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TGT.N - Q2 2021 Target Corp Earnings Call

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OVERVIEW:

Co. reported 2Q21 GAAP EPS of \$3.65 and adjusted EPS of \$3.64.

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Brian C. Cornell *Target Corporation - Chairman & CEO*

John Hulbert *Target Corporation - VP of IR*

John J. Mulligan *Target Corporation - Executive VP & COO*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation Second Quarter Earnings Release Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, August 18, 2021.

I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

John Hulbert - Target Corporation - VP of IR

Good morning, everyone, and thank you for joining us on our second quarter 2021 earnings conference call. On the line with me today are Brian Cornell, Chairman and Chief Executive Officer; Christina Hennington, Chief Growth Officer; John Mulligan, Chief Operating Officer; and Michael Fiddelke, Chief Financial Officer. In a few moments, Brian, Christina, John and Michael will provide their perspective on our second quarter performance and our outlook and priorities for the third quarter and beyond. Following their remarks, we'll open the phone lines for a question-and-answer session.

This morning, we're joined on this conference call by investors and others who are listening to our comments via webcast. Following the call, Michael and I will be available to answer your follow-up questions.

And finally, as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our most recently filed 10-K. Also in these remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on the first quarter and his perspective on our outlook. Brian?

Brian C. Cornell - *Target Corporation - Chairman & CEO*

Thanks, John, and good morning, everyone. Our second quarter performance showed that Target's leadership position is stronger than it's ever been, fueled by a one-of-a-kind strategy, resilient operations and a passionate, world-class team.

As you know, we've been investing for years to build the durable model that's in place today, one that puts our guests first and leverages all of our assets and capabilities to serve their evolving wants and needs. After years of investment and effort in building this model, it's clear that we've only begun to scratch the surface of what's possible over time.

In the second quarter, our business continued to perform and grow on both the top and bottom lines, even as we comped over record performance a year ago. Of course, seeing growth on top of growth is nothing new. Our business was already delivering consistent increases in sales and profitability in the years leading up to the pandemic. This was followed by a dramatic acceleration in 2020 and this year's continued growth.

In the second quarter, Target's comparable sales increased 8.9% on top of a record 24.3% growth a year ago. As a result, second quarter total sales have expanded more than 36% or more than \$6.6 billion over the last 2 years.

On the bottom line, we earned second quarter adjusted EPS of \$3.64, up nearly 8% compared with last year and double our performance 2 years ago.

As we described last quarter, guests have emerged from a year in which digital was the primary growth driver, and they're now returning to our stores in droves. As a result, the majority of our second quarter growth was driven by the stores channel, where comps grew 8.7% on top of 10.9% a year ago. In addition, traffic accounted for more than 100% of our second quarter growth, in contrast to a year ago when guests were limiting time out of their homes and the bulk of our growth was coming from bigger transactions.

Comparable digital sales grew 10% in the second quarter, building on the record growth of 195% last year. The digital channel continues to be led by our same-day services, in-store pickup, Drive Up and Shipt, which together grew 55% this year on top of more than 270% last year. Given their rapid expansion, same-day services now account for well over half of our digital sales.

Among those same-day options, Drive Up has quickly grown to be the largest, accounting for more sales than pickup and Shipt combined. To put it in dollar terms, over the last 2 years, second quarter sales through Drive Up alone have increased by nearly \$1.4 billion. And for the spring season, they've expanded by double that amount.

Beyond our fulfillment options, we continue to benefit from our unique multi-category assortment, which is perfectly positioned to serve our guests' evolving wants and needs. As a result, comp sales in all 5 of our core categories expanded in the second quarter on top of strong growth a year ago. As expected, apparel continued to lead the way as our guests continue to respond to newness and style across both our owned and national brands throughout the assortment.

Also as expected, we saw more moderate growth in our Hardlines and home categories this year as they expanded on top of really strong comparisons from a year ago. And notably, we continue to benefit from impressive performance across our less discretionary Food & Beverage and essential categories. These categories have again consistently delivered strong growth and market share gains, both in 2020 and again this year. I'll let Christina provide more details in a few minutes.

When we talk with many of you about what's driving Target's performance, we often hear the question, "What's the one thing that's been the key?" The honest answer to that question, we can't point to any one thing. Rather, it's been everything working together that's driven our performance. This includes our supply chain work, which has positioned our stores as fulfillment hubs, while transforming the way we replenish store inventory. Then there's our rollout of same-day services, which began more than 5 years ago with in-store pickup, followed by the nationwide rollout of Drive Up and Shipt beginning in 2018.

And there's the refreshment of our own brands, which began in 2016 with the rollout of Cat & Jack, followed by dozens of new owned brands over the last 5 years. At the same time, we've expanded our partnerships with premium national brands, including Disney, Levi's and Apple and, most recently, this month's opening of more than 100 Ulta Beauty shop in shops. Across our store portfolio, we began testing small formats in 2014. And we now have more than 140 of these productive neighborhood locations across the country.

We've also remodeled more than half the chain over the last 4 years, transforming the shopping environment while optimizing the layout in support of our same-day services. And we've reinvented our store operating model, focusing on enhanced service and subject matter expertise in key categories while investing in visual merchandising across our network.

Then there's Target Circle, which launched in 2019 and now has more than 100 million members, providing a new connection with our guests while offering meaningful rewards.

And of course, we made multiple investments in our team, including the attainment of our goal to bring Target's nationwide starting wage up to \$15 or more. This was certainly an important milestone, but far from the end of the journey. Just a few weeks ago, we announced an investment of more than \$75 million to provide \$200 recognition bonuses to all of our frontline, hourly, full-time and part-time team members across our stores, distribution centers and contact centers.

I've said it many times before, but I can't say it enough. Our team is the lifeblood of Target. And our success begins and ends with them. I want to thank each of them and every one of them across the world for everything they do to make Target such a special place to shop and a great place to work and build a rewarding career. And today, given the profitable growth that comes from all of these efforts, we can continue to invest in making our business even stronger and more durable over time.

In June, we were incredibly excited to launch Target Forward, an ambitious new sustainability strategy grounded in the vision to co-create an equitable and regenerative future with our guests, partners and communities. Target Forward is centered around 3 critical ambitions: to design and elevate sustainable brands, innovate to eliminate waste and accelerate opportunity and equity. This bold initiative is the beginning of the new chapter for how we'll define sustainability, position our business for long-term growth and resiliency and build on our rich legacy of corporate responsibility and sustainable practices.

As part of these efforts, in early August we announced that this fall, Target will be rolling out an industry-leading program to provide debt-free educational assistance for all of our U.S.-based full-time and part-time team members. This program will provide access to more than 250 business-aligned programs at more than 40 educational institutions, including historical black colleges and universities, along with institutions serving the Hispanic community. In total, we plan to spend \$200 million to offer this benefit over the next 4 years, serving as a meaningful example of how we're investing to promote opportunity and equity in our communities, beginning with our own team.

So now before I turn the call over to Christina, I want to acknowledge the likelihood that the second half of the year will continue to be volatile, particularly in light of the ongoing uncertainty surrounding the Delta variant. Of course, safety remains our #1 priority, as evident in the way we operate our stores and our ongoing investments to encourage vaccinations by making them easy and accessible for both our team and our guests.

In terms of our business, the last 18 months have proven, beyond a doubt, the flexibility and resilience of both our team and our business model. And while sales in stores have been soaring so far this year, our operations and team have demonstrated how they can pivot seamlessly between stores and digital commerce based on how our guests choose to shop. I also want to emphasize that as proud as we are of what we've already accomplished, we see many more productive opportunities to invest in continued growth.

And I also want to acknowledge the continued high level of execution we've been seeing across all of our teams. As John will outline in more detail, despite unusually high volatility for well over a year now, the Target team has been consistently setting the industry standard in terms of execution despite multiple challenges in the external environment.

Our team continues to embrace every challenge as one aligned Target team, taking care of each other as they focus on serving our guests. I am truly inspired by their work and grateful to share the outstanding performance they're delivering quarter after quarter, year after year.

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

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

Thanks, Brian, and good morning, everyone. Our guest is at the forefront of every decision we make. By listening intently to them, anticipating their wants and needs and building our strategy around them, we can drive deeper engagement, trust and a stronger preference for Target over time.

We built our same-day capabilities with that guest-first focus. And as we've shared before, when guests try services like Drive Up or Shipt for the first time, their overall spending increases, including an increase in conventional store shopping. In other words, digital engagement drives more engagement in our stores, providing us with more and more opportunities to surprise, delight and inspire them. This is one example of many showing how growth today creates a platform for additional growth in the future.

And of course, we wouldn't be where we are today without the best team in retail. So I want to take a moment and thank our entire team for delivering superior performance in a continued volatile environment even as they face ongoing challenges presented by the Delta variant, product cost inflation, supply chain bottlenecks and more.

Target's second quarter performance also demonstrates the strength and durability of our business model. Our unique, multi-category assortment offers the right balance of what our guests want and need even as they change, sometimes rapidly. As a result, despite record-setting growth last year, all 5 of our core merchandising categories grew again this year, proving that there's still plenty of runway ahead.

Second quarter results were strongest in apparel, which delivered mid-teens growth on top of low double-digit growth last year. Within apparel, swim, kids and young contemporary all delivered comps in the low 20% range.

Food & Beverage delivered low double-digit growth in the second quarter. Performance was led by our bakery, cafe and deli businesses, which grew more than 50% as these departments were closed during part of the second quarter last year. We also saw double-digit growth in our fresh categories, benefiting from an expansion in the number of items available for Drive Up. In fact, nearly half of this year's growth in our produce business has been driven by the growth in Drive Up orders.

The Essentials & Beauty category delivered high single-digit growth this quarter. Within essentials, baby care grew by more than 20%, and we saw mid to high teens growth in both pets and health care. Beauty continued to gain market share on comp growth in the high single-digit range in advance of this month's rollout of our in-store partnership with Ulta Beauty.

Hardlines delivered mid-single-digit growth this quarter on top of more than 40% growth a year ago. We continue to benefit from strong momentum in toys, which grew in the low 20% range. Sporting goods was also a standout with growth in the high teens. As expected, electronics experienced a moderate comp decline in the mid-single-digit range as it competed over last year's growth of more than 70% during a period when some competitors were closed. Importantly, over the last 2 years, both Hardlines and electronics have delivered strong growth and market share gains.

And finally, in home, following comp growth of more than 30% last year, we saw a low single-digit increase in the second quarter. Within home, we've seen moderating trends in categories like kitchen, storage and decor as they competed over outsized growth last year. At the same time, given our guests' increasing focus on gathering and celebrating holidays and family milestones, we've seen an acceleration in our seasonal and stationary categories, providing another example of the power of our broad, multi-category model.

And beyond individual categories, our diverse collection of owned brands continues to grow and provide differentiation across our assortment. In the second quarter, owned brand sales outpaced the company with growth in the mid-teens. And in Food & Beverage, where we're seeing tremendous growth in Good & Gather and encouraging results in our new brand, Favorite Day, we saw an increase in owned brand penetration of about 70 basis points compared with last year.

As we look ahead, despite uncertainties around the Delta variant and rising COVID cases, consumers have healthy balance sheets and remain eager to find safe ways to connect with their loved ones and find some sense of normalcy. We'll continue to safely meet their needs and add some much needed joy.

First on that list is this month's launch of Ulta Beauty at Target, the next chapter in Target's already strong beauty story. The shared values and cultures between our businesses and our collective desire to inspire and elevate the shopping experience make this long-term partnership a major win for both companies and our guests. And like our guests, we're incredibly excited to see this new concept come to life following months of anticipation.

But our guests aren't just excited for their glow up to their beauty game, they're also looking for affordable options to refresh their wardrobe as they cautiously plan for more in-person interactions this fall. So it's perfect timing that this September, Target is partnering with 4 dynamic and highly regarded designers, Nili Lotan, Rachel Comey, Sandy Liang and Victor Glemaud, to create a limited time, size-inclusive apparel collection of modern and classic wardrobe staples.

And our partnerships go well beyond apparel and beauty. In home, we've enlisted the talents of Justina Blakeney, Jungalow founder and long-time partner, to bring Jungalow's cozy, wild and free vibe into our Opalhouse line, making it the perfect addition to our eclectic owned brand.

And for our littler guests, our newest design partnership is sure to inspire their imagination and help them to create some great new looks. Christian Robinson for Target, a full-of-wonder creation of the beloved artist, illustrator and children's book author, is a limited edition collection that includes home goods, apparel and books for kids and baby. And last, not least, for the furrier family members in your household, we have just launched Kindfull, our new pet food-owned brand focusing on healthy, sustainable and affordable food options for our beloved 4-legged friends.

Beyond partnerships and product launches, our guests are telling us they're hungry to celebrate key holidays, life moments and everyday occasions with their loved ones, having missed out on so many of them over the last 18 months. So even as they're mindful of the ongoing risks, our guests are carefully balancing caution with optimism and focusing on finding safe and affordable ways to celebrate.

Already in progress, the back-to-school and back-to-college seasons are off to a great start. Regardless of whether back-to-school will be in-person or hybrid, Target has everything they need to be successful in any learning environment.

Similarly, as college freshmen look to move on to campus for the first time, our merchandising and inventory plans account for the fact that many sophomores find themselves in that same position, having attended their first year of college in a completely virtual environment.

Given the stresses that come with the start of school, Target is focused on making things as easy as possible for families with School List Assist. This feature, online and in the Target app, allows users to easily find their school-specific supply list and either shop by item or add the whole list with a click of a button.

And like we did for holiday last year, our back-to-school offers will be spread throughout the entire season, providing both value and a safe shopping experience for our guests. This reflects our ongoing focus on providing value that goes far beyond price. It's about affordability and accessibility all season long.

And on that topic of providing value, we're rolling out new functionality in the Target app based on hearing from our guests that the fear of missing out on a deal is real, something affectionately known as promo FOMO. With this update, when guests add items to their cart, the app will automatically show them all the applicable Target Circle offers before checking out, reassuring them that they won't miss out on a great deal.

Looking ahead, we'll soon be trading in shorts and t-shirts for cozy sweaters and denim as we usher in the fall. And for Halloween, no matter how you plan to celebrate, Target has a few tricks and no shortage of treats up our sleeves. We'll continue to focus on value and inspiration with affordable and exciting costumes, including a broader-than-ever array of adaptive, size-inclusive and gender-neutral options. And of course, we'll have all the sweet treats for self-indulgence and sharing with others, including great new offerings from our Hyde & EEK! and Favorite Day owned brands.

Beyond our near-term plans, what energizes me the most is our focus on creating a more equitable, sustainable and inclusive world. This is why I'm so proud of our recently announced sustainability strategy, Target Forward, which is a comprehensive vision that touches every aspect of our business in support of people and planet.

You've heard me talk about my role on Target's REACH Committee, which was formed with a goal of achieving lasting, systemic change for our black guests, team members and communities, serving as a perfect extension of the broader Target Forward strategy. The recruitment and retention of more diverse team members, more products from diverse suppliers, a new direction for our philanthropic efforts in communities of color and more equity for all, these are unwavering commitments in support of our goals.

While there's much more to accomplish, I'm pleased with the progress we've already made. One example is our commitment to increase black representation across our company by 20% by the year 2023. To date, we've seen progress at all salaried levels, most notably in a nearly 25% increase among our company officers.

So while it's incredibly rewarding to see how well our business is performing, I'm most proud of our commitment to invest in the long-term health of our team, our communities and the planet, our company purpose, focus on sustainability and then creating a more equitable and inclusive world. These are not a collection of separate initiatives tacked onto our core business. Rather, they are the bedrock of who we are and how we make decisions. While their benefit may be hard to quantify in a spreadsheet, I strongly believe that they're the foundation of how we'll grow our business, sustain our communities and move forward together over time.

With that, I will turn the call over to John.

John J. Mulligan - Target Corporation - Executive VP & COO

Thanks, Christina. As I've mentioned before, I'm an engineer by training. So it probably comes as no surprise that I'm naturally interested in machines and automation. And obviously, when our team works to optimize Target's operations, both for today and in the future, we have access to every available tool and technology, robotics, automation, machine learning, artificial intelligence and more. But when we choose to invest in technology, we're not looking to remove the human element from the Target experience. Instead, we're investing to enhance the productivity of our team members, freeing them up to focus on what's most important, like serving our guests.

This is another example of the power of "and", and how it runs through every part of our business. The choice doesn't have to be about people or technology. We can invest in both people and their productivity.

Here's one way to think about it. In our 2015 annual report, we reported that Target had around 341,000 team members as we entered 2016, a year in which our business generated just over \$69 billion in sales. 5 years later, our 2020 annual report showed that we had about 409,000 team members going into this year, representing about 20% growth in the number of team members over that 5-year period.

However, based on our results so far and our expectations for the back half of the year, our business is positioned to deliver more than \$100 billion in sales this year, representing growth of 45% or more compared with 5 years ago. So even as we've added nearly 70,000 people to our team, we've also benefited from a significant increase in their productivity, creating financial capacity to provide enhanced service for our guests and make significant investments in pay and benefits.

And as Brian mentioned, our team has been performing at an incredibly high level, raising the bar on historically strong execution. Specifically, in the second quarter, we saw an improvement in already high Net Promoter Scores for all 3 of our same-day services, most notably for the in-store pickup experience. In addition, Drive Up, which remains our highest-rated service, saw an increase in guest satisfaction compared with last year, on top of last year's improvements over 2019.

And we continue to find ways to enhance our industry-leading pickup and Drive Up capabilities. In the second quarter, we added another 5,000 items to the assortment available for pickup and Drive Up, ranging from items in adult beverages to fresh pet food, meal kits and greeting cards. We also continue to roll out technology enhancements, including functionality to provide backup suggestions when an item is unavailable, a

chain-wide rollout of numbered parking spaces for guests using Drive Up and the ability in the app to seamlessly designate an alternate person to pick up an order.

Beyond same-day capabilities, we also saw a meaningful increase in satisfaction with our in-store shopping experience, driven by improvements across multiple attributes, most notably around team member interactions, both on the sales floor and at checkout. These increases reflect the impact of our new service initiatives, which focus on serving our guests on their own terms, while authentically bringing our company purpose to life through the guest experience.

This spring, more than 300,000 team members completed training on these initiatives, offering them tools to provide a consistent, differentiated shopping experience regardless of how our guests choose to shop. Higher guest satisfaction scores provide clear evidence that our team has enthusiastically embraced this training as they build their confidence and expertise in establishing authentic connections with our guests.

As Christina mentioned, our teams at headquarters have also done a great job as they navigate multiple challenges across the supply chain. And while we're happy that in-stocks have improved meaningfully compared with a year ago, we have more work to do as our guests are still seeing empty shelves on some occasions. In some of those situations, we've simply sold beyond our expectations, and our team is working quickly to secure additional quantities. In other cases, the vendors themselves are facing constraints in their ability to deliver product. And we're collaborating with them to address these constraints together, securing as much product as possible on behalf of our guests.

And our team has been successfully addressing supply chain bottlenecks, which are affecting both domestic freight and international shipping. Steps include expedited ordering and larger upfront quantities in advance of a season, mitigating the risk that replenishment could take longer than usual. Bottom line, with Q2 ending inventory up more than 26% or nearly \$2.5 billion compared with a year ago, we believe we're well positioned for the fall and ready to deliver strong growth on top of last year's record increases.

In everyday life, when you see an artist, performer or athlete who's at the top of their craft, they typically make their work look simple. The mastery they've achieved makes it easy to look past all the effort and passion behind their high level of performance. That's true in business as well. When you see a successful company generating impressive growth on both the top line and the bottom line, it's easy to miss the passion and hard work of the team that's delivering that performance. So as always, I want to pause and thank our team members everywhere in the world for everything they do to propel our business forward regardless of the challenges that come their way.

Our properties team has had a busy year as they ramp up our remodel program following last year's temporary suspension. In addition, they're working to open new neighborhood stores, distribution centers and sortation centers across the country. More than 100 remodel projects are currently in flight, and we're on track to complete about 140 remodels in 2021 and an even higher number in 2022.

The team has also opened 19 new stores this year, spanning from 3 more stores in New York City to all the way across the country in Hollywood. We're on track to open 12 more stores this fall, including a new location in Orlando adjacent to Disney World, a new site in Hawaii and a campus location in Madison, Wisconsin, welcome news to all my fellow Badgers out there.

We opened 2 new distribution facilities in the second quarter: 1 in New Jersey and another near Chicago, creating additional replenishment capacity within our network. We're planning to add more capacity in 2022, given the sales growth we've already sustained over the last 1.5 years and the continued growth we expect to generate going forward.

And to support our ship-from-store capability, the team is getting ready to open 2 new sortation centers in October, followed by 2 more after the holidays. These new facilities offer faster delivery times at a lower cost in markets with a high density of shipments. In addition, they free up backroom space at store locations they serve, expanding capacity for more digital growth over time.

And finally, in support of our commitment to being a net 0 enterprise by 2040, the team is driving towards 0 waste to landfill in our U.S. operations and improving overall energy efficiency as we transition to renewable energy. This includes investing in contracts for off-site renewable energy and additional rooftop solar projects as we move beyond our 2020 goal of having rooftop solar at 500 facilities.

So it's clear we have many opportunities to invest capital productively across both our stores and the broader supply chain. But I want to end my remarks where I started: with our team. I've been at Target for 25 years now, and one of the many reasons I've stayed here is the way we've always invested in our team, creating a uniquely strong culture and a high level of engagement.

But in recent years, we've doubled down on what was already a strength. Obviously, this includes our investments in pay, including our starting wage, but it goes much further. We've also made investments in benefits and recently announced that several programs we added during the pandemic have now become ongoing benefits for all U.S.-based team members, including free access to health care through virtual doctor visits and free online resources and apps to support mental, emotional and physical health.

And as Brian mentioned, in support of Target Forward's ambitions to advance opportunity and equity and create an equitable and inclusive workforce, we are really proud and excited to announce our new debt-free education assistance program earlier this month. We have the most comprehensive program in the industry, offering more than 340,000 team members debt-free access to undergraduate degrees, certificates, certifications and more, beginning with their first day at Target. Importantly, the program pays for smaller out-of-pocket costs, such as textbooks and course fees that might otherwise hinder participation. And for those who want to continue beyond their undergraduate education, the program will pay up to \$10,000 annually for team members pursuing a master's degree.

As Brian has said many times, of all the investments we've made over the last 5 years, none have been more impactful than the ones we've made in our team. And like any investment that's generating a high return, we continue to look for opportunities to do more, deepening our team's connection with Target, while they deepen Target's relationship with our guests.

Because of the investments we've made over time, store team member turnover remains low at a time when the labor market has been heating up to levels we haven't seen in a very long time. That's one of the many reasons I'm grateful to serve alongside this great team, and I'm excited about what we can accomplish in the years ahead.

Now I'll turn the call over to Michael.

Michael J. Fiddelke - Target Corporation - Executive VP & CFO

Thanks, John. After a record year in 2020, the theme of this year's performance has been growth on top of growth. Of course, we laid the groundwork for this year's growth through the investment decisions we were making years ago in our stores, owned brands, supply chain, technology and our team. And today, we continue to see a host of opportunities to invest in our future. That certainly includes the capital we're investing in support of our stores and supply chain and the investments we're making in our team, including recently announced team member bonuses and our new debt-free education assistance program. And while the return on team member investments isn't measured as a distinct line in our financial statements, they're the most important investments we make.

Total sales grew 9.4% in the second quarter, driven by comp growth of 8.9%. Within the quarter, May saw the smallest increase this year, given that it was comping over a 33% increase a year ago. On a 2-year basis, results were much more consistent throughout the quarter, as we saw 2-year growth in excess of 30% across all 3 months.

As Brian mentioned, with guests spending more time out of their homes, we've seen them shopping more often and making slightly smaller trips. Specifically, traffic grew 12.7% in the second quarter, partially offset by a 3.4% decline in average ticket. However, given that last year's comp growth was primarily driven by average ticket, on a 2-year basis, we've seen double-digit increases in both traffic and ticket since 2019.

As Brian also mentioned, the store channel has been our primary growth driver this year. Specifically, store comparable sales grew 8.7% in the second quarter. And given that store comps increased 10.9% last year, we've seen compounded growth of our in-store sales of more than 20% over the last 2 years.

In the digital channel, comp sales grew 10% on top of 195% a year ago. And reflecting this year's change in guests' shopping habits, the mix of our digital fulfillment changed meaningfully. Specifically, same-day services grew 55% in the quarter, while sales on orders shipped to home actually

declined from last year's elevated levels. This provides vivid evidence of the stickiness of our same-day services. Once guests try them, they love them. So even as they've ramped up their in-store shopping, they've continued to rely on these services as well.

Another indication of this year's shift in guest behavior, the percent of total sales from the digital channel actually fell slightly compared with last year, moving from 17.2% in second quarter 2020 back to 17% this year. Obviously, this isn't a trend we expect will continue over time, and it's important to note that this year's digital penetration of 17% is well over double the 7.3% we reported in second quarter 2019.

Our second quarter gross margin rate of 30.4% was down about 50 basis points from 30.9% a year ago. Among the drivers, last year's change in the sales return reserve estimate, which contributed about \$110 million to second quarter gross margin last year, accounted for about 50 basis points of rate pressure this year. In other words, without last year's benefit from this change in the reserve estimate, our second quarter gross margin rate would have been about flat compared to last year.

Among other gross margin drivers, we saw about 70 basis points of pressure in merchandising, reflecting the impact of higher product and freight costs, partially offset by the benefit of low markdown rates. This pressure was offset by about 40 basis points of tailwind for merchandise mix, combined with a small benefit from supply chain and digital fulfillment, driven by the shift in digital mix toward our less costly same-day options.

On the SG&A expense line, we saw a rate of 19.3% this year, down about 10 basis points from last year. This change reflected the continued leverage benefit from strong sales growth, offset by pressure from an increase in some expense rates in areas like marketing from lower-than-normal levels a year ago. This year's SG&A expenses also reflect continued growth in pay and benefits for our team. On the D&A line, we saw about 20 basis points of rate improvement from last year, driven by leverage on our sales growth.

Altogether, second quarter operating margin rate was 9.8%, down about 20 basis points from a year ago, but more than 2.5 percentage points higher than second quarter 2019. On the bottom line, our second quarter GAAP EPS of \$3.65 was 8.9% higher than a year ago, and adjusted EPS of \$3.64 was 7.9% above last year. Second quarter GAAP and adjusted EPS have both doubled over the last 2 years.

So far this year, our operations have generated just over \$3.4 billion of cash. This is historically strong performance, but about \$1.7 billion lower than a year ago due to some unique circumstances affecting last year. Specifically, our inventory position at the end of the second quarter last year was much lower than we'd have preferred given that our sales had far outpaced our expectations during the first half of the year. As a result, at this point last year, inventory turnover and payables leverage were running unusually high and would have been lower had we owned the appropriate amount of inventory to support our sales.

As such, this year, our inventory is in a much better position, more than \$2 billion higher than last year. And our payables leverage has begun to decline to a more sustainable level, both of which are near-term headwinds to operating cash flow. In addition, our year-to-date income tax payments are more than \$1 billion higher than at this time last year, given the volatility in our taxable income through the first half of last year.

As I turn to capital deployment, I want to start where I always do, which is to reiterate our priorities, which have remained the same for decades. First, we invest fully in our business in projects that meet our strategic and financial criteria. Then we look to support the dividend and build on our record of annual dividend increases, which we've maintained every year since 1971. And finally, we return any excess cash over time through share repurchases within the limits of our strong middle A credit ratings.

So far this year, we've invested just over \$1.3 billion in CapEx to support the new store, remodel and supply chain projects that John outlined earlier. And for the year, we're now expecting CapEx in the \$3.5 billion range. This is about \$0.5 billion lower than our original expectation and reflects the retiming of some project spending into next year. As a result of this retiming, our view of next year's CapEx is somewhat higher than our prior view, in the \$4 billion to \$5 billion range. And we'll continue to refine our view as we move into next year. Bottom line, we're excited about the productive opportunities in front of us and we'll govern our investment decisions with a focus on delivering continued growth and superior returns.

Beyond our capital investments, we paid dividends of \$336 million in the second quarter, and we returned another \$1.5 billion through share repurchases at an average price of just over \$230. And as we announced today, our Board has approved a new \$15 billion share repurchase authorization, which will allow us to continue buying back shares once the current \$5 billion program is completed. This authorization is consistent

with the capital deployment priorities I outlined above. It also reflects our confidence in the ongoing strength of our business and the robust cash flow we expect to generate over time.

Even after this year's investments in our business and team and the return of capital to our shareholders, we ended the second quarter with cash and cash equivalents of about \$7.4 billion. This is up slightly from a year ago and well above the cash position we expect to maintain over time. But as I've said before, given our current cash position and elevated volatility in the current environment, we believe it will be a multiyear journey before our exceptionally strong cash and credit metrics move fully back to long-term levels consistent with our single A credit ratings.

Before I turn to our expectations, I want to close my review of our current performance with a brief discussion of our after-tax return on invested capital, which measures the performance of our investment decisions over time. For the trailing 12 months through the end of the second quarter, Target's after-tax ROIC was 31.7% compared with 17.2% a year ago. This is an amazing number and a testament to the performance of our business model and our team over the last year. As we've said before, we expect this metric could settle back into the mid to high 20s over time, but to deliver a sustainable after-tax return in that range is a remarkable performance in any industry. And these superior returns are one of the many reasons we're eager to continue investing in the growth and resilience of our business to the benefit of all of our stakeholders.

Now let's turn to our comp sales expectations for the fall season. As you'll recall, in our conference call 90 days ago, we described how our business was positioned to deliver single-digit comp growth in the back half of the year, on top of very strong growth of more than 20% in the back half of 2020. While the environment remains volatile today, and there are many uncertainties as we look ahead, Target's performance through the first half of the year has consistently exceeded our expectations. This performance, combined with the continued strength in the U.S. consumer, gives us increasing confidence that this fall, our business can generate comparable sales growth in the high single-digit range, near the high end of our previous guidance range.

We have a similar outlook regarding profitability. 90 days ago, we said we expected our full year operating margin rate would be well above the 2020 rate of 7%, with a potential for it to reach 8% or somewhat higher. From today's perspective, based on our expectation of high single-digit comp growth in the fall, we expect to see an operating margin rate near the high end of our previous range. Specifically, we now believe that Target is positioned to deliver an operating margin rate of 8% or higher for the full year.

I've been at Target for more than 17 years now, and I've never experienced a time like this when every aspect of our diverse strategy is coming together like we're seeing today. Obviously, our guests are noticing, too, based on their higher level of engagement, which you can see in our outstanding performance.

Typically, in retail, if you saw a large, mature company like ours growing at the rate we're seeing today, you'd assume we were comping over soft numbers from the prior year. Instead, we're comping over a year of record growth in 2020 on both the top and bottom lines.

Like Brian said earlier, our success begins and ends with the team. So on behalf of all of our stakeholders, I'd like to close my remarks today by thanking the entire Target team for the exceptional results we're reporting today.

Now I'll turn the call back over to Brian.

Brian C. Cornell - Target Corporation - Chairman & CEO

Thanks, Michael. Before we move to your questions, I want to pick up on Michael's last point, which is the way we've been able to synchronize every aspect of our strategy. A few years ago, we embarked on a project to better articulate our company purpose. Across our team, there was already a strong sense of who we are and what we stand for, but we wanted to put it into words distinctly.

Out of that work came the purpose we articulate today: to help all families discover the joy of everyday life. Those words have deep meaning for our team: families, discovery, joy and the word all, which represents our strong commitment to inclusion across every aspect of our business.

Some might ask if everyone at Target already had a strong sense of purpose, why go to the trouble of putting it into words? The answer is the alignment that it creates, alignment of our strategy and alignment of our team. In the same way we had a focus on what really matters most in our articulation of our purpose, we're relying on that purpose to focus both our strategic work and our everyday activities.

If we find ourselves working on something that doesn't advance our purpose, we can set it aside and relentlessly focus on the things that will move Target forward. That kind of focus has enabled the performance we're reporting today, and it's behind all of our investments, strategies and activities as we look ahead.

With that, let's move to Q&A. Christina, John, Michael and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris Horvers with JPMorgan.

Christopher Michael Horvers - JPMorgan Chase & Co, Research Division - Senior Analyst

Two questions. My first question is, can you talk about what you're seeing in back-to-school so far? Are you seeing any effect from Delta on purchasing patterns? And how are you thinking about growth in the different categories as you move forward relative to the second quarter?

Brian C. Cornell - Target Corporation - Chairman & CEO

Chris, we're off to a really strong back-to-school start, and it is broad-based right now. Christina and Michael, John and I were out in stores yesterday, and we were seeing guests shopping our entire back-to-school assortment. I think we've got a great assortment at a tremendous value, and we're off to a really strong back-to-school and back-to-college season.

Christopher Michael Horvers - JPMorgan Chase & Co, Research Division - Senior Analyst

Got it. And then a follow-up, Mike, on the gross margin. Can you talk about how you're thinking about the gross margin in the back half overall? And within that, what are the puts and takes? Does that -- do the product and freight headwinds persist or perhaps elevate? And to what degree are you assuming higher clearance and promotion levels to drive the 8% or more operating margin outlook?

Michael J. Fiddelke - Target Corporation - Executive VP & CFO

Yes. Chris, you've heard us talk over time about all the levers we have within the business to offset some of those puts and takes. And I think the second quarter is a really good example of that. If you take out the sales return adjustment in last year's actuals, margins were essentially flat year-over-year. And so we found some good offsets there and feel really good about our profit performance.

I actually think that same theme comes through loud and clear if we zoom out a little bit and look at a longer time period. If you go back to first half of this year versus first half of 2019, 2019 gross margin rate was 30.1% for the Q1 and Q2 season. We're sitting at 30.4% right now in Q2 and 30.2% for the spring. And so a lot's happened over the last 2 years, and we feel really good about our ability to manage the profitability of the business. And I think that bodes well for the back half of this year and beyond.

Operator

The next question is from Paul Lejuez with Citi.

Paul Lawrence Lejuez - *Citigroup Inc., Research Division - MD and Senior Analyst*

Two quick ones. Just curious on the inflation front, if you can maybe talk about the cost pressures that you're seeing in the food grocery category versus general merchandise, any quantification that you might be able to provide.

And also wanted to go back to private label performance. You mentioned it grew faster in 2Q. Curious what sort of the gross margin tailwind that provided. And how do you see private label performance playing out in the second half? Is that going to be a continued gross margin driver for you?

Brian C. Cornell - *Target Corporation - Chairman & CEO*

Well, let's have Christina talk about the strength we're seeing in our owned brand performance and how we're managing costs in this environment.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

I'd be happy to take that one. Let's start with owned brands. As you know, owned brands are a huge part of our strategic imperative and desire to continue to differentiate in the market, bring great quality products to our guests. And so our commitment is to continue to accelerate our owned brands at a faster rate than our base, and that is what exactly what we saw in the second quarter. That's the pattern we've been on. And as long as we continue to find unique opportunities to meet the guests' needs, that's going to persist.

And so you also know that owned brands represent a big portion of our sales mix, but even a bigger portion of our gross margin. So that creates tailwind for us on the profit side.

And then going back to your first question on costs, yes, we're seeing cost pressures on product costs as well as freight. But going back to Michael's point, this is what we do every day. We manage the profitability of the business by leveraging the full suite of levers that we have to offer great value to our guests while delivering on the financial expectations you have.

Operator

The next question is from Karen Short with Barclays.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

So I wanted to just ask, you look at your sales productivity, you're up more than 40% on a sales per square foot basis since 2017. So I guess what I'm wondering is, with this higher productivity, how should we think about kind of the long-term margin structure? Or maybe said a little differently, would you look to lean into investments going forward? Or could we expect a little more sustainability in terms of the higher operating margin structure?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

If I step back from your question a little bit, Karen, at the end of the day, growth powers so much of our margin equation. And that's why we're so focused on investments that drive growth. And you can certainly see that in the improved productivity. That comes to bear. And the math we do

on new stores, that comes to bear for how we adjust our store footprint in a remodel. And so you'll see us consistently focused on investments that drive growth. With that growth comes good productivity on a per square foot basis, and we can translate that growth to good bottom line profit.

Brian C. Cornell - *Target Corporation - Chairman & CEO*

Karen, Michael summarized it well. I mean our theme for this quarter was growth on top of growth. But you should expect that theme to continue going forward. We're going to continue to invest in our stores. John talked about the remodel plans that we have in place. We'll continue to invest in new, highly productive stores, invest in our brands, invest in our fulfillment services and invest in our team. And our focus on continuing to drive consistent growth and market share expansion quarter after quarter will be a theme you'll hear for years to come.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And then just you also commented on the 70 basis points of gross margin pressure from higher product and freight costs. On the product front, can you maybe just give a little color on what you're seeing on the cost inflation versus the retail inflation? And are you absorbing some of that cost inflation?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. I think Christina said it well, our teams are experts at managing the puts and takes across the business. So if we rewind the clock a couple of years ago, we'll be talking about tariffs and how we offset that. And I feel really good about how our teams manage any complexity in the business.

To underscore something Christina also said, value matters, and we'll be laser-focused on making sure our guests find incredible value on our site and in our stores. And so we've done a lot of hard work to invest in solid price perception. And we want to make sure that our guests continue to find that value going forward, inflation or not.

Operator

The next question is from Scott Mushkin with R5 Capital.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

I guess the first one I have is, obviously, you're holding a lot of cash on your balance sheet. You guys talked about the new share repurchase. But what is the ideal level of cash for you guys to hold? And what do you do with what you got now, I guess, in more of the short term?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. Well, the answer to that question, priority 1 has been and always will be invest in the business. And continuing to invest to drive growth is the first use of that cash. Our second capital priority is to support the dividend. We announced just last month a north of 30% increase in our per share dividend. And we have the good fortune of a business that continues to generate a lot of cash as we grow. And so that gives us capacity for share repurchase as well.

Over time, you'll see us carry less cash than that \$7.4 billion we have today to be sure. Optimal and normal times, it's something closer to flat to a little north of that cash on the balance sheet, depending on the period of the year we're in. But we want to be prudent about how we kind of step back into the sweet spot of our middle A credit ratings.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

Okay. Great. And then my second question is really, I guess, more strategic over the next 12 to 18 months. Brian, I think you went over just what tremendous work the team has done. But if you step back and look at the next 12 to 18 months, what are the biggest, I guess, initiatives going forward that would drive outsized growth, that market share gain compared to competitors?

Brian C. Cornell - *Target Corporation - Chairman & CEO*

Scott, it will be a very familiar theme to you. We're going to continue to invest in remodeling our stores. And despite the progress we've made, and we've remodeled just about half our stores today. So you'll continue to see us invest in remodels.

We've got a very strong pipeline of new stores that we'll be rolling out over the next few years. We'll continue to invest in our brands and our owned brand performance. You'll continue to see us continue to invest in Drive Up and pickup and the expansion of Shipt. And we'll continue to invest in our team, again, all built around that thematic of growth.

And as we think about the key metrics going forward, you'll hear us talk about traffic, and we felt exceptionally good this quarter about driving traffic growth of almost 13%, continue to drive strong comps in both our stores and digital channels. And we'll continue to make sure we always are laser-focused on market share gains.

So those themes will be very consistent going forward. The investments we make in our stores, our brands, our fulfillment channels and our team will continue to drive traffic to our stores and visits to our site, continue to drive strong comps that equate to market share gains across our entire portfolio. So that's our continued commitment for not just the next few quarters but for years to come.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

Perfect. And what a tremendous job you guys have done.

Operator

The next question is from Michael Lasser with UBS.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Target continues to see outsized gains in traffic. Over the last 90 days, has there been any change in the nature of the pattern of traffic, more weekly traffic versus weekend, especially as consumers go out and travel and do other activities? And how are you expecting your traffic to unfold over the next couple of quarters as you guide to high single digits for the back half of the year?

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Michael, maybe I can jump in on this one. Traffic has been very consistent, and it's been consistently strong. And we're very excited about the early momentum in back-to-school and back-to-college as well. What I would tell you is that the strength of our portfolio allows us to flex between patterns in consumer behavior changes that are more at the micro level, not at the aggregate level. The aggregate has been consistent and healthy.

But there are behavior changes within businesses. We've talked about the fact that last year, there was a bigger need for household essentials and people were stocking up. Now we're seeing less of that, and we're seeing more the return to going out. And therefore, they're wearing dresses and beauty products, and luggage business has been very strong. So there are patterns underneath, but the macro and aggregate is that Target is outpacing the industry. And it's really led by broad-based strength across all of our businesses.

Brian C. Cornell - *Target Corporation - Chairman & CEO*

And Michael, I would just come back to -- I know there's been lots of questions about the impact of the Delta variant. And we watch this very carefully. We're obviously very focused on safety. But we continue to see a very optimistic consumer, certainly shopping with caution and they're wearing masks more and more across the country. But we're seeing tremendous resilience in the consumer today. And our traffic patterns, I think, represent that, as we see this consistent flow of traffic into our stores. So a very resilient consumer. And we're seeing that as we start the third quarter. That traffic pattern and that resilience is continuing.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

My follow-up question is, after 1.5 years past the start of the pandemic, you've comped the comp, you've seen really sizable returns on the investments that you've made and you've entered into a stable operating rhythm. So why wouldn't Target now be able to sustain at least an 8% operating margin over the long run? Is there something unique about this current environment such as a low level of promotional activity that might return in the future that would weigh on Target's profitability?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. So Michael, there's always something unique in the environment. I can't remember one of these calls where there wasn't a specific good guy or bad guy on the margin line we weren't talking about. And so I think what matters most is our ability to put together a P&L that hangs together great, and that always starts with sales growth.

And so while we aren't in a position today to share a new algorithm, go forward, we'll be centered on continued sales growth and continued market share gains. And with those, I'm confident in our team's ability to put together a P&L that translates into a bottom line we'll all feel good about.

Operator

The next question is from Edward Yruma with KeyBanc Capital Markets.

Edward James Yruma - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

I guess, first, just to click down a little bit on the ship-to-home that you said was negative, was that just a symptom of kind of tough compares and the decision with consumers see that same-day digital services?

And then I guess as a broader question between the really strong growth you've had in Target Circle and your digital businesses, you have a lot more data on your consumer today. I guess how are you acting on that on a real-time basis? And kind of what have you learned?

John J. Mulligan - *Target Corporation - Executive VP & COO*

Ed, this is John. On the ship-to-home, I think you hit right on it, there's really 2 things going on. Just tremendous growth last year in ship-to-home at -- particularly early in the second quarter last year. So very, very strong growth, and we're just comping over that.

I think the second thing, and probably more importantly, is the continued growth in our same-day services, tremendous growth in Shipt, in Order Pickup and Drive Up. And the growth in Drive Up is truly remarkable, but the one I like to look at is Order Pickup. We started that 6 years ago, and it continues to grow meaningfully quarter after quarter, year after year after year. So all 3 of those are acting incrementally each year and not taking business away from each other.

And as you know, the thing we love about that, it's great service for our guests. They're our highest-rated services. Drive Up is the single highest-rated service we have. But also for us, it's fast and very, very efficient. And we love the margin that comes along with those products. So as we've grown our digital businesses over the last several years, and in particular over the last 18 months, the same-day services have grown significantly faster, and that's good margin for our digital business.

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

And Ed, I can jump in on the Target Circle component. As you accurately reflected in your question, it's been a great program for us, and we're up to over 100 million members in Target Circle, 100 million. It's quite substantial. And what primarily this is about is obviously making sure that we are more relevant to our consumer in giving them great deals, more personalized offers and relevancy that they appreciate.

And so as an example, in the second quarter, guests benefited from \$70 million of savings from the 1% earnings on purchases plus another \$600 million worth of savings from the promotional offers. So in our commitment to offer affordability, accessibility, Target Circle is just another amazing proof point that we'll keep building on.

Operator

The next question is from Steph Wissink with Jefferies.

Stephanie Marie Schiller Wissink - Jefferies LLC, Research Division - Equity Analyst and MD

Congratulations on the results. My question is about the second half OpEx, and just trying to bridge your comments on operating margin for the year to the second half plans on a year-over-year basis. And I think, Christina, you might have mentioned that marketing as a focus for the back half. Maybe talk a little bit about how much you spend on emphasizing your same-day services versus how you plan to communicate to the consumer your value message in some of your key categories of emphasis.

Brian C. Cornell - Target Corporation - Chairman & CEO

Steph, I might start. I think you've actually answered the question for us. You'll see us balance our messaging in the holidays around obviously, affordability, great value. We'll certainly emphasize our same-day services, and we know how important they'll be for the guests during that holiday season, and the strength of our multi-category assortment. So it will be a very steady stream of great product news, great service news and will underscore value.

Operator

And does that conclude your questions?

Stephanie Marie Schiller Wissink - Jefferies LLC, Research Division - Equity Analyst and MD

I did have one follow-up. I'm just trying to understand the OpEx spend for the back half. Could you just give us some context around, is that the step-up in marketing is what we're seeing in terms of the year-over-year offset versus prior year? Is there something else happening in operating expenses if gross margins are going to be flat, but operating margins are going to be down a bit to the prior year?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. We aren't getting into the specifics for gross margin or SG&A. It's all wrapped into our expectation for that OpEx line on the year. And similar to the second quarter, I expect you'll see some puts and takes. I mean one of the things we're excited about in Q2 is to get back to a more normalized level of marketing spend because we kind of had to put our foot on the hose last year as we changed course in the early stages of the pandemic. And so we feel good about returning to what I view as a really healthy level of marketing investment that should power growth in the back half of the year.

Operator

The next question is from Robby Ohmes with Bank of America.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD*

I was hoping you could comment on how much more items you have to go to add to Drive Up. So I think you guys said 5,000 items were added in 2Q. How much more is there to go on Drive Up that can kind of keep driving that super growth of that business?

And then kind of related to that, grocery, you added a lot of fresh items on Drive Up. Did you add a lot of fresh items in general to the grocery mix? And maybe can you speak to how much further Target can go on grocery? I know historically you've said you're not really a full grocery destination. But are you moving towards adding enough items to be more of a full grocery shop?

John J. Mulligan - *Target Corporation - Executive VP & COO*

Robby, first on the Drive Up question, I think there's 2 things there that really are driving growth. First is category expansion, like you said. And we continue to work our way through the through the categories there. There's work for us to do. We'd like to add things like clearance to Drive Up. And we'd like to add returns to Drive Up. And so I think there's a lot further we can go there from a category or product perspective.

The other side is just improving the service itself, and you'll see us continue to do that. We added more Drive Up locations. We're adding canopies to help with the weather. We added numbered parking lots so that we can find your black SUV among the 12 black SUVs that sit out in our parking lot waiting for Drive Up at any given time. And we added substitutions. And we added the ability to add another driver to come do your pickup order for you. So I think you'll see us continue to innovate the service as well.

So we see a long runway for us to continue to improve driveway (sic) [Drive Up]. And at the core of that, of course, is continued high execution from our store teams which leads to very, very high NPS scores that we see in Drive Up. And Christina, I'll let you talk about the food assortment.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. The Food & Beverage business has been a real source of strength for us and continues to do exceptionally well, including our owned brands that we have launched. Good & Gather and Favorite Day are growing because they're just so relevant. They taste delicious. They look great. They're across the whole portfolio, and guests are finding them easily amongst the assortment.

On your question about, is the assortment expanding? Or is it really the expansion on to Drive Up. The assortment is always going to be a curated point of view. But when a guest starts in the digital experience rather than the physical experience, there is much more understanding of who we are, and they quickly are converting because of that convenience in Drive Up to Target Food & Beverage. And I think you will see a lot of upside in the future from the success that we've built over the last several years in this business.

Operator

Our last question is from Kelly Bania with BMO Capital.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Just wanted to ask another question about EBIT margins clearly coming in higher than expected for the year. But just looking at the first half of 9.8%, it suggests something in the low to mid-6% range for the second half. And I realized Target's typical cadence is for lower EBIT margins in the second half, but this seems -- the magnitude of this deceleration seems to be about twice as much as the historical pattern. So just trying to get a sense of conservatism or costs in the back half. You called out the marketing expense, or just what you're planning for promotional activity in the back half. Maybe any color you could help with that.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

You're right, Kelly, there's some seasonality to how profit flows through our P&L quarter-by-quarter, spring versus fall. We feel really good about the back half of the year and the growth we expect to deliver, and we think that yields 8% or north-of-there operating margins for the year. And so while getting too precise on any specific line, I think, would be an exercise in imprecision right now, we're really confident we'll be able to put that all together for a profit rate in the back half of the year that we feel good about.

Brian C. Cornell - *Target Corporation - Chairman & CEO*

Well, operator, that concludes our second quarter call. Thank you for joining us today. Enjoy the rest of the summer, and we look forward to talking to you later in the year. Thank you.

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