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TGT - Q1 2013 Target Corporation Earnings Conference Call

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OVERVIEW:

Management discussed 1Q13 results, reporting GAAP EPS of \$0.77 on a comparable store sales decline of 0.6% vs. 1Q12. Guidance was for 2Q13 GAAP EPS of \$0.90-1.00 on a meaningful ramp in comparable store sales vs. 1Q13, and for 2013 GAAP EPS of \$4.12-4.32 on a comparable store sales increase of 2.0-2.5% vs. 2012.



CORPORATE PARTICIPANTS

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Kathee Tesija *Target Corp - EVP of Merchandising*

John Mulligan *Target Corp - EVP and CFO*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation first-quarter Earnings Release conference call. During the presentation, all participants will be in a listen-only mode. Afterwards, we will invite you to participate in a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded Wednesday, May 22, 2013. I would now like to turn the conference over to Mr. Gregg Steinhafel, Chairman, President and Chief Executive Officer. Please go ahead, sir.

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Good morning and welcome to our 2013 first quarter earnings conference call. On the line with me today are Kathee Tesija, Executive Vice President of Merchandising; and John Mulligan, Executive Vice President and Chief Financial Officer. This morning I'll provide a high level summary of our first quarter results and strategic priorities for the rest of the year. Then Kathee will discuss category results, guest insights and upcoming initiatives. And finally, John will provide more detail on our financial performance along with our outlook for second quarter and the full year. Following John's remarks, we'll open the phone lines for a question-and-answer session.

As a reminder, we're joined on this conference call by investors and others who are listening to our comments via Webcast. Following this conference call, John Hulbert and John Mulligan will be available throughout the day to answer any follow-up questions you may have. Also, 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 SEC filings. Finally, in these remarks we refer to adjusted earnings per share which is a non-GAAP financial measure. A reconciliation to our GAAP results is included in this morning's press release posted on our Investor Relations website.

Our first quarter earnings fell short of our expectations, as we faced a choppy and challenging environment caused by unfavorable weather and this year's payroll tax increase. Our US business generated softer-than-expected sales and traffic, particularly in our seasonal categories, as we experienced one of the coldest spring seasons on record, following record warmth a year ago. While we are not satisfied with this quarter's performance, we remain highly confident in our strategy and our team's ability to deliver strong results going forward across a broad range of



conditions. In the first quarter our US segment generated adjusted earnings per share of \$1.05, down 5% from last year's outstanding performance. Our first quarter GAAP earnings per share were \$0.77, \$0.28 lower than adjusted EPS, driven primarily by \$0.24 of dilution attributable to our Canadian segment.

As we mentioned in our fourth quarter call, this year there are several notable changes affecting our financial reporting, which John will cover in detail in a few minutes. In the quarter, comparable store sales declined 0.6% from last year's 5.3% increase. First quarter comparable transactions were down 1.9%, following last year's increase of 2%, keeping us essentially flat on a two-year basis. In much of the US, traffic in our seasonal categories was unexpectedly soft as guests held off purchasing spring items in the face of cold and wet weather. Our merchandising teams did a great job reacting to the pace of sales in these categories, retiming receipts and adjusting them downward so we are still in a healthy inventory position today.

Despite the weather impact on seasonal categories, sales and traffic in our digital channels continued to grow at a robust pace. Overall first-quarter digital sales grew in the high teens and increased more than 20%, net of our most seasonally sensitive categories. Target's mobile traffic and sales continued to grow at a triple-digit pace, with mobile traffic representing more than 30% of our digital traffic in the first quarter. We're pleased with these results as mobile is rapidly becoming the key platform for digital commerce across all of retail and we know that Target guests have a particular affinity for mobile engagement.

After two years of preparation, in March we opened our first 24 Canadian stores in the greater Toronto area and we're very pleased with the reception we received from our new Canadian guests. We experienced an unexpectedly strong surge in sales as guests were eager to see their newly opened Target store. The mix of sales in Home and Apparel was even higher than expected as guests shopped our assortment of stylish own brands and national brands responding to the outstanding value we provide on both. Now that we are beyond the grand opening surge in this first cycle of stores, we're encouraging our new Canadian guests to make Target a preferred destination for categories throughout the store including Food, Health, Beauty and Household Essentials as these categories play a key role in driving trip frequency over time. As it is already in the US, REDcard rewards will be a key differentiator for Target in Canada, and we're encouraged that REDcard penetration of sales in our Canadian segment was ahead of plan in the first quarter.

Two weeks ago we opened our second wave of 24 Canadian stores in British Columbia, Alberta and Manitoba and we're very pleased with the initial guest response in these markets and the ability of our teams and systems to accommodate the increasing volume of traffic and sales. We plan to open another 20 stores in Canada later in the quarter, on the way to operating 124 Canadian stores by the end of the year. This means we expect to open more Target stores in our first year in Canada than we opened in our first 10 years in the United States, an incredible accomplishment that has required unprecedented effort by teams throughout the Company. In the US, we opened six new stores in the first quarter, including an additional City Target location in Los Angeles. We now operate six City Target locations in four cities, and we continue to be pleased with the results in these stores. Sales have essentially met our expectations and the mix of Home and Apparel has been better than expected. Similar to our Canadian stores, we are focused on our City Target stores on driving sales and visits in our Frequency and Commodity categories, changing guest habits and inspiring them to visit us more often for both wants and needs.

In the first quarter, we also closed the sale of our US Credit Card receivable portfolio to TD Bank Group and began deploying proceeds to reduce debt and repurchase shares. We're very pleased to have reached the right agreement with the right partner in a transaction that removes these more volatile assets from our balance sheet. The portfolio continues to perform well, generating meaningful income for Target through our profit sharing arrangement with TD.

As we look ahead to the second quarter and the remainder of the year, we remain cautiously optimistic about both the macroeconomic environment and consumer behavior. Both of these business drivers continue to reflect slow, uneven growth and ongoing cross-currents of positive and negative indicators, just as they have for the past few years. For example, while we're pleased that the housing market has stabilized and jobless claims have been declining, we're mindful that household formation and job growth remain particularly weak among younger demographic groups. In addition, guests continue to face the headwinds of this year's payroll tax increase and a meaningful lack of income growth. With these considerations in mind, we remain focused on strategies that position our business for profitable growth, both today and in the long term. We continue to invest in initiatives that integrate multiple channels, like our recent beta launch of Cartwheel, a result of our collaboration with Facebook along with tests



of same-day delivery with Google and eBay. And we're testing opportunities within our own supply chain that will leverage our existing store and distribution assets to provide additional services and capabilities our guests value most.

We're investing to drive adoption of our 5% REDcard Rewards and Pharmacy Rewards loyalty programs, which have proven to be unique and powerful differentiators and sales drivers for Target. Both of these programs offer guests the opportunity for even greater savings, leading them to shop more merchandise categories more often. We're investing in efforts to better serve all of our guests, driving traffic and sales by segmenting our stores and assortments to match local tastes and preferences. And we continue to offer digital innovations that create a link between our stores and social media. We're continuing to pursue new and differentiated merchandise in all of our assortments, including our recently announced partnership with Warner Brothers and DC Entertainment to feature Justice League merchandise across multiple categories. Kathee will provide more detail on programs like these that create a sense of discovery for our guests while deepening their loyalty for Target.

Beyond the value we provide on exclusive, well-designed merchandise, we continue to invest in everyday low prices which we reduce even further in our weekly ad. In addition, we stand behind our prices with policy to match local competitor print ads as well as our largest online competitors. And through REDcard Rewards and Pharmacy Rewards our most loyal guests have the opportunity to save even more. Throughout the Company we take a disciplined approach to the deployment of cash, combining strong financial rigor and capital investment decisions with a focus on returning cash to our shareholders through dividends and share repurchase. And of course, none of our efforts would be possible without the outstanding work of our more than 360,000 team members who greet and serve our guests every day, carefully manage inventories and expenses in this challenging environment, and proudly represent our brand in the communities where they live.

In spite of first quarter tax increases, unseasonably cold weather and challenging prior-year comparisons, our underlying business continues to be stable and healthy. Our team is focused on driving outstanding results across categories, channels, regions and guest segments every day, even while we continue to position our business for success with investments in new stores and formats and more flexible ways of serving our guests. We believe that our outstanding team, aligned in support of a well-defined strategy will drive strong performance both this year and over time.

Before I turn the call over to Kathee, I want to take a moment to thank Terry Scully, who retired from his role as President of Target's Financial and Retail Services team in April. Terry has been a valuable member of the Target team for nearly 35 years and under his leadership the Financial and Retail Services team has played a key role in strengthening guest loyalty and delivering substantial profitable growth for Target. Over the last few years, Terry and his team have worked tirelessly to find the right partner to purchase our Credit Card Receivables portfolio, culminating in this quarter's sale.

And finally, I want to pause to express our condolences to the residents of Moore, Oklahoma, including Target team members, guests and their families who were affected by this week's devastating tornado. We have been working with emergency responders, community organizations and local schools to evaluate immediate needs and ways that Target can help. And yesterday we announced that Target is donating \$250,000 in support of relief efforts. \$200,000 of cash and in-kind donations to emergency responders and community organizations including the Red Cross, and the Salvation Army, and \$50,000 to support rebuilding efforts at the two elementary schools that were badly damaged by the tornado. Now, Kathee will provide more detail on first-quarter results and outline initiatives for the second quarter and beyond. Kathee?

Kathee Tesija - Target Corp - EVP of Merchandising

Thanks, Gregg. Those of you who have listened to our conference calls over time know that often when we're asked about weather impacts, we point out that on average, the weather is average. This is certainly proven true in the last two spring seasons. Last year it was an unusually early and warm spring across much of the country. We saw very strong sales in our seasonal and weather-sensitive categories.

This year in the face of a cold and late spring, sales were quite soft in those same categories. And while we are committed to delivering strong results in all types of environments, we believe it's important to understand the impact of this year's weather on our first-quarter sales results. Specifically, first-quarter comparable store sales in weather-dependent categories like Seasonal Apparel, Lawn, Patio and Sporting Goods lagged the rest of our assortments by 6 to 7 percentage points. This sales gap was even wider in areas of the country which experienced below-average temperatures, and which was much smaller in areas that experienced much more normal spring temperatures, like the Western US.



Looking more broadly at our category results, first quarter comparable store sales continued to be strongest in less discretionary categories such as Food, Health, Beauty and Household Essentials, all of which experienced low single-digit increases. Our Home and Apparel categories were both down in the low single-digits and Hardlines saw a mid single-digit decline in comps. Within Hardlines, Electronics continues to see softness in video games, along with televisions, particularly early in the quarter as last year's fifty-third accounting week moved Super Bowl-related sales out of the quarter. As Gregg mentioned, our guests continue to shop cautiously, planning their spending and sticking to shopping lists as they continue to feel the burden of economic pressures. Recent guest surveys indicate that 75% of our guests are aware of this year's payroll tax increase and among those, the majority have noticed the impact of the tax increase on their paychecks and indicate that it's affected their spending.

Basket data confirms that needs-based trips have been increasing while wants-based trips focused on discretionary categories have been declining. And notably, recent data from the conference board indicates that while sentiment among consumers regarding their current situation has been improving since late last year, consumer sentiment regarding the future has been declining in recent months. To drive traffic and sales in this environment, we know it's more important than ever to provide value to our guests on a high-quality, differentiated assortment delivered through a convenient shopping experience. In the Digital space, we continue to apply a test-and-learn approach when rolling out applications and capabilities so we can determine what works best for our guests. We're pleased that our Digital traffic grew faster than industry benchmarks again this quarter.

We continue to explore ways to integrate digital technologies with social media and our stores to provide a unique shopping experience for our guests. This quarter's beta launch of Cartwheel, which we developed in collaboration with Facebook, is a perfect example. This first-of-a-kind experience gives guests a fun way to save on hundreds of items throughout our stores. Upon authenticating this application through their Facebook profile, guests receive ten spots to fill with deals of their choice from among hundreds of items throughout our store. Depending on the product, the deals feature a range of discounts and expiration dates and guests can switch between offers at any time. Deals are redeemed at checkout in our stores either by scanning a single bar code on a mobile device or a printout from our desktop computer.

Guests can share Cartwheel with their friends on Facebook to show off their latest finds and see what their friends are buying. And the more guests interact with Cartwheel by choosing and redeeming deals and sharing those deals with friends, the more offers they unlock for themselves. We launched Cartwheel in beta and we're encouraging guests to provide feedback so we can make ongoing, real-time enhancements to the Cartwheel experience. Initial sign-ups for Cartwheel have exceeded expectations. Thousands of guests signed up in the first week and we saw a meaningful increase when we added a link to Cartwheel on Target.com. More than 10% of guests who have signed up already have redeemed Cartwheel offers in one of our stores.

Also this quarter, we launched a Beauty Box test to understand our guests' appetite to pay for samples of Beauty products. We tested this offer on Target's Facebook style page and sold through our inventory within a week. In addition, the offer generated favorable media coverage and positive feedback in social media. Based on these results, we will continue to explore ways to surprise and delight guests with Box-based offers that support our Expect More, Pay Less brand promise.

In March, we were very pleased to announce our agreement to acquire Chefs Catalog and assets of cooking.com in two separate transactions. These e-commerce acquisitions are aimed at expanding Target's presence in the growing cooking and kitchenware market. We combined the assets of cooking.com with Chefs Catalog to create a new wholly-owned subsidiary which will continue to operate the two brands under their current names. We believe these transactions present a strategic growth opportunity to serve guests who are increasingly looking online for cooking solutions to make their lives easier, from utensils and cookware to recipes. These strategic transactions provide us a great way to address this growing opportunity and provide expanded online options for our guests.

In select markets, we're continuing to test same-day delivery in partnership with Google and eBay. Our focus in these tests is to understand the level of guest engagement and this fulfillment opportunity. These projects, which are still in the test phase, continue to provide valuable information on the store backroom capabilities and processes needed to support this offering. And as we mentioned last quarter, this year we're launching our own test Flexible Fulfillment in the Minneapolis market. This month we launched a test in which team members are given the opportunity to order online and pick up in store. We will use our team members' feedback to improve the process and experience before the pilot becomes guest-facing later in the year. Two other team member pilots, Pay in Store to Pick Up at Another Store and Pay Online and Ship From Store are planned for late in the year.



In both our stores and online, we feature great designers and brands and continue to roll out new, unique merchandise that creates a sense of discovery for our guests. Our goal is to show guests that design means more than fashion and that great design doesn't have to mean high prices. In Home, we continue to be pleased with results from our partnership with Nate Berkus. The collection includes a growing list of products in a wide range of categories including Bedding, Bath, Accessories, Lighting, Rugs and Stationery. We also continue to see great results from the roll-out of the Threshold brand which is replacing Target Home, our largest own brand. We debuted Threshold last fall and guests continue to respond to this fully redesigned, high-quality collection that's inspiring them to update their homes. To celebrate this new brand, earlier this month Target constructed a life-sized dollhouse in New York's iconic Grand Central Terminal, where guests could explore a two-story, seven room doll house decorated with more than 3,500 pieces from the Threshold collection. Select furnishings were tagged with QR codes to be shoppable right from the dollhouse.

In our Stationery category, we're excited about our collaboration with Todd Oldham on the Kid Made Modern collection, which offers creative activity kits and supplies to inspire kids through art. The collection has a clean, simple and fresh design that's gender-neutral and age-appropriate to inspire all children and parents. We launched this collection of creative design tools late last year and set a new collection this spring. Following our successful first quarter partnership with Prabal Gurung and Kate Young, we recently announced our latest design collaboration with Lauren Bush Lauren and the roll-out of the FEED USA + Target collection. In late June, we'll feature a lifestyle collection of stylish products in Home, Sporting Goods, Stationery, Apparel and Accessories. The collection, which reflects a modern Americana aesthetic while supporting an important cause, includes more than 50 products across a range of price points, with most items less than \$25. Each item in the collection has an associated number of meals listed with it and with each sale, Target will donate the monetary equivalent of that number of meals to Feeding America, the nation's leading domestic hunger-relief charity, and a partner of Target since 2001. During the time that the products will be available, we expect to provide more than 10 million meals for families across the US.

In Canada, we've been very pleased with results from our partnership with Roots Outfitters, an iconic Canadian brand that offers quality craftsmanship and comfortable styling on a line of apparel for men, women and kids. And we're very excited that we recently announced a fall partnership with Beaver Canoe, a member of the Roots Canada family, to offer an exclusive collection of cabin-chic apparel and home items in our Canadian stores this fall. Entertainment had a great first quarter, including the release of our exclusive deluxe version of the 20/20 experience from Justin Timberlake. The strength of the guest response put this release among the top three at Target in the last 10 years. We followed this success with releases of exclusive albums from the Band Perry and Michael Buble in April. In Electronics, we've partnered with Wired Magazine to offer a custom curated assortment of consumer Electronics and gadgets tested by their editors, featuring their expert tips on usage and key features. And in April, Target became the exclusive mass retailer to debut the Beats by Dr. Dre neon mixer headphones, available in eye-catching green, orange, pink, yellow and blue.

We've long known the value we can create through segmentation of our stores and assortments based on store location and demographics. We continue to develop tools and processes that allow us to further localize assortments and experiences to match the specific markets where our stores are located. We are focused on providing a deeper presence of locally relevant products and brands across the store, including categories like Food, Beauty, Home and Entertainment. And we continue to invest in unique multi-channel experiences like Cartwheel that allow guests to choose their own offers and further integrate their Target experience into their social networks. Now John will share his insights on our first quarter financial performance and our outlook for the second quarter and full year. John?

John Mulligan - Target Corp - EVP and CFO

Thanks, Kathee. As Gregg mentioned, we're disappointed with our first-quarter financial performance. Sales in the US were softer than expected, even relative to updated guidance we provided in April, causing our reported earnings per share to fall short of our updated guidance, as well. Adjusted earnings per share, which measures the results of our US operations, were \$1.05, representing a 5% decrease from last year. First quarter GAAP earnings per share were \$0.77, reflecting losses on early retirement of debt which reduced our EPS by \$0.41, EPS dilution related to our Canadian segment of \$0.24, and net accounting gains of \$0.36 related to the sale of our Credit Card portfolio.

Before I turn to our segment results, I want to remind you of a couple of factors that will be affecting our financial reporting this year. First, with the sale of our receivables, beginning with the first quarter we are no longer reporting a Credit Card segment and we now have two reportable segments, a new US segment and a Canadian segment. In the first quarter we began recognizing profit sharing payments from TD, net of operating



expenses within SG&A expense in the US segment. To provide context, in an April 16 8-K, we provided revised quarterly segment reporting for fiscal years 2010 through 2012, in which Credit Card revenues net of expenses from our former US Credit Card segment, were recognized within SG&A expenses in the new US segment. In this year's financial reporting revised 2012 US segment results will be presented at prior-year results.

To provide additional context, this year's rate analysis includes a comparison to last year's performance in the historical US Retail segment. For simplicity, to the extent that's possible, in my discussion today I will focus only on this year's US segment results compared with last year's revised US segment results. Second, as I mentioned in our last conference call, we've made changes to our vendor agreements regarding payments received in support of our marketing programs. As a result, in fiscal 2013 these payments will be recognized as a reduction in our cost of sales rather than a reduction to SG&A expense. This change is expected to create equivalent year over year increases in our US segment gross margin and SG&A expense rates of 20 to 25 basis points, without affecting EBITDA and EBIT margin rates.

With that as context, I'll turn to the first quarter performance in our new US segment. Total sales increased 0.5% on a 0.6% decline in comparable store sales combined with the contribution from new stores. Among the drivers of comparable store sales, traffic was down 1.9% partially offset by a 1.3% increase in average ticket. Our first-quarter traffic decline essentially offset a 2% increase a year ago. As we told you at the time, we believed first-quarter 2012 traffic was unusually strong due to the warm weather, and that proved to be the case as full-year 2012 traffic was up 0.5%. While we expect traffic will continue to be challenging given our near term outlook for the economy and the consumer, we don't expect to continue to see traffic declines of the magnitude we saw in the first quarter.

With the added pressure on household budgets from the recent payroll tax increase, the simplicity and compelling nature of our 5% REDcard Rewards discount is clearly attracting an increasing number of guests. The penetration of sales on REDcards reached 17.1% in the first quarter, up from less than 12% a year ago. While discounts from this program continue to put pressure on our gross margin rate, this investment pays back through the benefit of increased loyalty and sales. We continue to see households increase their spending more than 50% on average when they begin using a REDcard. And in Kansas City, which is a year ahead of the rest of the country, penetration is above 20%. And the rate of increase has shown no sign of slowing down.

Our US segment gross margin rate was 30.7% in the first quarter, up about 50 basis points from a year ago. The change in recognition of vendor payments explains about 20 basis points of this increase. The remainder of the improvement was driven by rate increases within categories, which more than offset continuing gross margin rate pressure from our sales-driving REDcard Rewards and Remodel programs. Every year, Kathee's team works hard to incrementally improve gross margin rates within categories, and the year over year benefit from these efforts can vary meaningfully from quarter to quarter. In the first quarter, the magnitude of category rate improvement was stronger than normal and we're expecting to see a more modest benefit in upcoming quarters.

Our first quarter US segment SG&A rate of 20.3%, was about 130 basis points higher than last year's revised US segment rate. The primary drivers of this variance are about 50 basis points resulting from lower earnings on the Credit Card portfolio, and about 40 basis points related to technology, including our multi-channel efforts. In addition, the change in vendor payments drove the rate higher by about 20 basis points and of course, with lower than expected sales, we saw less overall expense leverage than we anticipated. On this last point, it's important to note that our first quarter results reflected meaningful store productivity improvements and the entire organization did a great job controlling expenses. As I mentioned in the last call, we're anticipating incremental expense pressure from technology investments throughout 2013 and we plan to offset that pressure through disciplined expense management across the enterprise as the year progresses.

Also, I think it's important to provide more context for the decline in our earnings from the Credit Card portfolio, because the portfolio continues to experience outstanding performance. However, there are three separate reasons which drove lower earnings from the Credit Card portfolio in the first quarter. First, the asset is smaller than a year ago. Second, we're annualizing a \$35 million reserve release in the first quarter of 2012. And finally, we began sharing portfolio profits with TD after the sale closed in March. Notably, among these three reasons, profit sharing drove less than 50% of the year over year reduction in Target's earnings from the Credit Card portfolio. And we expect all of these pressures will continue for the next several quarters.

Moving down the US segment P&L, we reported a first quarter EBITDA rate of 10.4%, about 80 basis points lower than last year's revised US segment rate. With about 50 basis points related to our Credit Card portfolio, that means our US Retail operations accounted for only a 30-basis-point decline



in EBITDA rate compared with last year, which is remarkably stable when one considers that sales were unexpectedly soft this year and we were annualizing a 5.3% comp last year. In our Canadian segment, we generated \$86 million in sales from 24 stores that were open on average a little more than half the quarter. Whenever we open a new store in the US, there is a rush of traffic and sales as curious guests shop it for the first time. But the rush in Canada exceeded our expectations.

The first quarter gross margin rate in Canada was more than 38%, which is much stronger than our long-term expectations for a couple of reasons. First, in new stores we experience a strong initial mix of Home and Apparel sales as guests tend to shop these categories on their first trip to these stores. In addition, given the short time these stores have been open, they have not yet experienced any meaningful transitions or clearance activity. So this quarter's Canadian gross margin rate didn't reflect the impact of mark-downs we'd expect to see over time. The first-quarter Canadian segment P&L was dominated by start-up expenses related to the 100 additional stores we're preparing to open later in the quarter. For the quarter, Canadian segment operations drove \$0.24 of dilution to our consolidated earnings per share.

With the sale of our Credit Card portfolio in March, we recognized a pretax accounting gain of \$391 million, of which \$166 million was cash received in excess of book value and \$225 million was related to a beneficial interest asset. This asset effectively represents a receivable for the present value of future profit sharing payments we expect to receive from TD on the credit card balances transferred at the time of the sale. Going forward, a portion of the profit sharing payments from TD will be applied to unwind the beneficial interest assets. We expect to fully unwind it in three to four years and expect to reduce its size by about 50% in the first 12 months following the sale. Also following the portfolio sale, we began deploying proceeds to retire debt and repurchase shares.

Concurrent with the sale, we repaid at par \$1.5 billion in funding that was previously backed by the receivables. We also launched debt tender offers to repurchase another \$1 billion in high-coupon debt, which led to losses recorded in interest expense of \$445 million in the quarter. Of course, these tender offers created a meaningful economic benefit not reflected in the accounting for these losses. During the quarter, we also paid off commercial paper that we had used to provide short-term funding following the \$2 billion in debt maturities last January.

Finally, there is another \$500 million maturity in June which we expect to fund with proceeds from the sale. We're pleased that with the completion of the sale, we were able to remove these more volatile assets from our balance sheet and quickly reduce a meaningful amount of debt that was funding them. Over time, we expect to apply the remainder of the proceeds from the portfolio sale to repurchase shares. In the first quarter, we invested \$547 million to repurchase 8.5 million Target shares at an average price of just over \$64.

For the full year, we continue to expect to invest in more than \$2 billion to retire shares. And we'll continue to govern the pace of execution in support of our goal to maintain our strong investment-grade credit ratings. We paid first quarter dividends of \$232 million, marking the 182nd consecutive quarterly dividend we've paid since becoming a public Company. We will recommend that the Board approve an increase in the dividend later this year, which would make 2013 our forty-second straight year in which we increased the annual dividend.

Now let's turn to our expectations for the second quarter and the year. In the US we remain cautious about the near-term sales environment given the economic and consumer challenges Kathie and Gregg mentioned earlier. Yet with the recent weather challenge behind us and an easier comparison from last year we expect second-quarter comparable store sales will recover into the 2% to 3% range. So far in May, we've continued to see cautious buying behavior from our guests but the pace of sale has supported our view of the quarter. In the US segment, we expect the second quarter gross margin rate will be up slightly from last year, driven entirely by the change in recognition of vendor payments. We expect our second quarter SG&A expense rate will be just over 21%, nearly a full percentage point higher than last year's revised US segment rate, driven primarily by a smaller benefit from credit card income and the change in recognition of vendor payments. This would put our second quarter EBITDA margin rate at about 10.5%, and with expected leverage on D&A an EBIT margin rate of 7.5%.

In Canada, second-quarter sales will ramp up meaningfully from the first-quarter pace, yet startup expenses will continue to dominate the P&L. As a result, for the quarter we anticipate expenses from our Canadian operations, including interest expense measured outside the segment, will create \$0.16 of dilution to our earnings per share. We continue to expect Canadian dilution will come down further in the third quarter and by the fourth quarter we expect our Canadian operations will be slightly accretive to our consolidated earnings. All together, we expect second quarter adjusted EPS of \$1.09 to \$1.19. We expect our GAAP EPS will be \$0.19 lower than adjusted EPS, in the range of \$0.90 to \$1, reflecting \$0.16 of dilution due to Canada and \$0.03 of dilution related to the unwind of the beneficial interest asset related to the receivable sale.

For the year, we have an even more tempered view of sales than we did three months ago. Without some unexpected improvement in the economy and the consumer, our full year comparable store sales will likely grow in the 2% to 2.5% range, somewhat below the 2.7% we outlined at the beginning of the year. This updated view of sales has also tempered our view of full-year earnings per share, costing us to take our expected range for adjusted EPS down \$0.15 to the \$4.70 to \$4.90 range. We expect full year GAAP EPS to be \$0.58 lower than adjusted EPS, in the \$4.12 to \$4.32 range, reflecting Canadian segment dilution, losses on early debt retirement and net gains from the Credit Card portfolio sale.

Longer term, we continue to feel very good about the health of our business and the steps we are taking to keep our business relevant over time. We continue to invest in our remodel program, loyalty initiatives, technology, the integration of our store and digital experience, the new City Target format and our Canadian segment. Yet even with those initiatives, we continue to expect to generate far more cash than we need to invest in our business, giving us the opportunity to return billions of dollars to our shareholders through dividends and share repurchase. As a result, we continue to expect Target will deliver earnings per share of \$8 or more by 2017, combined with a dividend of \$3 or more that same year. That concludes today's prepared remarks. Now Gregg, Kathee and I will be happy to respond to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Peter Benedict, Robert Baird.

Peter Benedict - *Robert W. Baird & Company, Inc. - Analyst*

Great. Thanks, guys. Just a couple questions. On the US gross margin performance, can you give us a sense of maybe what that REDcard impact was in the quarter?

John Mulligan - *Target Corp - EVP and CFO*

The rate impact of the REDcard, Peter?

Peter Benedict - *Robert W. Baird & Company, Inc. - Analyst*

Yes, John.

John Mulligan - *Target Corp - EVP and CFO*

Yes, the combination of that with the store Remodel program, very consistent with what we've seen over the past several quarters, somewhere between 25 to 30 basis points of impact.

Peter Benedict - *Robert W. Baird & Company, Inc. - Analyst*

Okay. That's helpful. And then a longer-term question. You said for the year you're now thinking 2% to 2.5%. I assume that's still has a pretty modest view for comping in the fourth quarter. A, is that correct? And then secondly, when you think out beyond, do you guys think that maybe 2% to 3% is the longer-term comp profile for the business? Or do you think it could still be north of 3%, when you think of a more normalized environment, on an annual basis? Thanks.



John Mulligan - Target Corp - EVP and CFO

Yes, I think your view of Q4 is right. I think in particular, this Q4 will be particularly difficult, given the fifty-third week and the way the calendar shifts this year, you'll recall we're going to lose six business days between Thanksgiving and Christmas this year, which will make the comp feel much more difficult than it otherwise might. I think over the longer term, we continue to think a 3% comp is about the right place to be. If you look, again, at our Company over 15 years or 20 years, if you net out the contribution of new-store annualization, we essentially ran a pretty consistently a 3% comp over time through good times and tougher times. So we think in an economic environment that might just be a little bit better than today, doesn't have to improve drastically but a little better than today, we think a 3% comp makes sense.

Peter Benedict - Robert W. Baird & Company, Inc. - Analyst

Okay, that's helpful. One last housekeeping. On the Canadian D&A, what do you think the run rate is for that, once you get out -- you've opened a bunch of the stores, once you get towards the end of the year, what kind of run rates were you thinking about for Canadian D&A? Thank you.

John Mulligan - Target Corp - EVP and CFO

I think you'll continue to see D&A grow throughout this year as we continue to put significant assets into service. And we'll provide a little bit more color, I think, as we get later into the year and have a little bit more clarity about sales margin and the entire P&L, we'll provide a little more clarity about the entire P&L for Canada.

Peter Benedict - Robert W. Baird & Company, Inc. - Analyst

Okay. Fair enough. Thank you.

Operator

Sean Naughton, Piper Jaffray.

Sean Naughton - Piper Jaffray - Analyst

Thanks for taking the questions. In terms of dissecting the comp in Q1, transaction trends as you mentioned were relatively stable on a two-year basis and did improve from Q4. But the units per transaction were down 50 basis points, and I think that's the first time since '09. Just wondering what would explain that decline, given the increase in the Remodel program from Q1 last year.

John Mulligan - Target Corp - EVP and CFO

Actually, Sean, I'm not quite clear on your question. Units per transaction in the first quarter were up year over year. Help me with that again.

Sean Naughton - Piper Jaffray - Analyst

Oh, I thought they were down 60 basis points. Maybe I'm missing something here.

John Mulligan - Target Corp - EVP and CFO

No, selling price per unit was down 60 basis points.

Gregg Steinhafel - Target Corp - Chairman, President, CEO

That was mix related.

John Mulligan - Target Corp - EVP and CFO

Right. Entirely mix. But units were up consistently for some of the reasons you described.

Sean Naughton - Piper Jaffray - Analyst

Okay. Got it. And then, Gregg, you'd touched briefly on the price matching, curious if you are seeing the number of requests for the price match change at all. And has there been any competitive response to that in the marketplace?

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Both the stores with the matching of competitors' physical ads and the online match has been fairly stable and has not grown materially over the last quarter. So it still represents a very small portion of our transaction. That's because our everyday price and our promotional prices are so strong, there is generally not much of a gap, if any. So we continue to watch our competitive prices on a day-in and day-out basis and move where we have to be competitive in the marketplace. And so we expect over time this not to change all that much.

Sean Naughton - Piper Jaffray - Analyst

Okay. Great. And then lastly on Digital, you're obviously seeing some nice traction, nice growth outside of the seasonal categories. Can you talk about the impact on margin for that sale today? Is it dilutive or is it accretive to the margin? What do you think that can -- how are you planning that over time?

John Mulligan - Target Corp - EVP and CFO

Yes, I think first I'd start with how we think about this longer term. And we think about, from a longer term perspective, sales through all of our channels, regardless of the channel, need to generate a return, and a return on investment that's similar to what we see in our current US store base. What we see today is, honestly, we're learning a lot about that channel and a lot of this depends on how we're going to ultimately settle on the supply chain that our guest wants to interact with us. How much is ship from store, how much is ship to store. That will have a significant impact ultimately on the EBITDA margin rates of that particular channel. But I think once again, depending on where those EBITDA margin rates land, sales or capital will move around and we feel very confident that we'll get back to a return that makes sense. Having said all that, I think as it relates to the rates embedded within that channel, we feel very comfortable that ultimately we'll get back and operate at that 10% EBITDA rate that we've set as part of our long-range plan.

Sean Naughton - Piper Jaffray - Analyst

Got it. That's helpful. Best of luck in Q2.

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Thank you.



Operator

Matt Nemer, Wells Fargo Securities.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Thanks for taking my questions. First, I'm wondering if you can comment on sales in geographic areas that have more neutral weather like Florida. Were the transactions and the comps positive in those markets?

Kathee Tesija - Target Corp - EVP of Merchandising

You know, we did see better results in areas that had more normal weather, so that would primarily be the West Coast and they were toughest in those seasonal categories where we saw weather off the most, and that would be primarily in the Midwest. So we did see quite a swing between the different geographies.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

In terms of the second-quarter guidance, do we assume that there's some incremental mark-down risk in seasonal categories? You did mention that within categories the rate improvement would be a little softer in the second quarter than the first quarter. So just wondering what the mark-down risk is in the seasonal categories.

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Yes, like we said, the teams did a very good job of responding to the sale shortfall, retiming receipts and making cancellations. We're going to know a heck of a lot more in the next 30 days as we see what happens and how the sales of these categories play out before we have to take mark-downs in the 4th of July. And if we get really good weather and we have good sell-throughs, then we're going to be right back on plan. If things stay damp and cool for an extended period of time there might be some risk. We don't expect to see a significant risk, whatsoever. We're talking about things on the edges right now.

John Mulligan - Target Corp - EVP and CFO

Matt, the other thing I'd add is it's a little bit hard to see with the inventory on the balance sheet. The inventory per store in the US is essentially flat to last year. All of the inventory build year over year is attributable to Canada. So we feel really good about where the inventory positions are in aggregate.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

That's very helpful. Lastly, if we look at your operating expenses in the US Retail segment, growth, dollar growth, accelerated a little bit versus last few quarters. I'm assuming a lot of that is technology investments. But given the more moderated view of comps for the full year, could we see the dollar growth potentially come back down a little bit?

John Mulligan - Target Corp - EVP and CFO

Yes, you're right, first of all, that the vast majority of that is multi-channel technology and we've said a little bit of missed timing here. We expect to offset that on the year with expense savings and improvements we're making in our business, but the investment coming a little bit ahead of



that. To your second point, I think that's absolutely right. It's interesting. We said this last year, when our sales accelerate or decelerate rapidly from our expectations, we tend to see our SG&A lag both directions. It doesn't climb as fast when sales go up like last year, and doesn't come down quite as quickly when we see sales decelerate. As we adapt to wherever sales are going to be, you'll see our SG&A settle in at a more appropriate level.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Great. That's helpful. Good luck this quarter.

Operator

Colin McGranahan, Bernstein.

Colin McGranahan - Sanford C. Bernstein & Company, Inc. - Analyst

Good morning, thank you. First question on Canada, understand that the gross margin rate of 38% is not the long run rate. But where do you think that settles out? And was the 38% above where you expected even adjusting for the mix that you saw?

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Yes, I would say out of the blocks, 38% was a little higher than we expected because the mix was a little bit better than we expected out of the blocks. Whether it's in Canada or the US, clearly when we open a new store we get a higher gross margin rate, but the mix was even higher than the higher that we expected. So we do expect that to settle down and be slightly higher than what it is in the US, because we expect the mix to be a little bit better than it is here in the US.

Colin McGranahan - Sanford C. Bernstein & Company, Inc. - Analyst

Of course. As the consumables business ramps up it mixes down. From a productivity perspective, can you tell anything yet on these first stores that are open, in terms of opening expectations relative to what you had thought? Or was it just too much hoopla that you can't discern anything yet?

Gregg Steinhafel - Target Corp - Chairman, President, CEO

I wouldn't call it hoopla. I would just say that the guests were very, very excited and we experienced tremendous surges in sales. And it's just very, very early to draw any conclusions. And we really wanted to deliver a great experience and so to a certain extent we went in with staffing levels to make sure that we were taking care of the guest, both at the front end and we had the right team members there for the supply chain and we had the right teams on the sales floor. So we know that over time and in a run state in addition, we have to work hard at making sure that we get our productivity levels where the business models dictates them to be. And we know our gross margins will settle in and we've got to become more productive and run the business. Over time our consumables share will grow.

That's the hardest trip to change with the guest and so we're going to continue to focus on those frequency-oriented categories so that we can not only get the good mix that we're getting, but we want to now start driving more trip frequency into the store. We didn't want to come out of the blocks by hitting those categories too hard because we wanted to make sure that we led with our strength. And we wanted to make sure that all the supply chains and the operational disciplines were in place. We feel very confident now that they are. We're ready to start making those kinds of adjustments in merchandising and supply chain and in store operations to start refining the model.



Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay, that's helpful. By the way, hoopla's a technical term we use here on Wall Street. (laughter)

Gregg Steinhafel - *Target Corp - Chairman, President, CEO*

I use that sometimes here, too. (laughter)

Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

Secondly, on the credit, I actually thought the contribution, \$105 million, while you explained it was low, seemed to me it was higher than I would have expected, especially given the bad debt reserve release last year. Is there anything there that reflects the \$105 million profit share?

John Mulligan - *Target Corp - EVP and CFO*

I think the one thing I'd remind you is, we only had a half a quarter's worth of profit sharing with TD. Next quarter we'll have a full quarter's worth of profit sharing with TD.

Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

So the \$105 million was really a \$210 million quarterly run rate?

John Mulligan - *Target Corp - EVP and CFO*

No, no, no. That's net of our operating expenses as well.

Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

All right. I'll follow up offline with you on that, John.

John Mulligan - *Target Corp - EVP and CFO*

We can take it offline and walk through that in detail, Colin.

Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

Finally, coming back to SG&A, the dollars were up I think \$233 million. If I ex-out the credit difference of \$36 million, the vendor allowance of \$13 million, the technology spend, it still looks like the growth was pretty healthy. John, I know you mentioned that there's a lag in terms of how quickly you can get after that if sales are disappointing. Would you also expect some of the expense things you're doing on a longer term basis to impact that? I guess my question is, can we see better performance out of that line? Because sounds like 2Q guidance doesn't get us there.

John Mulligan - *Target Corp - EVP and CFO*

Yes, no question. What we're seeing, I think we talked about this a little bit three or four or five weeks ago when we were together. You'll see the ramp-up in our expense initiatives throughout the year and through next year, actually. Many of them are a little bit longer lead times to pull out



expense, all the easy stuff we've done long, long time ago. So we do expect through time, SG&A will come down and manage to a level that is more appropriate.

Colin McGranahan - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. Thank you.

Operator

Bob Drbul, Barclays.

Bob Drbul - *Barclays Capital - Analyst*

I guess the question that I have for you is a two-fold. It revolves around traffic. When you look at the initiatives that you have in place, REDcard and PFresh and you consider -- I understand the seasonal piece Q1 this year versus last year. But when you think conceptually traffic was down in the fourth quarter and that was down again in the first quarter, how do you get us comfortable with, essentially, the efficiency and the effectiveness of these initiatives over the longer-term period? The second question that I have is when you -- the lower comp assumption for this year, can you maybe just break down the traffic component in that new 2% to 2.5% expectation?

Gregg Steinhafel - *Target Corp - Chairman, President, CEO*

I'll take the first part. I think the traffic -- this was a disappointing quarter for us. We had very, very strong traffic last year. There was pluses and minuses throughout 2012 and we expect traffic trends to get stronger as the year goes on.

And we have all of our initiatives designed to, not only deepen the relationship, but build frequency. So we'll perhaps be a little bit more aggressive on price. You have to look at the competitive environment, it was a little bit more aggressive than it had been in the past where there was more emphasis on price, and that, I think, impacted it a little bit. Overall, we really expect to be able to generate traffic levels that are flattish, give or take, over normalized periods of time.

John Mulligan - *Target Corp - EVP and CFO*

Bob, the other thing I'd add, I don't think we need to run traffic numbers like we did last year in first quarter to generate that 3% comp. I think if you look over the past several years, about 0.5 points of traffic combined with ticket gets us to a 3% comp. That's about the formula that we feel really good about.

Kathee Tesija - *Target Corp - EVP of Merchandising*

The only other thing that I would add is, this time of year our seasonal categories can be a big traffic driver for Target, and clearly they weren't in the quarter and they were last year. So all of the things you mentioned, 5%, PFresh, help us all year long but during key seasonal categories, key seasonal time frames, we need those categories to drive traffic as well.

Bob Drbul - *Barclays Capital - Analyst*

Okay, thank you very much.



Operator

Deborah Weinswig, Citigroup.

Deborah Weinswig - Citigroup - Analyst

Thank you so much. Appreciate all the color. Lot of conversation regarding mobile and digital traffic. Can you also talk about what conversion was like during the quarter?

Kathee Tesija - Target Corp - EVP of Merchandising

Our conversion has been improving over the past year, Deb, and we were up slightly in this quarter as well. So we're really pleased with the improvements that we've made on this site but I'll tell you, we still feel we have a long way to go with conversion. And we are very committed to continuing to work on our navigation and our search function and the basic functionality of our site to continue to make big improvements there.

John Mulligan - Target Corp - EVP and CFO

I think the other thing I'd add, Deb, is we have a little bit of a mix headwind which is positive from our perspective. Mobile, in general has a much lower conversion rate than the site, and our mobile is growing much, much faster than the site. We think that's good because we think that's where things are going and it also shows that she is spending a lot of time with us on the mobile applications we have. But conversion's just naturally lower there, and so creates a little bit of a mix number as we look at the aggregate.

Kathee Tesija - Target Corp - EVP of Merchandising

If you look at conversion on our site, it's up to last year. If you look at conversion on mobile, it's up to last year. But because of the big growth in mobile, to John's point, conversion comes down slightly in aggregate.

Deborah Weinswig - Citigroup - Analyst

All right. Then a broader question. Can you talk about how you're positioning yourself in terms of taking advantage of the Affordable Care Act?

John Mulligan - Target Corp - EVP and CFO

I think we've said a couple times the Affordable Care Act, the changes for us will be relatively -- well, they won't be relatively -- they will not be material externally. We're still continuing to work through all the regulations and what we will exactly do, but it won't be material changes to what we're doing today, or financially from a financial perspective.

Deborah Weinswig - Citigroup - Analyst

Okay. And then I think Gregg touched on segmentation, how you're looking to match local taste and preferences. Where are you? I know there was a lot of work done in Canada, but where are you domestically in terms of that?

Gregg Steinhafel - Target Corp - Chairman, President, CEO

We feel good about where we are. We've been working on this for a long time and we continue to deploy resources to get better and better at that. So this is just a long-term initiative that we have to continue to focus on, whether it's in Food, whether it's demographics, whether it is ethnic



groups, we've just got to continue to get better at our localization efforts. We think we've made good progress there and we are going to continue to focus on it.

Deborah Weinswig - Citigroup - Analyst

Was there anything that you learned from Canada that you could go back and apply to the US? Or is it exactly what you expected and you're just continuing on the path?

Kathee Tesija - Target Corp - EVP of Merchandising

I would just say, Deb, I think it's a little early to learn from Canada and bring that back to the US. I will tell you, though, we learned a lot from the City Targets that we applied to Canada. As you know, those stores are in dense urban areas and so are our Canada stores. We took a lot of that learning and the testing that we did last year and applied that to what we're doing in Canada. Throughout this year of course, we'll be reading the Canada results and bringing that back to the US. But the same teams work on localization for both countries.

Deborah Weinswig - Citigroup - Analyst

Great. Thanks so much and best of luck.

Gregg Steinhafel - Target Corp - Chairman, President, CEO

Thank you. We have time for one more question.

Operator

Chris Horvers, JPMorgan.

Chris Horvers - JPMorgan Chase & Co. - Analyst

Good morning. Couple questions. First on the top line, in the Home and Apparel categories can you talk about the stacked comps that you had in the first quarter? And broadly how that has trended, those categories have trended over time, the past few quarters?

Kathee Tesija - Target Corp - EVP of Merchandising

When we look at the stack comps, we feel a lot better about it, since you're just looking at this quarter, both were positive if we look on a stacked basis. Going forward, our compare in second quarter is not nearly as difficult as our first quarter, so we would expect our comps to improve and over time we want that two-year stack to improve. We're not happy with flat or up slightly. We want to make sure that we're making progress there. It was, on a two-year basis, better.

John Mulligan - Target Corp - EVP and CFO

I think I'd just add a little color to that. Apparel, for instance, the two-year stack is around a 2%. Running that consistently through time, we'd feel really good about running 2% in Apparel. As Kathee said, Home is positive. That's a big improvement from where Home has been over the past several years. On a two-year basis we feel good about both those businesses.



Chris Horvers - *JPMorgan Chase & Co. - Analyst*

That's great. Also, thinking about the EPS pressure from Canada, can you talk about how much of the expenses in the first quarter are one-time in nature, pre-opens and so forth? And as you think about the guide for the second quarter, a similar question, how much of that expense pressure is actually something that goes away in future quarters?

John Mulligan - *Target Corp - EVP and CFO*

Yes, you know, that's difficult to parce out. The example I would give you is exactly what Gregg said, where we started with the stores staffed very heavily. We know through time we have to refine that model, is that one-time expense or operating expense. Certainly the expenses related to hiring team members early and training them at the next cycle of stores we'll open up, that is all one-time and will drift away. What I'd tell you is, through time we expect ultimately well down the road to get to SG&A rates that make sense and productivities that are very similar to the US. So as I said before, as we get a little bit more clarity, right now expense dominates the P&L in Canada. And as we get more clarity on sales, margin, operations later in the year, we'll provide a lot more color about how we expect those stores to operate.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

And then one final one. In terms of being in the stores, it seems like at times you're actually too thin on inventory in some of the discretionary categories, whether that's Home or Apparel. What's the internal discussion around balancing rate versus balancing sales? And do you think that you've leaned too far towards the rate side? Thanks.

Kathee Tesija - *Target Corp - EVP of Merchandising*

This is something that we are always looking at and adjusting. But, I guess I would tell you I don't feel like we've gone too far. Our inventory as John mentioned, our average inventory per store is flat to last year. It's actually up a bit in Apparel given the softer sales in the first quarter. So we're always looking at that. We look as much at out-of-stocks as we do in-stocks, in trying to improve those stores. It's a constant focus for us and we can always improve, but I feel pretty good about where we are right now in terms of in-stock.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

Thank you.

Gregg Steinhafel - *Target Corp - Chairman, President, CEO*

Okay. Thank you. That concludes Target's first quarter 2013 earnings conference call. Thank you all for your participation.

Operator

Thank you for participating in today's conference call. You may now disconnect.



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