Nordstrom, Inc. (JWN) Management on Q3 2019 Results - Earnings Call Transcript

Nov. 21, 2019 9:48 PM ET
by: SA Transcripts

FQ3: 11-21-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.81 beats by $0.17 | Revenue of $3.67B (-2.03% Y/Y) beats by $1.13M

Earning Call Audio

Subscribers Only

00:00 -47:34

Nordstrom, Inc. (NYSE:JWN) Q3 2019 Results Conference Call November 21, 2019 4:45 PM ET

Company Participants

Trina Schurman - Director of Investor Relations

Erik Nordstrom - Co-President

Anne Bramman - Chief Financial Officer

Pete Nordstrom - Co-President

Conference Call Participants

Omar Saad - Evercore

Oliver Chen - Cowen

Edward Yruma - KeyBanc Capital Markets

Alex Walvis - Goldman Sachs

Connor Konicke - Robert W. Baird

Tracy Kogan - Citi

Michael Binetti - Credit Suisse

Heather Balsky - Bank of America Merrill Lynch

Operator

Greetings, and welcome to the Nordstrom Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. We will begin with prepared remarks followed by a question-and-answer session [Operator Instructions]. As a reminder, this conference is being recorded.

At this time, I'll turn the call over to Trina Schurman, Director of Investor Relations for Nordstrom. You may begin.

Trina Schurman

Good afternoon, and thank you, for joining us. Today's earnings call will last 45 minutes and will include 30 minutes for your questions. Before we begin, I want to mention that we'll be referring to slides, which can be viewed by going to the Investor Relations section of nordstrom.com. Our discussion may include forward-looking statements, so please refer to the slide showing our Safe Harbor language.

Participating in today's call are Erik Nordstrom, Co-President and Anne Bramman, Chief Financial Officer, who will discuss the company's third quarter performance and outlook for 2019. Joining during the Q&A session will be Pete Nordstrom, Co-President.

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

Erik Nordstrom

Thank you for joining us today. We're pleased with our results. Our market strategy is transforming our business model and how we're serving customer. We have a unique mix of assets, Full Price, Off Price, stores and online, and we are further linking our business to serve customers in new and differentiated ways. The success of our strategy in Los Angeles adds to our confidence as we expand to our top 10 markets. We recently achieved an important milestone with the opening of the New York City flagship store, significantly increasing our presence in the world's top retail market.

Turning to our third quarter results. Our earnings exceeded expectations, demonstrating substantial progress in the delivery of our strategy and strength of our operating discipline. Through our customer focus, we drove broad base improvement in top line trend of more than 200 basis points relative to the first half of the year. In particular, the Off Price business delivered positive sales growth and increased profitability through strong inventory and expense execution. We're encouraged by the momentum in our Full Price and Off Price businesses as we execute our holiday strategy to establish Nordstrom as a gifting destination for our customers.

Through our focus on driving top and bottom line, we've made notable changes to two key events, our anniversary sale and holiday. As we discussed previously, the priorities for anniversary are to improve customer satisfaction, drive sales and increase profitability. Customer feedback from this year's event was positive, significantly raising satisfaction scores. We curated the assortment by building more depth in key brands and items, driving higher sell-throughs. As a result, we had fewer mark downs on anniversary product in the third quarter, which contributed substantially to merchandize margin.

For the holidays, we are meaningfully expanding our gifting offer across Full Price and Off Price, and making it easier for customers to find gifts by recipient and price point. We're also making shopping more convenient with services, such as free next day shipping, 24/7 order pickup and complementary gift wrapping.

The momentum in our Off Price business delivered positive sales growth on less inventory. We also increased turns for the eighth consecutive quarter and exceeded bottom line expectations. We've been purposeful about improving inventory flow, refining product allocation and emphasizing merchandise that's seasonally relevant. Our favorable inventory position allows us to be opportunistic in the marketplace, and leads to having a good flow of new product for customers to discover.

Another way we're leveraging inventory is through our market strategy. The investments in digital capabilities, along with assets of people, product and place, enable us to serve customers on their terms. Our goal is to gain market share while driving customer engagement and inventory efficiencies. There are two elements to this strategy. First, we're giving customers greater merchandise selection with faster delivery without increasing inventory levels. Second, we're engaging with customers by offering express services, such as order pickup, returns and alterations at additional locations.

We first launched our market strategy in Los Angeles, our largest market, where results are exceeding expectations. Third quarter sales growth outpaced other markets by 100 basis points. In LA, the growth in customers shopping in stores and online was also 100 basis points higher than our average. We anticipate that these customers will increase their spend by four-times. Additionally, merchandise sell-throughs were higher in these stores than in other markets, contributing to profitability.

We recently rolled out our market strategy in New York City, San Francisco, Chicago and Dallas. In a broader New York City market, customers now have faster access to inventory across eight full line stores, including our flagship and our fulfillment center. This represents seven times more selection available for same day pickup or next day delivery.

Leveraging existing store assets and digital capabilities enabled us to implement their shared inventory approach without making additional material investments. Order pickup is our most profitable transaction and the fourth quarter accounts for 40% of its volume. This represents a meaningful opportunity to increase convenience for customers during the holidays and at a lower cost for us.

Going forward, we're accelerating this strategy to our remaining top 10 markets by the end of 2020 through our continued focus on shared inventory and access to services. This includes plans to open more Nordstrom local service hubs in Los Angeles and New York. We will leverage additional Rack locations to offer express services, such as order pickup, returns and alterations.

And finally, we opened our New York City flagship store on October 24th. We've seen strong customer response with 85,000 visits during the opening weekend alone. New York City represents our largest online market, and we expect to see a halo effect when we open a physical location. Already, the sales uptick in the men's store is exceeding expectations.

In addition, one of Nordstrom's key points of difference is the breadth of our merchandise assortment, which creates an inclusive shopping experience. Customers at this store have responded to our offering and top performing brands include Nordstrom Maze Labels, Topshop, Nike, Canada Goose, Louis Vuitton and Valentino. Opening this flagship has been perhaps the most important milestone in our company's long history. It is a combination of efforts across so many people, and we are grateful to them all.

First of all, to the many Nordstrom alumni who over the years established the reputation with customers and as an employer that allowed the opportunity to be there for us and to our current team across the company, our business is about team and this has never been more true. We are proud of their dedication and passion to bring this store Nordstrom life. Pete and I feel most fortunate to work with so many talented, caring and hardworking people.

I'll now turn it over to Anne to discuss our financial results and expectations for the remainder of the year.

Anne Bramman

Thanks Erik. For the third quarter, we reported EPS of $0.81, exceeding our expectations. We made meaningful progress in improving the customer service and continuing our operational discipline. The consistent strength of our inventory and expense execution contributed to EBIT margin expansion for the quarter. We are delivering on our strategy while driving top and bottom line results.

Third quarter sales decreased 2.2% in line with expectation. Full Price decreased 4.1% and Off Price increased 1.2%. Sales trends improved by more than 200 basis points from the first half of the year. We saw broad based improvement across Full Price and Off Price, driven by actions we're taking related to loyalty, digital marketing and merchandize assortment. Digital sales represented 34% of our business, up 300 basis points from a year ago. We saw sequential improvement in digital trends throughout the quarter, mostly notably at nordstorm.com.

Customer satisfaction of course our royalty program continued to rebound, and digital marketing efforts are driving traffic. As we rebalance our merchandize assortment, we are increasing depth in key items in Full Price, and accelerating seasonal receipts in Off Price. All merchandize divisions in both businesses improved relative to the first half of the year.

Our gross profit rates increased by 100 basis points over last year. We had fewer markdowns as a result of disciplined inventory management in Off Price and higher sell through of anniversary product in Full Price. We ended the quarter in a favorable inventory position, down 2.7%. And, we maintained a positive spread between sales and inventory for the third consecutive quarter.

Our strong expense discipline drove our third quarter earnings beat. Expenses were down 2% from last year, excluding the credit charge in 2018 and pre-opening expenses to the New York City flagship. As a reminder, we planned $35 million in pre-opening expenses, of which roughly $10 million was incurred in the first half and $25 million in Q3. We continue to reduce our fixed costs by realigning our support structure in stores, making end-to-end process improvements in supply chain and technology and minimizing discretionary spend.

Year-to-date, we have achieved $170 million in savings and expect to well exceed our plans of $150 million to $200 million for the year. Our financial position remains strong. We apply a consistent approach that balances reinvesting the business and returning capital to shareholders. For the past several years, we have made significant investments in new markets and in digital capabilities to fuel future growth.

With the opening of the New York City Flagship, we're exiting this generational investment cycle. As a result, we expect CapEx to slow down from 6% of sales this year to 3% to 4% beginning in 2020. This reflects a normalized level, inclusive of our market strategy investments related to technology, supply chain and additional Nordstrom locals. We anticipate that moderating CapEx will accelerate free cash flow next year.

We remain committed to our investment grade credit rating. Adjusted debt to EBITDAR was 2.8 times, and we expected it to be roughly 2.7 times by the end of the year in line with 2018. On November 6th, we issued $500 million in debt and in early December, we expect to use the proceeds to fully retire the outstanding May 2020 notes. A onetime financing charge of approximately $0.04 in the fourth quarter is not included in our revised EPS outlook.

Turning to our expectations for the full year. We updated our EPS outlook by raising the lower end of our range by $0.05. We're maintaining our annual expectations for a sales decrease of approximately 2%. We expect SG&A dollars to be down roughly 1% for the year when excluding last year's credit charge. Gross profit rate is expected to be relatively flat. As you may recall, we planned sales growth in the second half to reflect 400 basis points improvement from the first half, and we are on track to meet these expectations.

For the fourth quarter the New York City Flagship is expected to contribute approximately 150 basis points of growth, and the remainder is evenly waited across three drivers, merchandise assortment, loyalty and digital marketing. As a reminder, gross profit is expected to deleverage from occupancy costs for the New York City Flagship. Merchandize margin rate is planned flat, which contemplates a continued promotional environment.

To wrap up, we're pleased with our third quarter results. We've made significant strides in delivering on our strategy and we're encouraged by the customer response. Our achievements, including strong Off Price execution, improved anniversary economics, success of our market strategy and the New York City Flagship, reflect continued focus on the customers and operating discipline. I will now turn it over to Trina for Q&A.

Trina Schurman

Thank you, Anne. Before we get started with Q&A, we would appreciate if you can limit to one question to allow everyone a chance to ask a question. Also as a reminder, the company does not plan to comment on its 8-K filing on October 28th. We will now move to the Q&A session.

Question-and-Answer Session

Operator

Thank you [Operator Instructions]. Our first question is from Omar Saad with Evercore. Please proceed with your question.

Omar Saad

I wanted to ask some follow-ups around the omnichannel initiatives, what you're seeing in local market strategy, dive in a little bit deeper in New York and I think you now rolled out San Francisco, Dallas, Chicago. What's different New York base from what you learned in Los Angeles? And it seems to be really feeding into this overall improvement in the profitability of the company as these capabilities come online. Is that the right way to think about it in the next year as you expand to even further new markets? Thanks.

Erik Nordstrom

Let me start at the end. I think the way to think about, number one, is it resonates with customers. And you know these strategies work if it doesn't resonate with customers. A lot of customers, all the customers like more selection and receiving things faster. But a good chunk of customers like the control of picking up at store, be it apartment without a doorman, or things you can store at their porch, or they want to try it on before they take it home, having that alternative means a lot. Secondly, how you should think about after customer relevance. It's really about leveraging for the most part the existing assets that we have to serve the customers better. So it's a really efficient for us.

Our biggest investment is inventory and inventory in stores in particular and that inventory in stores is close to customers. So being able to leverage that inventory to give customers bigger selection at a faster delivery is terrific, but it also helps efficiency of our inventory significantly. I think what we've learned in New York so far and I think it makes sense. We opened two local service hubs in September, and the traffic to those have ramped, both those has ramped up much faster than what we saw in Los Angeles. It's just more intuitive to customers who live in New York that they're not getting in their SUV and drive to a parking lot, so to be able to have neighborhood service hub where they can do returns and pickups and alternations, customers get it immediately. Now our traffic in those locations with the locals has been very strong. And it’s also we’re utilizing our Manhattan Rack locations as well for those services and the uptake on those services has significantly exceeded our expectations.

Operator

Thank you. Our next question is from Oliver Chen with Cowen. Please proceed.

Oliver Chen

Regarding rebalancing the assortment and merchandize, what are your thoughts about that opportunity ahead? And will that continue to be an opportunity into next year? And as we think about digital -- both digital market and your digital sales growth, how should we model that line and what inning are you in with refinement of digital marketing, which I’m sure is very dynamic?

Anne Bramman

So Pete, do you want to take the rebalancing assortment and I will -- Erik maybe if I can [indiscernible] the digital marketing…

Pete Nordstrom

Sure. Oliver, it's Pete. In terms of balance our assortments and relative to price points, I guess what I'd say about that is we’re really in innings of it, because we really landed on the strategy and tactically got after a couple of months ago, but the lead time are pretty long it's just in the Full Price part of the business but it’s not something you can effect very short-term, because largely what you're dealing with are MSRPs and so it's not how we bring in and choose to market down, it's coming in at a regular price. And so it really has to do with the assortment and the selection upfront.

I think it’s as long as we can, we will do this to continue to ground our efforts and actions around the customer data so that we have more objective view. And I think it's good, take us to the right place and what you should expect to see is continuous improvement on those lines over the next several months. We’re not here to declare victory that we get at all aces at this moment, but I think we have a clear understanding of how to more surgically implement our buys in a way that's going to benefit the business. So we feel good about what we're working on there.

Erik Nordstrom

Let me take a stab and Anne can follow on the digital subject you asked. The big drivers in our digital sales growth loyalty, digital marketing and merchandising, and we've talked about the last couple of quarters where we're at with the journey on those. Loyalty has made significant progress all through the year program there and we're seeing that with increased engagement online with our loyalty customers. Digital marketing is becoming more productive for us. We're seeing increased traffic online and we believe there's still some runway there. The merchandise piece having the right balance, Pete just touched on.

The other comment I'd just make on are digital sales is, we view digital sales as a mean to an end and at both the end of in and of itself. And what that means is we look at digital assets or other assets, how do we get to where we can serve customers better and often in unique ways. I'm not going to tie it back to our market strategy. I think some good example is how much order pickup in stores is driving online sales growth. So overall for the quarter one half of our digital sales growth came from order pickup. And in Los Angeles, where we're most advanced in our market strategy, it was two thirds of our digital sales growth came from in store or pickup. So that's going to be a big part moving forward and we are like barely in the first inning on that one.

Oliver Chen

Just to follow up, New York's competitive market and you've been really holding your own. What are your thoughts regarding the promotional environment in New York and department store closures that we've been having here?

Pete Nordstrom

It's Pete. The promotional thing is something that we've got to be reactive to, and there's all kinds of factors going on out there. It's probably, and I think Anne mentioned one of the wild cards in terms of how we predict or how we are going to end up with this next quarter. We like the momentum that we're on and everything, but it's difficult for us to predict exactly what's going to happen with the promotional part of the business.

So I guess what I can tell you about that as we pay close attention, we're monitoring what's going on everywhere and we're working closely with vendors to make sure that whatever adjustments we need to make we can make them quickly and so that customers feel like they can trust our pricing and everything. So it's just part of our ongoing long term strategy about making sure they're really staying close to it. And I wish I had a cleaner answer for you there. There are factors that we are having with others that really are in our control, so we have to be a bit of reactive to both.

Operator

Thank you. Next is Edward Yruma with KeyBanc Capital Markets. Please proceed.

Edward Yruma

Just real quickly on the digital sales, I know you guys have indicated that sales have accelerated intra quarter. I know that you've been doing performance marketing into loyalty. But kind of maybe any more color you can give on why the department has accelerated? And then as a follow up to the previous questions on local. As you think about for longer term opportunity to rollout local, how quickly do you think you can move now that you've tested the different types of cities and markets? Thank you.

Erik Nordstrom

So digital sales -- I guess, in addition I'll comment Oliver's question in stock rates has been another area in our merchandise mix we have focused on. And we've made good progress on that over the last quarter definitely contribute to part of the momentum that you see in our results. As far as the speed of the local rollout, we went into the quarter. Our plan was to expand our market strategy to New York. So adding Chicago, Dallas and

San Francisco, was something we were able to do ahead of our plans. And it reflects that we came pretty quickly on it. There is not a material capital investment to expand into other markets. It is mostly a story of leveraging existing assets.

There is some work to be done. We can't just flip it on there. There is some systems work and certainly some operational work to prepare. Our plan is to -- we're in five of our top 10 markets now and our plan is to have this market strategy rolled out to the rest of our top 10 markets by the end of next year. And we will be pushing that as fast as we can.

Operator

Thank you. Next is Alex Walvis with Goldman Sachs. Please proceed.

Alex Walvis

I had a question on the inventory management coming in again below sales this quarter. Can you talk about how happy you are with the composition of level of that going into the holiday period? And then just related to that, I think that you said that the merch margin guide was around flat for the fourth quarter. Can you talk about the puts and takes there? And you know if that kind of surprises one way or another, what would be the drive there?

Anne Bramman

So I’m going to take the first part of it, Alex and Pete, feel free to enhance the answer. So on the holiday, so coming into our inventory position, overall, we are very, very pleased. I think as both Erik and I referred to you in our comments, in particular our Off Price business has done an remarkable job of increasing their inventory turns of much I think more fluid flow model, being very opportunistic in the market place as far as seasonal relevant goods in the Off Price space. And that’s really reflected in what we're seeing in the top line and bottom line results.

So we talked about that. We also talked about the fact in Q3, the sell through in our anniversary product we had few markups in sell-throughs, which really high -- which is very intentional part of our anniversary strategy. So that certainly helped our merchandize margin rate in Q3. And we did see a highly promotional environment, but those two factors between anniversary mark down and our Off Price business really helped offset any promotional headwinds we might have seen in that quarter.

In the fourth quarter going into from holiday prospective, we've actually pulled forward some of our holiday receipts. We've set holiday gifting. If you go on our site or in our stores, you'll see that we have a very deliberate message on gifting at certain price points just for the customer and what they are looking for, because we know from our customer feedback people buy at certain times for certain people at certain price points, and we've really tailored the strategy and the inventory levels to match that.

And so you're seeing that both in our Off Price business and in our Full Price business, and so we're --. I would also say that we've got -- we're very encouraged by the early reads we're seeing in our gifting strategy as we set that early as we did last year.

Pete Nordstrom

The only color I would add to that is, our inventory is in really good position, and we got there the right way, we didn’t do it through a bunch of markdowns to get ourselves in line or cancelling a bunch of things. As Anne I mentioned, because we've been achieving our plans and having a lot of discipline around our execution of our plan has allowed us to pull inventory forward, to be responsive what's going on with the traffic in the stores. And it's certainly helpful to our top line and being in a fluid position as we go forward like this just create so much more flexibility and I think opportunity for us that we feel good that we've gotten there in a really healthy way with the business, and that should pay benefits as time goes on too.

Operator

Thank you. Next is Paul Trussell with Deutsche Bank. Please proceed.

Paul Trussell

You spoke to the Off Price business having some better execution. During the quarter, obviously, turning positive on the top line, but also having some better than expected bottom line results. Could you just discuss that a bit more?

Erik Nordstrom

We went into the year seeing actually more opportunity on the bottom line and the top line with plenty of initiatives around both. But we had good performance profitability wise in Off Price all through the year. But third quarter the top line really changed its trajectory, and it really is broad based. I mean it starts with having sales increases on less inventory and Anne touched on this in Off Price in particular being fluid so you can be opportunistic for buys in the marketplace.

And I think in particular the environment we're in right now, there is great merchandise at great prices out there if you have the open divide to get after and our team certainly did that. The result of that is we have more newness in our mix, it's more seasonally relevant. And again, we're seeing faster turns and higher margins. There is elements in the store and execution that we've seen since conversion improvements, there is elements online, our Rack.com and HauteLook business, there's digital marketing, again through the merchandise offer, through flash events, really across the board improvements in traffic and conversion.

Paul Trussell

And just a quick follow up on the updated outlook. Is the adjustment to EBIT and EPS solely a reflection of exceeding your own expectations for the third quarter, or has there been any adjustments made to your prior view for the fourth quarter? And I noticed that the interest expense, I think, remains guided towards $110 million, but you've only done $66 million to-date. Maybe just touch on the outlook please.

Anne Bramman

So yes, as you mentioned, we did tightened the bottom end of our range and it really is an output from what we exceed in our own expectations for the quarter. So our view is not changed in the fourth quarter. And as you heard from the Q&A from our opening commentary, we are executing -- and the levers that we've been pulling and the drivers that we have in our business, we're continuing to deliver on what we set out for the second half of the year.

As far as the interest expense, you are right, the fourth quarter does top. I'd just remind you that we do have large capital projects we do capitalized interest. And I think you guys are aware, we opened a very large investment in New York in Q3. So as that comes online, that interest would not be capitalized going forward.

Operator

Thank you. Next is Jay Sole with UBS. Please proceed.

Jay Sole

Just on the New York store. Do you feel like it's opened up at like say 100% of the productivity that you will see, or do you expect that there'd be a ramp up period of a year or two? And then secondly, Anne, on just the SG&A space. By the end of 4Q, will the company have realized all -- with the run rate of savings that you got completely realized, so it's a $200 million or $210 million whatever it's going to be. Will that be it or will there probably be more going into Q1? Thanks so much.

Anne Bramman

Let me take the SG&A first and then Pete why don't you take New York. So on the SG&A, there will be a tail going into 2020 we haven't qualified that and we'll include that as part of our 2020 guidance at the end of next year. What I would say more broadly though is that we are continuing to look for opportunities to drive productivity and efficiencies in our business. I think you've heard us talk about this quite a bit, particularly with the generational investments as we continue scale, we will get more closer on that.

And we are also looking -- as you know, we're been making lot of investment in digital capabilities. So we're continually looking for ways to gain scale and productivity in those areas as well going forward. So I would say we had a very strong operating discipline on this year, and I would say we're not done.

Pete Nordstrom

This is Pete, relative to New York and the productivity and what to expect going forward. Now one of the benefits Erik and I have, this has been around a long time. And I think between the two, we've seen, I don't know, 80 store openings in our time. And as a result of that, we have really good contacts and analogs around how to expect the maturity of stores and how long that takes. Our brand New York has got its own thing. But I think in terms of being able to grow into its full potential, we got a few years there to be able to do that.

We're not rationalizing, we're settling for something -- anything less than the best we can possibly do between now and then. But it's safe to say that even after a great and start everything that we fully anticipate that we will grow over the next, call it three or so years and do more of a mature position. And there's still things to learned there. There is a lot of improvements we can make and customers get to know us better. So it all feels super promising right now.

Jay Sole

And then maybe if I can just ask one more on the Full Price stores, because it sounds like, so digital was up seven, overall Full Price was down four, you closed about six stores year-over-year. What kind of contribution was closing the stores to that overall sales growth number for the Full Price stores -- for the Full Price business in total? Because otherwise, like it looks like the Full Price stores were down like high singles, and sort of wondering if that's like the real run rate, or if that's sort of a combination of different factors that don't really represent the comp, which is obviously something that people are actually going to think about.

Anne Bramman

So let me -- so the digital sales number that we gave to total JWN that includes beyond our Full Price also includes our Off Price business as well. We did call out that we saw demand improvement throughout the quarter, particularly in nordstrom.com. And so when we look at closing stores, I think we've talked to you guys about how we look at this, but it's generally at the end of an operating covenant or operating model, we look at the return we get we invest in that store, and also what was going on in that market, particularly what's going on in that mall, so typically stores that get close to pretty small volume stores what's going on in that mall, so typically stores that get close to pretty small volume stores, and so it's not a significant impact to the top line overall for the company. I would also remind you there are stores -- all of our stores are cash flow positive. So from a contribution margin, they actually -- we don't have any that would be -- are cash flow negative, even the ones that we closed.

Erik Nordstrom

I would just -- this is Erik. I would just add to it and connected to our market strategy. We're early days on it but we're seeing so far when we can connect a whole markets worth of inventory. Proportionally, the small stores benefit the most, and I think that makes sense. It's the biggest increase in inventory of what's available for next day delivery, or next day by in-store -- buy online pickup in-store.

So I think the point there is we're learning a lot, and the feet of small stores is not sealed or determined. And as part of what we're excited about with our market strategy is the convenience, the kind of intimacy of a smaller store that customers like, if we can materially change the selections available to them, then those stores could be on a different trajectory. And so we still need to play that out and see what happens there.

Operator

Thank you. Next is Connor Konicke with Robert W. Baird. Please proceed.

Connor Konicke

This is Connor on for Mark. Thanks for taking my question. I know you touched on the anniversary event in prepared remarks. But any more color there and maybe some of the key learnings you can take into the holiday quarter?

Pete Nordstrom

It's Pete. I think it's another example of where we use objective data and analysis to make smarter decisions. We've been doing the Anniversary thing for a long time and you would think that, that practical experience would give us all we need, but the changing landscape relative to how much more online business we've done in the past, and it grows disproportionately and we have more online business at that time, if that happens in anniversary also happens in holiday that it impacts really the profitability of event.

So it felt great that we went into it with the plan and to improve really the bottom-line performance, and that has worked. I will tell you that we weren't able to get after this plan early enough to fully impact, I think what's possible with that event. So I think the good news is that event went very well and there is a lot of reason to believe that we will be able to improve upon it again for next year, because we have the full year to be able to plan for it.

So I think what that implies for holiday, there is a lot of similarities and that there's time bound events and there is very specific actions related to price and category that are applicable from anniversary to the holiday time. So we believe that we've got some proof there that we're on the right track and with the right strategy, and it's nice to see kind of how our teams responded all that and their confidence about how to attack holiday and again anniversary next year on the heels of what was the successful anniversary. So it's all been positive so far.

Operator

Thank you. Next is Tracy Kogan with Citi. Please proceed.

Tracy Kogan

I was wondering if you could talk about the performance of your stores in Canada, both the full-line stores and the Rack stores, and how they performed relative to your expectations. And then also what do the four-wall margins look like there compared to the U.S.? And then I just wanted to have a quick follow-up on something you said about using your Rack locations in your local strategy. I was wondering if you could give more color on that. Thanks.

Anne Bramman

So I'll take some of the Canada questions and Erik do you want to take the Rack conversation. So in general, we report Canada as part of our generational investments, so we don't specifically break out. For example Canada, we aren't going to break out New York in particular and then -- the other two of our generational investments, our Nordstrom Rack and HauteLook.com, as well as TrunkClub. And so what I would say is, in general, when we look at our generational investments for the year, they are absolutely in line with our expectations that we laid out earlier this year for both the top and a bottom line perspective.

Tracy Kogan

Was there anything specifically you could say about the Canada stores, relative to your expectation just broadly?

Anne Bramman

So again, I would just revert you back to our generational investments and they're progressing as we -- and we've also talked about the fact that we're going to continue to get scale and leverage in those investments as we continue to grow.

Tracy Kogan

Thank you.

Erik Nordstrom

This is Erik. To add a little color to my comment on store, the role our Rack stores can play with our market strategy. We did in New York -- I'd step back and say we approached New York as expanding our market capabilities versus opening a four-wall store. Now our flagship store is a tremendous asset to add to the market, but it's as we mentioned, Manhattan is our largest market for online sales. We opened two local service hubs. We had two Rack stores there, as well as a TrunkClub clubhouse.

So we've been expanding for a bit now of having express returns in Rack stores, where customers can return Full Price merchandise. And in New York, we expand that to, not only be able to do returns from any of our businesses, but to do order pick-ups from any of our businesses or nordstrom.com, buy online pickup in-store and we have alterations available as well. The response to that has exceeded our expectations. We thought it was going to be good. It's been especially good.

So we put a plan together to roll that out to more Racks', but we'll share that with you once we have that set. The other piece, I would just remind you again like M&A, it starts with giving customers things they like. And a lot of customer the convenience of going into a Rack, they really appreciate. So on the business side, getting customer engagement across channels drives a lot of value.

When our customer goes from engaging with us in one of our businesses to two their spend with us increases 4x. And if we get engagement all four, so that four in-stores Nordstrom.com, Rack stores, Rack.com, their spend goes up 11x. So there's a lot of value there that we're excited about.

Operator

Thank you. Next is Michael Binetti with Credit Suisse. Please proceed.

Michael Binetti

Congrats on a nice quarter and on New York. Anne, I think you originally described second half sales to accelerate by 400 basis points and fairly evenly split between four initiatives, New York being one of them. It sounds like you now expect New York to be about 150 basis points, if I heard you right. And it sounds like you saw Rack accelerate a little more than what you were thinking in the quarter. You seem pleased there. The compares get easier and the comparison Rack physical stores since we have those data points last year get a couple of hundred basis points easier. So the momentum in a few key areas here is maybe better than you thought. Any new takes you tried to embrace as you looked at the year that kept you from raising the target in fourth quarter for your comments earlier given the momentum in the business there?

Anne Bramman

So just to clarify, the 400 basis points and in particular in New York with a 100 basis points for the second half, and so what I try to do is give you a little bit more context on what the impact is for the fourth quarter, because the store opened last week of the quarter and so primarily, the sales are in the fourth quarter piece. So I was just trying to give you some context of those different levers to, but the overall levers, if you look at second half haven't changed with the 100 basis points across the four things that we talked about. As far as Rack, it's doing well, the business overall do well, but we have a lot of the quarter left, we have a lots of year left to deliver a big holiday season and we also -- in my comments, try to incorporate the fact that it's going to be competitive and highly promotional holiday season, we believe, and so we want to make sure that we were continuing to deliver on our expectations.

Michael Binetti

Can I follow up that and ask you on that directly, on the merch margins. I think you said you plan them flat or up in the fourth quarter, if I got that right. Maybe just walk us through few of the components, is New York and is the impact for New York positive to merch margins and then maybe you could help us put some kind of a basis point quantification? How much better the margins are around the end of Anniversary sale. I mean you said, there is lower inventories and you don't have to clear as much there in third quarter. I think that goes away as a tailwind in 4Q. I guess, around the competitive space, we've heard pretty conservative assumptions on merchandise margins. So I wanted to just check and see how you built up or you guide to for fourth quarter.

Anne Bramman

So we did guide -- we thought merch margins will be relatively flat for the fourth quarter, and we did include into that guidance, competitive and highly promotional environment. I think you've heard from, I think all three of us. Given our inventory position going in the quarter, and given where we really focused on our gifting assortment, and in particular the flow and sell-through in Off-Price, but also in Full-Price as we really have been executing Holiday strategy, leveraging the learnings and the data and analytics Anniversary in the holiday, and some of the encouraging signs we're seeing as we set holiday early. We've incorporated all of that into our guidance and feel very comfortable where we are.

Operator

Thank you. Our last question comes from Heather Balsky with Bank of America. Please proceed.

Heather Balsky

This is Heather on for Lorraine Hutchinson, and thank you for taking our question. I was hoping you could dig in a little bit in terms of the profitability impact you're seeing in LA from the local strategy. What are you seeing in terms of any gross margin improvement, and the SG&A leverage that you've mentioned that you're seeing better profitability from higher sales, so just curious if you can dig into that?

Erik Nordstrom

I mean, directionally, it is positive. We're getting higher sell-throughs, its more efficiency of our inventory investment. We can extend that inventory investment that's in all of our stores there and spread it to demand for next day delivery or next day pickup in-store across all of the stores. So it's early, we need to go through a full year certainly, but right now, we didn't know, we're seeing higher sell-throughs, that's encouraging.

Well, there is puts and takes on the expense part of it, but overall for us, I would say, we see a significant upside in profitability. And I think part of the story, just of our execution of this again goes around inventory, our OpEx investments in inventory, which is our biggest cost can be markdown. So it's able to move that merchandise around in a marketplace in almost every case, some extra handling to get an incremental sale and avoid a markdown as well worth it.

Trina Schurman

Again, thank you for joining today's call. A replay along, with the slide presentation and prepared remarks will be available for one year on our Web site. 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.