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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation's second-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, August 21, 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 Corporation - Chairman, President and CEO*

Good morning and welcome to our 2013 second-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 second-quarter results and strategic priorities for the rest of the year, and 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 the third quarter and full year. Following John's remarks, we'll open up 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.

Target's second-quarter financial results reflect strong US profit performance in spite of soft traffic and sales. Our second-quarter comparable sales increased 1.2% below our expectations going into the quarter, but nearly 2 percentage points ahead of our first-quarter pace. As a result, we delivered second-quarter adjusted EPS of \$1.19, at the high end of our expectation going into the quarter. Our GAAP EPS of \$0.95 was in the middle of our expected range, reflecting higher than expected dilution of \$0.21 from our Canadian segment. As we monitor the economy and consumer sentiment, we continue to see a mix of signals in which emerging optimism is balanced with continuing challenges.

This year's payroll tax increase continues to affect spending, particularly among lower and moderate income households and household formation in the younger demographic groups remain stubbornly negative. Recent job growth numbers have been encouraging, but labor force participation and income growth remain weak. And while emerging strength in the housing and automotive sectors is a long-term positive, the near term spending on these big ticket items is crowding out other spending, particularly in today's environment in which access to consumer credit remains tight. As you've heard from all operators and other retailers, we continue to see the impact of trip consolidation in US households, as our second-quarter comp was entirely driven by an increase in basket size, partially offset by a small decline in traffic. Second-quarter sales in our digital channels grew in the teens overall with mobile traffic and sales continuing to grow at a triple-digit pace.

Second-quarter operating margins in the US were quite strong, especially in light of the pace of our sales. We delivered a healthy gross margin rate as we saw a relatively balanced mix of sales across categories. And our merchant teams did a great job managing inventory and price investments. In addition, we continue to benefit from very disciplined management of expenses, particularly in our stores. In fact, excluding the impact of the decline in the contribution from our credit card portfolio, US segment operating margins increased from last year's second quarter.

Altogether, we feel very good about our second-quarter US segment performance as we overcame softer than expected sales and the year-over-year impact of credit card profit sharing to deliver a 6.1% increase in adjusted earnings per share. These results demonstrate the resilience of our team and our operating model in the face of a challenging economic and consumer environment.

In our Canadian segment, we've reached the halfway point in our 2013 market launch. We opened another 44 Canadian Target stores in the second quarter, putting our total at 68 today, on the way to our goal of operating 124 Canadian stores by year end. Launching our Canadian segment has required a massive effort from teams throughout the Company, including building a completely new supply chain infrastructure and integrated technology solution, completely reconstructing former Zellers locations transforming them into brand new Target stores, hiring and training more than 15,000 Canadian team members, and creating unique merchandise strategies and assortments to fit the preferences of our Canadian guests, including a very strong presence in our home and apparel categories.

The teams execution on these efforts has been excellent. As a result, our Canadian stores have seen strong initial traffic and the mix of our sales in home and apparel has been even higher than expected. However, now that we've successfully opened 68 stores in Canada, we need to drive trips and conversion and frequency categories like healthcare, food and other basic commodities. Sales in these categories have grown much more slowly than we expected causing overall sales and profit momentum to build more slowly as well.

Multiple surveys indicate that our prices are very competitive and right where they need to be when compared to competition in local markets. Yet we know there is a gap in guest awareness of how low our prices really are. As a result, we are deploying multiple tactics to help our guests better understand the great value and convenience we provide in these categories. Over time we expect these efforts will drive greater awareness of the assortment and value we provide on these frequently purchased items, leading our Canadian guests to regularly shop Target for a balance of both wants and needs.

Our expectations are informed by our experience in launching the PFresh remodel program and City Target format, as well as our historical experience entering new markets in the US. In many of these markets we saw similar pattern in which sales momentum was slower than expected at the launch, but grew rapidly in the first several years after opening, resulting in achievement of our fifth year sales goals. For the stores we've opened, the team in Canada is working to adjust inventory and store staffing to match the pace of sales in each individual location. And for the segment in total, we have updated the expected timing of earnings accretion.

Having said that, we remain highly confident in our strategy. We are very pleased with the look and feel of these new stores and we have an outstanding Canadian team. We've invested in this segment to position it for long-term success and we continue to believe we'll achieve our longer term financial goals in Canada.

Across the Company, we are moving quickly to position our business to succeed in a rapidly changing retail environment. This requires our routine to stay laser focused on near-term execution while simultaneously allocating resources and effort to initiatives that will drive longer term sales growth and profitability. Recent examples of this include the beta launch of Cartwheel, our mobile coupon platform on Facebook that has experienced rapid growth since its launch in April. This platform which integrates our stores and mobile into guest social networks has seen very high levels of

guest engagement. In fact, our partners at Facebook have told us that engagement statistics for Cartwheel are among the best they have seen in the beta stage of any App, both within and outside the retail space.

We're also dividing meaningful resources to enhance the flexibility of our fulfillment network, which includes our stores, regional distribution centers, online fulfillment centers and import warehouses. In addition, we're investing in data systems that will provide a single holistic view across vendors, items, or distribution infrastructure and stores that will allow us to more efficiently and seamlessly fulfill guest demand in whatever channel they choose.

And we're pleased with our recent agreement to acquire the DermStore Beauty Group. This unique opportunity, which follows our acquisitions of chefs.com and cooking.com earlier in the year, provide us insight into the superior online experience DermStore provides along with access to brands, content and resources that are valuable to our guests.

As we look to the remainder of the year and beyond, we're taking steps to drive guest traffic both today and over time. We're steadfast in our commitment to provide value to guests who continue to shop cautiously, investing in every day low prices and even lower prices in our weekly circular and flier, combined with compelling discounts available on Cartwheel. We reinforced this commitment to value with price matching policies for both online and local print ads from competitors, and 5% REDcard rewards and Pharmacy Rewards allows guests to save even more off our already great prices. The continued rapid adoption of both of these programs demonstrates the value they provide for our guests.

Beyond low prices, we work to differentiate our assortment and guest experience by partnering with designers and others to provide unique, unexpected, value-added products and services. For example, in our stores, we're adding service elements to categories including beauty and electronics. And outside our stores, we will continue to explore acquisition opportunities to augment our digital capabilities, content and brands.

Additionally, we're building the Digital Acumen of the organization through hiring and collaborations with leading technology partners. For example, our recently opened technology innovation center in San Francisco provides us the opportunity to benefit from technology talent in the area and rapidly explore opportunities that can be brought to Target, accelerating the pace of our innovation and adoption of emerging technologies and trends.

And we're building the capability to operate stores in smaller spaces, particularly in urban markets. We are analyzing results in our first seven City Target stores to understand where in the stores we have the ability to reduce space even more, allowing us to further shrink the size of this store format. Ultimately, we believe we will succeed over time by providing value to our guests in a world of and, where we provide the ability to conveniently shop in stores and digital channels, enjoyable shopping for both wants and needs, access to great design and low prices, and the ability to save money with an ethical Company that supports the communities where we operate.

At Target we've long understood the power of and, which is summed up by our brand promise to Expect More and Pay Less. We believe this promise is more relevant than ever in today's environment and we are committed across the organization to delivering on it every day in every channel.

Before I turn the call over to Kathee, I want to take a moment to thank the Target team for their outstanding effort in this challenging environment. The team has already accomplished a lot this year, successfully launching a record number of stores outside the US for the first time, selling our credit card portfolio to an outstanding partner in TD Bank and preserving profitability in a softer than expected sales environment in the US. Throughout the organization, we are focused on becoming more nimble, moving quickly to test and learn from new initiatives. I'm proud of this team and confident that our efforts will position Target for long-term success.

Now, Kathee will provide more detail on second-quarter results, outline initiatives for the third quarter and beyond. Kathee?

Kathee Tesija - Target Corporation - EVP Merchandising

Thanks, Gregg.



We're very pleased with the ability of our team to manage inventory and profitability in our US business during a quarter in which consumers shop cautiously and competitors promoted heavily to clear excess inventory. In our second-quarter US results, we saw a relatively narrow spread in comparable sales between the strongest and softest performing categories. Not surprisingly, sales in less discretionary areas like food, healthcare and household essentials grew somewhat faster than the Company average. However, sales in our home category also grew faster than the Company average, driven by particular strength in our domestics and stationary categories.

Among the other more discretionary categories, second-quarter comparable sales in both apparel and hard lines declined slightly. Within apparel, our children's categories had the strongest results, while the more discretionary women's assortments experienced softer results in the face of a very promotional environment.

We continue to deliver excitement through limited time partnerships with influential designers who help us differentiate Target in support of our Expect More, Pay Less brand promise. In the second quarter, we were very pleased with the results of our collaboration with Lauren Bush Lauren and FEED USA, featuring products in home, sporting goods, stationary, apparel and accessories. Beyond the merchandise, this unique program reinforced our commitment to communities as Target provided more than 10 million meals for US families through this collaboration.

We're also very pleased with the initial results for the beta launch of Cartwheel, a differentiated mobile experience that delivers value for our guests. We launched the Cartwheel App on the IOS and Android platforms in June and it's already a Top 20 Lifestyle App in the Apple Store. Cartwheel is growing rapidly. It currently has more than 1 million users who have saved more than \$2 million so far.

Among active users, more than 50% have completed multiple Cartwheel transactions demonstrating the power of the program to drive sustained guest engagement. As expected, guests are searching for deals while they're shopping in stores and we've seen redemption rates in excess of 50% for offers downloaded by guests while they're shopping. We're pleased with these initial results and will apply what we've learned to improve both the Cartwheel experience, as well as the development of our multi-channel experiences in the future.

Beyond new mobile experiences like Cartwheel, our mobile sales and traffic continued to grow at a rapid pace. To build on this momentum, we're investing to enhance speed, search, product information and check out on our mobile site. And this Fall we'll begin testing other innovations to enhance the in-store mobile experience including wayfind -- wayfinding and improved search. And we continue to invest to further integrate the shopping experience across channels. Based on successful results from our team member test of buy online and pick up in store, we are moving quickly to begin offering this option for guests in the third quarter. We'll begin in the Minneapolis market before expanding the rollout to other markets. We expect to complete the rollout to all stores by the holiday season.

Simultaneously, we are planning team member tests of other flexible fulfillment capabilities which will begin later this year, including the ability to deliver online orders from stores as early as the same day, and the ability to pay in one store and pick up in another. Based on the results of the team member tests, we will look to move to guest facing tests next year.

And beyond investments to build on our own digital offering, we continue to monitor the landscape to identify opportunities to augment our capabilities through acquisitions. The recent decision to acquire DermStore reflects a strategic opportunity for Target to learn from their online expertise, customer service, content development and product curation which combine to create an exceptional online beauty experience. In addition, DermStore's broad assortment of prestige and dermatology brands will complement Target's product offerings.

We continue to approach the economic and competitive environment with longer term optimism but near-term caution. While overall consumer confidence statistics have improved this year, it's notable that optimism among lower income households is lagging behind. And as Gregg mentioned, this year's payroll tax increase and consumer spending on autos and housing are crowding out spending on other goods and services. For example, in surveys regarding expected spending on back-to-school and back-to-college items, consumers indicate they intend to spend less than a year ago by focusing on sales, discounts and reusing items they already own.

As a result, in preparing for the third quarter and beyond, we're building flexibility into our inventory plans and creating merchandise and marketing programs focused on driving traffic and sales with compelling offers, innovative partnerships, and key seasonal programs. Target is known for delivering key seasons for our guests and only the fourth-quarter holiday season is bigger than back-to-school and back-to-college.



This year we've created a multi-layer strategy to deliver a great guest experience and outstanding value. For back-to-school, we are offering parents a convenient one stop shop for all the must have items on their shopping list at a price -- at a range of price points to accommodate a variety of household budgets, including hundreds of unique items in fashion, school supplies and accessories for less than \$20. In fact, we have nearly 400 items for \$1 or less, clearly demonstrating our commitment to deliver value. Our back-to-school direct mail catalog includes more than \$25 worth of coupons and we've increased the number of online coupons this year as well. And of course parents who use their Target REDcard will receive 5% off their entire purchase and free shipping on every order from target.com.

To support our back-to-school merchandising, we have a set of new broadcast themes in various lengths and languages which focus on telling stories around iconic school moments that make kids feel like real life heros. In addition to the unique Kids Got Style Instagram program, Target celebrated kids as the most original style leaders. Earlier this month, parents could Instagram a picture of their children showing off their individual style. Target's stylists use select photos as inspiration to create Kids Got Style mood boards of colors, fashion items and supplies inspired by each child's unique style which were posted to Instagram, Facebook and Twitter. Parents were tagged so they could view and share their photos to their social networks as inspiration for the new school year.

Because we know that quality education is the number one social priority for our guests, it's also the number one focus of our giving programs. So following last years' success, we're excited about the return of our Give with Target program, through which Target will donate \$5 million to schools across the country. Last year, our guests impacted more than 30,000 schools through donations from this program which were used to purchase classroom resources like electronics, office supplies and storage and organization products. New this year, Target is inviting guests to allocate the full donation, double the amount designated by guests last year to schools of their choice.

For back-to-college, we've created innovative resources and new live experiences both online and in person to provide the inspiration and tools to make shopping fun and easy. Last month, Target introduced a first of its kind online live experience featuring popular YouTube personalities in life sized virtual dorms. From July 15 through the 18, visitors were invited to shop Target products from the dorm rooms, enter to win college gear and interact with the roommates.

Also online, we've created youth stlyer, a style focused design resource that puts students in the drivers seat as they put together their unique dorm room look. Looks can be named, saved and shared on their favorite social media sites where their friends are able to shop them. And we've created the checklist, a customizable list of key products available in store and at target.com to help students shop for small space living.

On campus, Target is hosting 95 shopping events for incoming freshmen around the country as part of welcome week festivities. These events include after-hours shopping events which provide free bus transportation to and from our store where students will be able to shop for everything they need and want.

Halloween is also a key season for Target and the holiday falls in our third quarter this year. We plan to deliver this season with a multi-channel approach focused on driving traffic and growing our market share. We'll offer a comprehensive assortment of costumes and accessories for the whole family including parents, kids and pets. We'll offer a dominant presentation in our stores and extend the assortment on target.com. In home, Target's product design and development team has created an innovative collection of halloween decor ranging from classic to scary to help mom decorate her home inside and out for the big night.

As Gregg mentioned, we're increasingly focused on differentiating our store experience through enhanced service. The baby category is already one of our signature strengths, but we believe we have an opportunity to further deepen relationships with guests who are entering this life stage. Expectant parents establish new shopping habits, and it's a time when they're looking for easy shopping solutions to save time.

As a result, we're continually exploring new ways to elevate the shopping experience for expectant parents. For example, in 10 Chicago stores we are testing an interactive shopping experience which features accessible product displays including feature fixtures with mannequins to showcase outfits and allow guests to touch and try out products. There's also a collaboration center in the area where guests can sit comfortably, access a registry or get personalized assistance from a team member. Digital tools on hand such as iPads also provide guests easy online access to product information.



Another part of the store where we see an opportunity for enhanced service is our beauty area. Based on results from our Chicago market test of the Beauty Concierge program, we've rolled out the concept to an additional 200 stores in the second quarter including stores in LA, Washington D.C., Baltimore and Minneapolis markets. These beauty consultants are brand agnostic and provide guests with detailed unbiased information on all beauty and personal care categories in the store, including product attributes and ingredient benefits serving as a knowledgeable source and a friendly face in what can often be an intimidating category. We believe this program serves to differentiate Target and the beauty space while still meeting guest needs for value and convenience.

And of course, in the third quarter we will continue to introduce unique merchandise throughout our assortments to deliver newness and excitement for our guests. For example, this Fall we're excited to be partnering with Phillip Lim. Phillip is a designer we've been watching for years. His aesthetic is chic, yet understated, and is focused on democratizing beautiful fashion, makes him a perfect fit for our brand.

Beginning September 15, Target will offer a limited edition collection of apparel and accessories including an assortment of bags, shoes and scarves for men and women at most Target stores and target.com. Prices will range from \$20 to \$300 with most items under \$50. The entire Phillip Lim for Target collection will be presented in the women's apparel department when it debuts in our stores, allowing guests to find the entire collection in one easy to shop area of the store. After the first week, we plan to move items to their respective departments within the store.

In late September we'll launch a new line of mens pants from Hagggar called Hagggar H26. Hagggar is a premium brand in men's pants, and we're excited to offer a no iron premium khaki in a classic fit, performance slack in a classic fit and original chino in a straight fit. And in beauty earlier this month, we expanded our hair care assortment with the exclusive launch of Toni & Guy, Hair Meet Wardrobe, a premium hair care line introduced in the UK in 2011. Available for the first time in the US at Target stores and on target.com, Hair Meet Wardrobe includes a full range of shampoos, conditioners, hair accessories and styling tools, and range in price from \$5 to \$40.

And finally, we continue to feature exclusive partnerships with influential artists, reigning Academy of Country Music Entertainer of the Year, Luke Bryan teamed up with Target for his latest release, *Crash My Party*, which set last week. The Target exclusive deluxe addition of the album contains four bonus tracks. And following last Spring's success, we're thrilled that once again we're partnering with Justin Timberlake to release the special edition of the continuation of his third studio album, the *20/20 Experience, 2 of 2* featuring two exclusive bonus tracks. Guests can preorder the album now on target.com, or purchase online or in stores beginning September 30.

While we continue to experience the impact of cautious consumer spending and trip consolidation, we continue to innovate across all our channels to provide our guests unbeatable value and unique experiences. We are confident we have the right plans in place for the third quarter, and we're moving quickly to ensure we stay relevant in an increasingly digital marketplace.

Now, John will share his insights on our second-quarter financial performance and our outlook for the third quarter and the full year. John?

John Mulligan - Target Corporation - EVP and CFO

Thanks, Kathee.

I'm very pleased with our second-quarter US segment financial performance, as the team generated outstanding profitability despite softer than expected traffic and sales. Second-quarter US segment comparable sales increased 1.2%. Sales strengthened somewhat as the quarter progressed and were further aided by this year's calendar shift which move some early back-to-school sales into July. Like many other retailers, we continue to see the impact of trip consolidation among US consumers as average transaction size drove more than 100% of our comparable sales growth, reflecting increases in both item per basket and average retail per unit.

Year-over-year penetration of sales in our proprietary debit and credit cards were nearly 600 basis points in the second quarter, and for the first time in our history, debit penetration moved beyond credit. The debit card has proven to be the engine that has propelled REDcard rewards beyond our initial stretch goals. It is the right product for a large set of guests who simply don't want another credit card in their wallet. We continue to measure the change in household spending when guests begin using one of our debit or credit cards. And we continue to see on average a 50% increase in household spending when guests apply for and activate one of our cards.



Second-quarter gross margin rate in the US was 31.4%, up slightly from last year. As I outlined last quarter, this year we've made changes to our vendor agreements regarding payments received in support of our marketing programs, which create equivalent year-over-year increases in our US segment gross margin and SG&A expense rates. These changes raised our second-quarter gross margin rate by only 20 basis points -- by about 20 basis points. Excluding the benefit from vendor payments, gross margin would have declined slightly as our gross driving REDcard rewards and PFresh remodel programs created moderate pressure, which was partially offset by rate improvements within merchandise categories. The merchant teams also did a great job managing receipts in the face of softer than expected sales. At the end of the quarter, average inventory per store in the US was up only 1.8% from a year ago.

As expected, on the SG&A expense line, we continue to see the impact of a smaller contribution from the credit card portfolio, which we sold to TD Bank in March. And while we tried to do a thorough job last quarter explaining the impact of the sale and the associated change in our segment reporting, we've received feedback from some of you that we could have done a better job. You know who you are. So, to provide greater clarity this quarter, let's go back a year and revisit our second-quarter 2012 US Credit Card segment results, in which we earned EBIT of \$143 million.

This segment EBIT reflected the impact of \$74 million in profit sharing with the US retail segment, which was described as loyalty program charges in our financial statements. So in total, the Corporation earned EBIT from the credit card portfolio of \$217 million, \$143 million in the US Credit Card segment and \$74 million in the US Retail segment. Importantly, all of this \$217 million is reflected in the revised 2012 results for our new US segment.

Moving now to the second quarter 2013. We received profit sharing of \$183 million from TD, which was partially offset by approximately \$65 million of our expense to service accounts on their behalf, meaning second-quarter contribution from the credit card portfolio was about \$118 million, down about \$100 million from a year ago. Two other things are important to remember.

First, not all of the year-over-year decline in credit contribution was driven by the sale to TD, as the portfolio is smaller than a year ago and we're annualizing a \$30 million reserve release in second quarter 2012. Second, outside the US segment, we continue to offset some of the impact of profit sharing as we have deployed proceeds from the sale to reduce our net debt position and repurchase shares. With that as context, we can turn to our second-quarter US segment SG&A expense rate of 20.6%, which was up from 20.2% in last years' revised US segment. More than 100% of this increase, or about 0.6 of 1 percentage point was driven by the decline in the contribution from the credit card portfolio.

In addition, we continue to experience expense pressure from this years' incremental investments in technology and distribution in support of our multi-channel efforts. And finally, the change in vendor payments increased our SG&A expense rate by about 20 basis points. Offsetting these multiple pressures, we benefited from favorable leverage of compensation expenses, including incentive compensation and store payroll. And we continue to benefit from our Company wide expense optimization efforts which are identifying opportunities to increase productivity throughout the organization.

Altogether, our second-quarter US segment EBITDA and EBIT margin rates were down only slightly from last years' revised US results. However, without the headwind from the credit card portfolio, those rates would have increased slightly. These results are outstanding and notably better than we would have expected in a quarter in which sales fell well short of our expected range.

In our Canadian segment, sales accelerated from the first quarter as we continued to open stores at a robust pace. However, we've seen a slower than expected ramp up in sales following the grand opening rush, particularly in our frequency categories. Second-quarter REDcard penetration in Canada was 2.3%, and consistent with our US segment, debit penetration was slightly ahead of credit. As we've seen in US since the launch of the program, we expect REDcard penetration to continue to grow in Canada driving incremental sales across all categories.

The Canadian segment earned second-quarter gross margin of \$87 million, or 31.6%, reflecting a very favorable mix of sales in the home and apparel categories offset by the impact of some inventory clearance. Second-quarter SG&A expenses were \$207 million, reflecting both ongoing operating expenses combined with meaningful start up expenses as we prepare to open new stores. Altogether, second-quarter dilution attributable to the Canadian segment including depreciation, amortization and interest expense recorded outside this segment was \$0.21 compared with our estimate of \$0.16 going into the quarter.



Even in a year where we are making meaningful investments in distribution, technology and our Canadian market launch, we have been able to return a large amount of cash to our shareholders through dividends and share repurchase. In the second quarter, we paid dividends of \$231 million and repurchased more than \$900 million worth of our shares. Year to date, we've paid dividends of nearly \$0.5 billion and repurchased shares worth nearly \$1.5 billion. And we were pleased to announce in June that our Board of Directors had approved a 19% increase to our quarterly dividend from \$0.36 to \$0.43 per share. As a result, 2013 will mark the 42nd consecutive year in which this Company has increased its annual dividend.

Now let's turn to our expectations for the third quarter and full year. In the US segment, we're expecting third-quarter comparable sales in the range of 1% to 2%. While this outlook is somewhat ahead of our second-quarter pace, it is supported by our experience so far in August and it reflects the benefit of this years' calendar shift, which moves the Halloween holiday into October from last years' fiscal November.

We expect a small decline in a gross margin rate compared with last year reflecting the impact of our growth initiatives partially offset by the benefit of the vendor payment shift. We expect our third-quarter SG&A expense rate will be approximately 21.4%, reflecting about 60 basis points of pressure from a lower credit portfolio contribution and continued pressure from our multi-channel investments and the shift in vendor patient payments, partially offset by the ongoing benefit of our expense optimization efforts. Altogether, these expectations deliver a third-quarter EBITDA margin rate about 1 full percentage point below last years' third-quarter revised US segment EBITDA margin rate.

In Canada, the team continues to refine operations in the stores already opened, ensuring that inventory and expenses match the current pace of sales in each individual store. It's important to note that we're still very early into our market launch, and as Gregg mentioned, we're deploying multiple tactics to drive sales in our frequency categories over time. However, given that we had initially positioned our expense structure, fulfillment network and inventory to support potential upside to our initial sales forecasts, we are incurring markdowns and higher than normal operating expense rates as we adjust to the current pace of sales. This has raised our dilution expectations for this segment through the end of the year.

Specifically, for the third quarter, we expect the Canadian segment will drive \$0.22 of dilution to our consolidated earnings per share. In total, we expect third-quarter adjusted EPS of \$0.80 to \$0.90 and GAAP EPS of \$0.55 to \$0.65 reflecting Canada dilution along with \$0.03 of expense from the unwind of the beneficial interest asset resulting from our credit card portfolio.

For the full year, we've become incrementally more cautious in our US sales outlook, given our own recent results and those of our competitors. We now expect a full-year comparable sales increase of about 1%, down from our prior outlook from an increase -- for an increase of 2% to 2.5%. We believe planning for this pace is appropriate and will help to mitigate downside risk of taking a more aggressive inventory position. As always, Kathee's team remains prepared to chase business if the US environment strengthens unexpectedly.

Even with our more tempered sales expectation we believe full-year adjusted EPS will remain in the \$4.70 to \$4.90 range we provided previously, although our expectation has moved to the low end of that range. We expect full-year GAAP EPS will be approximately \$0.95 lower than adjusted EPS reflecting \$0.82 of dilution from the Canadian segment combined with a net \$0.13 of dilution from the credit card portfolio sale and associated debt repurchase.

Beyond this year, we expect year-over-year EPS performance in the Canadian segment to improve meaningfully in 2014. While Canadian segment sales are starting from a different base than we expected, we have ample experience with US market launches to give us confidence that we can drive stronger sales increases in the next several years and ultimately reach our longer term sales and profit goals. As we said many times, our experience in opening Target stores for more than 50 years has shown that we're much more accurate when estimating fifth-year sales than first-year sales. We're still very confident in our Canadian strategy, stores and team and continue to believe the segment will generate \$0.80 or more of EPS in 2017.

And finally, beginning next year, we expect to see a meaningful increase in cash available for dividends and share repurchase. Our US operations continue to generate very strong cash flow. In addition, we expect capital expenditures in Canada to fall more than \$1 billion in 2014 while US capital expenditures are expected to stay essentially flat -- flat. The resulting increase in free cash flow will allow us to continue growing the dividend at our current 20% annual rate and meaningfully grow share repurchase from the current pace while maintaining our goal to preserve our current strong investment grade credit ratings.



That concludes today's prepared remarks. Now Gregg, Kathee, and I would be happy to respond to your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Sean Naughton, Piper Jaffray.

Sean Naughton - Piper Jaffray - Analyst

First question on the comp, John, I think you mentioned that it did get steadily better throughout the quarter. Any additional color you could give us there? And then on -- were there any regional differences that you could potentially isolate in terms of where some of the transaction weakness was in the quarter?

John Mulligan - Target Corporation - EVP and CFO

I think on the sequentially, yes it improved month to month within the quarter. None of the quarters were negative, which compared to first quarter was significant progress. July was notably the strongest, but a portion of that certainly was attributable to that back-to-school week moving in from August last year. So we did see it strengthening, but I wouldn't want to overplay that, certainly a portion of it is attributable to the calendar. Geography wise, we have not seen anything meaningfully different in aggregate across the quarter. In any one week or day there's differences, depending on when back-to-school starts in various portions of the country, but nothing meaningful across the country.

Sean Naughton - Piper Jaffray - Analyst

Okay, got it. And then you talked about some lower advertised prices in the circular, is this really just in Canada or is it also in the US, and is that some of the gross margin pressure that you're thinking about in the second half as you've done a very nice job in terms of a rate improvement in between categories over the last four or five quarters here?

Gregg Steinhafel - Target Corporation - Chairman, President and CEO

Well I would say, this is Gregg, in the US, we continue to offer hot pricing. There isn't going to be a meaningful change in our strategy, because day in and day out we have unbeatable prices when you take a look at our -- the fact that our prices are competitive, the price match policy both online and in store, and our REDcards performance day in and day out. We have a very strong value proposition. And then our circular pricing is even more aggressive than that, and we take market leading positions.

In Canada, we know that we have an opportunity to break those shopping habits and we've got to focus on driving need-based trips. So, there in particular we will sharpen up our pricing, and make sure that we are taking a more of a market leader position. Our REDcard penetration is still very, very small there, and we expect that to grow over time. But it's more in Canada that we're going to make sure that our prices get more noticed than they have been up to this point.

Part of that was a conscience plan on our part to make sure that we really won in Home and Apparel, and we feel real good about where we are in those two businesses today, so we're proud of that fact. Now we have to just turn on the gas a little bit on the other side of the equation to make



sure that we're getting the Canadian guests to understand what great values we offer on frequency categories and break some of those well-established habits.

Sean Naughton - *Piper Jaffray - Analyst*

Okay and then real quick, on the dilution in Canada, obviously up quite a bit here in 2013 from the initial expectation. Any way or ability to paint us a picture, I know you still remain confident in that five-year outlook on the progression towards that \$0.80 in 2017? Thank you.

John Mulligan - *Target Corporation - EVP and CFO*

So, I'm not entirely clear where you're going. Is it that why are we confident about the \$0.80, or what will we see happen here as we go forward, Sean?

Sean Naughton - *Piper Jaffray - Analyst*

Yes, so the question is is there an ability to say that the Canadian business will be -- you believe the Canadian business may be accretive in 2014.

John Mulligan - *Target Corporation - EVP and CFO*

So on 2014, I think it's very early here, and we've given you our best view. I think when you step back we've been operating 60 some stores for on average about 2.5 months, and so we're giving you our best information here for 2013. And clearly sales are a little bit short of where we need to work through some of the inventory and optimizing the business and optimizing our expense structure.

I think as we look forward getting another 56 stores open, getting through a holiday will certainly provide a lot more information about where we expect to be. But in 2014, I think we expect to see meaningful improvement in the profitability of Canada. We'll cycle past all of the start up expenses, we'll have our inventories more in line with sales patterns that we now have some information on. Our expense structure will be optimized to the sales level and we'll start to grow sales. So I think we'll see meaningful improvement in 2014, but I would say probably from this perspective today, unlikely that we'll see profitability on the full year. And we'll be back to provide a little bit more information on what that looks like, and the cadence throughout the quarters, again, as we get a little bit more information this year, get the stores open, get new markets and get through a holiday season most importantly.

Sean Naughton - *Piper Jaffray - Analyst*

Okay, that's really helpful. Best of luck in the back half, thank you.

Operator

Greg Melich, ISI Group.

Greg Melich - *ISI Group - Analyst*

I wanted to follow up on Canada and then touch on the US. Just to make sure I've got that right, or maybe ask it a different way, John, if you look at the incremental Canadian dilution this year, how much of it is related to those items of clearance? How much of it would be related to, if you will, start up costs or advertising? How much of it do you think is just a different margin structure in the business to drive that frequency in trips?



John Mulligan - Target Corporation - EVP and CFO

Yes, I think parsing that all out is difficult. I would say that the second one, incremental marketing and advertising is not material to the total move from where we were to where we are today. I think the biggest driver of the change in profitability or dilution this year comes from, we had a set of sales expectations as we entered in the market, and we also, given all of the excitement that we saw building over two years, we protected on the upside from an expense standpoint and from an inventory standpoint, and the sales have been somewhat disappointing. And so we need to work through those inventories. There's some clearance activity, there was some excess inventory this quarter, as well, that we work through. And we need to right size the entire expense structure for what -- for the sales numbers that are currently -- that we're operating at. So, I think that's the vast majority of it.

I don't think we see, I know we don't see going forward a change in the overall our view of what the margin rates were going to be, EBITDA or EBIT rates were going to be in Canada over the long term. We feel very good about gross margin, and frankly, we expect gross margin will deteriorate a little bit as we begin to drive these frequency categories. You don't see that in this quarters' results, because there was a fair bit of clearance and excess inventory that we moved through, but we expect margin rates will come down as we grow sales in those frequency categories. But net, net that'll be good for the business and start to apply leverage against the fixed expenses that we've built for the Business.

Greg Melich - ISI Group - Analyst

Okay, great. And then second, turning to the US, Kathee it was helpful to go through all the initiatives you have, and it seems like the issue that is bigger than anything is traffic staying negative versus what you guys would have probably hoped or expected a year or two ago. If we think about the traffic side of it more specifically, what in the back half do you think is going to help stabilize and improve that traffic trend, or is it just the way it is now, that this trip consolidation and that's the way the consumer is, and if we're getting comp it needs to be with more items and top line?

Kathee Tesija - Target Corporation - EVP Merchandising

You're right, Greg. Traffic was our issue, and I do think that somewhat that is the way it is right now. We're seeing a lot of trip consolidation across all guests. I think the part that I'm pleased about is that when you look at our basket, we are seeing that they're buying more units from Target, as well as increased selling price, and they are trading up into higher price point product, so that's great. I think as we move forward the thing that we're focused on and driving traffic is really making sure that as they're consolidating and they're doing more in one store, that we're offering that compelling value. And Gregg talked a lot about all of those components, but that we make sure that that continues to be rock solid. As well as the innovative product, and I mentioned a lot of those that we have coming like Phillip and Haggard and in our seasonal categories we've got a lot of new stuff coming, so that's key.

And then, I guess, the third thing that I would add is just making sure that our in-store experience remains outstanding. Because we want them to be pleased when they come, and continue to consolidate their trip and to do more at Target. So we have great service every day, but in addition to that, some of the new things that we're doing with flexible fulfillment, like buy online, pick up in store, I think will be fantastic in the back half. And then we're also looking at really upping the in-store experience in key categories like Beauty and the test that I described in Baby. So it's a combination of those three things.

Greg Melich - ISI Group - Analyst

Thanks.

Operator

Matt Nemer, Wells Fargo Securities.



Matt Nemer - Wells Fargo Securities, LLC - Analyst

A quick follow up on Canada and then a couple on the US business, as well. Could you talk to the inventory overhang in Canada, the clearance that you spoke to, is that primarily also on frequency items, or is that more a discretionary product?

Gregg Steinhafel - Target Corporation - Chairman, President and CEO

The inventory overhang is a function of the shortfall primarily in some of the seasonal categories. So, think of -- even though Apparel and Home was strong, the variability by store, and the fact that some of our seasonal categories, like Lawn and Patio didn't perform at the level that we were expecting. So, it was not in the basic categories or the non-discretionaries, primarily in a subset of the discretionary categories. But it's one of those things where it's more obvious, because it's such a large number of stores.

But it's the same kind of fine tuning that we go through every time we open a new store here in the United States, and they have experienced for years and years. There is always a tremendous amount of fine tuning and getting the right match of sales volatility, variability, assortment, and aligning that with inventory. What we're seeing in Canada is there's such a big critical mass that it stands out, and it's far more obvious. But it's no different than what we've experienced here.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay, great. And then in terms of the average transaction size, could you elaborate on which categories are benefiting from the larger basket and the trade up that you alluded to?

Kathee Tesija - Target Corporation - EVP Merchandising

Yes, I think that we're seeing larger basket in many different areas they're shopping, as I said doing more in one store so shopping around the store. In terms of the selling price, we're seeing strength in trading up to higher price points in back-to-school. We're seeing strength, for example, in home with threshold, where they're buying that better product versus opening price point product. And then we're also seeing some softer sales in our one spot at the front of the store, which is very seasonal and impulsive product, so that combination I think is driving that selling price.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay, great. And then lastly, if we look at some of the omni channel and multi-channel initiatives that are launching in the back half, is there any way to quantify the potential impact or potentially in your survey work you could talk to how much demand there is for these products, specifically on Click and Collect or Buy Online, Pick Up in Store? I know that's half of the volume in some cases for some of your competitors' Online businesses. Could you talk to how big you think that could be for you in the back half? Thank you.

Kathee Tesija - Target Corporation - EVP Merchandising

Well we don't have a number that we can share on that. We have, as you know, been testing it with team members, and I think the key for us is just the convenience for guests to be able to buy it online. But then they want to pick it up in store. Sometimes they don't want it delivered and sitting on their doorstep, but oftentimes they want to be able to get other things in the store either that go along with that core item or just the rest of their list. So, we think it will be very interesting to our guests. It certainly has been with our team members, but we haven't quantified the sales number yet.

Gregg Steinhafel - *Target Corporation - Chairman, President and CEO*

Yes, I would just say this is -- we're in a learning environment right now. We'll be able to give you a lot more specifics after we get through the holiday season. And for us to try and quantify at this stage would be, it would be a shot in the dark. So we really don't want to speculate how our guests are going to use that and -- but we'll be back to you at the end of the holiday and we'll give you a lot more color around the adoption, the acceptance rates by our guest.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Great, thanks so much.

Operator

Deborah Weinswig, Citi.

Deborah Weinswig - *Citigroup - Analyst*

If you think about the spending in the first half of the year versus the back half of the year on marketing, and why the competitive environment, can you help us think about how that spending might take place in the back half versus the first half of the year?

Gregg Steinhafel - *Target Corporation - Chairman, President and CEO*

There is not really a meaningful difference in terms of the rate of spend first half, second half. We didn't overspend or under spend in the first half to shift dollars to the second half. We've always felt that the allocation of resources by quarter, by half has been pretty appropriate, and our spend is going to be similar in those kinds of percentages. What we have seen is, we've ramped up our spend in the digital channel. It's a less expensive channel that gives us different guests and broader reach, and we become far more efficient in the use of our marketing dollars. So, I think we're getting the same or more bang for our buck for essentially the same investments that we've made in the past.

Deborah Weinswig - *Citigroup - Analyst*

Okay and with regards to Canada, can you elaborate a little bit on the announcement this week with regards to the metro partnership in Canada?

Gregg Steinhafel - *Target Corporation - Chairman, President and CEO*

Yes, we're excited to have Metro as partner to run our pharmacies in the Quebecian Province in the eastern part of Canada. We think they are a great partner. They run a terrific business, and we're thrilled to have them as our partner.

Deborah Weinswig - *Citigroup - Analyst*

Okay, and then lastly, it seems like you have a unique opportunity with the REDcard to tailor communications between Canada and the US. You have almost 20% of your customer base. Can you talk about through e-mail and text what you're doing in terms of personalization?

Kathee Tesija - *Target Corporation - EVP Merchandising*

We're doing a lot with both e-mail and text. But I would tell you, Deb that we're in the beginning of that journey. We think there's a lot more that we can do, but we're doing things with personalization in terms of seasonal and timing, but also product categories that resonate with our guests



and we're seeing great results. We've upped particularly e-mail a lot this year, and it's really paying off. And so we're on a journey, and we think that there's a lot of head room there, and we will go after that in a big way.

Deborah Weinswig - Citigroup - Analyst

Great, thanks so much and best of luck.

Operator

Jason DeRise, UBS.

Jason DeRise - UBS - Analyst

I wanted to ask about Canada's gross margin again. I know there's been a few questions already. But if you did better on more of those discretionary items, and I guess there was some shortfalls store by store, in terms of certain seasonal items coming through. Is this -- how is this, I guess, affecting maybe some of your plans? Are you adding more planograms? Is that going to add to the SG&A cost to service all these stores, if it's just different demand for different products? And just reflecting how diverse Canada actually is, or is it just weather effects, and what have you learned from that process?

Kathee Tesija - Target Corporation - EVP Merchandising

I don't think that we'll be adding a lot of planogram versions. I think we're still tweaking what's on those planograms. But we've -- we understand that, and we've got many different versions throughout Canada for all of their differences across geography and their guests. But I think what Gregg was talking about was, number one, getting the buy right by store in all of those categories, and then some of the seasonal categories were softer. So making sure that we get that buy right going forward, that has less to do with the planogram itself. And then in addition to that, as we're driving more trips with our frequency categories, that's the side that's been weaker, we think that traffic will also help sales throughout the store, because the guests clearly likes our differentiated merchandise on the Apparel and Home side. So it's a combination, but it's more about the buy than it is about planograms.

John Mulligan - Target Corporation - EVP and CFO

The other thing I'd add, Jason, if you step back to where we were three months ago the gross margin rate was a little bit above 38%. And the two things we said at that time, I think, are still appropriate. One, it's going to be noisy here early by quarter because it's just naturally that way as we're opening up stores. But two, don't expect us to operate at that high a level. While the mix was very favorable, we hadn't gone through any seasonal clearance. And so seasonal clearance is going to naturally bring that rate down.

This quarter a little bit more than we would have expected, but there again I said we're working through some excess inventory given our sales levels. So we expect through time that the gross margin rate will normalize at a reasonable level that ultimately will allow us to deliver EBITDA margin rates let's say 12% in Canada like we've talked about all along.

Jason DeRise - UBS - Analyst

Okay, and then I wanted to ask on the US side about the efforts to increase service, omni channel, flexible fulfillment, and all those things, obviously that costs a lot to implement and the way I see it, and you can correct me if I'm wrong, you're very centralized already. So, should we think about this is just necessary to keep sales growing? And maybe it comes in at a lower margin or are there areas that you could offset that impact?



Gregg Steinhafel - Target Corporation - Chairman, President and CEO

I would think of it as this way. In our Business in any point in time there are investments that we have to make to continue to get better at what we do, whether it's a service or supply chain or technology investment or investments in the guest experience. And so this is -- we're calling attention to this. But these are investments that we're going to make in the business because we want to provide a great experience, which means our expense optimization efforts, as they have in the past, have to more than offset these kinds of investments.

So, we look at it all-in holistically and we're saying hey we got to get leaner and meaner in certain parts of the organization, and become more efficient, and we demonstrated that last quarter. We were very, very rock solid in our expense and our productivity and that affords us the ability to -- and the capacity to get more aggressive and do some of these kinds of things, and invest in transforming the Business to the future.

Jason DeRise - UBS - Analyst

Could you maybe elaborate on that? I know that you talked a bit about that there's the compensation accrual and that that helped, but then you also mentioned that you were better on payrolls. Is that something where you think there's more room to go in terms of the in-store labor, or is that something where you really wouldn't want to push too hard on because of the potential implications on revenue? And if that's the case, where else could the savings be, if it's not the store?

John Mulligan - Target Corporation - EVP and CFO

Jason, we said at the beginning of the year the investments in multi-channel and everything we were doing would be \$0.20 to \$0.25 of incremental dilution or incremental expense in our Business. And we said at that time that through our expense optimization efforts we expected to offset virtually all of that in the year. We do that in a variety of ways. The stores have continuously over a long period of years looked for ways to increase productivity faster than wage rate and faster than sales, so lowering our expense rate. And we think there's opportunities to continue to apply technology to improve productivity in our stores. But what Gregg was talking about, our expense optimization efforts are across the entire organization, headquarters, distribution, supply chain. Everywhere we operate, we are looking for ways to take expense out so that we can afford to invest in the Business.

Jason DeRise - UBS - Analyst

Okay, thank you.

Gregg Steinhafel - Target Corporation - Chairman, President and CEO

Great. Well that concludes Target's second-quarter 2013 earnings conference call. Thank you all for your participation.

Operator

Thank you. This does conclude today's conference call and you may now disconnect.



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