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JWN.N - Q4 2021 Nordstrom Inc Earnings Call

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OVERVIEW:

Co. reported 4Q21 net sales increase vs. 4Q20 of 23%. Expects FY22 revenue growth to be between 5-7% and diluted EPS guidance to be $3.15-3.50.

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PRESENTATION

Operator

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

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

Heather Hollander - *Nordstrom, Inc. - Head of 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 fourth 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 fourth quarter results were marked by sequential sales improvement, strong digital growth, improved profitability and continued progress in executing on our long-term strategy.

Looking back on the fiscal year, revenue increased 38% versus 2020 and we delivered an EBIT margin of 3.4%, in line with our guidance.

Importantly, we've made progress on our strategic initiatives and have line of sight to achieving, in the coming year, the financial targets we presented at our 2021 Investor Event. Our team continues to work with urgency to build additional capabilities to better serve customers, expand market share and deliver greater profitability.

We are laser focused on the 3 key areas we outlined in the third quarter: improving Nordstrom Rack performance, increasing profitability and optimizing our supply chain and inventory flow.

Starting with Nordstrom Rack. Last quarter, we undertook a thorough analysis of the business and developed prescriptive plans to optimize the customer experience and improve our performance. As we raised inventory levels and improved average price points in our stores, we posted a sequential sales improvement of 320 basis points in the fourth quarter.

Though we are in the early stages of implementation, the Rack results and improving store customer satisfaction scores reaffirm our confidence in the plans we've outlined.

Nordstrom Rack is a unique mix of brands with limited distribution in the off-price sector. Customers are drawn to the Rack to purchase sought-after brands at a terrific price. Rack faces a unique challenge as off-price procurement of the same top brands that we carry at Nordstrom is particularly difficult in the current environment with production constraints and lower levels of clearance product.

As a result, we are executing a multilayered plan to both expand our offerings of the most coveted brands we carry as well as source from new vendors to ensure we have the selection our customers want.

In Q4, we improved our in-stock position at the Rack by increasing the flow of inventory, making more frequent deliveries to our stores, partnering with brands to prioritize Rack deliveries and focusing our sourcing efforts on core categories that matter most to customers such as shoes and apparel.

We're also increasing our opportunistic use of pack and hold inventory, allowing us to buy larger quantities of select relevant items when available then hold a portion of it to deploy in periods with high demand, tight supply or system constraints.

As we improve our supply of premium brands and fine-tune our assortment to better align with customer needs, we expect to achieve a better balance of price points at the Rack.

Finally, we are taking action to strengthen Rack's brand awareness and drive traffic. We are pleased with the results of our "More Reasons to Rack" marketing campaign, which showed a meaningful increase in future purchase intent.

Through this comprehensive set of actions, we anticipate continued improvement in Rack performance throughout fiscal 2022. To be clear, we are confident in our ability to profitably grow our Rack business and won't be satisfied until we do so.

Turning to profitability. We delivered significant improvement in merchandise margin this quarter. Pete will take you through our progress to date and our plans to deliver incremental improvement in 2022 through strategic pricing and category management.

Within SG&A, we rationalized our overhead cost structure in 2020 and remain committed to sustaining our expense discipline. Given the significant macro-related pressure in fulfillment and labor costs that we're facing currently, the team is taking action to mitigate the overall impact from those pressures, including optimizing our supply chain to drive efficiencies.

We expect that the supply chain optimization workstreams we began implementing this quarter will enhance the customer experience and drive top line growth while also driving efficiencies in labor and fulfillment in 2022. Pete will provide more detail on our plans for supply chain improvement in a moment.

Turning to fourth quarter performance. In addition to sequential improvement in our Rack banner, we saw strong enterprise digital growth of 23% versus 2019 and increased utilization of the interconnected capabilities delivered by our market strategy.

Nordstrom banner sales were flat, while gross merchandise value, or GMV, increased 2% in the fourth quarter versus 2019. We continue to see significant disparity in geographic performance. The Southern U.S., where 44% of our stores were located, was a source of strength for the Nordstrom banner, outperforming the Northern U.S. by approximately 7 percentage points. Notably, suburban locations outperformed our urban locations by 10 percentage points in the fourth quarter as city centers have been disproportionately impacted by the effects of the pandemic.

In addition to the 3 focus areas that I've discussed, the team continues to make progress in the key strategic growth priorities we laid out at our Investor Event last year, winning in our most important markets and increasing our digital velocity.

Starting with our priority to win in our most important markets. We are leveraging a strong store fleet that positions us physically closer to the customer. Our strategy links our omnichannel capabilities at the local market level, allowing us to drive customer engagement through better service and greater access to product no matter how customers choose to shop.

This platform is a unique differentiator, delivering unmatched convenience and providing customers with 4x more product available for next-day pickup, a 1-day reduction in average shipping time and the ability to pick up orders at the Nordstrom, Nordstrom Local or Nordstrom Rack location of their choice.

We continue to scale the enhanced options we launched in 2020, like the expansion of order pickup and ship to store to all Nordstrom Rack locations, with order pickup reaching a record high 11% of Nordstrom.com sales this quarter. And 1/3 of next-day Nordstrom.com demand was picked up at Rack stores, demonstrating the power of integrating capabilities across our 2 banners and across our digital and physical platforms.

We are encouraged by increases in order pickup demand, a leading indicator of future growth as customers utilizing in-store pickup have higher engagement and spend 3.5x more than customers who don't utilize the service.

Increasing Buy Online, Pick Up In-Store utilization is advantageous as it is both our highest satisfaction customer experience and most profitable customer journey. Customers clearly value the strength of our omnichannel model as evidenced by a dramatic increase in spend when they engage across our multiple channels, banners and services. For example, the average customer that shops across both banners, in-store and online, spends over 12x more than a customer utilizing a single channel and banner.

We also continue to evolve our approach to get closer to our customers than ever before, building deeper connections through our loyalty program and differentiated service model. Our Nordy Club loyalty program is a powerful engagement driver with 67% sales penetration in 2021. Our core customers remain highly engaged with loyalty customer accounts exceeding 2019 levels.

We're also pleased to see customers responding well to our assortment and services with new customer acquisition activity returning to 2019 levels. We continue to advance our digital tools, including virtual style boards and style links to allow our salespeople to offer our customers highly relevant recommendations, both in-store and digitally.

This year, remote selling sales volume increased 63% versus last year. We're encouraged by the results of this program with very high customer satisfaction scores and average customer spend over 6x that of an average Nordstrom customer.

With regard to increasing our digital velocity, we maintained strong growth at Nordstrom.com and NordstromRack.com this quarter with digital sales increasing 23% over the fourth quarter of 2019. With continued growth in digital, our total penetration has increased by 9 percentage points over the past 2 years to 44%. In the fourth quarter, we also saw a record high mobile app usage with mobile users representing approximately 70% of total digital traffic.

Though we still have much work to do on our transformation, the progress we've made gives us confidence in our strategic plans and business outlook for 2022. We believe there is a meaningful opportunity ahead for us to better serve customers by improving Rack performance and transforming our supply chain, leading to increased profitability and shareholder value creation.

We have line of sight to achieving the financial targets outlined at our 2021 Investor Event while building the capabilities to profitably grow market share beyond that. We look forward to sharing our continued progress in the quarters ahead.

As we look back on the year and look forward to 2022, we'd like to thank our outstanding team for their tireless dedication to serving customers, building new capabilities and evolving our company. Our people are truly our greatest asset.

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'd like to talk about our category performance during the fourth quarter then follow with an update on our initiatives to increase gross margin, improve supply chain and inventory flow, and transform our merchandising model.

Starting with the category performance. We were pleased to see continued strength in our luxury categories in the fourth quarter with designer and fine jewelry posting strong double-digit growth over 2019. Beauty also had a double-digit increase driven by strong growth in our Nordstrom banner and the launch of an expanded offering in the Rack.

And pandemic-related categories continued to outperform, particularly home and active with sales up 52% and 22%, respectively, compared to 2019 levels. Our core categories in apparel and shoes, which collectively make up more than 70% of our business, are not quite back to 2019 levels but they are recovering. We saw signs of renewing customer interest in post-pandemic occasion-based categories with improving trends in dresses, men's sportswear, outerwear and women's shoes.

Now on to our initiatives. We believe we have a meaningful opportunity to improve both the customer experience and our financial outcomes through our efforts around merchandising and inventory flow. This quarter, we made significant progress improving our merchandise margin versus 2019.

As we entered the holiday season, our team focused on driving sales and engaging customers through our compelling holiday offering while also increasing profitability. Leveraging advanced analytical tools, we identified opportunities to expand holiday gifting and increase our promotional effectiveness by optimizing the pace and depth of markdowns.

We're very encouraged by the results with merchandise margins up 235 basis points over 2019, and we see more opportunity to drive additional margin improvements in '22.

To provide the best possible assortment for our customers, we are also using a data-driven, customer-centric approach to optimize our category management. Through this work, we are defining the role of each category at Nordstrom and Nordstrom Rack and then optimizing our assortment for the role each category plays.

Our goal is to attract new customers, increase share of wallet with existing customers and improve merchandise margins by focusing on the most highly sought-after items.

Women's Denim is a great example of the potential in our category management work. Denim has always been an important category for our customers and a strong performer for us too. But our analysis highlighted an opportunity to lean into it as more of a destination category. In response to our analysis, we increased inventory depth for the most highly sought-after jeans to ensure that we are in-stock for our customers, piloted a dedicated in-store Women's Denim shop to better highlight our extensive selection and make it easier to shop, and planned a campaign aligned with April's Earth Month to showcase a curated group of denim brands with a focus on sustainability. We are very pleased with the initial results we've seen with our category management initiative and plan to build on this momentum in 2022.

While we continue to develop these merchandising capabilities, we're simultaneously focused on improving our supply chain and inventory flow. We've all been dealing with global supply chain disruptions for a while now with product scarcity, order cancellations and shipment delays.

Entering the fourth quarter, we took an aggressive approach to securing product for the holiday season and early spring. This helped to ensure that we are in stock for our customers. However, these supply chain challenges have recently begun to improve a bit, and order cancellations weren't as significant as we anticipated. As a result, our ending inventory was higher than planned but we expect to cut our sales to inventory spread in half by the end of the first quarter.

We've learned a lot from our experience navigating pandemic-related supply chain disruptions and revolving our network processes and capabilities across several fronts. First, improving the consistency and predictability of unit flow through our network; second, improving velocity and throughput in our distribution and fulfillment centers; third, increasing delivery speed; and finally, expanding the selection for in-store shopping as well as same day and next day pickup.

These actions will improve the customer experience, increase sell-through and reduce markdowns by allowing us to place the right assortment with the right depth closer to the customer. They will also help us improve our expense efficiency. We expect to see benefits from these actions beginning in the first half of fiscal 2022 with more to follow in the second half.

As we look ahead, we are excited about the ongoing transformation of our business and our plans to deliver enhanced experiences to our customers and value to our shareholders.

We continue to scale our Nordstrom Media Network, which allows our brand partners to directly connect with Nordstrom customers through on and off-site media campaigns to increase traffic, sales and engagement. We grew the concept in 2021 with some of our best brands, and we're pleased with the value it brought to our customers and partners. We look forward to expanding this program over the next 2 to 3 years.

We are also delivering newness, selection and inspiration to our customers by partnering with brands in new ways. Our alternative partnership models have gained approximately 300 basis points as a percent of Nordstrom banner GMV since 2019, reaching 10% today.

We launched over 300 new brands and partnerships this year, including Open Edit, Farm Rio, Fanatics and ASOS DESIGN. We also grew and scaled top brands through 2021, including Nike, Ugg, Tory Burch, Adidas, Free People and Luxottica. We've also scaled brands that started out as direct-to-consumer partners such as SKIMS, On Running, LL Bean, Good American and Vuori. And we continued to grow our business in designer and luxury brands, including Chanel, Gucci, Saint Laurent, Dior and Burberry.

After growing choice count by 50% this year, we entered 2022 with record-high selection. We'll continue to significantly expand our choice count, leveraging our category management process and enhanced analytics to deliver a curated, relevant assortment that attracts new customers while expanding wallet share with our existing customers.

In closing, as we enhance our capabilities, the customer remains at the center of our work. We are transforming our approach and leveraging deeper insights to give the customer more choices while increasing relevance and profitability. As we improve our supply chain and merchandising ecosystems, we'll deliver a better experience through faster and more flexible fulfillment, providing newness at the right price with the right quantities where and when our customers want it, all while improving our agility and productivity.

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

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

Thanks, Pete. I'd like to begin with a review of our results, then take you through our outlook for fiscal 2022.

Overall, net sales increased 23% in the fourth quarter compared to the same period in fiscal 2020 and decreased 1% compared to the same period in fiscal 2019. Total revenue finished the year up 38%, in line with our guidance.

From this point forward, I'll speak to comparisons versus 2019 unless otherwise noted.

In the fourth quarter, Nordstrom banner sales were flat while GMV increased 2%. As alternative vendor partnership models have become a more significant portion of the business, GMV provides an additional measure of our top line performance.

Nordstrom Rack sales declined 5% in the fourth quarter, a sequential improvement of 320 basis points over the third quarter, as we raised inventory levels and improved average price points in our stores. And as Erik mentioned, we are executing a multilayer plan to improve Rack's performance and capture market share in the off-price sector.

Our digital business continues to grow with fourth quarter sales increasing 23%.

Gross profit as a percentage of net sales increased 340 basis points primarily due to increased promotional effectiveness, fewer markdowns and leverage in buying and occupancy costs.

Ending inventory increased 19%, with approximately half of the inventory increase due to planned investments to ensure in-stock merchandise availability. As Pete indicated, we plan to reduce our sales to inventory spread by half by the end of the first quarter.

Total SG&A as a percentage of net sales increased 340 basis points in the fourth quarter as a result of continued macro-related fulfillment and labor cost pressures. We made purposeful investments in both store and fulfillment center staffing as we prioritize serving our customers and navigating the continued COVID-related disruption. These increased expenses were partially offset by continued benefits from resetting the cost structure in 2020 and a $32 million noncash asset impairment charge in 2019.

EBIT margin was 6.8% of sales for the fourth quarter, an improvement of 10 basis points. For the year, EBIT margin was 3.4%, toward the high end of our guidance.

We continue to strengthen our financial position, ending the year with $1.1 billion in liquidity, including $800 million fully available on our revolver a leverage ratio of 3.2x.

Now turning to our outlook for fiscal 2022. I'll begin by outlining the macroeconomic assumptions underlying our projections.

We expect that wage growth and higher employment levels will support consumer spending in 2022. Potential headwinds include the impact of inflation, which could reduce overall discretionary income, and geopolitical risk to the economy and financial markets. We are seeing encouraging early signs of a resumption of activities such as travel, in-person social events and return to office after being delayed by the Omicron variant.

At the same time, we continue to be prepared for the potential of further pandemic-related disruptions in consumer behavior and global supply chain. Taking all these factors into consideration, we are assuming a roughly even balance of upside and downside macroeconomic risk relative to current conditions and are planning accordingly.

Our 2022 outlook reflects our plans to drive top line growth through our interconnected digital and physical assets and deliver continued improvement in Nordstrom Rack performance.

As we derive more benefits from our pricing and category management improvements as well as planned mid-single-digit average retail price increases, we expect continued merchandise margin improvement.

Finally, we plan to partially offset inflationary freight and labor costs with greater productivity from the actions we were taking to optimize our supply chain. Today, we are providing our fiscal 2022 business outlook with comparisons to 2021.

For the fiscal year 2022, we expect revenue growth of 5% to 7%. We anticipate that seasonality between the first and second half of the year will be consistent with pre-COVID levels, resulting in higher year-over-year growth rates in the first half as we lap softer comparisons from early 2021.

We also expect that year-over-year sales growth will be roughly consistent between Q1 and Q2, with the Anniversary Sale shifting back to the second quarter. We expect EBIT margin of approximately 5.6% to 6% for the full year. We anticipate that EBIT margin improvements will also be consistent between the first and second half of 2022 as a result of increased operating leverage, improvements in gross and profit margins and greater expense efficiencies.

Our plan assumes that first quarter EBIT will be slightly better than breakeven. Our effective tax rate is expected to be approximately 27% for the fiscal year. Given solid top line growth, coupled with progress on our productivity initiatives, we expect diluted earnings per share of $3.15 to $3.50 for the year, which excludes the impact of share repurchases, if any.

Turning now to capital allocation. Our first priority is investment in the business to serve our customers and deliver the highest quality experience. 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. Subject to completion of our year-end audit and the related certification process with our bank group, we expect to be in a position to resume returning cash to shareholders in the first quarter. We anticipate completing that process by mid-March and discussing with our Board shortly thereafter the resumption of a quarterly dividend at an appropriate rate.

As you've heard today, we delivered results in line with our guidance and demonstrated progress against our strategic initiatives. We now have a clear line of sight to achieving our Investor Event targets in the coming year. Though there is more work ahead, the early indicators we're seeing with improving Rack performance and increased merchandise margin give us confidence in our plan.

We also made significant progress on our merchandising strategies throughout 2021. Choice count is now at an all-time high with more than 300 new brands launched last year, and growth in alternative partnership models, all of which position us to grow sales by delivering newness, selection and inspiration to our customers. Our stores and fulfillment centers are fully staffed and ready to serve customers no matter how they want to shop.

We continue to act with a sense of urgency to achieve greater profitability and cash flow as we optimize across platforms and drive scale.

In closing, we remain excited about the future of our business, the work ahead and our ability to deliver significant shareholder value over the long term.

I'd like to now 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 Omar Saad with Evercore ISI.

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

Nice job, especially on the profitability. It's great to see. I had a question -- my first question on the guidance. Sales were, I think, kind of little slightly down versus pre-COVID in the quarter. You're guiding for mid-single digits, slightly better. What are the key kind of building blocks that give you comfort in that kind of acceleration you see in '22? Is it kind of there are already signs of this kind of post-January Omicron acceleration? Is it the seeing the return of occasion demand? Is there something in the customer data you're seeing, maybe some of the older customers or maybe some of the more Northern markets that have been impacted by COVID more, coming back strongly? I'd love to kind of get more flavor for some of the underlying color behind your expectation for that acceleration? And then I have a quick follow-up.

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

I'm going to start with the conversation on the guidance and then I invite Pete and Erik to weigh in if they have any incremental thoughts on that.

So first of all, our guidance is really on the top line of 5% to 7% up to -- '21 versus '22. And it's really on 2 pieces to it. And I think you already start to see the progress in this in Q4 as we're coming out of the quarter. But really, the guidance is based on expecting the top line growth to be driven by improved performance at the Nordstrom Rack and steady growth at Nordstrom.

And it's really leveraging our market strategy and all the advancements we have in merchandising plus some of the work that we've been doing in category management and supply chain improvement across the board.

We expect that our customer -- we're continuing to see progress with our customers coming out of Omicron. And we are encouraged by what we're seeing both on a trend basis and a macro basis as well as we see customers coming -- we see consumers in general coming back to doing things like travel, socializing occasions and some return to work.

We did balance all that out with the headwinds and tailwinds on the inflationary pieces to it and on par really just kind of equal each other out from the top and bottom line.

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

Yes. Omar, this is Erik. I'd just to add that off of Anne's comment on the external factors we see kind of balancing each other out, it's really about our internal efforts. And we continue to see kind of slow, steady, consistent progress quarter-to-quarter. And we have continued signs that's occurring.

We have a lot of effort going on in our Rack business. And while we saw some improvements last quarter, we have a ways to go. And we're hard at work on that, and we like our plans and believe there's opportunity for continued improvement there.

The Nordstrom banner business has been steady and very healthy. And the 2 geographic data points we continue to see, which give us an encouragement about the whole country opening up is, number one, the difference between North and South. Our Southern Nordstrom [markets outperformed our Northern Nordstrom markets] (corrected by company after the call) by 7 percentage points. And then the more urban stores versus suburban stores, our urban stores are 10 percentage points behind.

And it's pretty obvious when you're in these locations, the vast majority of workers in these really dense employment areas have not come back. And that's just starting to happen and we expect that not only will that help these locations. These locations are some of our biggest stores. So we see some opportunities. We do a lot of scenario planning, so we're prepared for volatility. But the direction of travel does give us confidence.

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

Omar, you said a second question?

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

Quickly, you guys obviously have a really big digital footprint at this point and a lot of traffic, sounds like a lot of it is on mobile. Maybe talk a little bit about your 3p/marketplace, advertising services, ways you can leverage that traffic? And when -- what's the kind of time line to see -- have those types of items be more impactful on the bottom line?

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

Yes, I'll start. For Nordstrom Media [Network] (corrected by company after the call) or our advertising platform, we started that and had a good response there. So again, a way of monetizing the traffic on our site and scale of our business, which I think it is the most important thing. When you look at our digital business, it's large. It's a big chunk of our business and gets a lot of traffic.

It is one of the key attributes that allow us to be the softer partner for a lot of up-and-coming brands, especially digitally native brands that we can expose their brands to a lot of people that wouldn't see them otherwise.

We've talked about alternative models for a while and have seen a lot of growth there. We think that's going to continue and grow quite a bit more. So we're focused on our platform -- technology platform to enable more ways to bring product to our customers and support different models. So I feel confident you'll continue to see that area grow for us.

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

Omar, I would just add, you're already starting to see that when we talk about our GMV, particularly with the Nordstrom banner. It's -- we're up 2% with our sales with -- our GMV included in that. So we're already starting to see some of that in that business.

Operator

Next is Oliver Chen with Cowen and Co.

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

Regarding the Rack division, as we look ahead, what are your thoughts about the good, better, best in the pricing architecture now? What are the big opportunities? And roughly, what inning are you on in terms of what's underway?

And then also on the inventory composition now, I would be just curious about categories where you may not have had enough and then the nature of categories where you had too much, as well as how you're thinking about processes just to do your best to manage supply versus demand on a sustainable value-creating basis going forward?

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

Yes. This is Pete. I think relative to the Rack opportunity, as you know, we've tried some different things. That started with really broadening the aperture of our price strategy there and offering some lower prices in an attempt to gain new customers.

And that works, I think -- but what we've also learned is you can't do that at the expense of the existing stuff that we have that customers really truly value, our existing customers. And that's kind of the more premier-type brands that we have some unique access to.

So I think what we've confirmed ourselves is we have a really good situation with our existing customers, the people that love Nordstrom Rack. And we need to build upon that by expanding what we do, not trading off what we do.

And so I think there's a lot of opportunity for us to improve the balance of our offer and to be more surgical about how we apply it geographically. We have better ability to do that through better insights and just the learnings that we've had over this last year.

So as to what inning it's in, I don't think that game ever ends. It's going to keep going into extra innings because there's just -- it continues to evolve, we continue to learn and we're investing a lot of energy in working on that. I mean it's important for us to improve our Rack business. And we have certainly sharpened our resolve and our rigor over this last year with what we've learned and have a lot of confidence about where we're going.

In terms of the inventory composition, yes, the headline numbers don't really tell the whole story because a big part of what we lived through this last year was kind of trying to chase in to and react to what was happening in real time with COVID. So you heard us talk about, for example, our big improvements in categories like home and active.

And that's all true, but at the same time, while that was a really good business and some other businesses weren't, things came back quicker than we could have anticipated largely last summer and fall. And then we found ourselves in a position of chasing inventory and stuff that traditionally we've been pretty strong at, any occasion types of dressing. And that's everything from travel to return to work to any kind of social occasions.

And so what we're seeing now really over the last several months is strong momentum on return with those types of franchise categories that we traditionally have done well with. But it's also true that we built up success with those expanding categories too.

So again, it's somewhat like the Rack thing. I think it's looking at it across the entire spectrum and focusing on the balance of where we need to go. And the volatility of -- simmers down a little bit because it was pretty lumpy. I think it gives us a lot of confidence that we have the broad assortment that it's going to be really good and effective for us.

So it's -- I think there's a lot for us to be focused on in terms of where we're going to invest going forward.

Operator

Next is Chuck Grom with Gordon Haskett.

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

Anne, I was hoping you could help bridge the gap for us from last year's 3.4% operating margin to the 5% to 6% operating margin guidance for this year between gross margin and SG&A? And also if you could elaborate on why you're expecting the first quarter to be close to breakeven? That's my first question.

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

Chuck, yes, let me give you a little bit of context around it. So while we don't necessarily guide to specific lines in our P&L, what I can share with you is that, really, we talked about we have got mid-single-digit price increases that are basically offsetting the inflationary cost pressures that we've seen both in our supply chain fulfillment as well as the labor cost, which all run through our SG&A line just as a reminder.

The biggest piece of the improvement, so over half of it is really coming from leverage that we're getting from top line growth. And the remainder of that bridge is really coming from the initiatives that Pete and Erik had talked about in their scripts and their opening comments between the merchandise margin work that we've been doing, the category management pieces to this that we've seen nice progress and early success in the fourth quarter that are going to continue into next year, as well as the efficiencies that Pete talked about in his comments regarding fulfillment supply chain efficiencies.

So that's really the -- if I had to give a high level piece of that, that is really the components of the bridge.

As far as Q1, that's always a very small quarter for us in general. While we did guide to the split on sales growth, first half, second half and it being more weighted from a growth rate perspective in the first half given the comps that we have, the comparisons we have to '21, it's always been a really small quarter for us. And with that, you do get a little bit less deleverage on the quarter.

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

Okay. That's very helpful. And then you touched on my second question. You referenced this, the mid-single-digit AUR increase. Can you remind us, I guess, what your AUR was in 2021 or maybe in the fourth quarter? And I guess how do you test to that? Have you seen any demand destruction and just your degree of confidence in raising retails to that degree?

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

Yes. So in general, I would say it's really split between the 2 banners. So for the Nordstrom banner, it's really -- we work with our brand partners and fix with the pricing in the industry.

The Rack is really we have a little bit more room to look at price elasticity. We did do some testing in Q4 primarily in Rack. And we haven't seen the customer pull back on purchases or any resistance at all. So that gives us a lot of confidence as we head into this year.

So what you're hearing us talk about is both what we're seeing in the market and hearing from our brand partners but also some of the work that we've done in the quarter as well heading into next year.

Operator

Next is Simeon Siegel with BMO Capital Markets.

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

Congrats on the quarter. The alternative brand story is really exciting. Congrats on the progress there. Just can you speak to where you think the delta between GMV and sales should go over time and what the margin impact should be for that evolution?

And then just my follow-up, any way to quantify the inventory growth between units versus cost? And to the earlier point, what percent of inventory is pack and hold?

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

Erik, do you want to talk a little bit about where we're seeing the GMV go? And then I can fill in with some of the other questions.

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

Yes. We really don't have precision to apply on what GMV will be versus sales. Directionally, to Anne's earlier point, GMV is going to continue to be a bigger gap, between that and sales. These alternative models will be a bigger chunk of our total business. That's what we're working on, and we've seen really strong results from that.

And I would step back and also add it's -- there's the financial model to it, but it's also super important of what the brands are. So being a coveted retail partner for the best brands in the world is something that -- its been super important for our business for many years and it continues to be. There is a real good story that we continue to see and have proof points with our brand partners of being able to grow the pie for both of us.

So then it becomes negotiation on how you split up that pie, and that's gone really well. So that's -- having the right brand partners is a big part of it, but there is a platform capability part of it that we continue to really work at. And I would say the direction should not be linear on that. It's as we build out our capabilities, it greatly enhances our ability to scale more choice.

And the example we've had recently has been with Fanatics and being able to add, I believe it's almost 50,000 customer choices onto our site in a much more accelerated way than we were able to previously, is a good example of where we're trying to go, where we can take coveted brands, take adjacent categories to what we sell and really drive some incremental business by adding significantly more customer choice.

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

And then on the -- I would just say in general, between how we're thinking about our inventory positioning, as Pete talked about, we're really focused on making sure that we've got the right assortment, we're leaning in on areas that we're seeing customers really starting to come back and respond to the occasion base of things.

And part of our strategy and what you're seeing as far as the guide for '22 is really based on getting that inventory closer to the customer because it does help reduce our cost to serve customers, as well as it gets the -- a bigger assortment in front of customers more quickly for same-day and next-day deliveries and particularly for specific markets.

As we think about the overall guide as well, we balance everything from price points to inventory. We are anticipating that we should drive more, I would say, profitability per unit as we go through the year as we continue to balance and have a more even flow of our inventory units.

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

And so just when thinking about the inflation, any delta between inventory units versus at cost, just how you're thinking about EC?

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

I don't think it's a meaningful piece of what you're going to see as far as sales to inventory spreads. Certainly, everyone's seeing increases in freight costs, landed cost, that type of thing. But in general, that's part of -- as we talked about the mid-single-digit pricing change, it really contemplates some of those components in that guide.

Operator

Our last question comes from Tracy Kogan with Citi.

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

I was wondering if you could talk about your EBIT margin guidance and what that assumes for Rack versus full pricing. I'm wondering if the EBIT margin improvement is more driven by a recovery in Rack? And if that's the case, where do you assume Rack gets to relative to historical levels?

And then secondly, I was wondering if you could just give us a little more detail on your overall SG&A dollar growth expectations for '22?

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

Yes. Thanks for the question, Tracy. I would just say we don't typically guide by segment on EBIT margin. What we'll do is give some rather context around our top line, how we're thinking about the growth in general.

Prior to COVID, both of our -- both our Nordstrom Rack and our Nordstrom divisions, in general, operated at parity around EBIT. Clearly, as the Rack continues to improve and we get more top line growth, we will see more leverage in our expense base, which would help drive more our profitability.

But what I would just say in general, as we think back on this, we're expecting to see top line growth both in Rack as it continues to recover and also steady growth in our Nordstrom banner, which will both contribute to our bottom line EBIT rates.

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

And then the SG&A dollar growth?

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

Yes. We typically don't give guidance on specific line items. What we did try to do is give you a bridge on where our EBIT rates were and how we're thinking about efficiencies both in our merchandise margins throughout the year.

And we're also continuing to see, working on efficiencies, productivity in our supply chain component of SG&A, which will help offset some of the inflationary pressures we're seeing on wages and freight costs.

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

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. Enjoy the rest of your day.
