amount of headwinds during the pandemic.

And there's signs of that turning. People are starting to get out more and people are starting to buy categories to get out more. We're hearing a lot from customers about weddings this summer. And so it's not necessarily buying suits to go back to the office in. But dresses, handbags, anything to get out -- it could be to a restaurant, could be on a trip. We're seeing a lot of movement there. And we're encouraged that the increasing store traffic has not cannibalized online. Online has remained very strong, and we're starting to see momentum across the board.

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

And anything on stimulus versus vaccine? Can you discern that?

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

Yes. No, we can't. It's hard to point to how much is driven by those factors. I'm sure it's in there somewhere.

Operator

Next is Dana Telsey with Telsey Advisory Group.

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

As you think about the Anniversary Sale, what are the differences that you see this year, whether it was relative to 2019 and you were just beginning to open in 2020, whether it's timing and how you're thinking of the promotions? And then, Anne, you mentioned the cost headwinds. Can you unpack what you're seeing in terms of port congestion, supply chain and the preparation for Holiday in terms of orders?

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

Erik, do you want to take the Anniversary question then I can circle back on the cost piece?

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

Yes. Yes. Dana, you mentioned comparing 2019. I think the big difference is digital there. Anniversary has always been, certainly in recent years, more of a digital event than other times of the year. And then you add to last year where it obviously took a huge step towards digital.

And we added some digital features, particularly the wish list feature to Anniversary last year. That greatly exceeded our expectations and our engagement there.

So this year, we still think there's going to be much more digital engagement versus '19. The big difference will be stores will have a lot more traffic in them than we had last year. And those digital features, really working to connect them to our physical assets as well, in particular, our salespeoples' ability and the tools we have for them to do remote selling. Again, we know customers, especially in the discovery part of Anniversary, like doing that digitally. And now our salespeople have tools, and over half our salespeople have been using them in the last quarter. We expect that to grow to Anniversary to where our salespeople can reach out to their best customers and use these digital tools to help them -- help customers discover new product for Anniversary.

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

Dana, this is Pete. The other thing I'd like to add there, one of the things that makes us optimistic about our Anniversary event this next year is just kind of where we are relative to everything in the pandemic and the fact that fall -- early fall represents a really good tipping point for people getting out there and resuming lives as they were before. For example, that could be return-to-office or back-to-campus. And that sale for us works best when it's people thinking about the upcoming season and getting great savings on new products. And so the timing is really great.

I think in terms of the opportunity that exists out there, people say, okay, I've been kind of on the sidelines maybe not buying these types of things for a while and now is the time, and here's a great reason to go shop at Nordstrom.

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

And to your question about what we're seeing more of the macro environment between supply chain disruption and labor and freight costs. I would just sit back and say, we saw pressures in 2020 that -- with COVID-19, and we have got pressures in '21. They're just different. And I think the thing that we learned throughout the past 12 to 18 months is that even though the environment remains volatile, we respond to it and we remain flexible and agile.

So as we continue to see some volatility, we're doing things to offset and mitigate that. So for example, we pulled forward some receipts from Q2 into Q1 to make sure that we had -- we can meet the customer demand and it was there for the customer as they were shopping and wanting to buy it.

The second thing is that we're looking at ways to offset some of the cost headwinds that we have. We're pulling a lot of levers in place on that. And as we went through our guidance even a few months ago, we contemplated a lot of scenarios out there. And so we -- as part of this, we are -- we contemplated puts and takes and this is -- we're responding to what we're seeing in the macro environment around that.

Operator

Next is Matthew Boss with JPMorgan.

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

Erik, maybe in terms of where your top line stands today relative to 2019, I guess, maybe what grade would you give performance to date at both the full line and the Rack? What gives you confidence in market share opportunity exiting the crisis? And any opportunities you see to expand key vendor relationships just given the broader consolidation of wholesale distribution?

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

Okay. Thanks, Matthew. Yes, we're very encouraged with our top line this last quarter versus last year and versus 2019. The sequential improvement across the board, both in Rack and Nordstrom, is significant and certainly exceeded our expectations, our plans. It's -- things are changing quickly as the economy starts to open up and customers start to get out there again. So we remain aggressive as we get into Q2. And we see lots of opportunities both to build on what we've been working on, particularly the last year over the pandemic where we invested a lot in our digital capabilities and the connections between our digital business and our physical business. We really see the opportunity for those investments to pay off.

And the second big opportunity is categories. Again, there's a lot of big categories for us, categories where we know customers place us top of mind and kind of higher stakes dressing. Those start coming back, and we see a lot of opportunity there.

Market share, that is the long-term standard we hold ourselves to is to grow market share. Certainly, during the pandemic that there were a lot of headwinds to that. But as we start to come out of the pandemic, we think the opportunities of our model -- and our model truly grounded in 2 big brands, Nordstrom and Nordstrom Rack, and having big businesses in stores and online. And we've been -- over half of our business was online last year. It's almost half of this last quarter. And the scale across those capabilities and how they're connected, we've seen a lot of proof points over the pandemic of how customers like to shop fit with the capabilities we have and things like our market strategy have shown. A lot of encouraging results that have us focused on scaling.

As far as key vendors, let me go pass it over to Pete.

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

Yes. I think I may have mentioned this the last couple of calls is perhaps the silver lining of these tough times is that it's created a great opportunity to improve relationships with key vendors because we've got a lot of common issues to solve for.

And I would tell you where I feel like we're really advantaged that way is there's some stuff that vendors really look to for us. First of all, it's our customer. We've got a lot of customers that are very attracted to most every brand we do business with. And in many cases, these customers don't go to them directly. They like Nordstrom. And so that's a big win for us. I think our capabilities, investments that we made over the years in terms of our ability to fuse the digital part of the business with the physical assets and the stores and the people, we're pretty far well along on that journey, and I think those capabilities are attractive.

Our service experience and the trust that they have with our brand -- these guys can sell to customers directly. And so they're just not going to sell to anybody that doesn't really elevate their brand or at least execute it consistently with their vision. And we take a lot of pride and care and making sure that we're working with brands to bring their assortments to life and through wonderful service in our stores with our people and then the functionality that we have online.

And then the last thing I would say is the consistency of our approach. We've got a really talented merchandising team that our leaders have had fair amount of longevity being in the business, and there's a lot of really good relationships there. And so there's a lot of trust that's been built up over the years, particularly all the change that's happened around us. That consistency, I think, has been really helpful.

So in the last 18 months, we've spent a lot of energy really trying to work with and through our vendors to kind of forge a new place to go. And I think that openness and willingness of both sides is going to serve us well.

Operator

Next is Mark Altschwager with Robert W. Baird.

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

Just wanted to follow up on the market strategy topic for a moment. Just any metrics you can share on trends in some of your key markets where the market strategy has been in place the longest versus the broader fleet? Curious what you're seeing in terms of customer engagement in these local stores as the reopening has progressed.

And then relatedly, just what are some of the key learnings, I guess, from the rollout over the past couple of years that you think can help accelerate the results as you move to the new markets in 2021?

REFINITIV

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

Thanks, Mark. Yes, I guess a couple of data points I would share with you. As we mentioned, our market strategy is now in our top 20 markets, which is about 75% of our sales. We rolled out in October, November last fall, including our Racks in that. And that's led to a significant uptick in order pickup and ship-to-store to all of our Racks there in our market strategy regions.

Our order pickup has more than doubled versus 2019. Nearly 1/3 of Nordstrom.com purchases next-day pickups in these market strategy markets are picked up at Rack stores. And I think that's a real important one. It goes to, again, these assets that we have, our physical assets, our Nordstrom stores and Nordstrom Rack stores. We've got about 250 Nordstrom Rack stores, and they provide very convenient pickup points for customers. And we really didn't have to market it, lighting up that capability to have about 1/3 of our Nordstrom.com purchases go to be picked up at Rack stores. Our next-day pickup is significant.

And it's -- the other factoid I'd share is just our salespeople as they can engage with customers and take advantage of our capabilities. Over half of our salespeople are now using our remote styling tools, which is up from 10% just in Q4. So we've gone from 10% of our sales people in Q4 to over 50% in Q1. And so we see that trend continuing. And part of it is the digital tool that our salespeople have. But the other part is the access to merchandise for their customers, and that provides greater selection and faster delivery.

You mentioned Locals. Locals, we actually saw a recovery in our Local service hubs to be faster than our stores in both New York and Los Angeles. And I think it makes sense. It's -- in the context of a pandemic where customers may be more uncomfortable coming into a big store, to have a neighborhood service hub where they can do an order pick-up, do a return, do an alteration, we saw that traffic come back the fastest.

Operator

Next is Steph Wissink with Jefferies.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst and MD*

We wanted to focus on Anniversary Sale a bit more if we could. I think you mentioned choice counts up double digits. But can you talk a little bit about the level of fashion in this year's sale relative to maybe the last few years? Are you able to take more risk without the inventory risk as you leverage some of your vendor partnerships in a new and different way?

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

It's Pete. That's a great question. I think that the thing that's made that a little more complicated is just how much things have changed relative to consumers' demand given the macro conditions that we've been in. I mean we plan this event quite a bit out in the future. And if you're thinking about what was really important for customers 6 months ago, it's a little bit different than what we know today. And we put off buying decisions as much as we could on commitments knowing that this was evolving.

So I'd like to think that we're going to nail it right on the head but I think it's going to be challenging, again, just knowing that there's this tipping point about people resuming social occasions activities: return-to-work, back-to-campus and that stuff. So again, 6 months ago, that wasn't abundantly clear. So we do know that there is part of that sale that's about people replenishing things that they would expect from Nordstrom. But usually the thing that really drives it is the reason to buy something new. So that's always true. And I think that there's that orientation to it at all times.

So we feel good about it. There has been some increased flexibility in choice given dropship. But we went into it relatively conservatively knowing that we need to sell through it well to put us in a good position for half 2. And ultimately, I think as we've been talking all along, we got to set the table for a really strong half 2. And we feel really good about that relative to Anniversary.

Operator

Next is Chuck Grom with Gordon Haskett.

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

A question for Anne. You're forecasting operating margins of 3% in '21. I think you said that there's potential to get up to 3.5%. But bigger picture, can you hold our hands on when you think you can back can get back to the 5% to 6% level that you were a few years ago? And also as a follow-up, with all the cost reductions you've made, what the top line needs to look like to get there?

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

Yes, Chuck. So when we think about the recovery and just would refer you to some of the information we shared with you at our investor event back in early February. So there's a lot of puts and takes in this. And I think what we tried to do was not knowing the pace of recovery, both from a customer demand, but also from a cost environment. We're continuing to think through or watch and figure out how we're going to deliver on some of these things as well. So as far as the pace, we're very confident we're going to deliver. It's just the timing and pace.

So as we go through this, the thing that I would draw your attention to is that we ran some scenarios and laid out those for you in February that with the cost reductions we took in our overhead expenses, we require about $1 billion less in top line in order to deliver a similar margin profile that we had in 2019. And similarly, if you had the same sales level from 2019, it would well exceed the 6% EBIT margin. So it's really about the demand recovery as well as some of the macro cost winds that we're seeing right now that we're working to offset. So don't have a finite time frame for you, but I would just say that we're working actively to get to that point.

Operator

Next is Lorraine Hutchinson with Bank of America.

Lorraine Corrine Maikis Hutchinson - *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

Just focusing on Rack for a moment. Are you -- were you able to move through the carryover product from the fourth quarter completely? And then are you happy with the level and content of inventory at Rack as you move into the spring and summer season?

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

Yes. Our inventory level is in pretty good shape with the Rack. We continue to work through some of the clearance stuff. And that's our typical end-to-end process as it works through what we might have in the Nordstrom stores that works its way through. But we're in good shape relative to our Rack inventory levels, I think, especially considering the improving sales trends that are happening there. So the way that we look at inventory is not based on the moment in time that we hit -- ended the last quarter, but as we have the amount of supply we need going into Q2. And I'm sorry, and the second part of your question to Rack, was what, about the Rack?

Lorraine Corrine Maikis Hutchinson - *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

I was just curious about, if you're happy with the level and content of inventory as you enter spring and fall?

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

Yes. Again, I think it's the same thing. We're working through all that. And the thing that's going to advantage us over time that we're keen to work on is a theme everywhere, it's speed and agility. And if we can shorten up our lead times around commitments in inventory, particularly in that channel, we're going to be advantaged. And these are things that we're consciously working on to increase flexibility as customers' demands evolve.

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

And just to add to that, when we look at the Rack inventory levels as far as what's coming through from a transfer from our Nordstrom brand versus what we're going through on clearance, it is really clean versus what we started with at Q1. And when we look at it compared to pre-COVID levels, it is exactly in line with what we had seen prior to COVID happening.

Operator

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

Simeon Avram Siegel - *BMO Capital Markets Equity Research - Analyst*

Just quickly to clarify on the outperforming markets, how are those Southern market store reps relative to their own 2019 levels? And then, Anne, can you just -- just a follow-up, is there a difference -- or how do you think about the difference in profitability that you book for dropship versus the owned inventory sales? And then any way to think about how large you expect that to get as a percent of the business?

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

On the outperforming markets, we haven't broken out our regional performance by -- against 2019. I'll say, we still have a bit of a gap there, but it's -- we have a number of stores right now who are exceeding their 2019 levels. So it's -- the trends all in the right direction.

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

As far as the dropship piece, I would frame it up a little bit differently and refer you to some of the investor event materials that we have laid out. Over time, over the next 3 to 5 years, we think the mix of our assortment is going to be moving to be about 50% wholesale model, about 20% of our Nordstrom branded goods or private label and the remainder being alternative partnerships, of which would be -- dropship would be part of that.

So this is kind of our -- this is our first phase of the alternative partnership component to it. But what I would say is the profitability journey on that particular customer journey is pretty much in-line and a bit above the average of what we look at for some of the other fulfillment journeys.

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

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.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.