Macy's, Inc. (NYSE:M) J.P. Morgan 9th Annual Retail Round-Up Conference March 30, 2023 8:00 AM ET

Company Participants

Jeff Gennette - Chief Executive Officer

Adrian Mitchell - Chief Financial Officer

Conference Call Participants

Matt Boss - J.P. Morgan

Matt Boss

Okay, we can get started. So, good morning. It's Matt Boss, Department Stores & Specialty Softlines, here at J.P. Morgan. To kick off day two of the Retail Round-up, really happy to have a staple at the conference since the day we started it, this is our ninth year, the team from Macy's, we have CEO Jeff Gennette; and now newly appointed COO and CFO, Adrian Mitchell. So, look, I don't even know where to start in terms of some of the news from yesterday. But first of all, thank you for joining.

Jeff Gennette

Thanks, Matt. Let me just open with, obviously, we had a series of announcements yesterday. So, I have been working with the Board for the past couple of years on what the right time and who the right candidates are to take and pass the baton on for the leadership of Macy's Inc. And I think one of the things that we looked at was when is the right time, where's the strategy, where's the talent of the organization. I think what you can always depend on with Macy's Inc. are smooth transitions. And I had the advantage of going through the President role, having a 10-month window when I was CEO-elect. That was kind of important to me to make sure that we were able to establish that for not only our own organization, but for the industry at large.

So, getting to where we are right now as an organization and looking at where our financial stability is, where we are with our operational efficiencies, and where we are with the strategies of the company that we believe will deliver low single-digit growth, double-digit EBITDA profile in '24 and beyond, that this was the right time for us to start to think through what we wanted to do. So, two years ago, we started a very extensive search that was external as well as internal. And we kept coming back to the strong talent within the organization.

And know that the talent in the organization, which is typified by Adrian in external talent that came in just over two years ago, but with just a wealth of experience from, obviously, his consulting background with McKinsey as well as BCG, very strong strategist, but also an extremely strong and capable operator when you think about what he did with Target, what he did with Arhaus, obviously all the stints that he had at Crate and Barrel. But an outsider perspective, and somebody who could come in and actually be a player that could really challenge what we had done historically, coupled with really legacy, deep understanding of the business and the customer across multiple nameplates, which is what we had with Tony.

And Tony Spring, having been a veteran of Bloomingdale's for his whole career, I mean I'll tell you why we -- where we went on this. So, it's the mash-up of really external and internal. We did that at a macro scale when we looked at the search in trying to find the right player, of knowing what the team was that this person would inherit. So, that led us to the decision that we made yesterday, a deal promotion. So, we basically anointed -- Tony is going to be the President, he goes directly to the Board of Directors, and he will be the CEO-elect. He takes over in February of '24. And Adrian is elevated to, in addition to his CFO responsibilities, would become the COO. And he will pick up all of stores, supply chain, and technology, so that is effective immediately.

And let me tell you a little bit about each of the players. So, Tony, for those of you who have met him, I think that what I would say first about Tony is he is an innovator for the customer. And when you look at what he has created at Bloomingdale's since he's been CEO and what he's done with Bluemercury, since he took that over a year-and-a-half ago, is representative of some of his great work. He's an innovator for the customer. He builds amazing strategies that are based around top customers. 70% of the Bloomingdale's base of customers right now are on the loyalty program, and we're getting outsized growth at the most loyal ones, particularly the top of the list, and looking at riding that luxury trend.

He's been fantastic in what he's been doing with this talent in the organization with respect to ensuring that they are very focused on the customer. So, if you look at the customer experience within Bloomingdale's, you look at the digital experience within Bloomingdale's, he's innovating around always on that. And he is a great brand-builder. So, when you look at the department store like Bloomingdale's, it stands for luxury, and it stands for advanced-contemporary. And so, doing that on private brands all the way up to brands that are brand new, doing that through a leased and an owned, and a digital model has been highly successful. And then, when you look at what he's doing with his team leadership.

So, Tony inspires loyalty. He is -- every one of his team members, they all move in the same direction. He has a very strong history of promoting people and making them better. Denise Magid, who we just announced last week as the first Chief Merchant in Bloomingdale's history, is an example of that, somebody that he found from Intermix. And Maly Bernstein, who he brought in from CVS, deep background, has been the CEO of Bluemercury over the past year-and-a-half, and what he's done with that brand. And just know that Tony has been a corporate officer of Macy's for the past three years, and has worked hand-in-hand with Adrian, myself, and the rest of the senior leaders of Macy's in really divining where Polaris goes.

So, this is a character that is going to hit the ground running. And he needs to get into our stores, he needs to get into the warehouses, he needs to get into the offices. He certainly has a big impact right now on the strategy of the company and with the senior leaders. And, but he is, as he said in his internal message to everybody yesterday, he's going to hit the ground listening. So, looking forward for everybody to spend time with Tony, but that's why we selected him. Very important at the same time, because this is really, when you think about where Macy's is going, it's the one-two punch of when you think about Tony and when you think about Adrian. And Adrian, to talk about him --

Adrian Mitchell

Well, he's going to embarrass me, I'm sitting right here.

Jeff Gennette

I'm going to embarrass. Is he's been just an incredible impact on Macy's success over the past two years. So, the strategist piece, obviously not only does he have all those outside experiences, but what he's doing also on public board. So, he sat on the REI board. He's now on the Black & Decker board, runs the audit there. He's done an amazing job at really helping us think about different things in different ways. The thing I love about Adrian is that he's an operator for omni-channel retailer. So, when you think about the pieces of the business that he's had an effect on, so inventory management, what we're doing in personalization, what we're doing in end-to-end fulfillment; he's got his fingers in a lot of these pies.

And so, when we gave him these expanded responsibilities of stores, and supply chain, and digital, there are seams in-between those organizations; he's going to stitch that together. Our opportunity to operate at scale and make maximum efficiency out of our inventory, get the right expense out, get the right expense put in, and squeeze that, and [where there] (ph) a profit is while making very happy customers is what he's deeply committed to. So, he operates at great scale, and that is a key reason that we picked him. And then, his financial prowess, I think that stands for itself. I think when you look at our balance sheet, you look at our debt maturities, you look at the cash flow of the company, Adrian has been instrumental in getting $1 billion of inventory out of the enterprise over the past three years.

You see that in our inventory control. To do that and have better allocation, have better sell-throughs at regular price, to make the commitment to not chase unprofitable sales has been a lot based on what he's been able to underline. So, what I just wanted to emphasize was that this is -- we're doing this into the -- that we've got a very strong team that Adrian and Tony are both typifying. We've got strategies that are underway, which I'm sure we're going to get into. I, 40 years in this company, it's been my life's work. I would not have felt good about turning this over unless I had the right strategists and the right team in place. And very happy with the announcement yesterday, which I think is going to take Macy's Inc. to the next level and get us back to profitable growth in the future.

Matt Boss

Well, congratulations to both of you.

Adrian Mitchell

Thank you.

Matt Boss

And congrats on the promotion, Adrian.

Adrian Mitchell

Thank you.

Question-and-Answer Session

Q - Matt Boss

So, maybe to switch gears to the fundamental side, Adrian, how do you feel about the overall health of your customer base today by income demographic? Are you seeing any noticeable differences in behavior from the lower-end relative to the higher-end customer?

Adrian Mitchell

Yes, when you think about our earnings conversation earlier this month, on March 2, we talked a lot about pressure on the consumer. And one of the things we talked about is that as we think about moving into 2023 versus 2022, we think a lot of the pressure that we saw build over the course of 2022 will continue into 2023, and seems like it's going to continue into 2024. What we continue to see is the stimulus is not here, inflation is still elevated. The jobs market has been holding up, but we're seeing a lot of different indicators as we look at our proprietary credit card data with credit balances building, and things like that. But this continued pressure that we articulated on the earnings call seems to continue to be an opportunity.

Now as we think about the different income tiers, what we've seen is that there's pressure on all income tiers. We feel that all of those consumers are going to be quite discerning in all of their purchases. But what we focused on is making sure we have the right stuff for them. So, really focusing on the right level of inventory, the right composition of inventory, and really focusing on profitable sales and having the things that they need, that's really critical for us. And that's seems to be working quite well.

Matt Boss

So, maybe in light of that, Adrian, on the top line cadence for this year and in your forecast, what is your confidence in the sequential revenue growth acceleration that you embedded as the year progresses?

Adrian Mitchell

What we spoke to was a combination of things, right? So, 2023, we feel there is going to be continued pressure on the consumer. But really what was important to take a look at was the compare of this year versus last year. So, you think about the first quarter, we had 13.6% growth over the previous year in the first quarter. The consumer had savings, the consumer had stimulus, the consumer had a lot of health. And we didn't see until the end of the first quarter, that the inflationary pressures were beginning to set in. Then it shifted in the second quarter, where supply chain started to loosen, retailers had a lot more inventory so promotional intensity began to pick up. And so, the consumer was under increased pressure with increased inflation.

And then as we got into the third and fourth quarters, as you remember, the pressure was pretty consistent and persisted to wrap those periods. So, as we think about our performance in 2023, the [sequentialness] (ph) and the compares we believe are much more manageable as we progress through the year. So, that's really how we're thinking about that cadence. The fact that we're coming into the year with the right level of inventory, down 3% to last year, down 18% to 2019, as Jeff spoke to in terms of how much inventory we're taking out for a comparable level of sales, we feel that we can focus on the things that matter for the customer, the right mix of product, where the demand is. We've demonstrated through the last two years that we can navigate these nuances by being very disciplined in what we're seeing and discerning, and making the right judgment calls to navigate appropriately.

Matt Boss

So, Jeff, maybe by category, could you speak to spring selling trends, what you're seeing out there? Any normalization in category trends maybe between active-home relative to some of the occasion-based wear?

Jeff Gennette

Yes, so what, obviously, we reported fourth quarter, and our guidance for the year, on March 2, so earlier in the month. So, not to comment on trends since then, but what I'd say is that what we talked about in the fourth quarter was clearly there were the pandemic categories that we saw a real drop-off really in the first quarter, starting in '22. And that didn't abate. But it will abate. Fashion is all about cycles. And so, when you have customers that were gorging on home, and casual, and active products during when they were kind of sequestered during the pandemic, that clearly was -- that retarded demand as you think about '22, but it will pick up. And so, we've got great trend curves.

We actually use Bloomingdale's because we get those early adaptors, as a fashion business we see the signals of when that is going to start by category. We use that as we interpret what that means for Macy's and what it means by brand. So, I do expect that's going to return as that was kind of abating. And you had all these occasion-based categories really pick up. It started about the same time the pandemic categories dropped off, so all the occasion-based one. So, the kind of return to travel, so the language business, the clothing business, the dress business, and that has been very strong for us all the way through the fourth quarter.

And you heard us talk about that we expected that to continue. And then, you have the gifting categories which have their own rhythm. It's really about newness. And it's about the choices that you make. So, from our advantage point we just went through Valentine's Day which I can't comment on. But, when you look at how we built Mother's Day and Father's Day, what we learnt from '22 that's going to built into our '23 gifting strategies.

The other thing is just that we are always looking for newness. You saw what we did with the brand. A category that we were -- we had vestiges of, but we frankly had not distorted it which is a category like toys. Not because the margin profile of toys is particularly strong. But, because of the customers that come in as a primary purchase, what they buy and the balance in their basket both online and in store. And that has proven out for us to be quite strong for us. And what we are looking at in terms of getting into categories with limited inventory risk is the reason we are so bullish on a category like marketplace. So, look, where all of our -- when we looked at our guidance, we anticipated where we were going to be with these categories. But because of the strength of our inventory and because the second you make a plan, it's wrong the next day, you always pivot with the customer.

And the fact that we have the flexibility and the built-in power with reserves to be able to respond to that, there is always an abundance of product in the industry at a brand level, maybe not a particular item level, but at brand level. So, when a customer starts signaling, we are pivoting. And expect us to continue to do that.

Matt Boss

So, as you think about Macy's as a destination for the customer and then you think by category, what categories excite you? Where do you see market share opportunity if you are thinking the next three years? Are there categories you would like to expand in?

Jeff Gennette

Yes, so let me talk about it in the context of just kind of day-to-day hygiene. And then, talk about it in terms of the five growth factors. Day-to-day hygiene would be just this whole kind of inventory discipline that we have to be able to chase categories that we may not have thought it was going to be as big as it's going to be. I think an example of that would be what we found from marketplace with electronics and videogames. That was not -- we didn't expect that to be as strong. When we came out of the blocks of marketplace in September, those were gigantic sell-throughs for us. And so, to be able to expand that and we know how these different economic models that help us either ones that have longer lead times that we might create for ourselves like private brand all the way to things that we can buy just-in-time. You can do it on marketplace. You can do it in vendor direct.

You can do it through lease. You can do it through -- so those are where we are very committed to transforming our company to go where the customer is going, so that would be the hygiene point. I think in terms of the growth factors which we are relatively early on this, that's what give us confidence when we think about growth in the future is starting with kind of private brands that has been a our total rebuild for us. You don't start seeing that until August of this year. And then, it goes all the way through '25. And I can talk about that later. The next one would be what we are doing with Market by Macy's and Bloomie's. So, knowing what the strength of our brick-and-mortar business is dependent on being mall-based right now and what is the growth factor to do it off -mall, knowing that brick-and-mortar spins the omnichannel flywheel and the digital penetration, it's always a good thing to have healthy flags. And so, we can talk about that when you think about what we do with personalization and the idea about going from broad based promotion to personalized communication and offers is a big opportunity for us. When you look at what we are doing with I talked about marketplace and the marketplace opportunity. For what we started with, it's exceeding our expectations.

You are going to see us add Bloomingdale's to that in back half of this year. And then last, I will just spend little time on is really luxury. And luxury has been clearly kind of typified by Bloomingdale's and Bluemercury. Bloomingdale's just had its record year last year. Record customer satisfaction and taking market share from the luxury neighborhood, which we are proud. And this is about a brand game. And this is about having an environment that these brands want to co-exist with you as we share customers. They are very developed D2C businesses. And, it's kind of a misnomer that they are all going to go to D2C and that the retailer or the wholesale channel is going to be cutout. We have not seen that. There is lots of opportunities. And when you look at what Bloomingdale's has been able to gather with some of these luxury brands and with our prowess in advanced contemporary which we create, it has been a huge win for us. So, when you have cracks in the luxury business in certain categories, there are other ones that emerge. And so, you have seen us play with those cycles through the years and continue to see that -- you'll continue to see that from us.

Bluemercury is a jab. And to have a company that we are building to more scale, the moment we open up a new flag within that year, it's profitable. It's a great cocktail of skincare and fragrance and color brands. There is a new category within it called Cache. Maly has done a great job with that, which is new and emerging. And I think the secret sauce of Bluemercury is the service. And you've got this guide-based service model that is just it's a catnap to these customers. They absolutely love it. When you have a Bluemercury experience, you are going to come back. You've got the spa on the back. You've got these amazing guides that are not brand dependent. And are not brand identified. They are put in together based on the needs of the customer, and doing that at scale is an objective of ours.

Getting that imbued into the digital program, so the digital business there has gotten much better, much more to do, kind of loyalty program that sticks the way that we expected to. The way that Loyallist was built at Bloomingdale's over the past five years. So, the luxury business is we continue to have -- you have an affluent customer that has discretionary spend. I think one of the things we found through the last couple of years is when you look at that tiptop customers and how much they are spending between all of the luxury neighborhood.

In our opportunity, we may have a customer that spends $50,000 with us. We look at every customer that spends $5000 and above. And they are spending equally that in other places. So, how do we get more of that share? And it's all about building these relationships. Doing it digitally through what we do with our style experts and what we do with digital selling or we do in a store. So, that's the objective with both of those two nameplates. We also have a big luxury opportunity at Macy's in beauty. And so, for us how do we compete with Sephora, how do we compete with Alta, how do we stand for something that's unique. And clearly, we have that in fragrance. But, how do you do that in beauty. So, what we have been doing is basically sizing down the [bohemias] (ph) on the floor of our big brands that have broader distribution and bringing in these luxury players to great success.

And Nata Dvir, who was the chief merchant, with her whole team has been reshaping the beauty floors of Macy's over the past six years. And to great effect Adrian and I are both big fans -- I mean in the beginning what was the ROI on that for the capital investment that was required, it has this wonderful spin-off because it is our front door, the animation that comes from that, the website in beauty has been designed. So, we are a big fan of where luxury can go across all three nameplates.

Matt Boss

Great. So, maybe to dig a little bit deeper on the private brand re-imagination, what are some of the early reads that you have seen? Seems like you are leveraging data and insights a lot more into this revamp, bu, maybe if you can just talk about that?

Jeff Gennette

Yes. I would say that when you look at private brand, it was always legacy of federated that became Macy's. And what the -- it was 24 private brands. And we made a commitment that each of them needed to be either refreshed, amplified, retired, and new ones joined in. So, it really started with the customer. So, when we made this deep commitment to say that we going to reorganize this, first thing was talent; getting Nata on board, getting Emily on board, getting Brian on board. So, think about our sourcing model and what we are doing with. Who was going to be the design lead for all of these. Sourcing was incredibly important. To recognize how many partners do we have overseas. How many should we be consolidating to, where there any big ones that we need? How do we share fabrics between general and brands? How do we really work on COGS and get that really spiked up. Adding in just-in-time, working on more hemisphere sourcing than we have done in the past.

But we started with the research. We have done like 80,000 surveys. We have done fit clinics. We have done shop alongs. We have done digital where we work with customers for the digital platform. Really spend time on clarifying the DNA of every one of the brands and looking at customer segments and life stages that we defined. We have really looked at kind of primetime which is this 30 to 50 year old. So, you think about the millennials right now that are making all the spend decisions. They have got kids. They are making huge investments in their homes and in their families and where did our brand speak to them on that. So, back and seeing where we holds, WHO did we want to go after first. Where are the biggest opportunities for us, what brands were resonating and which ones weren't? What it came down to and through all the customer research was number one was comfort. Number two was versatility. And number three, was how did it express their unique style. And so, we used that and kind of built on to kind of five vectors that we focused on. The first one was original design and making sure that this team was ready to interpret these customers through our brands. It made us a very sticky place.

Fit was huge. The opportunity to have consistent fit blocks in the all the factories and also have the consistent fit block for the customers that were buying between brands. Comfort was big. What were the fabrics. How did they drape. Versatility going from day to evening because people don't want to have costume changes, this idea about value of course. So, all that kind of boiled into every brand is under construction. Brands like INC, which is very well known to our customer. We started with that about a year-and-a-half ago. We reported in the fourth quarter we had a 28% increase with that important. All the learnings we get from that, we then bring into other brands that are existing. We've got one of the most exciting brands, which we haven't announced yet, is going to be the new one that's coming in in August that would love to show the investor community that that really brings all this together in a unique way that is coming at scale on the website and in our stores in August. Expect that every brand in home accessories and ready to wear is going to have a complete revamp over the next two and a half years. So, private brand is 16% of our business. It's been as high as 20%. Nothing but growth ahead for us, and obviously dad in the wool merchant, I can say this with passion. Having walked through all this with the teams, we are ready. It's incredibly well thought through and customer-centric, and I think it's going to be a big growth vector for us.

Matt Boss

Adrian, another key opportunity that you've walked through is the marketplace model. How does this play into the strategy? And do you believe this expands the customer reach?

Adrian Mitchell

Well, it's part of our omnichannel flywheel, and it's also one of our key growth vectors. As we think about engaging customers over the next several years and really getting back to growth, we won't see a meaningful impact in terms of 2023, but certainly we'll see a meaningful impact in growth as we think about future years. But what I get really excited about is the ability to have a curated marketplace that provides customers with more choice.

So, we win with the customer and having the different styles, the different brands, all these different offerings to really excite the customer to come to Macy's as a destination is quite exciting. What was also exciting is the margin profile. So, you think about slower moving items, and not having the inventory liability to be able to extend it to these additional brands or additional opportunities is really exciting for us.

When we think about where we are today, we've been introducing video games. We've been introducing electronics. We've been extending our kids apparel with new brands and new styles, and we're seeing the customer respond very favorably. And so, when you think about ending 2022 with 500 brands, and really our goal this year of ending with an incremental 2000, we're really excited about what it means for us. The third dimension that we're really working through is when you think about our own assortment, and we look at the Velocity profile and the sales profile of those items, there may be items that can go to Marketplace. And so, the profitability profile of Optimizing that mix between marketplace owned and vendor direct is another opportunity for us that we're really leaning into, and we're pretty pleased with what we've seen so far.

Matt Boss

Adrian, so we've talked a lot about omnichannel retailing, and it's obviously been a huge opportunity as you've joined the company in the last few years. So, as we think about brick-and-mortar, where are we on the pruning process of some of the legacy stores? And then what's the expansion opportunity?

Adrian Mitchell

Well, let's talk about the pruning process first. When you think about the number of stores we've closed since 2019, we've closed 80 stores since 2019. So, that's pretty material. We've closed a lot more over the last five or six years. But as we think about growth, what you see is that two and a half times the mall traffic is actually off-mall, and that's a place that we actually don't play. And so, when we think about Market by Macy's, we think about Bloomie's. These are opportunities to get closer to the customer. So, when you think about what we've seen so far with our one Bloomie's and our eight market by Macy's, that's in market, we see a customer that's engaging. We're seeing new customers even with infill strategies in markets like Dallas and Atlanta, where you have a mature market. We have 11 full line stores in Atlanta, and as we've opened up additional Market by Macy's, we're finding customers that we haven't served before.

When you think about the experience in these stores, on all dimensions, there's material differences between full line and these small boxes, where speed of checkout, availability of colleagues, quality of shopping experience like all the metrics, are significantly better. So, it's a huge opportunity for us. Now we've figured out a lot so far. We figured out the format, we figured out the size, we figured out the layout. What we're really focused on right now is, as Jeff pointed out earlier, stitching together the different elements of the operation to be much more localized in the assortment. We have seen a noticeable shift in our ability to identify what's local, and it also shows up in higher sales, higher conversion, and higher transaction on a comp basis as we look at fourth quarter of this past year to the previous year for the stores that we could comp. So, we're pretty excited about that.

Now, when you think about our mall-based stores, 99% of those stores coming out of 2022 were profitable on a four-wall basis. We've invested in the experience. We've invested in elevating the experience, simplifying the shopping experience throughout the store. We've de-cluttered a lot with the inventory that we've taken out. So, there's just a lot of opportunity to really continue to elevate the experience in those big boxes. And there's a material number of big boxes that are still quite relevant for us. So, as we think about all those different dimensions, it's about really landing the ecosystem, which is the digital overlay with the appropriate combination of big box and small box to engage customers when and where they shop.

Matt Boss

So, the other side of that would then obviously be digital. As we think about, I think digital represents the 30% of sales today.

Adrian Mitchell

Yes.

Matt Boss

As we think about the next leg here, what are the technology initiatives or how best to think about personalization and what do you think differentiates, say macys.com relative to a consumer that may go directly to the Web sites of some of the brands that you sell?

Adrian Mitchell

Yes, we have a huge advantage by being omnichannel. All the economics that I've seen at Macy's and that I've seen throughout my career in omnichannel is very consistent that when customers shop multiple channels, they're much more productive. They visit more frequently. They're clearly much more engaged. So, as we think about the role of digital, it's really about this intersection, this interconnectedness, the seamlessness between the digital experience and the physical experience.

Now, as we think about the digital experience, we've been focused on two things. Over the last year or two, what we've been focused on the digital side is really about the experience. You've seen us redesign the website. You've seen us enhance the app experience, both for Macy's as well as for Bloomingdale's, and you'll continue to see a lot of those investments, because, fundamentally how do we make the experience easy to shop wherever the customer chooses to engage, and they're engaging on their digital device in the stores.

And so, there's all these interconnected points of how do you get the customer much more engaged with a brand. The one thing that I'm personally very excited about is personalized offers and communications. And we've been through several tests so far this year, and we're seeing really exciting results. The ability to send a relevant communication, whether it's an offer, a category based on timing and a number of other factors. What we're seeing in our results is they're responding much more effectively than the broad-based promotions. And so, we're going to continue to amplify that. We're going to continue to increase the number of permutations to be able to get to that one-to-one. But as we go through this year and we continue to test and learn, we hope to scale it next year, and that's going to be another major contributor to our growth.

Matt Boss

Jeff, you touched on it before, but maybe could you elaborate on inventory management and really how the process of buying has evolved post-pandemic at Macy's?

Jeff Gennette

Yes, so I tell you that the pandemic was good for us in one way, which was that when the store shut down in March of '20, cash flow became absolutely the most paramount thing we could focus on. And so, two things that we did there was we changed terms, which clearly was not popular with our vendor community, but it was the right thing for us to do from a cash flow perspective. And then, we immediately went to net costing. So, we started to negotiate with the vendors to get kind of all of the stuff that had clearly been as part of the wholesale price that was built in for MDAs, markdown allowances would happen at the end of the quarter season. We took that out.

So, we basically worked on a net cost, but that forced us to be merchants. It forced us to basically make the decisions that were going to be right. And then, the onus was on us to create as much profitability from that after the customer voted. In conjunction with doing that, we also went from functional incentives to enterprise incentives. So, that, as I mentioned, the second a plan is done, it's wrong, if you've got a customer signal in a category that's a pandemic and you happen to be the active buyer and you see your business dropping by 20%, but you're on the hook from a functional review to make your sales, you're going to be very hard pressed to give up receipts.

You're going to want some sort of adjustment that would be made at the end of the year. We don't have to do that anymore. So, right now what we do is basically receipts as well as markdowns are kind of the domain of the enterprise. And so, if a business is trending because the customers are pivoting, those are what get those opportunities. They'll get receipts, they get markdown dollars, they get support in stores. That was the game changer for us. And so, in doing that, we also had the opportunity to say, okay, how do we want to make sure that we're taking all this inventory out and keeping it out and so building in reserves so that when you've get this fantastic idea and you're fully spent and you still want to go after it because we're aggressive. We're in service to our customer, making sure you've got dry powder to react to that. So, sometimes that reserve is fleeting. So, what we saw in the first quarter of last year, when you saw the abundance of inventory happen in the entire industry, and much of that was because of all this private brand that was supposed to arrive in terms of holiday for '21 was late across the entire industry.

So, it was all dumping into the first quarter that had to be liquidated. Markdown levels were going through the roof. The customer is super smart, savvy seen all these values everybody's sell throughs were dropping in those. We had to do the same thing with our private brands, which suck down our reserves. So, getting to a point which we're now in, which basically we have built-in reserves across our business. So, no matter what is happening, we're able to respond to that has really helped us. So, the aggregate numbers we talk about is what's going on with our inventory level. But the true beauty of this is what's going on for our customer at an FOB level, at a brand level, and the adjustments we're able to make in season based on the dynamics I'm talking about.

So, that was the right thing for us. It did help us get clear about what we were all there for, which was to work on content that made sense for the customer. But it meant that we had to train buyers. Some of them were ready for that and some of them were more about the deal, and they were all about the kind of the equation and getting them up to speed with it was a journey. Nata and her team have done an expert job with it. Tony's team was there, frankly already. Tony's team is now on net cost, so that one in cost accounting has been a big change in terms of your ownership for the customer. Macy's is based on what happened in Bloomingdale's, is going to cost accounting in 2024.

Matt Boss

So, Adrian, maybe if we put this together at the bottom line, profitability side, you've cited sustaining low double-digit EBITDA margins moving forward. What's the bridge between pre-pandemic, meaning what in your view, has made this a more profitable model?

Adrian Mitchell

Well, at the end of the day, it's been focus, it's been discipline, and it's been execution. Sorry about that. But if you think about the building blocks across that continuum, the first thing is in 2020 we readjusted our cost base. So, if you think about Macy's coming out of 2022, we have about 30,000 less colleagues than we did going into 2020. That's about a 27% reduction in headcount across the enterprise. And that's for a similar level of sales and workload and all the things associated with that.

The second thing that you heard Jeff and I speak to coming out of 2020 was the importance of margin expansion and all the disciplines around inventory management, around pricing science to understand. How do we think about the level of markdowns, which is the biggest expense on any retailer's P&L, how do we get that under control and win on full price sell through?

The other bet we made was on SG&A, and I think about SG&A in a couple of different components. We knew we had to make investments. So, when we thought about our talent, for the talent that was here, we know we need to make sure that our store colleagues were more productive, so they're about 20% more productive than where they were pre-pandemic. And we also need to build new capabilities, the data science capabilities, the marketplace capabilities, the Market by Macy's capabilities, the Blooming's capabilities in order to position ourselves for growth. So, on the payroll side, we're making investment in capabilities and tools and systems to be able to position ourselves for growth. On the non-payroll side, we had to be very disciplined on cost control, especially coming through the inflationary period.

So, when you think about our non-payroll SG&A, it grew low single-digits in '22 with a pricing index of 6% and some pricing index of 8%. So, that discipline, that execution, that focus on the fundamentals, that matter was really important. So, if you think about 2021, 2022, and where we're positioned for 2023, even in a challenged environment, we've been able to navigate because we have those disciplines in place and there's more to come, that's just going to expand as we think about growth on that base of discipline.

Matt Boss

So maybe last question before we open it up for some audience Q&A, Adrian, just on capital allocation, how would you rank priorities for cash?

Adrian Mitchell

Cash is king, in a moment of uncertainty, preserving cash and liquidity is really critical. And so, the question is, how are we deploying that cash? Because as Jeff pointed out, we've been very, very focused on free cash flow. So, on one dimension, it's about winning the customer. So, the discipline around inventory management, having a larger open to buy and giving us the flexibility to lead into the categories of brands, the styles that customers are craving in an environment where they're much more discerning in their purchases is actually quite critical. We feel that we're doing that well. We have to continue to do that.

The other dimension for us is investing in the business. When we think about expansion and scaling of Market by Macy's and Bloomie's, that's capital, but it's also growth. When we think about personalized offers that data science capabilities, we need to build and invest in those kind of capabilities to be relevant, but to also just be better and more competitive, then it's important to return value to shareholders. We're going to be very disciplined about how we think about our debt profile going forward. We're not done. We're going to be very disciplined about our dividend. We've committed to a modest but predictable dividend that grows 5% per year. We're committed to that. We're continuing to do that, and we're going to continue to take advantage of our share repurchase authorization of $1.4 billion. It's still sitting out there. So, we're just going to be very balanced and very thoughtful as we move forward. But it all starts with executing well, preserving cash, and thinking thoughtfully about the balance as we're moving through this environment.

Matt Boss

Great, so maybe with that, we'll open it up for Q&A to ask a question, maybe just if you don't mind using the microphones just for the webcast; quite good.

Unidentified Analyst

Maybe I will ask one, I can't stand silence. I guess my question is just a little bit more on your customer base. You talk a lot about full price selling, and you've done great work on inventory management and things of that nature. And so, I'm just wondering if maybe you can share a little bit from your customer file some of the metrics you're seeing in terms of age of your customer. And as you've gone through this process, I would imagine there are some customers that really shopped aggressively in kind of the sales side and things of that nature. If you're seeing maybe those customers not shopping as much or leaving and kind of the rate of change of kind of the loss of those customers as we get through this process, if that maybe starts to slow and your customer base is healthier and kind of a better, more high, multiple customer base, if you will. Anything you can share would be great.

Adrian Mitchell

So what are we really trying to do in terms of winning on growth. It's all about the customer and the engagement with the customer. There are two things that we're very focused on in terms of our capabilities. Number one is really understanding where can we get a broader base of customers across all demographics and all geographies. We have a national footprint and we also have international reach. What we're also focused on is for the customers that we know, how do we get them more engaged with a brand. So, you think about the staple categories that we've had for many years and the categories we're expanding to with the marketplace it's all about engagement and frequency and deeper purchases.

Fundamentally, what we're trying to win on a share of wallet on the discretionary side of the business. And so, as we think about what we've seen over the last couple of years, we've certainly seen a much healthier customer that's been spending. But more recently, as we articulated on March 2 is there's been a noticeable shift away from goods and towards services. At some point that will rebalance and we want to be ready for that. What we're focused on are the capabilities to be able to adjust. We want younger customers, but we also want to serve our older customers as well. And we think that the personalization capabilities, not just in terms of how we communicate, but the style choices and the breadth of styles and fashion is going to be critical, especially as we're expanding across multiple categories.

Jeff Gennette

What I'd add to what Adrian just said is when you think about the customers that we know and making sure what we're hyper focused on is conversion and both digital conversion as well as all the way across the funnel. Where do we have them? How are we improving? What are they responding to? Where are we losing them, and making sure that we're getting as much out of our existing base as possible, same thing in stores. So, we've made a big investment in technology, in stores to really understand that, we use retail next to really understand what their traffic patterns are, when they come in, where they're tearing, what that means in terms of flow, what register placement, fitting rooms, where are the hotspots.

We use Theatro to make sure that we've got colleagues that are being redeployed based on where customers are going. 70% of our business now is on customers that are part of our loyalty program. It gives us a huge advantage to be able to reduce promotions and start to personalize offers and messaging that's going to improve conversion. So, we've been advantaged over time with basically continuing to move up our AUR. But if you've got categories that are very, very price sensitive, then you have got to find other ways to be able to get your sales objectives, and it has to come through the conversion bucket. So, that's what we're hyper focused. Everybody has a role in that too.

I mean when you think about it's a full enterprise exercise to ensure that conversion and holding on to the customers that we have and acquiring the customers that are our future is all part of it. So, what I'd say is the other part of your question is what we talked about at the second quarter and through the fourth quarter calls was that where we're starting to. see some changes is really happening across the portfolio. It's not like I've got a spender who's making 150,000, that is spending less than categories versus the person who's making 150,000. So, we have not seen through the fourth quarter changes there. That has been a pretty consistent pattern.

Unidentified Analyst

You talked about the Market by Macy's and some of the off-mall, and it sounds like even some of your mall properties are still doing very well. I'm curious if you have any thoughts in terms of just the longer-term health of the malls that you're in. And then, as you shift more off-mall over time from growing off, does it change your real estate strategy and there's any thoughts about real estate?

Jeff Gennette

Yes, let me talk about malls, and I'd love Adrian to take the second part of your question. Look, we've got very deep relationships with our mall developers. And I'd tell you that, leading with really the Simon properties and what they're doing in those particular properties, what I appreciate about what David is doing is really remixing his lease tenancy in malls to make it a more modern, and really get more food and beverage, more hospitality, more experiences, not as much direct competitors in fashion, apparel, and home that you see in a lot of malls. So, I think David, which is kind of the kingpin of American malls, I think he's got a very modern approach to every one of his properties, and we're in lockstep on that.

The other developers we're working very well with too. I'd say in all the B and the A malls, we have a really strong strategy of that. I'd tell you on the C and D malls, which are what Adrian was talking about when we looked at the 125 malls that we quoted, in '19, that we were going to close, 80 we've done thus far. There are still some C and D malls that we are in where we're cash flow positive. We're watching how things settle there. I think what we have learned on our customer base is that when you close a store you're firing customers, you immediately see a drop-off in the digital business, which is a third of our business. And that omni-channel behavior that Adrian was quoting is so evident. So, that we really want for the off-mall strategy to have a handoff strategy.

So, what we just did in Chesterfield, in St. Louis, was he had a mall that used to be a pretty robust mall, it was like built in the 1980s, it was a $40 million building for us, it was a 15% profit profile. We are the last man standing; the rest of the mall have kind of imploded, it was the last one there. It was a very important piece of St. Louis for us. So, when we did Market by Macy's, we put it two miles down, in a thriving strip center. We closed it the same day when we opened this. We had a long strategy to be able to preserve the customers, and clienteling, and the colleagues that moved over to populate the new store. That really is why we're so interested in ensuring that we get Market by Macy's with the right ROI profile to be able to scale that, because it does inform what we're going to do with mall that are on -- in healthy mall situations. So, that's the first part of your question.

Adrian Mitchell

Yes, so as you think about the off-mall strategy, we've taken a very disciplined approach to it. So, the first thing that we did is we got a lot of customer data that we had, we looked at a lot of external data, for example [indiscernible], sorry, to really understand where are the footsteps in the market. And so, from there, what we've been able to do is to use a lot of our science to actually create what we think is a future footprint for Macy's Inc., both on the Bloomingdale's side, as well on the Bluemercury side, as well as on the Macy's brand side. So, a lot of what we've been doing the last year-and-a-half with these new openings is really testing the science in a very pragmatic way.

And we're very pleased, and we continue to learn a lot about it. I think the thing that we get excited about is as we look at CBSAs across the country and DMAs across the country, there's clearly a lot of opportunity to build a lot of in-fill stores in markets where we already have big-box stores, there's still opportunity there. As Jeff pointed out, there are also places where we just haven't been. The largest market that we haven't been, to 50, is Jacksonville. We don't have a physical experience in Jacksonville, but it's one of the 50 largest markets in the country. And then there are markets that we've exited that we should go back. So, that the ability to open up 30,000 to 40,000 box gives you a lot more flexibility than having to open up a 200,000 square foot box.

I think the thing that gets me really excited about what we've seen operationally with the business is you have off-price next door, you have grocery next door, you have a nail salon next door. And we're seeing comp year-over-year, higher sales, higher conversion, higher transactions, like the stats are very exciting. But we want to do it in a very disciplined way. We think that we're close in terms of our expectations of readiness to scale. But 2023 is going to be an important year for us to really go through and make sure that we're bulletproof in all the different dimensions. And then, look, there are 11 billion-plus footsteps in places where we currently don't have a lot of footprint.

Unidentified Analyst

Would you use your own use your owned real estate value, selling that to help investments with the new strategies, or any thoughts to using that owned real estate value?

Adrian Mitchell

Well, when we think about the real estate off-mall, they're going to be new relationships with partners. We're going to be leveraging, certainly, the brand experience to make sure that we're getting into the right centers, and the right positioning, and the right location. So, there's a lot of equities there. There's a lot more that we're learning. But from the real estate standpoint, so far so good and we're pretty pleased.

Matt Boss

Adrian, I had one from a profitability perspective, you seem very confident in the low double-digit EBITDA margin.

Adrian Mitchell

Yes.

Matt Boss

You also cited flexibility, and a number of different drivers that seem, if anything, newer to the model. I guess what's the real-time flexibility or what is your ability to flex the model in scenarios if spending were to slow from a larger picture perspective?

Adrian Mitchell

When you think about what we've done the last two years, we have been flexible. So, you think about 2021, which is a market where they had tremendous growth and demand, we're able to respond. In 2022, when there's tremendous contraction in demand, we're able to respond on the inventory side, the profitability side and managing the demand, our fair share of demand. What we're also able to do within that environment was pivoting categories. So, the indicators that we look at and the bets that we've made have been very educated and insight-driven bets. We made a bet, in 2022, that we need to move aggressively away from pandemic categories, and so we've seen the result of that.

We've also had to make significant category pivots as we think about where we were in 2019 to where we are today. So, a lot of what we've been doing is building more flexibility into the operation. So, not just having judgment, but having science, because the combination of those two are quite synergistic and quite complimentary. And we're just at the beginning. We're just such early innings in our ability to really look at the right data points, the right tealeaves to be able to anticipate and flex. But when you think about things like high velocity skews, full-price sell-through, moving lower velocity skews to marketplace, we're also de-risking our ability to be flexible, while still giving the customer choice and driving more engagement.

Matt Boss

Time for maybe one more, maybe I'll just end it with inventory. It seemed when we were together in January, in Orlando, you seemed very confident on the state of inventory coming out of holiday. Maybe could you just elaborate on inventory, and maybe any categories of concern or vice-versa, where that confidence really rise today?

Adrian Mitchell

The confidence is really around the disciplines. If you think about where we came out of 2022, we had 3% less inventory at cost versus 2021, which was a pretty lean year, 18% at cost coming relative to 2019, and an even larger number when it comes down to actual units. And so, from our perspective, the discipline is to be able to buy the right amount and the right composition in the right channel or the capabilities and disciplines that we continue to build, and that's serving us quite well. So, we feel confident that we can respond to whatever is on the horizon, whether it's an acceleration or a deceleration. And that's really reflected in how we've talked about the business, how we've guided our outlook for 2023, those are things that we're very focused on.

Matt Boss

That's great. Jeff, Adrian, congratulations on the news.

Adrian Mitchell

Thank you.

Matt Boss

And thank you for joining us today.

Adrian Mitchell

Thank you.

Jeff Gennette

Thanks. Thanks everybody.