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JWN.N - Q1 2022 Nordstrom Inc Earnings Call

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OVERVIEW:

JWN reported 1Q22 diluted EPS of $0.13. Adjusted EPS, (excluding a gain on the sale of interest in corporate office building and an impairment charge related to Trunk Club property) was a loss of $0.06. Expects FY22 revenue growth to be 6-8% and adjusted EPS to be $3.20-3.50. 2Q22 revenue growth to be approx. half that of the 1Q22.

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PRESENTATION

Operator

Greetings, and welcome to the Nordstrom First Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Heather Hollander - *Nordstrom, Inc. - Head of IR*

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.

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

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

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

Good afternoon, and thank you for joining us today. Our first quarter results were marked by strong top line growth and continued progress in our transformation. We know customers look to Nordstrom for the occasions that matter most to them.

This quarter, we saw customers shopping for long anticipated in-person occasions such as social events, travel and return to office. Beyond occasions, customers also reevaluated and refreshed their wardrobes. We are encouraged by this opportunity because it favors the core categories of our business and the core capabilities of our service model.

We were well positioned to serve this demand and deliver an excellent customer experience, powered by our unique product offering, interconnected model and strong commitment to customer service. Our integrated digital and physical assets continue to allow us to be nimble and enable us to quickly adapt to the channel shift in the quarter as customers increasingly choose to shop in-store.

We were staffed, well stocked and ready to serve customers as store traffic increased. And our dedicated employees delivered an experience that was clearly reflected in our store level customer satisfaction scores. Putting the customer first is in our DNA, and our teams continue to exemplify that spirit this quarter. We've always believed that service and selling go together. That was reflected in our team's improved productivity with 75% more Nordstrom salespeople reaching the $1 million sales mark in 2021 versus 2019. We cannot be more proud, and we'd like to thank our outstanding team for their unwavering commitment to serving customers and delivering results.

Turning to first quarter performance. Total sales increased 19% over the first quarter of 2021. Nordstrom banner sales increased 23% over last year and exceeded pre-pandemic levels, an important milestone. Nordstrom banner gross merchandise value, or GMV, increased 25% for the first quarter versus the prior year.

As we saw a return to occasions and customers updating their wardrobes, we experienced broad-based growth across core categories and geographies. With customer traffic and activity returning in city centers, Nordstrom urban store sales collectively rebounded and reached pre-pandemic levels. In fact, the Nordstrom Manhattan flagship store had the highest year-over-year sales growth among our stores this quarter. For the Nordstrom banner, the Southern U.S. continued to outperform the Northern U.S. compared to pre-pandemic levels, but the spread tightened to 3 percentage points.

Our team remains focused on building additional capabilities to better serve customers and drive shareholder value, with particular emphasis on 3 key areas: improving Nordstrom Rack performance, increasing profitability and optimizing our supply chain and inventory flow.

Starting with Nordstrom Rack. Sales grew 10% versus last year, driven by increased store traffic, improved conversion and better in-stock levels. We also built momentum with sales increasing as we move through the quarter.

By increasing our supply of premium brands and fine-tuning our assortment to better align with customer needs, we are achieving a better balance of price points at the Rack. As we've said before, 90% of the top brands at Nordstrom are sold at Nordstrom Rack, and we believe our work to improve the availability of those brands will fuel Rack's growth. And we're pleased with the results of our More Reasons to Rack campaign, which drove improved brand awareness, affinity and traffic.

As we move through the year, we expect to see continued benefits from our multi-layered plan to both expand our offerings of the most coveted brands we carry, as well as source from new vendors and increase our use of pack and hold inventory, to ensure we have the right selection that our customers want. By improving inventory levels, optimizing our assortment and driving brand awareness and traffic, we are confident that we will profitably grow our Rack business throughout the remainder of the year.

Turning to profitability. While we drove improvements in both merchandise margin and SG&A this quarter, we are focused on plans to deliver incremental improvements and elevated flow-through as we move through the rest of the year.

Within SG&A, we expect that the supply chain optimization work streams underway will enhance the customer experience, drive top line growth and produce efficiencies in labor and fulfillment, which will compound as we move through the year. Pete will take you through our progress to date and plans to drive additional merchandise margin and supply chain improvement in a moment.

In addition to the 3 focus areas that I've outlined, winning in our most important markets and advancing our digital capabilities are key strategic priorities for us, and we continue to make progress in these areas.

Starting with winning 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. By leveraging a strong store fleet and linking our omnichannel capabilities at the market level, we deliver a level of convenience and connection that our customers enjoy.

Throughout our market strategy rollout, we've seen the power of offering additional pickup options. Customers clearly value our interconnected model, with order pickup comprising 10% of Nordstrom.com demand this quarter, an increase of 200 basis points versus the prior year. In Q2, we'll continue to scale our market strategy by expanding next day order pickup capabilities to over 60 additional Rack stores in our top 20 markets. Customers utilizing in-store pickup have higher engagement and spend 3.5x more than customers who don't utilize the service. Buy Online Pick Up In Store also remains our most profitable customer journey and one of our highest satisfaction customer experiences.

Our styling program also continues to be a powerful engagement driver as we deliver convenience and build deeper customer connections through our Closer to You strategy. As we position our styling program for further growth, we are sunsetting Trunk Club and redirecting our resources to the services that our customers tell us they value most.

I want to be clear. This move reflects our belief and commitment to styling, and we are dedicated to growing and investing in these services. We have a range of styling services from low-touch outfit inspiration through our digital channels to a high-touch and personalized relationship with a stylist, all of which achieve high customer satisfaction scores. We are directing our investment towards these programs to ensure that we are well positioned to serve customer needs and drive growth. Customers spend 7x more and report higher levels of satisfaction when engaging with a stylist, either in-store or online. While we still see the highest number of customers engaged with our in-person styling, we are seeing rapid growth within our digital services.

We continue to leverage data science and advance our digital tools, including virtual Style Boards, to empower our stylists with highly relevant recommendations for their customers.

With more customers returning to stores this quarter, digital sales were flat versus the first quarter of 2021. Digital remains an important part of the business, with 39% penetration, and digital capabilities are an important part of our in-store experience. We'll continue to leverage our digital platforms to deliver personalization at scale, especially as we connect with customers through our upcoming Anniversary Sale in the second quarter.

We're excited about our plans for the year and the progress we're making on our transformation. Investments in our market strategy and digital assets put us in a strong position to capitalize on favorable market opportunities as events and overall demand continued to recover.

Beyond top line growth, we've made progress improving merchandise margin and driving SG&A efficiency, and we have specific work streams in place to drive incremental improvement in the second half of the year. We have line of sight to achieving the financial targets outlined at our 2021 Investor Event and remain committed to shareholder value creation. 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, Director & Chief Brand Officer*

Thanks, Erik, and good afternoon, everyone. I'll start by talking about our category performance this quarter and then give you an update on our work to increase gross margin, improve supply chain and inventory flow and evolve our merchandising model.

Starting with the category performance. We were excited to see customers shopping for events and updating their closets this quarter, and we were ready to serve them with the best product and selection across the brands that matter most to them.

Men's Apparel was our strongest category this quarter. More broadly, both Men's and Women's Apparel had double-digit growth over last year and sales that exceeded pre-pandemic levels. Strength in Men's and Women's Apparel was driven especially by suiting and dresses.

While we always strive for balance across all relevant categories, it is true that event and occasion-based categories are important to our customers and represent a significant portion of our business. We also offer differentiated services such as styling and alterations that help customers to feel good and look their best as they prepare for important occasions.

The apparel demand we saw this quarter goes beyond occasions, though. We also saw robust demand for wardrobe refreshes, especially for the spring and summer seasons. Shoes had a strong double-digit growth with increased demand across formal, casual and athletic styles.

Our designer offering across all categories continued to perform very well, also posting strong double-digit growth and sales significantly above pre-pandemic levels.

Turning now to our initiatives. We put the customer at the center of everything we do, and our strategic initiatives in merchandising and supply chain are designed to optimize the customer experience, resulting in increased profitability.

This quarter, we continued our progress in improving our merchandise margins. Our team used advanced analytics to better understand customer needs, find opportunities to improve our assortment and presentation and optimize markdowns. We also increased average retail prices without seeing a negative impact on transaction volumes. We're very encouraged by our Q1 results and the additional opportunities we've identified for the rest of the year.

To provide the most relevant curated assortment for our customers, we're also using analytics and consumer insights as part of our category work to improve decision-making around our assortment and allocation of inventory.

Beyond merchandising capabilities, we're also working on our supply chain and inventory flow. We recognize the critical strategic and operational importance of supply chain, especially amid the broader supply chain challenges facing our industry. As a result, we identified opportunities across our network to improve efficiencies and capabilities, which ultimately improves our service to customers.

We have 4 initiatives in flight. First, improving the consistency and predictability of unit flow through our network. Second, increasing productivity in our distribution and fulfillment centers. Third, accelerating delivery speed. And finally, expanding the market level selection for in-store shopping as well as same-day and next-day pickup.

We believe these actions will improve the customer experience, increase sell-through, reduce markdowns and drive expense savings. While we still have work to do, we are encouraged by early results, and we expect to see more significant benefits in the second half of this year.

We also continue to evolve our merchandising model to improve customers' choices while increasing relevance. Alternative partnership models represented 12% of Nordstrom banner GMV this quarter as we continue to provide newness and selection by partnering with brands in new ways, beyond the legacy wholesale model.

We're also excited about our new brand launches. In the second quarter, we are launching Allbirds, a compelling fashion-forward, sustainable shoe brand. Nordstrom will be one of Allbirds' few key retail partners. Beginning June 1, we will offer men's and women's styles in select stores, with plans to launch on Nordstrom.com later this summer.

And we've also expanded our ASOS partnership, opening a new store at the Grove in Los Angeles last Friday, specifically designed to engage young adult customers. This is the first ASOS co-branded physical retail location and our first representation of a full ASOS in-person shopping experience. We had a great customer response to the launch, and we are excited for the opportunity ahead with this partnership.

We are expanding our choice count to grow wallet share with both existing and new customers. We entered Q2 with record high choice count, and we'll continue to use our category management process and enhanced analytics to offer more choices while increasing relevance.

As we look ahead to the second quarter, we are excited to serve our customers at our Anniversary Sale and believe that they will benefit from the timing of the event as they return to events and update their wardrobes. As always, our Anniversary Sale rewards and engages our loyal customers with brand-new product from the best brands at reduced prices for a limited time.

To deliver an even more compelling and profitable event, each year we look to make continuous improvement, using data science and consumer insights to identify the most successful components of past events and identify new opportunities for the upcoming year. For example, we're leveraging advanced analytics to inform the right depth and breadth of offers to drive profitable sales for this year's event. We have also put considerable effort into tracking Anniversary product and pulling forward receipts, which we expect will result in an improved inventory flow and allocation, better sell-through and an enhanced customer experience.

With this year's Anniversary Sale, we're focusing on new and highly coveted brands, bringing back in-store events and launching a new digital catalog. We are excited about our approach to Anniversary and the opportunity for us to provide a unique experience for our loyal customers while introducing new customers to Nordstrom.

In closing, with the work underway, we are confident in our ability to transform our business, deliver an even better customer experience and improve our efficiency and productivity.

I'll now turn it over to Anne to discuss our financial results.

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

Thank you, Pete. I'd like to begin with a review of our results, then take you through our outlook for the remainder of the year.

Earnings for the first quarter were $0.13 per diluted share. After excluding a gain on the sale of our interest in a corporate office building and an impairment charge related to a Trunk Club property, adjusted EPS was a loss of $0.06. Our first quarter earnings were negatively impacted by $0.05 per share due to discrete tax expenses, primarily related to stock-based compensation, which we do not expect to impact our full year projected rate of 27%.

Overall, net sales increased 19% in the first quarter. Nordstrom banner sales increased 23%, while GMV increased 25%, with both exceeding pre-pandemic levels. Nordstrom Rack sales increased 10% in the first quarter, driven by increased store traffic, improved conversion and better in-stock levels.

Digital sales were flat compared to the first quarter of 2021 as customers increasingly chose to shop in-store.

As contemplated in our guidance, we took retail price increases this quarter in response to inflationary pressure and higher MSRP prices from our vendors. At Nordstrom Rack, through our strategic pricing actions, we raised prices on items with the lowest elasticities. Across both banners, we saw minimum unit impact from these pricing actions. This quarter, our sales growth was supported by pricing actions, favorable mix shift and transaction growth.

At this point, we have not seen inflationary cost pressures adversely impact customer spending, which we believe is due to the higher income profile and resiliency of our customer base. This quarter, both customer counts and spend per customer increased versus the prior year.

Gross profit as a percentage of net sales, increased 190 basis points, primarily due to leverage on buying and occupancy costs and improved merchandise margins largely driven by favorable pricing impacts and lower markdown rates.

Ending inventory increased 24%, with approximately 1/4 of the inventory increase due to pull forward of Anniversary Sale receipts. As Pete indicated, we have taken steps to improve our tracking of Anniversary product and receive inventory earlier, which we expect will improve flow and sell-through. As a result, we believe we are well positioned for our upcoming Anniversary Sale.

Total SG&A as a percentage of net sales decreased 320 basis points in the first quarter, primarily due to leverage on higher sales. However, we continue to see pressure in labor and fulfillment, and we've been working since last year to deliver offsets through our supply chain optimization initiatives. We expect that benefits from supply chain optimization will build as we move through the year.

EBIT margin was 2.1% of sales for the first quarter. After excluding the gain on the sale of our interest in a corporate office building and the Trunk Club impairment charge, adjusted EBIT margin was 0.9%.

We continued to strengthen our financial position, ending the first quarter with $1.3 billion in available liquidity, including $484 million in cash and the full $800 million available on our revolving line of credit. This month, we entered into a new $800 million revolving credit agreement, replacing the previous agreement that was scheduled to expire in September 2023. The new agreement is another milestone in improving our capital structure post-pandemic, providing additional flexibility as we go forward.

Now turning to our updated outlook for fiscal 2022. I'd like to begin by describing the macroeconomic backdrop contemplated in our outlook. We continue to be encouraged by the momentum in our business as customers update their wardrobe and prepare for long-awaited occasions. To date, we haven't seen an adverse impact on customer spending from inflationary pressures, which we suspect is due to the higher income profile of our customer base.

We continue to see macro-related cost pressure in labor and fulfillment, which we factored into our guidance, along with offsetting benefits from our supply chain optimization initiatives. At the same time, we continue to consider macroeconomic headwinds, including the potential of more pronounced inflation impacts and supply chain disruption, both to our customer as well as to our margins.

Taking all these factors into consideration, we are updating our 2022 guidance to reflect our first quarter top line performance, which exceeded our expectations, while holding assumptions for the second quarter and the rest of the year consistent with our previous guidance.

For fiscal year 2022, we now expect revenue growth of 6% to 8% versus 2021. We continue to expect adjusted EBIT margin of approximately 5.6% to 6% for the full year. Our forecast assumes that year-over-year improvement in both gross profit margin and SG&A leverage will be significant contributors to 2022 adjusted EBIT margin.

Improvements in both gross profit margin and SG&A will be driven by leverage on higher sales, especially in the first half of the year, and benefits from our strategic initiatives, which will build throughout the year. All said, we expect similar levels of adjusted EBIT margin improvement between the first and second halves of the year compared to 2021.

Our effective tax rate is expected to be approximately 27% for the fiscal year. We now expect adjusted EPS of $3.20 to $3.50. Our outlook excludes the impact of any share repurchases.

I'd also like to provide some additional detail on our forecast for the second quarter. We anticipate that second quarter revenue growth will be approximately half that of the first quarter. Our projections include the impact of 1 week of our Anniversary Sale shifting into the second quarter, which adds approximately 200 basis points of revenue growth to the quarter. We expect that our second quarter EBIT margin will approach 2019 levels and that our tax rate will be roughly in line with our full year rate of 27%.

Shifting to capital allocation. Our first priority is investment in the business to better serve our customers and support long-term growth. We're planning capital expenditures at normalized levels of 3% to 4%, primarily to support supply chain and technology capabilities.

Our second priority is reducing our leverage. We are committed to an investment-grade credit rating and remain on track to decrease our leverage ratio to approximately 2.5x by the end of 2022.

Our third priority is returning cash to shareholders. This quarter, we resumed our quarterly cash dividend, and last week, our Board of Directors declared a quarterly cash dividend of $0.19 per share. Our Board also authorized a new $500 million share repurchase program. We plan to take a measured approach to share repurchases this year, aligning with our cash flow and market conditions.

In closing, we are very pleased to see the momentum in our business and customers reengaging with our core categories. We made the right investments to prepare for this shift, and we are well prepared to serve our customers in the moments that matter most to them. We are very excited about the momentum in our business and our plans to deliver shareholder value over the long-term.

With that, I'll turn it over to Heather for Q&A.

Heather Hollander - *Nordstrom, Inc. - Head of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Oliver Chen with Cowen.

Katy Hallberg - *Cowen*

This is Katy on for Oliver Chen. We would just love to know more about sort of how you're seeing the sales and cost environment. Obviously, labor and fulfillment, cost inflation. But just sort of as gross margin or on the sales side, you're seeing sales equal to that of 2019 levels, but gross margin, SG&A are sort of below those. Sort of could you bridge the gap there? Sort of what needs to happen in order to get gross margin back to the 2019 level.

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

Katy, I'll start off talking a little bit about this from a financial perspective. And then if Pete, Erik want to chime in from a macro -- more than welcome to.

As we talked about for the Q1, we knew we were coming in heavier in inventory and needed to work through some of that with the markdown component to it. So we compare some of our margin EBIT against Q1 of '19.

I would say the 2 biggest factors for us are: one, clearing through the markdowns that we've had, and we've gotten ourselves in a really good situation. We have a little bit of pockets in Q2 to address, but really coming out of Q1, we're very -- we've worked through a lot, worked through the majority of our inventory. We feel good about where inventory situation is.

And the second is, I think, as everyone's seen, is inbound freight costs, driving some of the cost of the product coming in and the gross margin component to it. I would just say stepping back and looking at our business in general, we are really pleased with our customer resiliency and the demand on the -- on our -- what we offer.

What we see from a sales perspective is that people are coming back to shopping for formal occasions. They're returning to office. And there's a wide range of categories and styles to update their wardrobes that really -- we're serving the customers well. We were prepared for this and ready for this, and I think the customers are really responding to that from a sales perspective.

As we've also talked about, we, like everyone else, have seen some inflationary pressures from labor and supply chain costs. We started seeing that last fall. It's contemplated in our guidance, and we started working early to try to address some productivity and offset to that throughout the year, which you're seeing in our guide.

Operator

Our 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*

Really nice quarter. I'd love for you guys to dive in a little bit deeper on Rack. It's been a little bit of a laggard among your segments the last several quarters, the flow of inventory, the access to some of the better inventory, maybe some merchandising opportunities.

Can you give us an update where we stand on Rack? It sounds like the business maybe got a little bit better, roughly around the same area. But are you seeing that flow of inventory, the quality that more improved especially as people start there, I think you mentioned refreshing the wardrobe, bring in new fashion for the real (inaudible)?

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

Great. So Omar, I think Erik is going to address that question for you.

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

Yes. Thanks for the question, Omar. We're pleased with our Rack results. Our plan going into the year and really going back last year was to, as we communicated, have sequential improvement quarter-after-quarter, and Q1 did achieve that.

As we've talked about, we've identified clear areas of focus for us and are making progress. So I would say we're still in the early innings on these initiatives. But Omar, specifically, a big one, which I think you touched on your question is the content of our inventory really getting to what is the secret sauce for our Rack business, is the coveted brands at great prices.

And those brands were harder to get. We were light on those last year, which drove our average price down more than we think is good for business, really what customers are looking for. That's starting to come back, not back all the way, but a much better position in getting the mix of brands that we want that's helping with our price points.

Another piece I just commented, it affects Rack, it affects our Nordstrom banner, too, as you look at Q1. Last year, we talked -- and certainly thought we were experiencing headwinds in the pandemic, both category-wise, what we have and geography of having more stores in more urban-type areas densely populated areas where there's an office component.

A lot of those headwinds have turned to tailwinds in Q1, and Rack participates in that as well. As customers are out more and care more about looking their best as they leave the home more, we benefit from that. And our category mix is set up really well for that. So that is a big part of the Rack business.

The other piece we've talked about in Rack is addressing traffic. Our traffic did increase over the quarter. We also saw improved conversion, better in-stock levels. And encouragingly, our momentum built throughout the quarter, each month being a little better than the previous month.

Lastly, I'd just point out, we felt we were hurt last year from some access to inventory and not having a pack and hold inventory to lean upon. We've been building that up, double to triple the size we had pre-pandemic. And we feel good about that, but that's -- there's still a lot of bumpiness out there in supply chain. We're certainly not immune to that. So having that pack and hold inventory, we feel good about.

Operator

Our next question comes from the line of Chuck Grom with Gordon Haskett.

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

Just one quick one for me on the Rack. I guess how would you guys handicap the mix today of premium brands versus where you want them to be in terms of editing the assortment versus pre-COVID levels?

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

Sorry, Chuck. Can you get -- I didn't get the first part of your question. Chuck, can you repeat the question?

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

Yes. So I mean just could you guys handicap the mix today of premium brands versus where do you want that to be in terms of any of the assortment over time?

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

Yes. I've talked to our merchandisers, the number, and this isn't a precise number, but it's about 80%. They felt that back -- so coming back most of the way, I'm not quite all the way back of having the access to these premium brands operating. So we still think there's some room to go there, and we've seen that continue to improve.

Operator

Our next question comes from the line of Simeon Siegel with BMO Capital Markets.

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

Congrats on the merch margin expansion. What was the ASP growth this quarter? And then maybe, Anne, just can you quantify what you're planning for merch margin in the second quarter and the full year embedded within the guide?

And then just lastly, as it grows, can you just quantify the margin benefit you received from the growth in alternative partnerships?

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

Yes. So on the ASP component, I would just say, in general, our top line increased by -- the vast majority was both category mix, as well as ASP improvements, both in Rack and in the Nordstrom banner. And we also see transaction growth as well. So when we combine all together, that -- those are really the big 3 drivers for both banners, for the growth in Q1.

As far as the margin components to it, in the guidance that we gave, what we really talked about for Q2 was that we -- that there's a 200 basis point swing compared to last year for pulling another week of Anniversary Sale in the quarter. And then it's roughly the same flow through, and we expect second quarter EBIT margin to start approaching 2019 levels.

And then in general, when we look at gross profit margin and SG&A leverage for the year, the way we're really thinking about this is that both our supply chain initiatives and our gross profit margin initiatives going on around our merchandise margin. It's really going to be -- those are really driving the improvements.

And we'll receive the leverage on higher sales, especially in the first half of the year, and then the benefits from our strategic initiatives, building throughout the year, but really being more impactful in the second half of the year.

And so when we think about the adjusted EBIT margin improvement, it's really similar levels of improvement between the first and second half compared to '21.

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

Great. And then just -- so how does the flow through work on the alternative partnerships? I assume as that grows, does that benefit?

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

Yes. So the GMV, and we talked about that, that was a big -- was a driver for us as well in the quarter. It really -- we have multiple different relationships, as you can imagine. But at the end of the day, the way we think about this is that it helps our return on invested capital. It's a better choice for the customers, higher selection choice.

And so what you typically see is it's flowing through what we call contribution margin. Some of it hit some revenue, some of it hit in the contribution margin. But at the end of the day, we're looking at the return on the contribution margin.

Operator

Our next question comes from the line of Michael Binetti with Credit Suisse.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Thanks for all the detail here today. Anne, could you help us understand how much excess freight impacted the first quarter and maybe what you baked into the guidance for the first half versus the second half on freight? And when do you see that improving?

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

Yes. So we haven't given particulars for each specific line items. What we did, and I'll refer you back to our guidance, as far as how we're thinking about the improvements in our freight cost and as well as our supply chain productivity initiatives that are going on.

We -- as I mentioned, we did bake in what we saw going on from both the labor and supply chain cost inflationary headwinds starting last fall. And what we did is we just assume -- we worked that through for this year as well. But we started early on trying to identify offsets on productivity. And so we continue to see that impact coming through the year as well.

As far as the -- what we're seeing coming through on cost pressures, a lot is already contemplated in our guide. And I would just encourage you think about the trends that we saw from last fall, and we assume this continues this year from an inflationary perspective.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

If I could ask a follow-up, as we try to look at the shape of the business and compare the business coming out of COVID to pre-COVID 2019, I think we're getting to the second half being about 71% to 72% of the total EBIT for the year. And I think in 2019 it was a little lower at 64%.

And I'm just eyeballing the Anniversary Sale date. I think there's little Anniversary Sale in the back half of 2019. But in general, is this becoming a more second half weighted business if we try to normalize for that change in Anniversary Sale versus pre-COVID?

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

No. I think what we've talked about was we're seeing improvement in our EBIT rates pretty consistent from first half and second half. And so yes, Anniversary Sale certainly shifts things around between half 1, half 2. But in general, we're not seeing a huge shift in the curve, in particular, in the business. It's just, again, Anniversary costs (inaudible) a little bit. But we're -- the way we've given the guidance is that the EBIT rate improvement is pretty similar half 1, half 2.

Operator

Our next question comes from the line of Jay Sole with UBS.

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

I know you just addressed this, but just wondering if you could clarify the statement on the gross margin that's implied in the guidance for Q2 because it looks like the implied EBIT margin guide for Q2 was about 50 to 75 basis points lower than what was previously implied. So I'm just wondering if the gross margin is driving the decrease and what you are embedding for gross margin in Q2?

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

Yes, Jay. So, we're not going to give specific line item guidance, but what I can say in general is that we're expecting both the SG&A improvement from a leverage perspective, as well as seeing some of the initiatives coming through from our productivity, as well as the gross margin piece. And then just to remind you, we do have Anniversary Sale coming in as well in the second quarter.

And so when we think about the Q2 guide, what we really have been trying to do is talk about the top line piece, which we say is about half the same growth rate as Q1. And then the second quarter EBIT margin will approach 2019 levels. So we're not giving specific line items, but I think that gives you enough to go on.

Operator

Our next question comes from the line of Brian Callen with Bank of America.

Our next question comes from the line of Tracy Kogan with Citigroup.

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

I think last quarter you talked about having too much inventory, and I think you said a little while ago that you were able to work through most of it. I was just curious, if you were able to do that at a better rate than you expected because you did note that your markdown levels were favorable to last year. And I don't know if it's just favorable to last year or if it was favorable to what you had expected going in?

And then secondly, I just wanted to ask about the digital sales performance at the full price versus the off-price business?

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

Yes. So from a markdown perspective, I'm going to let Pete weigh in on this as well. But from a markdown perspective, it was about what we thought it would be for this quarter. We didn't have favorability and that was only the better than last year. We were able to move through a lot -- a little bit better on the rate from last year as well.

On the digital component, we don't typically break that out by banner. What I will say is, for the quarter, it was about 39% penetration. We expect this -- to continue to -- we expect to see stores continue to be a bigger growth driver for us this year, and that's what we anticipated. But digital, in general, is a very important part of our business.

And quite frankly, we're pretty agnostic how a customer shops just as long as it's a great experience for them.

Heather Hollander - *Nordstrom, Inc. - Head of IR*

And we have time for one more question.

Operator

Our last question comes from the line of Carla Casella with JPMorgan.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

I had a question about -- on the shipping as well. So what percentage of your goods are coming in through that Port of L.A.? And have you made any adjustments for the potential for a strike in July?

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

Yes. So we -- as you can imagine, we -- we have our own product that comes in multiple ports, but we -- our vendors ship to us, and so we've been working with them, we're quite pleased in adjusting for Anniversary receipts. We've received more Anniversary receipts this year than we have in years past.

So we feel like we're in very good shape to be ready for the Anniversary Sale. And then in general, it is -- we certainly, from a Rack perspective, have opportunities. We receive goods from multiple areas. And so certainly, we watch this very closely, but we are -- we're making sure that we've got all the Anniversary product available.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

Okay. And then just one follow-up. You mentioned this in your urban stores are back to pre-pandemic levels. I'm assuming there's still some upside from tourism returning. Can you give a sense for what percentage of your sales today are tourism and where you think they should be longer term?

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

I don't have that number right now. I would say the urban stores, there's a mix in there. And really, we define that category by stores that have real concentration of offices in the area.

But to your tourism question, there's a pretty wide range of tourism. I would say we still have a number of downtowns that rely more on tourism that still have a ways to go to get to '19 levels. And there are some big stores for us.

So just as we called out our Manhattan flagship, there's good momentum there. We're encouraged where we're going. But even Manhattan, as a lot of you are there, well, there's certainly more tourism than there was 6 months ago, it's still sort of got some room to get back to normal, especially the international tourism. So we see some upside there for our urban stores.

Heather Hollander - *Nordstrom, Inc. - Head of IR*

Thank you. 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 and enjoy the rest of your day.
