Macy's Inc (M) CEO Jeff Gennette on Q3 2019 Results - Earnings Call Transcript

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FQ3: 11-21-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.07 beats by $0.07 | Revenue of $5.17B (-4.27% Y/Y) misses by $-141.51M

Earning Call Audio

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Macy's Inc (NYSE:M) Q3 2019 Results Earnings Conference Call November 21, 2019 8:00 AM ET

Company Participants

Mike McGuire - Head of Investor Relations

Jeff Gennette - Chairman and Chief Executive Officer

Paula Price - Chief Financial Officer

Hal Lawton - President

Conference Call Participants

Matthew Boss - J.P. Morgan

Paul Trussell - Deutsche Bank

Lorraine Hutchinson - Bank of America

Alex Walvis - Goldman Sachs

Kimberly Greenberger - Morgan Stanley

Chuck Grom - Gordon Haskett

Paul Lejuez - Citigroup

Omar Saad - Evercore ISI

Michael Binetti - Credit Suisse

Oliver Chen - Cowen and Company

Bob Drbul - Guggenheim Partners

Dana Telsey - Telsey Advisory Group

Priya Ohri-Gupta - Barclays

David Swartz - Morningstar

Bernard Sosnick - Madison Global Partners

Operator

Good morning. And welcome to Macy's Incorporated's Third Quarter 2019 Earnings Conference Call. Today's hour-long conference is being recorded.

And I would now like to turn the call over to Mike McGuire, Head of Investor Relations. Please go ahead.

Mike McGuire

Thank you, Operator. Good morning, everyone. And thanks for joining us on this conference call to discuss our third quarter 2019 results and our full year 2019 outlook. With me on the call today are Jeff Gennette, our Chairman and CEO; Paula Price, our CFO; and Hal Lawton, our President.

Jeff and Paula have several prepared remarks to share, after which Hal will join us for question-and-answer session. Given the time constraints and the number of people who want to participate, we ask that you please limit your questions to one with a quick follow up.

In addition to this call and our press release, we have posted a slide presentation on the Investors section of our website, macysinc.com. The presentation summarizes the information in our prepared remarks, as well as some additional facts and figures regarding our operating performance and guidance. Additionally, our Form 10-Q will be filed in a few weeks and that too will be available on our website at that time.

Keep in mind that all forward-looking statements are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from the expectations and assumptions mentioned today. A detailed discussion of these factors and uncertainties is contained in the company’s filings with the Securities and Exchange Commission.

In discussing the results of our operations, we will be providing certain non-GAAP financial measures. You can find additional information regarding these non-GAAP financial measures, as well as others used in our earnings release on the Investors section of our website.

As a reminder, today's call is being webcast on our website. A replay will be available approximately two hours after the conclusion of this call and it will be archived there following the call for one year.

Now, I'd like to turn this over to Jeff.

Jeff Gennette

Thank you, Mike. Good morning, everyone, and thanks for joining us. As you saw in our press release this morning, after seven consecutive quarters of positive comparable sales, Macy's Inc had a tough quarter with comp sales down 3.5%. While we anticipated a negative comp, as we were lapping a very strong quarter last year, the sales deceleration was steeper than we expected. However, having cleared the excess inventory we faced earlier in the year, we were able to take a more balanced approach to sales and profit in the quarter. Versus the first half of this year, this resulted in a significantly improved margin compression on lower sales.

Let me share some details on the drivers of our sales decline. Our third quarter sales were impacted by continued soft international tourism, weaker than anticipated performance in our lower tier malls and the late arrival of cold weather. Given Macy's status as a destination for cold weather apparel, we saw an impact in both cold weather merchandise and in the same trip purchases that our customers typically attend. Now that the cold weather has arrived, we're beginning to see those sales flow through.

We also experienced a temporary impact on e-commerce business due in part of the work on the site in preparation for the fourth quarter. The team has completed that work, the site is updated and our customers can expect an improved experience this holiday season.

Based primarily on the impact of our third quarter sales trend we are lowering our annual sales guidance to down 1% to down 1.5% and adjusted EPS guidance to $2.57 to $2.77.

On the call this morning, Paula will take you through the third quarter results and provide additional detail on our outlook for the year. After Paula's comments, I will take you through our holiday plans and give you a preview of what to expect from our Investor Day in February.

Hal Lawton, President of Macy's is also on the call today and will join me and Paula for the question-and-answer session. So I'm now going to turn the call over to Paula.

Paula Price

Thank you, Jeff. Good morning, everyone. So let's jump right in. Sales in the quarter were $5.2 billion, a decline of 3.5% on an owned plus licensed comparable basis. Jeff explained the key drivers behind this performance in his remarks. But while sales overall were disappointing, our 2019 strategic initiatives continue to deliver the results that bode well for future performance. During the quarter, we continued to make progress on each initiative.

Within the Growth150 stores, we completed the work on the additional 100 stores. The Growth stores continue to outperform the rest of our store fleet, both validating our investments in this initiative and giving us great confidence in our outlook for this important segment of our store fleet.

We achieved our full year goal of expanding Backstage to another 50 stores. We exceeded our Backstage expectations in the quarter and Backstage locations open for more than a year continue to perform well up mid-single-digits and have improved both margin and turn.

Backstage continues to add recognizable brands that our customers expect in the off-price arena. This is offered through a lens for fashion and value and our customers are responding. The strength of our Backstage business is in ready to wear which is performing across all segments from sportswear in missy, contemporary and juniors as well as in active and intimate apparel. The kids category has also been a standout where our Backstage customer is responding to a mix of brand and classifications in apparel, as well as toys. We have seen strong improvement in the Backstage shoe business, which is always a major draw for our customers.

Turning to categories across the broader business. We had strong performance in mattresses, fine jewelry, fragrances, dresses, men's active and men's tailored. The weaker businesses in the quarter included women’s and men sportswear, especially the cold weather items, handbag, housewares and furniture. In terms of digital, as expected, we experienced the slowdown in growth from the second quarter into the third quarter as we lapped a very strong third quarter last year.

Our online business also suffered from the delay in cold weather in addition to a temporary impact we saw some from significant site changes rolled out in time for the fourth quarter. These updates are critical for improving the customer experience and as Jeff said we are confident heading into holiday with an improved digital experience for our customers.

So let me touch on a few of the many experience and feature improvements that we have made. We improved the speed and usability of our digital properties with the re-platform of our app and a redesign of our front end experience to a more modern, elevated design with improved user navigation. We also added numerous sites and apps features, particularly app features to help our customers with in-store navigation and shopping.

We continue to see our online growth fueled by Vendor Direct, omni pickup and the mobile app, all outpacing the overall digital performance. Mobile remains our fastest growing channel, outpacing overall online demand growth by nearly 4 times. We've seen triple-digit growth in our downloads year-to-date and significant growth in our mobile active users as we continue to improve the experience.

Vendor Direct is fueling online growth through increased selection with the addition of nearly 1,000 vendors and 1 million SKUs year-to-date across many categories, especially in home, men's and kids and Center Core. Omni pickup or BOPS and BOSS continue to grow as our customers love the security and convenience of picking up in-store. And we are pleased to have relaunched same day delivery to complement our same-day in-store pickup option.

Bloomingdales saw its strongest sales performance in its stores year-to-date, and experienced growth in both its digital business and outlet stores. Luxury fragrances, salon shoes and contemporary ready to wear led growth in the quarter. With only six weeks since launch My List is performing well. Its millennial penetration and its the subscriber base is currently more than double that of the total Bloomingdales’ ready to wear millennial penetration. While still small, these are promising results.

Bluemercury had another strong quarter with double-digit sales growth and we opened four stores in the quarter. Importantly, the brand also launched its first loyalty program BlueRewards and more than 30% of the customer base has already enrolled. With regard to our company sales transaction metrics, overall transactions fell 0.4% compared to the same quarter last year. Reversing a positive trend, this was the main driver of our sales comps performance reflecting the factors just discussed.

Items per transaction were down 1.8% and in line with trend, average unit retail fell 1.4%, which represents a trend improvement. The decrease in AUR is in part due to the expansion of Backstage, which reduces AUR but increases transactions.

Turning to credit revenue, we generated $183 million in the quarter, down 1.1% from last year. Credit card penetration was 48.3% in the quarter, slightly below last year's level. Gross margin in the quarter was 40%. While down 30 basis points versus last year, this represents a significant sequential improvement over the second quarter and indicates we are making progress in our efforts to combat margin compression and improve profitability.

Merchandise margin also benefited from the traction we are beginning to get from our productivity initiatives, such as hold and flow. These benefits were offset by delivery headwinds of approximately 40 basis points. Comparable inventory was flat to last year representing an improved result versus the prior quarter.

Within SG&A, we recorded $2.2 billion of expense in the quarter $53 million less than last year and up 90 basis points on a rate basis. The SG&A dollar reduction reflects both disciplined cost containment and lower variable costs associated with sales.

Adjusted net income in the quarter was $21 million versus $83 million last year. Included in these net income figures is the impact of asset sale gains of $13 million and $31 million, respectively. Adjusted EPS was $0.07 in the quarter compared to $0.27 last year, of which asset sales gains represented about $0.04 and $0.10 respectively.

Year-to-date cash flow from operating activities was $172 million compared to $429 million last year. The variance is due primarily to timing within accounts payable and also lower EBITDA offset by lower tax payments and is not indicative of the strength of our full year expectation.

Capital expenditures were $812 million compared to $677 million last year. And we remain on track to achieve our full year guidance of approximately $1 billion of capital expenditures.

Cash used by financing activities was $276 million less than a year ago, as 2018 included $344 million of early debt repurchases. We continue to expect to use excess cash to further reduce our debt in fiscal 2019 through voluntary debt repayment. We remain committed to paying an appropriate cash dividend to our investors and have paid $349 million year-to-date at the same per share amount as we've been paying.

Let me now turn to guidance. For the full year we expect comparable sales to be down 1% to down 1.5% on an owned plus licensed basis. We continue to expect our sales performance in the fourth quarter to be sequentially better than the third quarter as we not only remain confident in our holiday plans, but also we will cycle the disruption caused by the fire in our West Virginia mega center and the underperforming pre-Christmas promotional event last year.

Gross margin for the year is expected to be moderately down to a year ago and we continue to expect comparable inventory levels at the end of 2019 to be below last year. With a greater sales decline than previously anticipated we expect our annual SG&A rate to delever moderately. But as we continue our disciplined cost containment efforts in the business, we expect our full year SG&A dollars to be slightly below last year's level.

Our real estate team continues to do its excellent job of monetizing our valuable real estate holdings appropriately and opportunistically. We now anticipate about $150 million of asset sale gains for the year well ahead of expectation. Taking everything into consideration, we expect 2019 adjusted EPS to be in the range at $2.57 to $2.77, or $2.20 to $2.40 when asset sale gains are excluded. Our revised guidance also includes our expectations for tariff, as we have been able to successfully mitigate nearly all of the $0.07 impact that we previously anticipated.

While we had fruitful discussions with our vendors and suppliers and we're able to minimize the 2019 impact on our business and our customers, discussions are still underway for 2020. We'll be able to share more insights from those discussions when we provide guidance for next year. You can find our complete guidance in the slide presentation we posted on our website earlier this morning.

In closing, while we anticipated third quarter comps to be significantly lower than the fourth quarter, due to the cycling of a very strong quarter last year, our sales performance was certainly weaker than we expected. That said, we navigated the quarter with discipline and we're confident in our ability to continue to moderate our gross margin compression to contain our expenses, and importantly to execute at a high level to deliver of strong holiday season and fourth quarter.

And with that, I'll turn it back over to Jeff.

Jeff Gennette

Thanks, Paula. So again, while our sales performance for the third quarter did fall short, we feel good about the improvement in margin compression and remain confident in our strategies for the holiday and our path to the updated annual guidance. So the team has been hard at work all year and we are definitely ready to deliver holiday in 2019 with the following.

So we have an expanded gifting assortment at strong values. Our gifts and our strategy ensures that we will reach the breadth of our customer base with great brands and products at clear price points across all categories.

We have a colorful marketing calendar that addresses the cadence of a shorter holiday season. Importantly, we are engaging with both our best and our occasional customers with targeted events. Our stores are stuffed for the holidays. The work on both Backstage and the Growth150 stores was completed by the end of October. Product and visuals are strong and our colleagues are ready to serve our customers. We've enhanced our digital properties including mobile to both promote online sales and drive in-store activity.

We're on track with our seasonal recruitment and having improved our on-boarding and scheduling systems we are seeing lower turnover and our seasonal colleagues. And these strategies are underpinned with a strong operational plan. Our distribution centers and stores are ready to deliver flexible, secure and convenient fulfillment options whether our customers are shopping online, in-store, on mobile or across channels.

We also expect Bloomingdales and Bluemercury hit their strike for holiday and both brands also have strong gifting strategies. Additionally, Bloomingdales is continuing to amplify the experiential edge its brand, with exciting events and personalized service for both customers and visitors this holiday season. Last week, we opened our 39th Bloomingdales. This new store in Norwalk, Connecticut, will help us build on Bloomingdales' strong presence in the Northeast.

Holiday season officially kicks off for the Macy's brand next week, with the 93rd Annual Macy's Thanksgiving Day parade. This is a time for us to engage with the more than 50 million viewers that tune in live for the parade. All eyes are on Macy's and the increased media weight we're putting around the parade is part of our strategy to drive consideration with occasional customers.

As we announced this morning we will hold an Investor Day on February 5th to share our growth strategies and our three year plan. We remain intensely focused on areas of the business that are working and there are many but we are also taking a fresh and hard look at the things that aren't working. At Investor Day the team and I will take you through: First, a view of the Macy's customers franchise and actions we're taking to drive further engagement with our existing customers while we also bring new customers into the brand. This will include our merchandising strategies to deliver our quality fashion at affordable prices. Next, a detailed view of our omni-channel growth strategies built through the lens of our customer journey. This will include an update on our store segmentation. We will also share plans for our digital business both mobile and dotcom and the steps we're taking to further strength this engine of growth and profitability. Next, an update on the productivity program that we shared in September, we have seen positive early results and have a road map to significantly accelerate the savings. This will include detail on our supply chain transformation. And lastly, we will also share other actions we're taking to build a playbook to compete effectively in today's retail environment.

Retail is evolving at a rapid pace. American consumers love the Macy's, Inc. brands; Macy's, Bloomingdales and Bluemercury. And while we have made good progress on how we do business, there is more work ahead. We are taking significant steps and decisive action to change our course and to return to profitability growth. Our brands are stronger than our performance reflects. We have a road map to close this gap, and we have a clear vision for our future.

With that, we're going to open up the line for Q&A.

Question-and-Answer Session

Operator

[Operator Instructions]. And we'll now take our first question. It comes from Matthew Boss of J.P. Morgan. Please go ahead.

Matthew Boss

So Jeff, maybe outside of your Growth150, what's the turnaround timeline for the remaining 50% of the business? And given your comment today regarding lower tier malls, any update to the fleet size over time or just how you're thinking about some of those lower tier centers?

Jeff Gennette

Yes. Hi, Matt. So let's just -- I'm going to start with just when you look at the initiatives that we have employed that are driving our business right now. So destination businesses, Backstage, Growth 150, all those are working. And I'm going to have Hal add some color on the initiatives as well as one of the things that we've been under reinvest, which is really the ready-to-wear business. So I'm going to have him talk about that.

When you talk about the other opportunities that we have with our store fleet, we'll also give you a sense of where that is by tier. And so Hal is also going to address that about where our business is. What I would say about our malls is that, we're investing and our mall developers are investing, we're getting great outcomes. So when you look at the Growth150 strategy, which basically touches over 50% of our brick-and-mortar business, we're complete with all that work and we're taking these revitalized stores into the fourth quarter with us. And in most cases, you've also got mall developers that have also enhanced those mall properties.

So we're ready. I think our mall developers are ready. But the point I'd make on the rest of our stores is that we're all dressed and ready for a very successful fourth quarter. So I'm going to turn it over first really to Hal, he'll kind of give you some more color about some of the initiatives that we're working on right now as well as that we're building a ready-to-wear, and then also ask him to comment on some of the store segmentation, some of the malls that you're referring to.

Hal Lawton

As Jeff mentioned, we remain confident in our strategic initiatives. Specifically on our Growth stores, we've completed 100 this year, and they're ready for the holiday season. The trend variance, the performance in our Growth stores continues to be strong and better than the rest of our store base with a nice uplift that we -- that is significant in nature.

As it relates to Backstage, Backstage continues to exceed our expectations and specifically exceeded our expectations for the quarter. And this is very much driven by locations that have been opened up for more than a year. Those locations are running up mid-single digits year-over-year. And the locations are also improving in margin in turn. And we remain very confident in our Backstage initiative, Macy's get stronger and stronger in off-price every single day.

On our destination businesses, while they did not grow in the quarter in aggregate, as our business trended below our expectations, they did outpace the rest of the business. And we did see outsized growth in parts of the business. Paula mentioned some of our strengths earlier in categories like mattresses and fragrances.

As it relates to our mobile initiatives, it very much remains our fastest growing channel. We continue to see very strong growth in downloads and users in the quarter, and we added a number of new features to improve the in-store experience, drive traffic and engagement onto our mobile website -- I mean under our mobile app, and also enable less friction in the e-commerce experience.

Finally, as it relates to our fifth initiative, Vendor Direct, it continues to be very strong and a meaningful driver of our digital business. We've exceeded, as Paula mentioned, our goal for new vendors and also SKUs on-boarded for the year. And in our minds, there's only upside for our Vendor Direct initiative as it adds sales and profits as well as increases customer satisfaction with very minimal capital and inventory investment.

Turning to ready-to-wear. If you look at our ready-to-wear business, while it did continue to underperform in Q3, we're very optimistic as we look ahead. As we mentioned on our previous earnings call, in the spring, we made adjustments to the structure and put new leadership in place. That team has been fast away working on fashion and trends and really rejuvenating our exclusive brands and working closely with our market brands and reestablishing our private brands.

While they will be able to influence a small portion of our buy in Q3, there were a number of bright spots and green shoots that really give us confidence in this business as we move forward. A couple of examples that I'll call out was our Animal Prints and Emerald Green INC fashion drops that had sell-throughs well above average. I'll also call out our Becca Tilley x bar III collaboration that was a very big success with our customers.

And then turning to Q4. They've been able to have a bigger influence on Q4. Those assortments had just hit the stores in the last few weeks, but we're really excited about the early performance. An example of which very high sell-throughs is our INC holiday party assortment.

So that's just a brief update on our initiatives and our ready-to-wear. The last thing that I'll just reference as Jeff's commentary on malls. As Jeff said, we've been investing in malls where developers are investing, and that's specifically with our growth strategy. And we feel really good about that initiative, and those stores continue to outpace the breadth of our fleet.

As we talked about before, we had very much in-store segmentation strategy that starts with our flagships, predominantly Herald Square, our national flagship, 10 regional flagships, our Magnet doors and then our Neighborhood doors. We've been watching the trend across our malls for quite some time, specifically in the C and D malls, which are Neighborhood doors. And we did see a steeper decline in these doors than we anticipated in the quarter.

As the majority of our business is in the A malls, we've talked about that several times, and again, that is where we're investing. And that's where our growth strategy is having a big impact. As we move forward, we -- as we've talked about on previous calls, we will be communicating our plan for our neighborhood stores and providing an update on our store segmentation strategy at our Analyst Day in February.

So just in summary, we feel really strong about our strategic initiatives and the impact they're having on the business. We are optimistic about our ready-to-wear business as we look ahead to Q4, and we'll be providing a more thorough update on our store segmentation at our upcoming Analyst Day.

Matthew Boss

And then just maybe as a near-term follow-up, the change to your 4Q and holiday forecast versus three months ago, I guess, how much of this is Macy specific versus any change that you have on the U.S. consumer? And then just last, you mentioned commitment to paying an appropriate cash dividend. What do you see as an appropriate yield?

Jeff Gennette

Why don't we start with the -- what we thought, Matt, on the third quarter to fourth quarter was really just to be prudent on what our current trends in third quarter looks like. And so when you look at that and take that into the fourth quarter, and then layer in the pieces that we know are incremental to what we had in the third quarter. So again, cycling through the things that Paula talked about in her comments about what happened to us in West Virginia last year and the warehouse fire, as well as the change that we made to the promotional events, we know those are additive.

We also have the benefit of the higher penetration of the dot com business going into the fourth quarter. So when you layer those known opportunities that we have on top of the third quarter trend, you get to the proven range that we are now directing on fourth quarter.

Paula Price

So Matt, with respect to dividends. I always like to put that in the context of our capital allocation framework. And just began to remind, that really hasn't changed. And we start with investing in our business. And then the second priority is making sure that we continue to maintain a healthy balance sheet. And then third is continuing to pay an appropriate dividend -- cash dividend to our shareholders. And then finally, the fourth priority would be to resume the buyback program.

So specifically to your question around dividends, our board approves our dividends quarterly. We review that with them. And we don't have plans near-term to change our dividend, but we continue to evaluated it in the context of our capital allocation as well as our strategic plans more broadly. And so we're well aware that with the drop in our share price, our dividend yield is now outsized. But having said that, dividend yield is but one metric that we think about when we're thinking about our dividends and our dividend policy, and it's not one that we wholly control.

And so when we think about what is appropriate, again we evaluate that in the context of our capital allocation framework and then our broader strategic plans.

Operator

Thank you. And we can move to our next question. It comes from Paul Trussell of Deutsche Bank. Please go ahead.

Paul Trussell

When it comes to tourism, and that being softer, could you give any color on what kind of impact you saw from the softer tourism on a year-over-year basis? And maybe just juxtapose that against I believe you mentioned that Bloomingdales, actually maybe had its best quarter of the year. And then when it comes to the Growth investment model as well as Backstage, what is ultimately the percent of the store base, you believe those formats can be in? Thank you.

Paula Price

Hi, Paul. I'll start with the first part of your question. So tourism was down 6.3% in the third quarter. And that was actually slightly better than we expected when we exited the second quarter, but it is still quite negative on an easy compare versus last year when tourism was down 4%. That being said, we're acutely focused on our holiday 2019, as we've heard Jeff and Hal talk about, and their ability to execute at a high level for all of our customers. And so when we think about it, we'll continue to use somewhere between 6% and 9% down as a run rate for the remainder of the fall season.

In terms of Bloomingdales, in the third quarter, it was impacted differently versus Macy's. Bloomingdales was down low single digits. So around 2.9%, which represented a significant improvement from the second quarter.

Jeff Gennette

And then, Paul, we just set up the Backstage conversation. So we're obviously very optimistic about what we have been able to accomplish in Backstage since we opened in a freestanding format back in 2015 and have now brought it into Macy's stores and was now over 200 locations. So to answer your question, I don't think we see the limit yet in Backstage. We see Backstage could play in every single one of our Macy's mall footprints. And we're looking very carefully at freestanding as well. And I'll let Hal to give a little more detail about what we're learning about Backstage and what boosts our confidence.

Hal Lawton

Thanks, Jeff. As Jeff said, we are very excited about the opportunity and the impact that it's already having on off-price at Macy's. This year, we opened up 50 stores in a store locations. That puts our total at 215 stores in a store locations, a significant growth over what we were two years ago, as Jeff mentioned. We have plans to open many more in the future. We also, this year, as we talked about on previous calls, opened up an 800,000 square foot distribution center in Columbus, Ohio. And I'd just say more broadly, we're now at scale in off-price with our Backstage business at Macy's.

And our -- as I mentioned earlier, our Backstage locations continue to perform very well in the quarter, ones that were opened up over a year, were up mid-single digits, and we continue to see improvement in not only our sales, but also our margin and turns that are associated with the business. Our customers really enjoy shopping Backstage. For example, our Net Promoter Scores in the business are very strong and well above a number of the other businesses inside of a Macy's store.

Jeff mentioned our freestanding Backstages. We opened a number of these in 2015. Those also remain quite strong with strong positive comps. Just stepping back and talk -- as we look at Q4 with our Backstage business, we are locked and loaded. We have some amazing holiday deals in our Backstage businesses, including things like Family P.J., slippers, wade boots, the access to inventory has been strong. We have great brands in our Backstage business, and we feel really good about that business as we head into Q4. And just in summary, as Jeff mentioned, there's a lot of runway for off-price at Macy's, and we're very bullish about the future of our Backstage business.

Jeff Gennette

And Paul, just to add, we also have a lot of runway at Bloomingdales and Bloomingdales outlets, so we definitely found the right formula there. You see us adding stores there, and we're very satisfied with the results.

Paul Trussell

Just one follow-up. And I know you're going to discuss this much more in February, but you did mention in the presentation that you saw some early positive results on the productivity program. Anything you could elaborate on in that regard?

Paula Price

So what I would say there, Paul, is we have been very much hard at work on our productivity initiative. And what we are seeing is that the organization has taken both a cultural and a mental shift when we think about cost savings. So more -- we're looking at it more as ways to positively change the way we work, how we move our product and so forth.

And so as I said, in September, productivity savings -- we get productivity savings, and that's what we're seeing, which is an opportunity to really accelerate those savings versus the road map that we laid out at the conference in September. And then just to remind, we said that we would deliver $400 million to $550 million of savings on top of the $100 million to $200 million of savings that we do normally in sort of as part of our normal DNA. So that will impact gross margin. It will impact SG&A and working capital. And again, we see opportunities to accelerate that, and we look forward to describing that in more detail at the conference.

Operator

Thank you. We can now move to our next question. It comes from Lorraine Hutchinson of Bank of America. Please go ahead.

Lorraine Hutchinson

Paula, you talked about the free cash flow year-to-date not being indicative of what you expect for the full year. Can you walk us through some of the puts and takes there? And then just maybe share your expectations for what that free cash flow number should look like this year?

Paula Price

Yes. Lorraine, as you know, we don't typically guide our free cash flow, but we expect it to be commensurate with the way we deliver EBITDA and so I'm just saying that it was a function of the timing of the payables that we saw in the quarter.

Lorraine Hutchinson

And then just a follow-up on the gross margin this quarter, you mentioned 40 basis points of delivery headwinds. Is that the ongoing expectation? Or was that maybe a little lower because of some of the problems that you have in the e-commerce business?

Paula Price

I would say Lorraine that the sales growth rate of our digital business slowed in the quarter. And so, commensurate with that, lower-than-expected growth, we had a lower-than-expected headwind from delivery expense associated with our digital business and loyalty program. So I would just look at it in terms of that.

Lorraine Hutchinson

Okay. And then, is the fourth quarter expectation for gross margin, can you just share a little bit of detail behind that?

Paula Price

Sure. I would just back up a little bit and say that we're pleased with our gross margin performance in the third quarter and how we navigated the environment from a margin perspective, and which resulted in significantly improved gross margin compression in the third quarter, as you saw -- down 30 basis points versus down 160 basis points in the second quarter, and 120 basis points through the spring, albeit on lower sales. And so our goal is to always to be able to balance sales and gross margin and profit performance similar to or better than the way we did in 2018 as we move forward.

Where we also are beginning to see some productivity come through, we expect that to come through even more so in 2020 and beyond. But in terms of our gross margin, we guided it to be down moderately on the full year, which would imply that in the fourth quarter, it would also be down moderately, as well. But not near the compressions that we saw in the spring.

Jeff Gennette

Lorraine, just to give a little more color on that, I think there's -- when you're a fashion retailer, promotional retailer like Macy's, there's two things that we look at with respect to gross margin. The first one is that, we always want to be at the right stock to sales ratio because we're always flushing out the older fashions, we're bringing in the new. And then the second piece is that planning your promotions. And so I think one of the benefits that you saw in the third quarter for us was that, we didn't change some of our competitors' promotions, and we really held the line in those categories that frankly we're not perishable, that we're not fashion, that we're replenished based on sell-through.

When we look at the fourth quarter, we're locked and loaded, every single promotion has been planned, every special has been planned with our private brands, our market brands. So we have flexibility to respond to what is going on in the competitive environment, because our stocks are now in line, our stock to sales ratios are at the right balance. We recognize the importance of the gross margin opportunity that we have, and we are well positioned in the third quarter going into the fourth quarter.

Operator

Thank you. And then we now move to our next question. It comes from Alex Walvis of Goldman Sachs. Please go ahead.

Alex Walvis

My first question is on the inventory. Can you talk a little bit about the composition of inventory and the level of comfort that as we go into the fourth quarter and the holiday season with fewer days between Thanksgiving and Christmas, is that the right level?

Hal Lawton

We feel really good about our inventory position going into the holiday season, as Jeff just mentioned a minute ago. And then specifically on the inventory, we feel like we have a really strong gifting assortment, many of them exclusive. We've got excellent and strong values out there. As we've said several times on the call today, we work hard all year to put together a fantastic holiday set up for our customers.

As you've heard from others, it's a highly promotional retail environment. In Q3, we were able to take a much more balanced approach to sales and profitability, resulted in an improved gross margin rate compression, as Paula covered earlier. We were very deliberate on where and when we took promotional markdowns in Q3, and we'll take that same strategy into Q4. And the benefit is that we've been planning for Q4 all year. And we're going in with a very good inventory position.

we're going in with a very good inventory position.

And as we've said previously, we expect for comp inventory -- we said previously that we expect the comp inventory to be up entering the fourth quarter. And actually we ended with comp inventory flat at the end of Q3 here, so slightly better. And we've also said we expect inventory to be down at the end of the Q4. And our guidance takes all that into account, and that's still very much our guidance.

Alex Walvis

One question on the home category. I think you mentioned that housewares and furniture underperformed in the quarter. Can you talk a little bit about what's going on there? It seems like it's a pretty competitive category at the moment. So how is the business performing? And what's the plan going forward there?

Jeff Gennette

So Alex, as you've heard very highly promotional environment in the quarter. And in particular, when you look at the home categories, housewares, in particular, so there was a lot of pricing that was going on of extra promotions, more affiliate spending. And we've made the decision basically to hold with our existing promotional cycle and not compete there. It did cost us some sales, but it also resulted in much less margin compression in the quarter overall.

So while that was a decline in the quarter, we are going to be very competitive as we go into the fourth quarter. We planned for that. But I think just as an aggregate, where do we need to be promotional and where don't we when we're responding to the competitive cycle. And again, we -- what I just mentioned earlier, we want to make sure that when you're in fashion categories, that are perishable, take your licks, go where you have to be, be at the right inventory level as you enter the new season. But in areas that are replenishable, many of the home areas are replenishable. These are evergreen products that continue from season to season. You're going to see us demonstrate more balance in the future as we -- you saw us demonstrate in the third quarter.

Alex Walvis

And then, Jeff, maybe one more for me. You talked previously about the ability to take price in the event of tariffs. Can you talk a little bit about pricing on those categories that have seen tariffs so far? Any kind of updated thinking on how price might be used as a lever in the event that we see incremental tariffs?

Jeff Gennette

Yes. So just to kind of ducktail on what Hal talked about. So if you look at where we put value in the products. And we have some opportunity, particularly in our fashion goods and our apparel goods and our exclusive products, to be able to put more make into these products, we can get a higher retail. That can absorb if there's a tariff impact.

As Paula mentioned in her opening comments, we worked very closely with our private brand and our national partners on mitigating costs. We had, obviously, a strong position in the market. And we were able to mitigate -- we had talked at the end of the third quarter or at the end of the second quarter call that we thought it could be up to $0.07 of overall EBIT impact. And for the full year, we were able to mitigate virtually all of that in the second -- in the third quarter, and Alex we're anticipating for the balance of the fourth quarter.

So right now, we're hard at work with all of our partners on the 2020 assortments. And where we will raise retails, it's because we're putting more making these products. We're having better fashion that the customer will accept that. As Hal mentioned earlier, like the INC brand, seeing how that's performing in the fourth quarter and higher average unit retail with more make, that gives us some confidence that our strategies will work. But in general, if the content is the same as the previous year, I don't believe customers will take a price increase with it. We're working with our manufacturing partners very carefully on that. And so far, we've been able to mitigate all those increases.

Operator

Thank you. We will now move to our next question, comes from Kimberly Greenberger of Morgan Stanley. Please go ahead.

Kimberly Greenberger

I wanted to just follow-up on the discussion on your stores, in particular your neighborhood stores. I'm wondering why not close more stores, particularly in light of the underperformance or continued underperformance in C and D type malls? And then I wanted to just follow-up, if I could, Jeff, on the improvements that you've made to the e-commerce site. Could you just talk about the improvements you feel like you made that will matter to consumers here in the third quarter? Did e-commerce sales actually grow in third quarter? And then if you have any thoughts on one-day delivery, that would be super helpful. Thanks.

Jeff Gennette

Okay. We'll take the three-part question in two-part lines. So the first one, I'm going to turn it over to Hal, to talk about the e-commerce enhancements on the site as well as an update on same-day and delivery in general. Let me just talk about the lower tier malls.

So as Hal mentioned in his comments, I mean, we are committed to ending the year with a plan for all of our neighborhood stores. They are important in the neighborhoods that they serve. They have a very developed fulfillment business that goes out of it. Customers are going in there for basics. We are very mindful of every one of our store footprints, about how it influences our digital business and the entire omni-channel ecosystem. So we are going to be very thoughtful about -- of how we deal with that and how we address that. And as mentioned, we will be talking to everybody about that at our February 5 Investor Day, about how we're going to go forward with that.

And Hal, why don't you talk take-on about e-commerce enhancements?

Hal Lawton

Yes. Thanks, Jeff. As Jeff and Paula referenced earlier, we did experience a slowdown in our digital business, but it absolutely did grow in the quarter. We just did not achieve our customary double-digit growth. And some of the trends that Jeff mentioned, not only did they affect our brick-and-mortar business, but they also affected our line business, including weather and some of the promotional intensities we talked about earlier, particularly in the home category.

We continue to see very strong traffic to the site. But we really will resolve the softness with a conversion. And again, that was primarily due to some of the weather and the promotional intensity that we saw. But it was, in part, as Paula mentioned, due to some of the enhancements that we made for holiday. We released a number of enhancements in advance of holiday that have really had a big customer improvement experience, but it took us some time to work through these.

Now Paula gave you a strong list of these earlier. Some of them have included same-day delivery, which really increases our customers' fulfillment options. We just made several updates in our checkout process, including the addition of a save for later function, which improves convenience in checkout. And we also made a number of taxonomy updates that make the site easier to navigate and improve the customer shopping journey.

As we look ahead, the team has completed its work. The sites upgraded. The customers are already enjoying this, and our conversion rates are back in line with normal trends.

As we talk about same-day delivery, I'll just provide a little bit more color there. We offer same-day delivery to our customers in 33 markets. This covers about 40% of U.S. households and about 60% of our online volume. Just a brief -- if we step back, customers really expect a variety of fulfillment options. Sometimes they want things fast, sometimes they want things cheap, sometimes they want things super accurate. And that means we need to be offering our customers same-day delivery.

In Q3, we updated our -- as I've mentioned, all of our digital properties to make it easier for customers to identify, navigate and select items that were available for same-day delivery.

Additionally, in the month of October, we offered a limited time test for free same-day delivery for orders above $75. Our current price for same-day delivery in our typical price is $10. We were one of the first retailers to offer kind of this free same-day delivery over $75. The customers responded well to the test. But also just more broadly, the customers really responded well to same-day delivery. We're pleased that we've been able to make it more prominent to our customers. As I mentioned, they're adapting to it quickly. We're more excited about having it available for holiday as -- particularly as we get closer to the end of holiday.

Operator

Thank you. And we can now move to our next question. It comes from Chuck Grom of Gordon Haskett. Please go ahead.

Chuck Grom

Just a few questions for me. Just, one, just wondering if you could speak to the cadence throughout the quarter and potentially speak to how November started off? Number two, just on the lower tier malls. I think it's the first time you've called that out. I'm wondering if you could quantify what you think that drag was.

And then third, and probably most importantly, you guys are pretty upbeat here. But your comp guide for the year, which implies about a down 2.5% comp in the quarter, looks pretty conservative on the stack. So given that you're cycling that 70 basis points of one-time items from last year, can you just frame out for us your thought process and where there could be some potential upside here in the fourth quarter. Thanks.

Jeff Gennette

Paula, do you want to?

Paula Price

Yes, yes. So I'll start with the first question or a few questions here. The first one on cadence. I would say our cadence in the quarter, was fairly consistent, August through October. And then -- since I'm speaking and I'm sure that either Jeff or Hal will come on to the malls, let me just take the Q4 guide. Certainly, Chuck, we're confident as we've been saying in our holiday strategies. But as we look at our year-to-date performance and the Q3 trends, which Jeff discussed in his remarks, we have to recognize that our strategies are being built on a weaker baseline and the trends are weaker. And so we're building on top of those. And also, just sort of, as Jeff mentioned, the sales in the lower tier malls slowed. We saw digital growth moderate. Certainly lots of strategies in place that should provide the opportunity there to reaccelerate. But we also want to be mindful of the uncertainty in the environment, the macro uncertainties. The consumer is certainly solid, but we want to be prudent in the sense of our full range of our guide.

but we want to be prudent in the sense of our full range of our guide.

Jeff Gennette

And then, Chuck, to your question, it was about a 30 basis point drag to our overall comp, when you look at the lower tier malls versus what we had in the first half of the 2019 year.

Chuck Grom

And then just a quick follow-up for Paula. When you take a step back and look at the overall operating margin structure, along with your targeted $400 million to $500 million of the annual savings, do you view these as offsets to future investments and, I guess, promotional actions? Or do you think that operating margins can begin to expand in 2020, assuming more of a stable top line backdrop? Thanks.

Paula Price

Yes. I mean, the way I would think about our productivity savings is that we're looking at them as ways to mitigate headwinds, fund our investments and improve our profitability in time, so that -- we're looking for them to do all of those things. And again, we do see opportunity to accelerate those savings, and we're looking forward to telling you about that in more detail on Investor Day in February.

Operator

Thank you. We can now move to our next question, comes from Paul Lejuez of Citi. Please go ahead.

Paul Lejuez

Curious, how much Vendor Direct helps the comps this quarter, and what your expectations are for how that business can help you in 4Q? And also curious as the number of Vendor Direct SKUs grows, is there an opportunity to take inventory lower to make the business less capital intensive?

Hal Lawton

I'll start with just customers have a really high bar for retail experience. And that's not only in our brick-and-mortar stores, but across digital and also the way they cross-shop in an omni way across that. And that means we need to have a compelling digital property that's easy to shop, offers fulfillment options, appeal to both, as we talked about earlier, the time and the cost-sensitive customer.

That also means we have to have a great product assortment on our site. We want to have all the best and we want to have all the rest on our site. And what we want to do is help curate our customers' selection, but also provide great personalization to allow them to quickly find the items they're looking for.

As you mentioned, the advantage of Vendor Direct is, it allows us to have a vastly expanded assortment without holding the inventory. It's a real win for us and for our customers. In the quarter, Vendor Direct made up about 13% of our digital business. As Paula mentioned, we added over nearly 1,000 vendors and over 1 million -- we'll be adding over 1 million SKUs to the site this year. And year-to-date, we have exceeded those goals in time for holiday.

When we look at our competitive set, we know that our peers have a much larger ratio of online SKUs to in-store SKUs. And that continues to make us feel like we have a meaningful opportunity to expand our Vendor Direct program, and we see our customers engaging with it. And we think our Vendor Direct program only has upside. It adds sales and profit, increases customer satisfaction, drives traffic to the site.

Just to your kind of part B of the question, what I would just say is, we're constantly looking at our assortment. We're looking at the assortment we have in our stores. We're making sure we've got it in the right stores, seasonally relevant, location relevant. We're also looking at the inventory that we have in our distribution centers and how that services online, and we're very focused on inventory productivity.

And where we could find ways to take inventory out of our distribution centers and ask our vendors to fulfill that, we are doing that. And where we find opportunity, sometimes when we have a Vendor Direct item that's selling really well, and it's more beneficial to bring it in-house, we’re doing that as well. So it's something we're constantly looking at. It's something we're constantly assessing. And this is a muscle we have well developed.

Jeff Gennette

And Paul, just on February 5, you will hear more detail about the transformation of our supply chain that Hal has given you some texture on.

Operator

Thank you. We now move to our next question, comes from Omar Saad of Evercore ISI. Please go ahead.

Omar Saad

A couple of clarifications. I think most of my questions have been asked. You mentioned a couple of times that the colder weather area of the store isn't doing as well. Obviously, there's been a turn of the -- turn in the weather. Is that one of the factors that gives you confidence in the fourth quarter and gives you confidence in where you're going to end the year in inventory?

I also wanted to kind of get a bit better understanding with the digital slowdown in the quarter, worse than the bricks-and-mortar side of the business? Or do they both kind of perform lockstep?

And then my third question, last question is on the Neighborhood stores in those local markets, those second tier and third tier, is there an opportunity to really run those businesses, those locations with a lot less inventory? Maybe a local assortment and kind of all is in stock basics? Is there a chance to kind of think about inventory in those markets differently than you do in the 150 in the top markets where they have the full assortment stores and their destinations? Thanks.

Jeff Gennette

So let me take on the -- the first one on this, Omar. So on the cold weather, we definitely did get a jolt of customers and business based on the cold snap that happened in the country, in the really, the first two weeks of November. So as we mentioned, it had a material effect on -- not just on the categories of cold weather, but also on the appended sales both online and in stores, what we're up against from the third quarter of last year. We saw a nice piece of that coming back to us right now in the first two weeks of November.

With respect to Mcom and bricks and mortar, the degradation in trend was about the same relative going from the second quarter to the third quarter for the reasons that we quoted. And to the conversation about the third -- the tiered stores, we'll come back to you in February with what our plan is, exactly how we're looking at those buildings. It's also pursuant to your question about inventory levels, profitability and sustainability of those locations.

Operator

Thank you. We'll move to our next question, comes from Michael Binetti of Credit Suisse. Please go ahead.

Michael Binetti

A lot of our questions have been answered as well. But could you just speak to where -- maybe where you're seeing some of the incremental areas of real estate -- real estate monetization recently? I think as we've talked to you guys over the last few years. I think that your thinking was that, that those gains would slow a little bit going forward. You just stepped it up a little bit today. Do you view that more as a pull forward from something you were thinking about next year or have you found something incremental in the strategy? I know you guys have been working hard on that strategy for a few years.

Paula Price

Yes. Hi, there. So I would say that in terms of our asset sale gains, our real estate team, they keep abreast of the market, and they help us monetize the assets when the real estate value surpasses the retail value. And so that's an ongoing process. And an ongoing assessment of our store fleet. And due to this work, we've been able to see some acceleration in asset sales this year. And so we've raised our guidance to $150 million from $100 million in asset sale gains. But I would say that we still think a normal range of between $80 million to $100 million. And this is an active process. So from time to time, you will see an acceleration such as this.

Michael Binetti

Okay. And then if I could just ask, if we try to look at the full ecosystem a little bit here of some of the brands that have bigger businesses with you, many of them have guided fairly conservatively for fourth quarter. But I do want to ask you, do you feel like you got -- maybe you could help us think about how much support you got from the vendors to help clear through some of the inventory that you commented in the third quarter as we think about the full P&L you just presented. And do you think the vendors stand ready to offer that same amount of support if fourth quarter comes in below or do you think that, that -- how are you thinking about the vendor allowances to help get through the holiday? Thanks.

Jeff Gennette

So Michael, what I'd say in the first three quarters of the year, our support from vendors is very similar to what it has been in previous years. I think the most important thing we could say on the subject is how our vendors and our -- all of our merchants work hand-in-hand on opportunities for customer demand. And we feel particularly good about the holiday timeframe and all the gift assortments that the teams have been hard at work at over the past nine months getting ready. So a lot of that is exclusive content. We know that it is customer wanted. We've been either testing price points or content. We feel very aligned with our vendor partners in accomplishing our goals together.

The other thing I'd say is that depending on sell-through, there's more room in sales based on the stocks that we have, just based on getting better sell-throughs. So we're ready. We're done the updates of it. These have got to be, that's all comprehended in our guidance of fourth quarter margin. So we're in good shape with respect to where we are right now with our brands.

Michael Binetti

Okay. And again, Paula, could I just ask one technical one. You mentioned the operational blip on the digital site, and you said that was improved to get ready for the holiday experience. Was that -- just on timing of that, did that affect -- just so that we're calibrated correctly, did that affect anything in early November at all? Or was that completely done before the end of the third quarter and back up and running as you start the fourth quarter? Just to help us calibrate how you guys are looking at it. Thanks a lot.

Paula Price

Yes. I would say that we have put the fixes in place and that the customer is seeing an improved experience at this moment.

Operator

Thank you. And then we'll now move to our next question. This comes from Oliver Chen of Cowen and Company. Please go ahead.

Oliver Chen

Hi, thank you. Regarding a modeling question, how are the merchandise margins this quarter? And what's your outlook for fourth quarter? Another question we had is just managing SG&A and long-term investments needed versus the short-term and your thoughts on managing margins versus investing in the business and what then needs to happen.

And then finally, on women's. I'm thinking about the women's category, it's been a challenged category across the industry. What are your thoughts on what needs to happen to women's and also attracting a younger customer as well?

Paula Price

So I would start with gross margins. So what we -- when we look at our compression in the third quarter, which was down 30 basis points, I would describe that as due to the delivery headwinds that we expected to see. And in terms of SG&A, I would think about that in terms of our productivity program impacting that as we move forward. And so you'll hear more about that as we give you details of the -- further details of the program on Investor Day.

Jeff Gennette

And then, Oliver, let me take the ready-to-wear question. So as Hal mentioned, this one has been -- we've been hard at work at this, not only with the new team and new structure, but really addressing our existing customer base as well as a new customer that we are hotly pursuing. And so the first thing I'd say is that with respect to brands, really making sure that all of our key brands are under construction. And so those that had issues with sell-through, we really went back and made sure that we had the DNA right, we have the right cost structure, the classification mix. And what Hal was describing in terms of some of the impacts we're seeing in early sell-throughs on what they were able to effect, which was really fourth quarter, we're encouraged by some of what we're seeing.

We have this opportunity with the under 40 customers. So we've been looking at that in terms of content, about do you do it by end use, do you mix brands? How do you merchandise it? How do you market it? Where do we stand up in terms of telling the customer about it? So we've been experimenting. We've got a number of stores right now that we're playing with different merchandise models, different architecture of labels and brands that are coming into that. We're encouraged by some of what we're seeing.

We've obviously done a lot of focus groups with respect to the under 40 customer and we're clear about what we -- she needs to see from us in order to give us more for her allegiance. She's already shopping with us in categories like fragrance and handbags and many categories of women's shoes. What do we need to do to be more relevant in women's ready-to-wear?

So things like what we did with My List at Bloomingdales, things that we're doing with like thredUP, things that we're doing with what I've described in terms of new brands and new ways of merchandising and marketing them. That's all of where we're going for this under 40 customer. And we know that we need to accelerate our efforts, and you will hear more of that from us at the Investor Day in February.

Oliver Chen

Okay. And being promotionally prepared for fourth quarter, is the assumption that merchandise margins are going to be lower? And what about, Paula, hold and flow is a very good strategy to drive speed and also test read and react? How are you thinking about hold and flow across the range of your stores, lower productivity versus higher productivity?

Paula Price

So again, with respect to gross margin in the fourth quarter, we're expecting to see some compression that is implied in our full year guidance, but compression will be a little bit more compression than we saw in the third quarter, but not to the extent that we saw in the spring season as we continue to take a more balanced approach.

And then hold and flow, we begin -- we have begun seeing some of the benefits of it. We expect to see more and more of it as we move through the year, but certainly as we get to 2020. So we expect that to positively impact our margin as we continue to flow more and more product through the process.

Jeff Gennette

And just Oliver, what we mentioned earlier about the transformation of the supply chain, expect a thorough review of that in February.

Oliver Chen

Okay. In the transformations, do you think you need to materially step your margins and revenue base down just to give yourself more breathing room to adapt to this environment?

Paula Price

Well, that is sort of the idea of the transformation program. We have sales growth initiatives, we have productivity initiatives, and the idea is in combination to grow our revenue and our profit over time. And again, we'll talk about that in great detail on Investor

Day.

Operator

Thank you. We can now move to our next question. This comes from Bob Drbul of Guggenheim Partners. Please go ahead.

Bob Drbul

Just a question on the gross margin. Where are you on the markdown optimization initiatives that you've talked about? And then the second question that I have is, can you just give us an update on some of your re-commerce initiatives that you talked about, I think, in the most recent call? Thanks.

Paula Price

So I would just say that with respect to our productivity initiatives, namely hold and flow and markdown optimization, again, we're beginning to see some of the benefits of those in 2019, but we expect to see the more -- the fullness of those in 2020. And again, we'll outline that for you on Investor Day.

Hal Lawton

And then Bob, on re-commerce, so thredUP is -- it's now positioned in our stores. It's performing well. We're learning every day about how the second-hand market affects the balance of our assortments where it is adjacent to. We're very careful to make sure, what does it cannibalize? How is the customer responding to? Is it a new customer? So we're going through all that data right now. What I would tell you is that we're beating our plan sizably with respect to thredUP. Very pleased so far about how it's performing, but we want to look at kind of lifetime value of this with customers that are shopping around it. So stay tuned.

Bob Drbul

And can you update us on the rental initiatives that you have, I think with Bloomingdales and the opportunities with Macy's?

Jeff Gennette

Yes, sure. So let me take you through that. So that's what we call My List. So that has launched. We're in our first kind of six weeks of it. And it's hitting all the kind of the customer benchmarks that we expected. And then to just the previous question, is it resonating with the younger customer? Millennials make up approximately half of the customers that are enjoying My List. It's also helping us reach customers that are out of kind of the typical geographic reach of where a Bloomingdales is. Dresses is the top classification. But in Q4, we launched, within My List, a gifting program that allows customers to give subscriptions to new members digitally and in select pilot locations. So like thredUP, My List is off to a great start.

Operator

Thank you. We'll take our next question from Dana Telsey of Telsey Advisory Group. Please go ahead.

Dana Telsey

Can you talk a little bit more about some of the destination businesses that one called out and how their performance was? Whether it was beauty, women's shoes, anything that we're seeing there. And then also on the e-commerce portion of the business, is it back up and running now? What issues needed to be addressed? And what do we see digitally this quarter versus last quarter? Whether it was category sell-through or also frequency? Thank you.

Hal Lawton

Hi. This is Hal. As I mentioned earlier, we -- with all the pressures we saw in the quarter, our destination businesses did also experience a slowdown versus Q2, but they did perform better than the balance of the business. As we mentioned a couple of times, we saw some bright spots in mattresses, fragrances, dresses, fine jewelry, men's, etc. I think what I'd just say about our destination businesses is they're in great shape for the holiday. I'd highlight things like our gifts under strategy and beauty, our holiday party dress lineup, our elevated jewelry assortment, things like casual sweaters, stockings, uppers.

Our destination businesses account for 40% of our sales. We've got a top there market share in these-they're strong profit contribution. And we're very focused on making sure that these continue to be destination businesses for Macy's customers.

As it relates to online, we've talked about that a few times. But I guess, I'd just say, we implemented a number of releases and enhancements in Q3. We've worked through those. The site is upgraded. Our customers are already enjoying these enhancements. We're seeing good performance out of it. Our conversion rates are back in line, and we're ready for the holiday season.

Operator

Thank you. And our next question comes from Priya Ohri-Gupta of Barclays. Please go ahead.

Priya Ohri-Gupta

Paula, I was just wondering if you could speak a little bit to the level of confidence you have that you guys will be within your leverage target at year end, just given the third quarter performance, figure just inside of that at the end of third quarter. And sort of how we should expect that to progress going forward relative to some of the asset sale gains that you expect? Thank you.

Paula Price

Hi, Priya. So as I said in my earlier remarks, we plan to use excess cash in 2019 to further reduce our debt. And just to remind, we've been paying down debt, $3 billion over the past trailing four years, and we continue to move closer to our leverage targets. And again, I just would put that in the context of our capital allocation framework, which I outlined earlier, investing in the business. And second is certainly continuing to maintain a healthy balance sheet. So I would think about it in that way.

Operator

Thank you. And we'll now move to David Swartz of Morningstar. Please go ahead.

David Swartz

Yes. Can you tell us how the loyalty program at Bluemercury may affect sales? And also if the management chain -- change at Bluemercury affects the growth prospects or strategy of the company. Thanks.

Jeff Gennette

So the BlueRewards loyalty program that just launched within the quarter is off to a great start. And so that is -- we've already got about 30% of the Bluemercury customers have signed on for that. So excited about that. It's hitting our targets. We expect that to continue to go further.

We had some management changes. So Barry Beck was one of the original founders. He is no longer with the company. He's gone on to kind of an entrepreneurial venture. We're very happy for him. And then Marla Beck is staying on with us until we have the appropriate transition strategy. We are currently actively looking for a Chief Executive Officer, but she's got a strong team beneath her that is deeply committed to the Bluemercury brand. I do not expect any hiccup with this transition.

Operator

Thank you. We'll now move to our next question from Bernard Sosnick of Madison Global Partners. Please go ahead.

Bernard Sosnick

I'm hoping that you can help me summarize some of the thoughts regarding the fourth quarter guidance, which I take away from your comment was based on the trending of the third quarter sales. However, in the third quarter, mentioned four impacts, including late cold weather, and you already said, there's been a jolt in sales from cold weather sales. And that, to me, suggests improved gross margin prospects on cold weather merchandise due to a reduction later in the season for markdowns. You also cited the difficulty with improvement in -- with e-commerce in the third quarter and we've heard that things have been reconciled. And we know that e-commerce is comparing against difficulties last year.

And also with regard to international tourism there's a headwind because of the strong U.S. dollar, but international tourism has been down for so many years now that a low single-digit decrease in international tourism is de minimis with regard to the overall impact on sales. So it's difficult for me to reconcile the very optimistic commentaries that you made about your positioning for the holiday season and the guidance, taking into consideration that you want to be conservative. Could you flesh that out a little bit?

Jeff Gennette

So what I'd say on that, Bernie, is that we are being appropriately conservative. And what I would say is that there's many things that are outside our control; there's weather, there's macros. We want to make sure that when you look at where we went from third quarter into the fourth quarter, when you look at our annual guidance, it implies a fourth quarter range of being down [12] to down [29]. Remember, we were down [35] in the third quarter. So there's certainly some things that you are quantifying that we have confidence about.

We want to make sure that we have a fourth quarter strategy that we're very confident in, that we've been planning for. The confidence that you hear is everything that the Macy's and Bloomingdales can control on our side. But the macro conditions, anything that we can't control, we believe we have guidance that can -- that fits within all of those dynamics.

Operator

Thank you. We have no further question at this time. So I'd like to hand the call back to our speakers for any additional or closing remarks.

Jeff Gennette

Thank you, everybody. Happy holidays, watch the parade.

Paula Price

Thanks, everyone.

Operator

This concludes today’s call. Thank you all for your participation. You may now disconnect.