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EDITED TRANSCRIPT

TGT - Q3 2015 Target Corp Earnings Call

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OVERVIEW:

Co. reported 3Q15 GAAP EPS of $0.87 and GAAP EPS from continuing operations of $0.76. Expects 4Q15 adjusted EPS to be $1.48-1.58.

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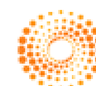

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation third-quarter earnings release conference call.

(Operator Instructions)

As a reminder, this conference is being recorded, Wednesday, November 18, 2015. I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

John Hulbert - *Target Corporation - VP of IR*

Good morning, everyone, and thank you for joining us on our third-quarter 2015 earnings conference call. On the line with me today are Brian Cornell, Chairman and Chief Executive Officer; John Mulligan, Chief Operating Officer; and Cathy Smith, Chief Financial Officer.

This morning Brian will discuss our third-quarter performance, including results across our merchandise categories and plans for the fourth quarter and remainder of the year. Then John will throw in an update on our operations and priorities going forward. And finally Cathy will offer more detail on our third-quarter financial performance and discuss our outlook for the remainder of the year. Following their 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 the call Cathy and I will be available 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. Also, in these remarks we refer to adjusted earnings per share, which is a non-GAAP financial measure, and return on invested capital, which is a ratio based on GAAP information with the exception of adjustments made to capitalize operating leases. Reconciliations to our GAAP EPS and to our GAAP total rent expense are included in this morning's press release, which is posted on our investor relations website.

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With that, I'll turn it over to Brian for his perspective on our third-quarter performance. Brian?

Brian Cornell - *Target Corporation - Chairman and CEO*

Thanks, John, and good morning, everyone. As we step back and look at our third-quarter results and our year-to-date performance, it's clear that our strategy is working and we're delivering on the financial commitments we laid out last March. Following an extended period of declines, traffic has turned positive over the last four quarters and has been accelerating on a two-year basis. Sales in signature categories have been growing much faster than our overall sales, and they are clearly exceeding industry benchmarks.

So while consumers continue to spend cautiously, we feel confident as we enter the holiday season. And we're focused on continuing to deliver on both our strategic priorities and our financial goals.

As we mentioned in our last conference call, our third-quarter plans were based on the knowledge that we are facing stronger prior-year comparisons than we had experienced earlier in the year. Now with the quarter behind us, I'm pleased to report that not only did we meet our forecast, we saw continued progress on our strategy. Specifically, two-year growth trends in comp sales, traffic, and signature category performances each accelerated in the third quarter following strong performance in the second quarter.

Our third-quarter adjusted EPS of $0.86 was 8.6% higher than last year and above the midpoint of our guidance range we provided at the beginning of the quarter. Third-quarter comparable sales were up 1.9%, also near the high end of our guidance and driven primarily by growth in traffic. We're really pleased that our guests are responding to the investments we're making in our assortment, presentation, and shopping experience. And we're focused on building on this year's traffic increases in both stores and our digital platforms in the quarters and years ahead.

Our third-quarter gross margin rate was down slightly to last year, reflecting the benefits of a favorable merchandising mix and the comparison over last year's intense promotional markdowns. These benefits were offset by reimbursement pressure in pharmacy combined with the impact of investments in quality and innovation on our own and exclusive brands. Third-quarter SG&A expenses were solid and in line with our expectation, as Kathy will cover in a few minutes.

We reported a very healthy after-tax return on invested capital of 13% this quarter, nearly 2 percentage points higher than a year ago as progress on our strategic priorities has driven improved profitability on a relatively stable basis of invested capital. Given this stable performance, we continue to have capacity to invest in our business while returning a compelling amount of cash to our shareholders. This quarter we will return well over $1 billion to a combination of dividends and share repurchases, bringing our total cash return to well over $3 billion so far this year.

Consistent with our guidance, our third-quarter comp sales increase was somewhat smaller than in the second quarter. From a category perspective the entire change of pace in sales was attributable to apparel and electronics. In apparel, third-quarter comp sales grew just under 3% compared with nearly 5% in the second quarter. This slowdown was correlated with warm weather in September followed by a reacceleration when somewhat cooler temperatures arrived in October.

In the electronics category, we saw a double-digit decline in the third-quarter comp sales. This performance reflects a comparison over last year's most intense electronic promotions, which occurred in August, and the continued softness in tablets consistent with industry trends. One standout in electronics was wearable devices, part of the signature wellness category, where we saw nearly 100% growth in comparable sales.

Another standout was our toy category, part of the signature kids business, which matched its second-quarter growth with another 12% comp sales increase this quarter. Beyond strength in licensed products, growth in toys was broad-based across multiple sub-categories including small dolls, Lego, action toys, and board games. We were also pleased with third-quarter results from seasonal programs, beginning with solid performance in back-to-school and back to college, all the way through Halloween when we saw very strong increases in costumes and decor and solid growth in candy.

And to show you why we're so excited about the upcoming Star Wars release, we had the number one market share in Star Wars when we launched it in our store back in September. Looking through the lens of our category roles, third-quarter comp sales growth was led by signature categories

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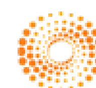

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which grew more than 2.5 times as fast as our overall sales. And as I mentioned, given the tougher prior-year comparisons, our two-year stack comps in signature categories were stronger in the third quarter than either of the first two quarters of this year.

Beyond toys and wearable electronics, our third-quarter standouts within signature included baby and kids apparel, women's ready-to-wear, and wellness items and food. In food overall, for the first time this year third-quarter comp sales growth out-paced comp sales overall, as our work to reinvigorate this category is beginning to shape our performance. In key categories like yogurt, where we added premium and better for you brands, we saw high single-digit comps sales increase in the third quarter.

We saw similar comp increases in craft beer and wine, reflecting our work to enhance the assortment and bring locally relevant brands to our guests. Looking forward, we'll continue to enhance our food assortment with a focus on wellness, local relevance, and seasonally appropriate items. And following the holiday season, we'll begin testing changes to food shopping environments in a set of 25 remodels scheduled for the LA market along with a set of SuperTarget remodels scheduled for next year.

Digital sales increased 20% in the third quarter, contributing about 40 basis points to our comp sales increase. While significantly outpacing the industry, this performance was well below our expectation of 30% growth which we outlined in the last call. As we look at the drivers of this performance, it's clear the third quarter softness in electronics was particularly impactful online. And like our stores, digital sales growth in apparel was slower during much of the quarter correlating with the relatively warm weather across much of the country.

We know that our digital investments drive engagement and sales in all of our channels, and we're pleased that our third-quarter sales were near the high end of our expectation. However, we believe we have an opportunity to accelerate digital transactions by enhancing the experience on target.com. Beyond our efforts to streamline the guest experience on our site, our team is rolling out multiple initiatives that we expect to drive digital traffic and sales over time.

And once again this holiday season we expect to be offering free shipping on all digital orders. We're very pleased with the guest response to this offer a year ago, and we expect it to be a key differentiator for Target again this holiday season.

Regardless of where our guest demand is ultimately fulfilled, in a store or on a guest's front porch, we know the vast majority of our sales in all of our channels are digitally enabled. For example, our guests access our brand through a digital device both in advance of and during their trip to one of our stores. As a result, we don't think of digital as simply a selling channel, but a critical enabler of the shopping experience in all of our channels.

This has significant strategic implications both in terms of organizational structure and the way we reward our team. Since I arrived last year, we have been evolving our approach to focus first on our core guest and build a total Target assortment that best serves the needs and expectations of our guests. Only after we've determined the appropriate assortment do we plan on how to offer it to each of our selling channels.

Consider our efforts in signature categories. For more than a year now we've been investing in these categories with the expectation that they will grow most rapidly. And we've seen this play out in all of our channels.

In fact, even while our digital footprint remains relatively small, we're approaching $1 billion of annual sales in our home category, making us one of the leading digital retailers in this space. As we look ahead to the holidays, we are excited about our merchandising and marketing plans, and we believe we'll further differentiate Target during a critical retail season. In hardlines, toys has already turned in a terrific performance so far this year, and we expect this strength to continue throughout the fourth quarter when we typically generate half of our annual toy sales.

This year, more than 15% of our toy assortment is exclusive to Target, including the exclusive BB-8 droid from the upcoming Star Wars movie, which we expect to be a top seller. We're also bringing back our Kids' Wish List App, this year with enhanced features to make it easy and fun for family and friends to shop for the perfect gift for every kid in their life. Our gift catalog, featuring more than 700 items, was distributed to 40 million guests this year through direct mail, newspaper, and distribution in our stores.

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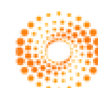

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On Cartwheel, we are seeing great results from our daily toy deal, which is featuring a different toy at 50% off every day through December 24. And finally, we're bringing everything together on our kids' gifting hub on target.com, which is designed to make shopping easy for parents and gift givers while creating a destination that's fun and inspirational for kids.

In electronics, we are excited to be one of the few retailers offering the Apple Watch in stores this season, and we expect this item to be a top gift item in wearable categories. Also in wearables, we partner with UNICEF to offer their Kids' Power Band, which increases kids to get more active and, based on the points they accumulate, improve the lives of kids around the world. We also expect drones to be a big hit this season, so we're featuring nearly 20 in store and about 4 times as many online.

We are planning for a big season in video games, a key gifting category, where hardware prices continue to moderate and software libraries continue to grow. And in entertainment, where we're very excited to be featuring a Target exclusive version of Adele's new 25 release that features three bonus tracks available only at Target. As we enter the holiday season, about 1,400 of our stores are featuring mannequins in apparel, which is about double the number we had a year ago.

Also this year we've enhanced the shopping experience by updating presentations in home and electronics in more than 200 additional stores for each group. So we feel great about the ability of our stores to showcase our assortment. And this year when our guests shop at Target for the holidays, they'll find an assortment focused on three key themes: entertaining, decorating, and gifting.

To support each of these themes, we've invested in quality and differentiation featuring real marble, hand carved wood, copper accents, and genuine leather. In fact, more than 20% of our holiday gifting items are handcrafted this year.

In food, we're highlighting exclusive brands and flavors, including Republic of Wine, our new exclusive brand which features unique discoveries from around the world. We're rolling out classic holiday and harvest flavors in Archer Farms. And we're offering exclusive indulgent seasonal flavors from great national brand partners with M&Ms, Hershey's, Dove, and Ghirardelli.

And finally, anticipation is building for Black Friday, which is just over a week away. Once again this year, we're opening our stores at 6 PM on Thanksgiving, and our team is already preparing to deliver a combination of great deals and a shopping experience that makes Target different from everyone else.

But we're committed to offering compelling savings, value beyond the traditional Black Friday event. Beginning this Sunday, we'll launch 10 Days of Deals on electronics, kitchenware, toys and more, which will run through Tuesday, December 1. This Sunday's weekly ad will also reveal special deals from our Black Friday presale, which takes place on Wednesday, November 25.

For our guests who prefer to shop digitally, all of our Black Friday deals will be offered on target.com. And finally, guests who spend $75 or more on Friday, November 27, will receive a voucher for 20% off on future purchases, redeemable from December 4 through the 13th.

Last March, in our meeting with the financial community we outlined our plan to grow profitably by focusing on a set of key enterprise priorities. And while we have much more work to do, we remain committed to that plan and are pleased with our progress so far. Through the first three quarters of 2015, we've successfully grown traffic, sales, and profits a bit faster than we originally expected by focusing on our core guests and providing them with differentiated assortment and the experience they expect and deserve.

But we're not slowing down because we see enormous opportunity still ahead of us. We're going to continue to focus on elevating the assortment, quality, and the presentation in our signature categories. Across every category, we'll differentiate Target's assortment by providing exclusive items from both our national branded partners, and one-of-a-kind items from our outstanding product design and development team. And while we're encouraged with the recent acceleration in food sales, we are still in the very early stages of our work to provide a unique assortment of fresh, local, and healthy items to our guests.

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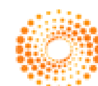

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And finally, while I'm pleased that we've already made early progress in our efforts to improve our in-stock performance, I believe we've got a multi-year opportunity to improve our reliability, both in stores and in digital channels by modernizing the way we work and refocusing on retail fundamentals.

Now I'll turn the call over to John Mulligan, who will discuss his team's early efforts to improve operations as well as John's priorities going forward. John?

John Mulligan - *Target Corporation - COO*

Thanks, Brian. Good morning, everyone. Today I'm going to provide an update on our initial efforts to reinforce our retail fundamentals, particularly our in-stock position. And I'll cover our priorities and progress in our work to modernize the supply chain in support of our strategic initiatives. The good news is that while we have lots of work still ahead of us, we've seen meaningful improvement in key in-stock measures based on changes we've made in the last few months.

While we strive to be in stock on every item in every store throughout every day, we know that need-based commodity categories are the most critical. If our guests don't believe that they can rely on Target to have their shopping list items available every time they shop, they will begin to skip some trips to Target even though they enjoy shopping our more discretionary categories. As a result, when in-stock metrics on our core commodity categories began deteriorating this year, we created an out-of-stock action team to conduct deep dives by category to identify both short-term and long-term solutions.

When the team identifies solutions within a category, we can quickly test them to confirm they improve our performance and then determine if those solutions can be applied more broadly. This team focused first on our household personal baby category, and more recently they've done work on our center store grocery category. In a short amount of time they've identified opportunities related to the way we generate vendor orders, optimize trade-offs between order quantities and frequency, and our reliance on system-generated solutions versus manual processes.

In high volume stores, the team has implemented adjustments to plan-o-grams to enhance holding capacity on fast turning SKUs, reducing the need for frequent store replenishment. And in our distribution centers, the team has identified opportunities to reduce lead-time variability, tighten delivery windows, and in some cases increase safety stock on key items. I should note that this increase in safety stock is one of the drivers of the 4% inventory growth we reported at the end of the quarter.

In a very short time, the results of our efforts have been encouraging. In household personal baby we've been able to reduce overall out-of-stock measures by approximately 50% in about 8 weeks. In center store grocery, in less than a month the team was able to reduce out-of-stock measures by about 25%. And importantly, we've been able to reduce out of stock even further on the items most important to our guests.

Given these encouraging initial results, the team is moving quickly to scale these solutions to a broader set of categories throughout the store, and conducting additional deep dives in categories like health and beauty. Looking ahead, the team has a number of key priorities, including work to optimize case packs which will better accommodate variability in store sales volumes across our network. In addition, they are implementing technology and process improvement to improve count integrity throughout our stores and distribution network.

Included in these efforts will be a test of RFID technology in a few of our apparel categories to gauge the effectiveness of the technology relative to the cost of implementation. This work is being supported by the roll out of an agile technology development in partnership with Mike McNamara, our new Chief Information Officer and our newly hired Senior Vice President of Operational Excellence, Anu Gupta. We are very excited to have Anu on the team. She has more than 20 years of relevant experience in driving operational excellence by leveraging best practices in a variety of operating models, including procurement and Lean Six Sigma process redesign across a range of industries, including retail. We're confident Anu will accelerate the efforts of the outstanding team we already have in place.

Beyond our work to improve reliability, our store teams are working diligently to support Target's efforts to become more flexible in the way we fulfill guest demand. As a result of last year's roll out of ship-from-store capability, stores have already shipped more than 10 million items directly to guests so far this year. And the percent of digital orders delivered in a three-day window has more than doubled compared with a year ago.

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To showcase this improvement in our capabilities, last quarter we rolled out new functionality we call available to promise, which offers guests a more precise shipping window. With available to promise, we expect nearly two-thirds of our digital orders will offer a guest a delivery window of 3 business days or fewer, compared with our typical window of 4-7 business days prior to the rollout. We recently expanded our ship-from-store capability to more than 300 additional stores, bringing the total to more than one-quarter of the chain. This will enable about 40% of digital transactions to be shipped from our stores in the fourth quarter.

In addition, two new direct-to-guest fulfillment centers became operational in the third quarter in advance of the holiday season. With the expanded capacity these changes provide, we expect to continue making progress on shipping speed next year.

As Brian mentioned, most of our store sales are digitally enabled, so we continue to integrate digital experiences into the stores. Guests increasingly use Cartwheel, our digital savings app with more than 20 million authenticated users, to plan their store trips in advance and then use the app to search for additional deals while shopping in store. In addition, because 10% to 15% of our digital orders are picked up in stores, we are exploring ways to streamline the pickup process by expanding holding capacity at the service counter and implementing process improvements to reduce wait times.

For next year's LA 25 remodels, we will feature all of our latest merchandising enhancements. We will test changes to the front end that will make order pick up even more convenient, including dedicated ambassadors to help store guests better understand Target's digital capabilities.

Before I turn the call over to Cathy, I want to thank our store and distribution center teams for their great performance so far this year and for their current efforts to ensure we provide an outstanding guest experience this holiday season. It's an enormous challenge for both our stores and distribution teams to accommodate the surge in volumes we see at Black Friday.

But our store teams don't focus only on moving merchandise. They focus first on our guests, and do an amazing amount of preparation to ensure guests have a pleasant and safe experience. It's one of the many things that makes Target unique, and one of the reasons why guests love our stores and our brand.

With that, I'll turn it over to Cathy who will share her insights on our third-quarter financial performance and our outlook for the fourth quarter and full year. Cathy?

Cathy Smith - *Target Corporation - CFO*

Thanks, John, and hello, everyone. As Brian mentioned earlier, we are pleased that this quarter's performance was near the high end of our guidance for both sales and adjusted EPS. As is often the case when you get into the detailed P&L, there were some ins and outs within the quarter that generally offset each other, which I'll cover in a few minutes.

This quarter adjusted EPS was $0.86 above the midpoint of our guidance range and 8.6% above last year. GAAP EPS from continuing operations was $0.76, $0.10 lower than adjusted EPS, driven by $0.05 of asset impairments, $0.03 of data breach expense, and $0.02 related to the corporate restructuring we announced last spring. Third-quarter GAAP EPS was $0.87, compared with the $0.55 a year ago, as this year we recognized $0.11 of tax benefit related to our investment losses in Canada, while last year we incurred $0.27 of after-tax losses related to Canadian operations.

Let's turn to third-quarter segment results. Among the drivers of our 1.9% comparable sales growth, we are pleased that traffic grew a very healthy 1.4% in the third quarter. This growth is even more encouraging when we look at performance on a two-year basis, as we faced a tougher comparison in the third quarter than either of the first two quarters of the year. October marked our 12th straight month of traffic growth, and we are laser-focused on this metric as a key indicator of the health of our business over time.

Breaking out our sales growth between stores and our digital platforms, the stores accounted for a little over three-quarters of our comparable sales growth, while digital contributed about 40 basis points to our third-quarter comp. Consistent with results from earlier in the year, our digital growth continues to be driven by a meaningful improvement in conversion. And although we have seen an acceleration in the last two months,

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we haven't seen the growth in digital traffic we expected to see this year. We believe our biggest opportunity to drive traffic continues to be our work to streamline and enhance the digital experience.

Third-quarter REDcard penetration was 22.3%, up about 130 basis points from a year ago. And we remain on track to meet our guidance for an increase of 100 basis points or more for the full year. As you'll recall, we tested REDcard rewards in a Kansas City market for a year before we launched the program nationwide. With the benefit of that head start, penetration in Kansas City continues to run well ahead of the rest of the country, giving us confidence that we have continued room to grow this rewards program in the years ahead.

In addition, we are optimistic that the industry's moved to EMV, or chip and PIN technology, will help restore confidence in the US payment system and increase the willingness of consumers to add new cards to their wallet. Regarding our move to EMV, we are pleased to be one of only a few large retailers in the United States that are accepting chipped cards for both credit and debit transactions in advance of this holiday season. We've already reissued chip cards to about half of our Target branded debit and credit card holders, and we expect to complete the rollout early next year following a pause for the holiday season.

Our third-quarter segment EBITDA and EBIT margin rates were both about 20 basis points higher than last year consistent with our guidance, as strong SG&A performance offset the impact of a lower than expected gross margin rate. On the gross margin line, third-quarter performance was about 10 basis points below last year, short of our expectations. While we continued to benefit from the comparison to last year's promotions, the benefit is waning as the intensity of those promotions began to taper in the third quarter of last year. In addition, consistent with results from earlier in the year, we're seeing continued margin pressure from quality investments in our owned and exclusive brands.

Finally, this quarter we saw reimbursement pressure in our pharmacy business, which we expect to continue until we complete the sale of this business to CVS. I want to pause for a moment and comment on the CVS transaction. We continue to work closely with the CVS team to obtain regulatory approval for the transaction. And while we don't have an update on the potential timing for the transaction to close, we are pleased with our progress to date.

Turning back to the third quarter P&L, on the SG&A expense line we saw unexpectedly strong performance in the third quarter, about 30 basis points lower than last year. As part of our efforts to control costs, this quarter's expense rate benefited from the discontinuation of an outdated, little used retiree medical plan. But we also saw discipline across the organization, which drove outstanding underlying performance. Even on the marketing line, where some expenses were retimed into the third quarter from the second quarter of last year, we recognized savings in other programs that led to overall favorability compared with last year.

As John mentioned and consistent with last quarter, our inventory position at the end of the third quarter was about 4% above last year. This reflects a significant improvement from the higher year-over-year increases we were seeing earlier this year. And while inventory growth is slightly higher than our pace of sales, it reflects changes in receipt timing compared with last year, combined with the intentional investments we're making in commodity categories to improve our in-stock position. As a result, we feel very good about our inventory position going into the holiday season in relation to both our sales plan and our work to improve in-stock reliability.

Turning back to consolidated metrics, third-quarter interest expense was $151 million, $5 million higher than last year. Our third-quarter effective tax rate on continuing operations was 34.3%, up from 30.6% last year when we recognized a $30 million benefit from the resolution of tax matters. We paid third-quarter dividends of $352 million, up about 7% from last year. And given our cash position and continued strong business results, we had the opportunity to invest another $942 million in share repurchase this quarter.

Given our long-range plan to generate profitable growth, we believe the continued opportunity to retire shares will prove to be a productive use of cash. To illustrate that point, under our current $10 billion share repurchase program we have retired more than 77 million shares, representing more than 12% of our current shares outstanding at an average price of less than $69.

As Brian mentioned, our after-tax return on invested capital, or ROIC, was a very healthy 13% for the trailing 12 months through the third quarter. This is nearly 2 percentage points higher than last year when our business results were under pressure following the data breach. Given our plan

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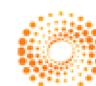

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to generate profitable growth on a relatively stable base of invested capital, we expect to continue to grow this metric over time, with a goal to reach the mid-teens or higher in the next five years.

Now let's turn to our guidance for the fourth quarter and what that guidance implies for our expected full-year performance. As we look ahead to the holiday season, we're mindful that the consumer remains cautious, and there are indications of heavy inventory levels at some competitors. However, we remain focused on the things we can control and what has been working all year.

These include our ability to deliver on our expect more pay less brand promise, by offering great products at a compelling value, iconic marketing, that guests love, and an outstanding store experience that differentiates Target from everyone else. With that context, we expect to deliver a fourth-quarter comparable sales increase of 1% to 2%, consistent with our third-quarter guidance. Underlying that guidance we expect digital growth of about 20%, consistent with our third-quarter performance.

Before I move down -- further down the Q4 P&L, I want to pause and discuss a challenge we hear a lot, which is based on the acceleration in two-year stacked performance we're planning for the fourth quarter. John answered this question last call, but I think it's worth addressing in more detail today. Last year our fourth-quarter comparable sales growth was 3.8%, but that was on top of a 2.5% sales decline in the fourth quarter 2013 when we announced the data breach on the weekend before Christmas.

So while the analysis of multi-year sales performance isn't always useful, I think in this case it's important to think about a 3-year stack of our comp sales. Specifically, if we hit the midpoint of our fourth-quarter sales guidance, the simple three-year stack would be a 2.8% comp, slightly less than the 3%, three-year stack we've delivered year-to-date. So while there are always risks to every sales forecast, we don't believe the two-year stack provides useful insight in this case.

Moving back to the P&L, we expect our fourth-quarter EBITDA margin rate to be flat to down slightly from last year's 9.8% rate. Among the drivers of EBITDA margin, we expect to moderate gross margin rate decline to be offset by similar improvement in our SG&A expense rate this quarter. We expect our fourth-quarter interest expense to be consistent with our third-quarter, and our tax rate is expected to be approximately 34% as we annualize over last year's favorable resolution of tax matters.

With our current cash position and expected business results, we plan to continue repurchasing our shares this quarter, and we will continue to manage the magnitude and pace of repurchase activity with the goal of maintaining our current investment-grade ratings. Altogether, this performance would lead to fourth-quarter adjusted EPS of $1.48 to $1.58 compared with $1.49 in fourth-quarter 2014. Let's look at what this guidance implies for our expectations for full-year 2015 financial performance, which I'll compared to the guidance we provided at our financial community meeting last March.

At that meeting, we laid out an expectation for 2015 comparable sales growth in the range of 1.5% to 2.5%. Given our year-to-date performance and fourth-quarter expectations, we expect our full-year comp to remain firmly in that range. I would note that the channel mix of our sales has been different than expectations. Specifically with year-to-date digital sales growth of 29% and our expected 20% growth in the fourth quarter, it's clear that in 2015 we don't expect to attain the longer-term 40% goal we laid out in March. However, we've delivered on our overall comparable sales goal every quarter this year, and we still expect to deliver industry-leading digital sales growth, both important benchmarks for us.

In March we laid out an expectation to grow our segment EBITDA margin rate by 20 to 30 basis points for the year. And we are on track to outperform that expectation with growth closer to 40 to 50 basis points in 2015. Regarding capital deployment, we are on track to meet our guidance for 5% to 10% dividend growth this year, and we've already met our goal for $2 billion or more in share repurchases through the first three quarters of the year.

And finally, we told you in March that we expected to generate $4.45 to $4.65 in adjusted EPS for the year. And despite a challenging backdrop, with our updated guidance today we are positioned to deliver performance at the high end or above that range for the year.

Beyond my love for the brand, I was attracted to Target because of our singular focus on delighting our guests and our tremendous desire to win. It's evident across our stores, online team, distribution centers, and headquarters. I recently visited one of our stores and had the opportunity to

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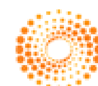

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meet Bev, who has been with the Company for an amazing 44 years. In her current role Bev is involved in the ship-from-store process, and she says their whole team loves this new capability because it allows our stores to drive sales by serving guests in new ways.

Now that I've been immersed in our business for the past three months, I am mindful of the opportunity ahead of us and the work we still need to do -- to accomplish. But I'm encouraged by the progress we've seen already. Traffic has increased for a full year.

Signature categories are leading our sales every quarter, and with a renewed focus on retail fundamentals and the dedication of team members like Bev, we are delivering on our vision to provide shopping on demand while maintaining our focus on everyday in-stock reliability across our store network. The ultimate measure of this year's accomplishments can be seen in our earnings. We've delivered a 16.9% increase in our adjusted earnings per share so far this year, and with our fourth-quarter guidance we are well-positioned to deliver double-digit growth for the year. We're excited about this initial progress, and we remain laser focused on building on this momentum over time.

With that, we'll conclude today's prepared remarks. Now Brian, John, and I will be happy to respond to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt Nemer, Wells Fargo Securities.

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

First, Brian, I'm hoping that we can get a little bit of the pulse of the consumer from you. Clearly there's been some weather impact in September and October.

But we're hearing negative comments about November from a number of retailers, so it feels like there's something else happening either from a macro or maybe a competitive standpoint. I'd love to get your sense for what you're hearing from your customers, your guests.

Brian Cornell - *Target Corporation - Chairman and CEO*

Well, Matt, I would tell you, we're feeling really good about the trends we're seeing, the reaction we're getting from the guests, certainly the growth in traffic for us is really encouraging. So we're seeing more Target guests come back to our stores and visit our sites.

And they're continuing to respond very positively to the work we've done in signature categories. So sitting here today, we're very confident about our position.

We think we're connecting with the consumer and our guest, and I feel fantastic about the plans we have in place for the fourth quarter. So while obviously still cautious, as we sit here early in November, we feel very good about the way the consumer and the guest is responding to our brand. And I feel as if we're really well-positioned for the fourth quarter.

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

That's great to hear. Shifting gears to gross margins, I'm wondering if you can call out the impact of the reimbursement pressure in healthcare and any sense for the total impact or run rate impact following the closure of your deal with CVS, how that could help you next year?

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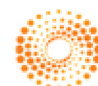

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And then secondly on gross margin, you did call out in the press release private brand investments. And I'm wondering if you could dimensionalize the potential size of that over the next few years? Thanks.

Brian Cornell - *Target Corporation - Chairman and CEO*

Let me talk about the owned brand investments we're making and then let Cathy talk through the Rx implications. As we've consistently talked about throughout the last year and year-and-a-half now, we think one of the things that differentiates Target is the value, the quality, the innovation we bring to our own brands.

So we're clearly looking to make sure we bring more value to our own brands. I talked about the number of handcrafted items we're going to have for the fourth quarter.

And we're being very surgical with those investments, but we're seeing a great reaction from the guest as we elevate the value we offer in our own brands. So we'll be very surgical, very selective, but we're certainly seeing a great return for the investments we're making.

Cathy Smith - *Target Corporation - CFO*

And Matt, good morning, this is Cathy. With regards to the pharmacy reimbursement pressure, as we said when we announced the transaction with CVS, that we lack scale and we knew that we were going to continue to see pressure here over time.

So what we're seeing in this quarter is in the range of 15 to 20 basis points of pressure in the quarter. And -- which is why we're excited to be partnering with CVS, because they'll be able to help with that scale.

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

Thanks for that color and have a great holiday.

Operator

David Schick, Stifel.

David Schick - *Stifel Nicolaus - Analyst*

Wonder if you could give us any extra color or update on the localization work in Chicago?

Brian Cornell - *Target Corporation - Chairman and CEO*

Right now we're still very focused on testing localization in Chicago. We are very pleased with the results.

And certainly a lot of localization is taking place in our food and beverage offerings. We're seeing the guests respond to that, and we're going to take the learning from Chicago and apply it to the 25 stores we're remodeling in Los Angeles.

So we'll continue to expand the learning, take it from Chicago to LA, but I am very pleased with the progress we're making. And we're partnering with John and the store and supply chain teams to make sure over time we can scale the learning from Chicago and Los Angeles to multiple markets around the country.

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David Schick - *Stifel Nicolaus - Analyst*

So last time you had updated us I think you said 100 to 200 basis point comp lift. Does the very pleased mean we're continuing to see that?

Brian Cornell - *Target Corporation - Chairman and CEO*

We are consistently seeing those kinds of returns.

David Schick - *Stifel Nicolaus - Analyst*

Got it. And then quick on the dot-com side of the business, there was some deceleration, still good growth in that line. Can you talk about any other metrics that help us understand the shift?

Is it time spent on the site, capabilities? What is driving the difference in the growth rate? And it sounds like a growth rate you're comfortable with for next quarter.

Brian Cornell - *Target Corporation - Chairman and CEO*

I think the most important measure to look at is what's happening with online growth overall. And just in the last 24 months -- or 24 hours we saw the October e-commerce growth rates in the US, and it was up about 8.6%.

The outlook that NRF has for e-commerce growth in the fourth quarter is somewhere between 6% and 8%. So while our 20% growth rate is not in line with our expectations, it's still dramatically outperforming the industry.

And I think the most important measure we're looking at is the fact that over 80% of our guests start their shopping journey online, either at home on their desktop or with a mobile device. And that digitally influenced guest is coming into our stores more often.

So as we've talked about our strategy, our strategy is to make sure we allow our guests to shop anywhere anytime they want with Target. And what we're seeing right now is they're voting with their feet to spend more time in our stores.

They're downloading our Cartwheel app: 20 million downloads so far to date. So I think we're seeing an overall slowdown in digital growth across retail.

And we're really pleased that we continue to outpace the industry -- dramatically outpace the industry, but our digital efforts are driving more traffic into our stores and helping us grow our overall comps. So while there's been a slowdown broadly across the sector, we continue to outpace the industry, and that's our fundamental goal.

David Schick - *Stifel Nicolaus - Analyst*

Thanks so much.

Brian Cornell - *Target Corporation - Chairman and CEO*

Thank you.

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Operator

Kate McShane, Citi Research.

Kate McShane - *Citigroup - Analyst*

It's encouraging to hear that a lot of the investments, especially in the signature categories, are panning out well for you. In your merchandising strategy specifically, where do you think you still have the most work to do, and what can we expect year over year when we see those categories for holiday?

Brian Cornell - *Target Corporation - Chairman and CEO*

I think we're making some very good strides starting in apparel. And while 3% in Q3 was slightly less than the growth rate we saw in the second quarter, compared to many of our peers we recognize that we're continuing to build traffic and growth in an important apparel category.

So the work we've done with mannequins, with changing the in-store experience, clearly paying off. One of the changes that we've announced recently is the addition of 1,400 visual merchandiser's to make sure we combine the changes we're making with mannequins, and fixtures, and layouts with experts in store that can maintain that great in-store merchandising experience.

So that's a new venture for us, we're standing it up for the holidays, we expect that to continue to strengthen the in-store experience, and we know with our signature categories we're still at the very, very early stages of standing up our wellness position. But we feel like we're in an excellent position with baby and kids, feel very good about our performance in the third quarter with kids apparel.

Certainly toys has been a highlight throughout the year, and we feel as if we're well-positioned coming off of second and third quarter comps in toys that were up 12%. The reaction we've seen from the guests to our Star Wars assortment, where we've captured an industry-leading position and expect to be a destination during the holidays.

So while we still have much more work to do, we feel very good about the progress we're making in signature categories. And I think the addition of visual merchandiser's in store will help us maintain our merchandising appeal throughout the holidays.

Operator

Scott Mushkin, Wolfe Research.

Scott Mushkin - *Wolfe Research - Analyst*

I wanted to get back into the food discussion, if we could. I think you're testing stuff in Chicago, you're going to roll that into LA.

Brian, maybe a lot of people don't notice, maybe they do, but you had a good experience back when you were at Safeway and then onto Sam's. I think you talked about 200 basis points you're initially seeing, but what can we expect out of the Company?

I think Safeway saw more than that as they brought in some refurbishments. And when can we expect to see more from Target as far as refreshing the decor and maybe doing a fuller roll out?

And is 200 basis points a good expectation? It seems to me it could actually be higher than that as you refine your lift, but wanted to get some more details there.

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Brian Cornell - *Target Corporation - Chairman and CEO*

Scott, I'm glad you asked the question. I do think one of our highlights in Q3 was the improved performance in food. We've actually seen food comp acceleration throughout the year.

And while we haven't made major changes with fixtures and in-store decor, we've been very focused on assortment changes and bringing more natural, organic, local items into many of our categories. And we're seeing the guests react very favorably.

So, to me it's getting the basics right. And before we start making fixture changes and decor changes, it has to start with the right assortment and making sure we have the items, the brands, our guest is looking for when they shop food at Target.

So the acceleration you're seeing right now is driven by section by section getting the assortment right, bringing more appealing items to our guests, adding more natural, organic, gluten-free items that are on trend to those categories. We made some significant changes in yogurt in the third quarter and saw very, very positive responses; high single-digit growth rates in those categories.

So while we are not shouting about it, we're making steady progress in food. We'll learn a lot more in 25 stores in Los Angeles where you will see some changes in fixtures and decor. And as we learn, we'll continue to grow.

So I think we do have significant upside, but Scott, this is about making sure we get it right, and we're going to take a slow, steady approach, solid, consistent results every quarter. And continue to deliver what the guest is looking for from an assortment experience standpoint when they shop food at Target.

Scott Mushkin - *Wolfe Research - Analyst*

Obviously key, and I think Cathy said you're measuring -- one of the big things you look at is frequency, and this is obviously core to that. So we look forward to seeing more.

But my follow-up question is on the investment side. We get it a lot, whether it be e-commerce, whether it be on the food and the logistics. Can you talk us through why there won't be a massive ramp up in investment as we go out the next couple years and that you have enough money in the CapEx and the SG&A to handle what the Company needs to do?

Brian Cornell - *Target Corporation - Chairman and CEO*

Yes. Scott, we've looked at this very carefully. I know we've talked about it a number of times. We feel very confident that the CapEx budgets we've had in place will be very adequate over time to make the changes we need to make from a technology standpoint, a supply-chain standpoint, continue to refresh our stores, and maintain our focus on maintenance investments.

So sitting here, Cathy and I have spent a lot of time recently, obviously John's been a great steward of our CapEx spending. And we feel very comfortable that our current spending levels will allow us to modernize the organization, enhance technology, improve supply chain, and make sure along the way we're continuing to enhance the in-store experience and match that up with a great online experience for our guests.

Cathy Smith - *Target Corporation - CFO*

I would offer just real quickly to add to that, because we have pressure tested this one ourselves a lot, we have not -- Target has not under-invested over the years. And I think that bodes well with the state of where you find our stores as well as our technology and supply chain investments we need. So I feel very good about where we are, and with that level of investment we've been pretty consistent.

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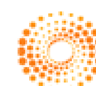

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Scott Mushkin - *Wolfe Research - Analyst*

Thanks, guys. Appreciate it.

Operator

Matthew Fassler, Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

I'd like to ask a two-part question. The first relates to the cost cutting initiatives that you discussed at your analyst meeting earlier in the year.

You spoke about $1.5 billion of SG&A and $0.5 billion on cost of goods over two years. If you could talk about the run rate that you're at now against those goals?

I guess another twist on Scott's question, the degree to which you've had investments insight that would offset some of those. I think that was also part of the plan that you set forth.

John Mulligan - *Target Corporation - COO*

So I'll jump in and take that. I think from a tracking perspective, what we said, your point, $1.5 billion of SG&A, $0.5 billion of margin, and we would deliver in 2015 about $0.5 billion of that.

We're running a little bit ahead of that pace. And both in the cost of goods and in the SG&A space, both are running perhaps a little bit ahead of what we envisioned going into the year. So we feel really good about that.

I think stepping back and tying this back to Scott's question, the other thing we said at the time was we're taking $2 billion out of the P&L but we didn't expect EBITDA margin expansion. And our view was that we would need this to fuel the investments, exactly some of the expense investments that perhaps Scott was referring to, and this would provide the capacity to do that.

And that is in fact what we've seen. We've seen great expense discipline across the corporation, but where we needed to invest, we have had the capacity to do that.

Matthew Fassler - *Goldman Sachs - Analyst*

If I could ask a quick follow-up, when you talk about $0.5 billion this year, is that delivered -- I noticed it's not been delivered to the bottom line because there are some offsets, but is that annualized run rate achieved or is that actual cost cuts that would have come out on the gross basis against your cost base offset by some of the investments?

John Mulligan - *Target Corporation - COO*

We will take out $600 million this year. And then part of next year's will be annualization of that, and part of it will be incremental.

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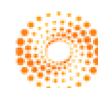

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Matthew Fassler - *Goldman Sachs - Analyst*

And then a very quick follow up, on wages, obviously Walmart made an incremental announcement since your last call. Any sense as to whether this issue is brewing up organically in the field, as you think about hiring and you think about intrinsic wage pressure in the marketplace and how you're thinking about that relative to your plan?

Brian Cornell - *Target Corporation - Chairman and CEO*

We don't see any material change in the marketplace. Again, we've talked a lot in the past about making sure we're investing to have the best retail team.

And we look at this very surgically year after year, market by market, we think we're in a great position and we think we're hiring terrific talent. And we're excited that we've got a great team in place as we get ready for the holidays.

Matthew Fassler - *Goldman Sachs - Analyst*

Thank you so much, guys.

Operator

Greg Melich, Evercore ISI.

Greg Melich - *Evercore ISI - Analyst*

I guess my two questions are a bit of a follow up. One on the last one, if you look at the fourth-quarter guidance, if I'm getting this right SG&A dollars are flattish.

And is that basically that cost out with the reinvestment going in? And then the nature of that question is really, John, you mentioned 40% of digital you thought would be ship from store in the fourth quarter. What has it been running and what does that do to the labor model?

Cathy Smith - *Target Corporation - CFO*

Greg, this is Cathy. I'll take the first part of it. To answer your question, yes, we expect it to be essentially flat and it will be pretty much offset.

We'll have pluses and minuses, so the savings we're getting we will continue to reinvest as we had planned. John will answer the 40% digital shipment.

John Mulligan - *Target Corporation - COO*

Sure, Greg. 40% this quarter, and it will peak a little bit higher than that actually, typically running in more in the 20% to 25% range. But as we peak, this is a great way for us to utilize our store assets.

The labor model, what happens here is actually it's quite efficient because we have dedicated teams in those stores who do the picking, do the packing, I mean we're just able to utilize them more efficiently. And so while there is more store labor that we are using, the offset clearly comes in our shipping expense, because we're much closer to the guest we are shipping to and they aren't on the same P&L line, but it's an outstanding trait for us.

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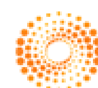

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Brian Cornell - *Target Corporation - Chairman and CEO*

Greg, I think it's important as you tie out the math on the ship from store. Last year at this time we had just over 120 stores where we were shipping from store. As we sit here today, we're up to 462. So we've expanded the base.

We're going to leverage and sweat the assets I think much more effectively. But importantly, that enhanced base allows us to deliver to our guests in a much shorter timeframe. So we would expect that to grow during the holidays.

We've certainly ramped up for it. And we think that's going to provide a much better shopping experience and allow us to deliver product to our guests in a much shorter period of time.

Greg Melich - *Evercore ISI - Analyst*

That's helpful. If I could follow up, I think earlier you talked about private label penetration a little bit. Could you talk about how the stronger dollar or falling raw material costs or lower fuel costs could be impacting gross margin today differently than you would have thought a few quarters ago?

Cathy Smith - *Target Corporation - CFO*

I'll answer briefly and then anyone can chime in. We're really not seeing an impact on it, in our product cost or in -- obviously in our margins. So it's really been kind of a non-event for us.

Brian Cornell - *Target Corporation - Chairman and CEO*

Remember, Greg, with many of those items, those are long lead time items. So we'll certainly be watching that over time, but as we sit here today many of those orders and POs were placed many, many months ago.

So we'll continue to monitor that over time, but we certainly like our position with our own brands as we enter the holidays, and that's an important way that we differentiate. Operator, it looks like we've got time for one more call.

Operator

Bob Drubl, Nomura.

Bob Drbul - *Nomura Securities Intl - Analyst*

Just two quick questions. First one is on the apparel performance, you talked a little bit about margin pressure in private label and exclusive. Was that new to the third quarter, and how do you see that playing out in the fourth quarter?

Then the second question that I have is, on the e-commerce business, can you give us an update on the subscription offerings and how that's going from a fulfillment perspective as well?

Brian Cornell - *Target Corporation - Chairman and CEO*

Bob, first on the A&A side, again, we think the guest is responding really well to some of the changes we've made with our own brand assortment. And the investments that we talked about today we've been consistently talking about for over a year now.

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Making sure that we're reinvesting in quality and innovation, in style, making sure that we deliver that expect more pay less brand promise. So the guest is reacting really, really well to that.

And we're going to continue to make sure that we deliver great value in our own brands. So it shouldn't be a new phenomenon. It's something that we've been very clear and transparent about.

And we think it's paying off with increased traffic and growth in those core signature categories. So looks like we've run out of time for today.

I do appreciate everyone calling in. And that will conclude our third-quarter earnings call. So thanks, everyone, for joining us.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for participating. At this time you may now disconnect.

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