Co. reported 2Q18 GAAP EPS from continuing operations of $1.49. Expects 2018 adjusted EPS to be $5.30-5.50. Expects 3Q18 GAAP and adjusted EPS to be $1.00-1.20.
Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation Second Quarter Earnings Release Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, August 22, 2018.

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

John Hulbert - Target Corporation - VP of IR

Good morning, everyone, and thank you for joining us on our second quarter 2018 earnings conference call. On the line with me today are Brian Cornell, Chairman and Chief Executive Officer; John Mulligan, Chief Operating Officer; Mark Tritton, Chief Merchandising Officer; and Cathy Smith, Chief Financial Officer. In a few moments, Brian, John, Mark and Cathy will provide their perspective on our second quarter performance, outlook for the full year and progress on our long-term strategic initiatives. 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 your follow-up questions.

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 non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on our second quarter performance and our outlook for the rest of the year and beyond. Brian?
Thanks, John, and good morning, everyone. We are really pleased with the second quarter financial results. Comparable sales grew 6.5% in the quarter, representing Target’s strongest quarterly comp performance since 2005. This increase was driven by traffic growth of more than 6%, an unprecedented number and, by far, the strongest performance since we began reporting this metric in 2008.

Total sales were up 7% from a year ago, reflecting 0.5 point of growth from our new and non-mature stores. Store comparable sales increased nearly 5%. And digital sales grew more than 40% in the second quarter as guests continue to respond to a growing menu of convenient fulfillment options, newness throughout our merchandising categories, freshly remodeled stores and a higher level of service across the chain. On top of the strong digital sales trend we’ve been seeing for many years, we saw a meaningful incremental lift from our 1-day sale in July, which came in far ahead of expectations.

With very strong traffic, both in store and online, we saw accelerating comp sales trends in all 5 of our core merchandising categories. While there are healthy increases across the board, comp growth in our Home category was amazingly strong, up nearly 10%. Hardlines also saw high single-digit comp growth, driven by strength in both Toys and Electronics.

And with stronger-than-expected sales, our business delivered stronger-than-expected profitability. Our second quarter adjusted EPS of $1.47 was near the high end of the guidance range of $1.30 to $1.50. This represents about 20% growth compared with a year ago despite the fact that our results continue to reflect significant investments in both capital and operating income to position Target for long-term success.

These investments include our plan to perform wall-to-wall remodels of approximately 1,000 stores over a 3-year period; our work to completely transform Target’s supply chain, placing our stores at the center of a modern network designed to deliver an unmatched combination of convenient fulfillment options; opening new small-format stores across the country, allowing us to reach guests we couldn’t serve with our larger formats; last year’s investment to ensure we’re priced right daily in support of the Pay Less side of our brand promise; our work to deliver a constant drumbeat of new and exciting merchandise throughout our own and exclusive brand portfolio; the rollout of new convenient digital capabilities that make it easier and more inspiring for our guests to shop, save and use their REDcard; and most importantly, investments in hours, wages and training for our team members. These investments enable our team to deliver higher levels of service and productivity, and our guests are responding to the change.

We embarked on this investment plan at the beginning of 2017, and our progress so far has been well ahead of our original expectations. There’s no doubt that, like others, we’re currently benefiting from a very strong consumer environment, perhaps the strongest I’ve seen in my career. But market share data demonstrates that our current results are benefiting from more than just the environment as we’re seeing broad market share gains across categories we sell. The question we continue to hear from many of you is whether we can separately measure the benefit of each of these investments we’re making, and the honest answer is we can’t evaluate each one of them in isolation. Instead, it’s the collective benefit of all these initiatives that is keeping Target more top of mind with guests, enticing them to visit our stores and our site more often.

Before I turn to our outlook for the rest of the year and beyond, let me comment briefly on the topic of tariffs. Like many of you, we’ve been carefully monitoring recent tariff announcements, and we’re aware of the potential for this situation to further escalate. As we’ve said many times, as a guest-focused retailer, we’re concerned about tariffs because they would increase prices on everyday products for American families. In addition, a prolonged deterioration in global trade relationships could damage economic growth and vitality in the United States.

Given these risks, we’ve been expressing our concerns to our leaders in Washington, both on our own and along with other retailers and trade association partners. However, our concern is centered on the impact of tariffs on consumers and the economy, not our ability to manage our business in the face of these challenges. As you know, when we’re faced with tariffs or any other external factors, there are multiple levers we can pull to remain price competitive and maintain profitability, and we are continually developing and implementing contingency plans as we learn more and things evolve.

While we always account for risks like this when we plan for the future, today, we are also focused on the multiple opportunities we see in front of us. In the first half of 2018, we delivered comparable sales growth of 4.8%, a result which is much stronger than the expectation at the beginning
of the year. As a result, we've updated our comp guidance, and we are now planning for comp growth in the back half of the year in line with what we've seen in the front half. In addition, we've also updated our full year EPS expectations. Cathy will provide more details in a few minutes.

These upgrades to our outlook reflect the current trends we're seeing across our business, including a very strong start to Back-to-School and Back-to-College. In addition, we continue to focus on unique opportunities in key toy and baby categories, given the recent closure of Toys "R" Us and Babies "R" Us across the country. And of course, as the year progresses, we'll continue to benefit from the broader rollout of new fulfillment capabilities like Drive-Up and Shipt, brand launches in multiple categories, the completion of additional remodels and the opening of more small-format stores.

As we look beyond 2018, we have increasing confidence that we can deliver very strong results in the years ahead as we move into the next phase of our strategic plan and achieve scale across the full slate of our growth initiatives. When we move beyond testing to scaling, we'll see efficiencies and cost savings, further strengthening our guest experience and overall position in the marketplace. And importantly, by the end of 2020, we'll have a newly refreshed base of stores, reflecting our plan to complete more than 1,100 remodels in a 4-year period through 2020.

So now before I turn the call over to John, I want to pause and thank the entire Target team for everything they're doing to deliver outstanding operational and financial performance. In pursuit of our plans, we're asking our team to deliver more change faster than at any time ever before. The team is responding enthusiastically to the challenge, and it is inspiring to see our vision coming to life. But I want to quickly add, while our progress feels great, we have no intention of slowing down. We'll continue to seize the opportunity ahead of us and offer our guests more inspiration and convenience than ever before.

With that, I'll turn the call over to John, who'll provide an update on our rollout of new fulfillment options, investments in new and existing stores and changes in our stores to make the shopping experience easier for our guests. John?

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

Thanks, Brian, and good morning, everybody. As I've discussed with many of you, the operations team faces a fundamental challenge in delivering on our strategic initiatives. As we work to make changes to virtually every facet of our operations, modernizing our supply chain, delivering new fulfillment options and increasing efficiency in our stores, we need to simultaneously focus on maintaining everyday reliability in support of a $75 billion business.

In the face of this challenge, I'm really proud of how our team is performing on both priorities, particularly in light of the rapid acceleration in sales we've seen in recent quarters. As you know, our strategic plan includes significant investments in the physical infrastructure of our stores. This is because our stores will continue to be the key fulfillment node for our guests, whether that's a traditional store trip, a Drive-Up order, an in-store pickup order, a trip by a Shipt shopper or a traditional e-commerce purchase shipped from a local Target store.

Our goal for the year is to deliver well over 300 remodels, and we are on track to deliver that plan. We completed remodels of 113 stores in the second quarter on top of the 56 we completed in the first quarter and many more underway. In fact, in July, we had 258 locations undergoing a remodel during at least a portion of the month, the highest at any time in our history.

While our remodel project creates an optimal platform for all of our fulfillment initiatives, it also provides our guests with a more inspiring environment that's easier to shop, and our guests continue to respond by shopping more often. Specifically, consistent with our plan, we continue to see traffic-driven incremental sales lifts of 2% to 4% in our remodeled stores following completion of the remodel. And while the data is limited, we are seeing some early indications that remodeled stores continue to out-comp other stores beyond the first year after the remodel.

We also continue to see encouraging performance from our new small-format stores. We opened 6 of these new locations in the second quarter on top of the 6 we opened earlier in the year. These locations deliver high sales productivity along with gross margin rates above the company average. And we continue to see strong growth as these stores mature. At the end of the second quarter, we are operating 26 mature small-format stores, and on average, this group saw high single-digit comp growth during the quarter.
Beyond the physical experience in our stores, we continue to invest in hours, training and wages for our store team, allowing them to deliver a higher level of service and a better overall experience for our guests. While this modernization is focused on the guest experience, it is fueled by efficiency. In the second and third quarter this year, we are investing in key member training across every one of our stores, focusing on how our team members can be more helpful to our guests as they shop.

We’ve rolled out new tools and technology that allow our team to find and order items on behalf of our guests and process the sale from anywhere in the sales floor. We’re hiring differently, focusing on the passion and expertise of team members who can deliver more information and service in key categories like Beauty, Electronics, Apparel and Food.

And in Food and Beverage, we are changing how the team accomplishes everyday tasks, allowing more opportunities for guests to interact with experts on the sales floor while also standardizing operations to ensure we have fresh and full presentations, a focus on food safety and a strong and efficient foundation for how we operate. While these investments are already helping us deliver stronger traffic and sales, we are also focused on driving efficiencies that can help us offset the costs. As a result, we have completely redesigned when and how our teams sort and stock product, reducing steps and creating more opportunity for guest interaction during key business hours.

In addition, we have implemented changes to our back-room organization for store teams to more efficiently ensure our guests have what they need on the sales floor, particularly on Apparel. And of course, our work on the upstream supply chain is focused on changes that will dramatically reduce store workload associated with unloading and restocking over the next few years.

Beyond store investments, I want to give you an update on our rollout of new fulfillment options across the country. The team has been moving at an amazing pace, and our guests continue to tell us that they need love the new options. I’ll start with Shipt, our same-day personal shopping service, which is now operating in more than 160 markets and serving more than 1,100 Target stores.

Over the last year, Shipt’s membership base has more than tripled while orders, revenue and GMV are 2 to 3x higher. While some of this growth is being driven by Shipt’s entry into new markets, we’re seeing orders and GMV in comparable markets, meaning markets in which Shipt was already operating a year ago, that are up nearly 100% year-over-year.

We’re also very pleased that new partners continue to sign in to the Shipt platform, attracted by the reliability and level of service that Shipt can provide. Year-to-date, the Shipt team has added to their marketplace a total of 19 new retail partners who operate under 24 unique banners across the country. This has more than doubled the number of new partners that Shipt added to its marketplace in all of 2017.

We’re also pleased with the rollout of our new service in dense urban market stores, which we call delivery from store. With this service, guests pay a small fee at checkout and choose a time window later at the same day when their shopping basket will be delivered to their front door. This service is now available in 58 stores across 5 markets, and guests continue to love it. The average basket size for this service is more than $200, the highest of any service we provide.

And last but certainly not least is our new Drive-Up service. We started the year offering Drive-Up in 50 stores, and at the end of the second quarter, it has expanded to more than 800 locations around the country. Our stores have done an excellent job training their teams to deliver this new service, and guest satisfaction is off the charts. Our most recent Net Promoter Score for Drive-Up is 88, a crazy high number, the highest of any service we provide. We expect to have this service rolled out to nearly 1,000 stores by the holiday season, and we will continue the rapid expansion next year.

On top of these services, we continue to see rapid growth and adoption of other digital fulfillment services, including Restock, in-store pickup and, of course, shipping to our guests’ front doors. And you’ve seen that growth in our numbers for a long time now as we’ve seen year-over-year growth in our digital sales in the 20% to 30% range for several years. However, this quarter, we saw a step-up in the pace of growth, and a lot of that acceleration was driven by our 1-day sale in July.

Among the many reasons to host a digital sale in July, it’s important for our team because it gives them the opportunity to stress test our systems and processes in advance of the peak holiday season. And this year, the July sale presented a really robust test as orders and sales far exceeded...
our expectations. The sale created by far the biggest digital sales day we’ve ever experienced outside of a holiday season, driving volume nearly 3x higher than our forecast.

While this was great news, of course, our store and supply chain teams had to react and recover quickly to fulfill all the end-plan demand and keep operations running smoothly. While that challenge presented some long days for our team, I’m really proud of how they responded, adding to my confidence in our ability to accommodate peak demand in the upcoming holiday season.

In a way, the story of the 1-day sale is similar to the story of the second quarter as we saw stronger-than-expected volume throughout the quarter. This has caused some in-stock challenges in certain items and categories, and the team is working quickly to recover and plan for higher volumes throughout the rest of the year. As a result, our inventory position at the end of the second quarter was up about 11% from a year ago. Of course, a meaningful portion of this growth is being driven by our current and planned level of sales, which are growing faster than we’ve seen in the many years.

In addition, the team has brought in extra inventory to recover and protect in-stocks, and we are seeing higher levels of in-transit inventory as our operations teams develop plans to accommodate the fourth quarter surge. And of course, our merchant teams have brought in extra volume to address the unique market share opportunity we’re facing in Toys and Baby. Bottom line, we continue to feel very good about our overall inventory position given our plans for the rest of the year.

Before I turn it over to Mark, I want to reiterate what Brian said earlier. Our current traffic and sales growth are not being driven by any single thing we’re doing but as a result of everything we’re doing for our guests. And I want to thank everyone on the team for making it happen. While there’s a lot of change that’s visible from the outside, there’s even more change happening internally. That amount of change presents a challenge so it’s incredibly rewarding when we see our guests responding in such a positive way.

With that, I’ll turn the call over to Mark, who’ll provide more detail on our second quarter performance and our upcoming plans in merchandising. Mark?

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**Mark J. Tritton - Target Corporation - Executive VP & Chief Merchandising Officer**

Thanks, John. As Brian and John have mentioned, the momentum we’re seeing across our business is amazing and we can’t point to any one single driver. Instead, the common denominator is our guest who is thinking of us and choosing to shop with us more often. As we benefit from this momentum, our goal is to maintain this focus on our guests and push ourselves to do more even more quickly in service to them.

As we’ve said before at Target, we’re at our best when we maintain a proper balance in our business with a focus on delivering "and," not "or". After all, we don’t ask our guest to expect more or pay less, we work to consistently deliver on both sides of that brand promise. But it doesn’t stop there. We feature a curated assortment that satisfies wants and needs, offers basic items and must-have style and highlights national brands and owned brand. We invest to ensure we’re priced right daily and offering compelling deals, design our assortment to support both stock-up and fill-in trips, and we feature all of it in stores and online.

Guest surveys give us confidence that we’re achieving a proper balance in the current environment. For example, in the second quarter, our guest scores for convenience and everyday pricing increased, and our differentiation score increased as well. This is a testament to the efforts of our entire team over the last 18 months and their focus on delivering the right combination of everyday prices and compelling promotions with the right assortment of innovative national brands, alongside exciting new owned and exclusive brands.

We’re also seeing good balance in our category performance. Comp growth in all 5 of our core categories accelerated in the second quarter, and all of them grew faster than our first quarter comp of 3%. Among the 3 months, May benefited from the recovery of temperature-sensitive sales and July benefited from the Back-to-School, Back-to-College and some calendar shift, but comps in all 3 months were stronger than our first quarter trend.
Also of note, we saw some of our strongest market share gains around key life moments like Mother's Day, Father's Day, Memorial Day and, of course, the 4th of July. But we also saw sustained results outside of those holidays, driven by the strength of our essentials in Food and Beverage categories, which saw share gains in every week of the quarter. We saw unusually strong second quarter growth across each of our style categories: Apparel, Beauty and Home. However, Home was the standout with a comp of nearly 10% growth, driven by even faster growth in decor and kitchen, which are benefiting from our new owned brand. Within Home, we also saw strong sales in seasonal categories, reflecting encouraging early results in the Back-to-School and Back-to-College seasons.

In Apparel, we saw high-teens growth in Baby, reflecting the benefit of the unique opportunity we’re facing to gain market share in Baby and Toys, given the recent closures of Toys "R" Us and Babies "R" Us across the country. Given the strong affinity between families with young children and our brand, both Toys and Babies are key categories for us, and we expect to see traffic and share gains in both of them for the rest of the year and beyond.

Outside of the style categories, our Hardlines, Food and Beverage and Essentials categories also delivered standout growth. Hardlines was particularly strong, driven by double-digit comps in both of Toys and Electronics. Now within Electronics, we saw really strong growth in video games as well as Accessories, where we successfully launched our new owned brand, Heyday, during the quarter.

In Essentials, the second quarter growth was strongest in Baby and in pets, both of which saw double-digit comp growth. In Food and Beverage, we delivered our sixth straight quarter of accelerating comps. Growth continues to be led by adult beverage and produce, areas in which we have made important investments over the last couple of years.

To continue supporting our frequency businesses, our successful Target Run and Done marketing campaign has begun featuring convenient fulfillment services like in-store pickup and Drive-Up, making sure our guests understand all the ways they can get their Target run done. As we look at our broad category strength, what’s especially encouraging is that it isn’t being driven by higher promotions. In fact, sales at our everyday price are up more than $2 billion so far this year, reflecting the continued benefit of our team’s efforts to establish a better balance between meaningful promotions and everyday pricing.

Even for the promotional events like our July 1-day sale, we’re thinking differently about how we can provide value. More than half of our digital sales on that day were in our highly differentiated and high-margin Home category. And as John told you, we blew away our forecast for that event.

As we look ahead, we have a lot more in store for the third quarter and beyond. On top of the new owned and exclusive brands we launched in 2017 and earlier this year, which continued to perform really well, we launched 4 new owned brands in the second quarter that will drive our results going forward. Three of these new brands were designed to invite young millennials and the emerging Gen Z guests to experience Target in ways that are authentic to them.

Wild Fable is our newest Apparel & Accessories brand for young women. It's driven by current trends and focused on enabling guests to create their own style for their own many life moments. For young men, we just launched Original Use, a street-meets-vintage modern brand focused on enabling guests to explore fashion, culture and individuality. Both Wild Fable and Original Use feature a wide range of sizes, reflecting our commitment to inclusive sizing.

As I mentioned earlier, we launched our exclusive Heyday brand of electronic accessories in June. This brand is designed to appeal to style-conscious guests at an incredible value without sacrificing quality, with trendy fun and quality tech at very affordable prices.

As in June, we launched our newest home brand, Made by Design, consisting of more than 750 items in kitchen, storage, bedding, bath and even furniture, with most items below $30. This brand is the ultimate expression of Target’s DNA, a commitment to the democratization of design, offering high-quality style and affordable prices. We designed each product to intuitively go beyond the expected, delivering smart solutions that make everyday tasks easier.
For example, the cookware incorporates pour spouts on the rims and built-in strainers in the lids. Glasses are stackable, and towels include hang hooks that keep them off the floor. And items were designed to forgive minor mistakes, like silicon and nylon tools that can handle heat up to 450 degrees, in case you accidentally leave your spatula on a hot fry pan.

And finally, in addition to our new owned brand, we are really pleased with the second quarter performance of our unique collaboration with Disney to celebrate Mickey’s 90th anniversary. This collaboration features more than 350 exclusive items spanning multiple categories, including Toys, bedding, beach gear, Beauty, even pets, all celebrating Mickey and the pure magic of summer, bringing joy you can only find at Target.

Of course, beyond new items and brands already launched, we have more newness planned for the third quarter and look forward to revealing more soon. But our differentiation doesn’t just happen with new brands. We also deliver newness to our existing brand portfolio. Look at Cat & Jack.

We launched this kids brand more than 2 years ago, and sales and market share continue to grow. That’s because we continue to invest in delivering newness and great design through Cat & Jack every day, every season. Whether we’re talking about new brand or an existing brand, it’s our focus on the guest, innovation and great design at a great price that are key for Target to continue to win through differentiation, and that is not going to slow down.

With that, I’ll turn it over to Cathy, who’ll provide more detail on our second quarter financial performance and outlook for the rest of the year. Cathy?
Altogether, our operating income margin rate was about 20 basis points lower than last year, somewhat better than our guidance for a 40 basis point decline. Notably, operating income dollars were 3.6% higher than last year as the increase in total revenue more than offset a slightly lower rate.

Below the operating income line, second quarter interest expense was about 12% lower than a year ago as we continue to benefit from last year's debt retirement and refinancing activity. Our second quarter effective tax rate was 21.8%, down nearly 10 percentage points from last year, reflecting the benefit of federal tax reform legislation. Bottom line, we reported second quarter GAAP EPS from continuing operations of $1.49, up 22.7% from last year and adjusted EPS of $1.47, 19.8% higher than a year ago.

Stepping back to look at the first 2 quarters of 2018 in total. Target's comparable sales have increased 4.8% from last year, and our GAAP and adjusted EPS are both up about 15%. This year-to-date performance reflects the traffic and sales benefit of our strategic initiatives, continued significant investments in operating income and the offsetting benefit from federal tax reform.

Turning briefly to the balance sheet. We ended the second quarter with about $9.1 billion of inventory. This represents an 11% increase from last year, as John covered earlier. Also notable on the balance sheet is the growth in payables, which were 20% higher than last year at about $9.1 billion as well. Payables leverage has grown substantially in the last couple of years as the team has focused on improving that metric as a source of funding for the meaningful investments we're making.

Even accounting for this investment in our inventory, our business continues to generate very healthy cash flow. Specifically, through the first half of 2018, our continuing operations have generated more than $2.7 billion in cash, providing ample capacity to make meaningful investments in our business while returning capital to shareholders.

In the second quarter, we made capital investments of just over $1 billion, and we remain on track for CapEx of about $3.5 billion for the year. These investments are concentrated primarily in store projects, including remodels, other presentation enhancements and new urban and college locations around the country. Beyond those capital investments, in the second quarter, we returned just over $0.75 billion to our shareholders in the form of dividends and share repurchases. And in June, our Board of Directors approved a 3.2% increase in our quarterly dividend from $0.62 to $0.64. With this increase, 2018 is on track to mark our 47th consecutive year of annual increases.

Finally, I always like to close my quarterly commentary with a discussion of Target's after-tax ROIC. This is a key metric we monitor closely as it incorporates both our operating performance and the quality of our capital deployment decisions. For the trailing 12 months ending in the second quarter, we recorded after-tax ROIC of 16%, including the discrete benefits of federal tax reform that we recorded in last year's fourth quarter. However, even after we exclude those discrete benefits, our second quarter ROIC of 14.2% was up about 70 basis points from a year ago. It's encouraging that we are returning to growth in this metric as we're seeing the initial impact of last year's strategic investments in capital and operating income, which were designed to best position Target for success over time.

So now let's turn to our guidance for the third quarter and the full year. As we look at the underlying drivers of our traffic and sales, there are more positive indicators than we've seen for many years. These indicators are reinforced by our comparable traffic and sales results, which have been gaining momentum over the last 1.5 years. As a result, today, we updated our guidance for both the third quarter and the back half of the year, and we are now planning for comparable sales growth in line with what we delivered in the first half of the year.

As we move down the P&L to the operating income line, we continue to plan cautiously and focus on the unique opportunity we're facing to capture additional traffic and market share in key categories like Toys and Baby. In light of that opportunity, we have updated our expectations for the gross margin mix of our sales for the remainder of the year, reflecting higher sales expectations in this lower-margin category. With this updated mix expectation, we are now planning for a gross margin rate decline of 30 to 40 basis points in the third quarter.

Combining that expectation with our forecast for a slight increase in our SG&A expense rate and a small amount of rate favorability on the D&A expense line, we are planning for a 20 to 30 basis point decline in our operating income margin rate in the third quarter. These expectations translate to an expected range for both GAAP and adjusted EPS of $1 to $1.20 in the third quarter.
For the full year, we are now planning for an operating income margin rate decline of 30 to 40 basis points on a higher base of expected sales. These expectations translate to a full year outlook for adjusted EPS of $5.30 to $5.50 compared with our prior range of $5.15 to $5.45. We believe this expectation achieves the appropriate balance between shorter-term and longer-term priorities. Namely, it reflects improved bottom line expectations resulting from an increase in expected sales while allowing the flexibility for our business teams to invest appropriately in the traffic and the market share opportunities we're currently facing in a number of key categories.

As we enter next year, we will be well positioned to benefit from these share gains. In addition, we'll benefit from achieving much greater scale across all of the capabilities we've been testing and launching across the country. With this scale, we will realize efficiencies and cost savings, which will position us to deliver profitable growth in 2019 and beyond.

Before I turn the call back over to Brian, I want to thank all of you who are listening for staying with us on the journey we began last year. At the beginning of 2017, we said that to position Target for long-term success, we needed to make some bold investments in both capital and operating margin to accelerate our transformation and deliver more relevant experiences, brand and fulfillment options to our guests faster. The momentum of our results since that announcement 18 months ago makes us more and more confident that we are making the right investments, and that affirmation is coming most strongly from our guests. We're seeing unprecedented traffic and the best comp sales trends in more than a decade.

As Brian said earlier, there is no doubt that the environment is an important factor in our current success as consumer trends are the strongest they've been in some time. But market share data continues to confirm that we are growing faster than the market in the broad set of categories we sell. While this is great to see, we are just entering the next phase of our transformation, and we have much more to accomplish in the months and years ahead.

With that, I'll turn the call back over to Brian for some final remarks.

Brian C. Cornell - Target Corporation - Chairman & CEO

Thanks, Cathy. Before we move to your questions, I want to add to what Cathy was just saying. 18 months ago, when we were developing our plan to make additional investments in our business, so we could move faster, we considered all of our stakeholders as we evaluated our options. Obviously, we started with our guests since they are at the center of everything we do, but we also decided to increase our investments in our Target team, adding hours, training and wages to allow them to better serve our guests.

We thought about our merchandise vendors and how we can change the way we work together to deliver quality, newness, differentiation and value to our guests. We looked at our community giving and corporate responsibility efforts, focusing on the issues most important to our guests and where Target can have the most impact. And we obviously considered you, our shareholders, because your capital supports all the investments we make.

So as I mentioned at our Financial Community Meeting last spring, I am very grateful for the personal comments I received from many of you in support of the commitments we've made to our business, our team, our community and creating long-term shareholder value. I hope you're as excited as we are to begin seeing the benefit of the long-term decisions we made last year, which are already driving a higher level of engagement between our guests and our brand.

With that, we'll move to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Seth Sigman with Crédit Suisse.
Seth Ian Sigman - Crédit Suisse AG, Research Division - United States Hardline Retail Equity Research Analyst

My question is about the guidance. So the guidance seems to imply, I guess, slightly better operating profit growth in the second half of the year. In the second quarter, it was up, and it was up for the first time in a very long time, which is nice to see. But it was down for the full first half on similar comps to what you're assuming for the second half. So can you just remind us of some of the drivers? And Cathy, we got the margin commentary, but just help us a little bit more with some of the levers as we move into the second half of the year, some of the cost savings and other opportunities that will help support that operating profit growth.

Catherine R. Smith - Target Corporation - Executive VP & CFO

Yes, Seth. Thank you. As we did say, we're obviously very, very pleased with the quarter, so thanks for the comment. And as we think about updating our guidance for the remainder of the year, we expect consistent sales. So first, on the top line, we see the back half and we've got plans for consistent sales growth in that same range, which is obviously very strong, consistent with the traffic and sales we've been seeing. And then on profitability, we see a great opportunity to continue to take share and go after some categories, specifically Toys and Baby. So we baked that in into the back half of the year. So all of that said, we'll continue investing in both the fulfillment aspects, which are coming through in gross margin, and then the category mix. And then on the SG&A line, we'll continue to invest in our stores. All of that said, we expect the back half of the year for a slight deterioration in op income margin rate.

Brian C. Cornell - Target Corporation - Chairman & CEO

But Seth, we feel like we're very well positioned for the back half of the year. As I've mentioned with my prepared comments, we're seeing a very strong start to Back-to-School and Back-to-College. We continue to see very strong traffic trends. And we expect to monetize that in the back half of the year. So you should expect continued strong performance from Target throughout 2018, but it also sets us up for a very strong performance as we go into '19 and beyond. So I think we're well positioned to continue to build off of the current momentum. And you should expect us to begin to grow operating income from a dollar standpoint.

Catherine R. Smith - Target Corporation - Executive VP & CFO

And as you've mentioned, op income dollars did grow in the second quarter.

Seth Ian Sigman - Crédit Suisse AG, Research Division - United States Hardline Retail Equity Research Analyst

That's great color. If I could just follow up, Brian, on your point. I mean, clearly, there's broad-based strength here, and you highlighted that you don't think it's any single initiative. But can you maybe speak to the biggest surprises relative to your expectations? Because, obviously, the quarter turned out better than expected as well as the outlook. So just any more color on, relative to your expectations, what is outperforming?

Brian C. Cornell - Target Corporation - Chairman & CEO

Yes. Seth, I'll start with each one of our key initiatives is ahead of the schedule that we have set 18 months ago. We continue to see really positive responses from our store remodels. And John mentioned that in the month of July alone, we had over 250 stores under construction. In each and every market, we're seeing really strong guest response to those reimaged stores. Our new small formats continue to impress and are driving productivity from a sales standpoint that are beyond our expectations. The reaction the guests has had to our new brands has been spectacular in Home, in Apparel and now in electronic. And each one of the fulfillment capabilities continues to deliver a great response from the guests. John talked about the Net Promoter Score we're getting for a service like Drive-Up that we'll bring to scale for the holiday season, the reaction we're getting in each and every market to Shipt and the quality of Shipt shoppers that are servicing their members. In urban markets like New York or Chicago, San Francisco, Boston, D.C., the ability to shop our urban small formats and then, hours later, have someone deliver that package to your
doorstep for a $7 charge, very well received. And the investment that we’ve made in our store teams and putting more expertise in departments like Beauty and Apparel, in Food and Beverage, in technology, the reaction we’re getting from our guests exceeded our expectations. So all of our key initiatives, as they’re working together as one, are ahead of the schedule that we would have set 18 months ago. And now as we move into the holiday season, we’ll have more of those at scale, and as we move in to ’19, we’ll be further ahead of the original plan that we had established back in February of 2017. So each one of the key elements is working ahead of the schedule we have set back in February of 2017, and we expect that to continue to accelerate. And as you’ve heard me say numerous times, the traffic number to me is the most important measure that our strategy is connecting with the consumer both in our stores and online, and we continue to see very strong traffic as we go into the third quarter.

Operator

Our next question comes from Mike Lasser with UBS.

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

You mentioned that the remodels were -- the dramatic activity done in July. Was there actually a drag from that, the traffic and same-store sales results would have been better had it not been for some of the remodeling activity?

Brian C. Cornell - Target Corporation - Chairman & CEO

Yes. Mike, it’s certainly disruptive when we’re remodeling stores. And now we’re doing it at scale. So we’re very focused, John and his team, on shortening the construction cycle, less disruption, rapid recovery. But you can only imagine, with over 250 stores under construction during an important month like July, there was significant disruption in those stores’ sales. We’re going to see the recovery as we go into the third quarter, and we certainly expect to have even better response in those stores in Q4. So when we remodel, there’s significant disruption in sales, but we’re seeing that return very quickly once we complete the remodel.

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

And is that also the case -- I mean there was a shift with your same-store sales, and it seems like, based on your guidance, the shift has been really a meaningful story here in what you saw in the third -- in the second quarter and what you expect for the next couple. And then I have one last follow-up.

Brian C. Cornell - Target Corporation - Chairman & CEO

Yes. Mike, while we’re very pleased with the rollout, at this point, it’s a very, very small impact to our overall sales. So we certainly expect over the next few years that Shipt will have a more meaningful impact on our overall performance, but at this point, it’s still on a very nascent stage.

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

I’m sorry, that was my fault. I meant like a calendar shift rather than...

Brian C. Cornell - Target Corporation - Chairman & CEO

No.
Michael Lasser - UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines

I'm sorry, my fault, I should have spoken clearly.

Brian C. Cornell - Target Corporation - Chairman & CEO

We've seen no major impact to the calendar shift throughout the season.

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

Okay. And then the last question -- the follow-up is -- so it sounds like the gross margins could be impacted by the mix, which is a prudent strategy and totally reasonable for the back half. Is there also some effect from fulfillment costs as e-commerce becomes a bigger portion of the mix? And does that act as a continued drag beyond just the next couple of quarters?

Brian C. Cornell - Target Corporation - Chairman & CEO

We're certainly going to face some headwinds from the rapid growth that we've seen online. Our digital performance is up 41% on top of 32% last year. But I think Mark and our entire team have done a sensational job of managing gross margin rate. You look at the kind of growth we drove in the second quarter, up 6.5%. You look at digital growing by 41%. And we're able to basically maintain gross margin rate equal to last year. I mean, the erosion was 10 basis points. So with that kind of explosive growth, we're managing mix very effectively. And it's -- we're -- and again, you've heard us talk about this before. The continued performance of our own brands plays a very prominent role in allowing us to manage our mix. To have a category like Home grow at almost 10%, driven by some great new brand launches, led by Made by Design during the quarter, that's how we're managing to mitigate some of the gross margin rate deterioration that others are experiencing right now. So I feel really good about the efforts of the team and our ability to continue to drive store growth at almost 5%, build our online business at a rate of 41%, but use our mix management and our owned brands to deliver very strong gross margin rate performance in the quarter.

Operator

The next question comes from Oliver Chen with Cowen.

Oliver Chen - Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst

Our question is about pricing and promotion. What are your thoughts on managing that in the context of what you've been doing and the consumer environment? You've done a really good job with that gross margin rate. I'm just curious about value and how you'll continue to communicate that. Also, we were curious about the loyalty program. You have a very loyal customer, but what's ahead in terms of what you're thinking there just to capture that and continue to engage [that customer]?

Brian C. Cornell - Target Corporation - Chairman & CEO

Oliver, why don't I start with loyalty, and then let Mark talk about our continued efforts to support our priced right daily positioning. I mean, the loyalty program is off to a very solid start in the Dallas market. We're watching that carefully. John Mulligan and I are actually going to be heading down there this week to assess the program, and our performance in the market, still in a very early stage. But as we think about 2019 and beyond, we certainly expect our Target loyalty program, Target Red, to play a very important role in building even greater engagement and loyalty with our guests. So lots more to come as we get into 2019 and think about loyalty. But Mark, why don't you talk about our efforts on the pricing and promo front and our continued support of being priced right daily.
Yes, Oliver, I think that what we did with priced right daily beginning in 2017 and our opening price point stance, which really spans how we're pricing everyday both in national brand and owned brand, has been really key to part of the traffic generation and seeing consistent flow, whether it's in stock-up or, more importantly, in fill-in trips that are changing our frequency business, but also, across the board, make it very easy for the guests to shop in store and online with great transparency and simplicity of pricing. So we've been able to exercise great pricing, communicate simply to the guest, and we're getting credit for that. And then the data that we're seeing in share in each of the categories is really reinforcing that.

Oliver Chen - Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst

That's really helpful. Our last question was about supply chain. You made a lot of really encouraging progress on supply chain. What are your thoughts about the state of speed and stock levels? And we saw a lot of the technology and thoughts you have ahead at your Investor Day at Target lab. What are you seeing in terms of how you'll manage the bricks-and-clicks story and also how you'll manage for the smaller pack sizes? Would love an update there.

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

Yes, another great question. I think I talked about this a little bit in my remarks. The challenge for us is balancing changing the business while we operate the business. And as you said, we showed you a lot of what we're doing to change the business. We'll start scaling a lot of that work in 2019, and that has the opportunity to significantly move our capabilities forward as we begin to scale that work. I think, right now, we said as the sales accelerated particularly in Q2 -- Q1 to Q2, there are some areas where we've been spotty on in-stocks, and we're not happy with that. And you see the response in our inventories. We've -- we're flowing goods in a little bit earlier for Q4 so that we can flow them into the stores appropriately. We've taken positions in things like A&A basics, things like denim, chinos, where last year, frankly, the new brands came out and we are almost immediately out of stock. We've made investments there. And then we're working hard on Food and Beverage. And as Mark said, we're gaining share for 6 quarters in a row, so we're learning how to operate that business both differently in the store and in the supply chain. So we feel good about the progress we've made, but we are not satisfied with our current in-stock position. There's more work to do there.

Operator

The next question comes from Chris Horvers with JPMorgan.
Christopher Michael Horvers - JP Morgan Chase & Co, Research Division - Senior Analyst

Why don’t you – you focused a lot on scaling in terms of 2019 the different initiatives but also in terms of the investment phase. At the Analyst Day earlier this year, you called out ’18 as an investment year, and you’re reiterating your view of profitable growth in ’19 and beyond. Can you frame how you think of that in terms of the margin rates in the business, including gross margin and operating income rate? Could we see flat grosses in ’19 and up OI rate? Or are you thinking about profitable growth in terms of a flow-through on a flat OI rate?

Brian C. Cornell - Target Corporation - Chairman & CEO

Chris, this won’t to surprise you. We’re not going to give 2019 guidance today.

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

I’m trying.

Brian C. Cornell - Target Corporation - Chairman & CEO

I know you are, and you’re trying hard. But I would refer you back to Cathy’s comments earlier. When we look at our second quarter progress, really strong gross margin rate for a company that grew at our level. And for the first time in a while, operating income is growing from a dollar standpoint. So we’re seeing some improvement in our performance. We expect that to continue over time. But you’ll have to stick with us for another day when we’re ready to give 2019 guidance.

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

Understood. And then in terms of the e-commerce growth, you called out a big lift from the 1-day sale, but at the same time, you’re scaling a lot of fulfillment options into the back half. So do you think you can maintain sort of that 40% online sales growth into the back half? And how much of that contributes to the updated comp outlook versus, say, share in Baby and Toys in these key seasons coming up?

Brian C. Cornell - Target Corporation - Chairman & CEO

Chris, I’ll let John build on this, but we expect very strong digital growth in the back half. Obviously, we’re guiding to comp sales that are going to be very consistent with our first half performance. You’re going to continue to see us scale up Drive-Up and Shipt same-day delivery in urban markets, so that’s going to play a very meaningful role. But you should expect our stores to be a very important driver to our growth in the back half of the year and complemented by continued maturity in our fulfillment capabilities.

Catherine R. Smith - Target Corporation - Executive VP & CFO

I’ll just add real quickly, Chris. Stores did almost [5%] comps by themselves. And obviously, our stores are fulfilling much of that 41% digital growth, and so well over 2/3 of that digital growth is being fulfilled out of our stores. And so we’re blurring those lines every single day, making sure we have a great experience for our guests and letting them choose to shop how they want to engage with Target. And so we’re going to start talking less and less at some point about that actual digital comp because it is truly our entire business fueled by those stores.

Operator

The next question comes from Matt McClintock with Barclays.
Matthew J. McClintock - Barclays Bank PLC, Research Division - Senior Analyst

Brian, I was wondering if I could ask a macro question. So the broader retail industry has truly enjoyed a resurgence across the board this quarter. Target seems to stand out because of the traffic, as you highlighted. But I was wondering if I could get your thoughts on what’s driving this. Why does the consumer -- the American consumer all of a sudden just wake up and start going to retailers again? And then thinking forward, how should we think about Target’s strength this quarter and the traffic trend this quarter, the strength in everything in that all throughout the year when we get to 2019 and you’re up against that comparison in 2Q? Because I just want to say, in 2Q of next year, there's going to be a lot of skepticism that you can comp the comp at that point in time. So just your thoughts.

Brian C. Cornell - Target Corporation - Chairman & CEO

Let me start with the macro environment. And we've talked about this a lot over the last few years, and there's been a lot of questions about the role stores would play and was everything going to shift online. And I think the one voice that was missing from that conversation was the voice of the consumer, and consumers continue to vote with their footsteps. And as we sit here today, the numbers tend to vary from week-to-week, but on any given day, 90% of retail sales are done in physical stores. And I think what you’re seeing right now from a macro basis is well-run retailers with strong balance sheets that generate cash that they can invest back in their business are winning right now. And there’s obviously others right now that can’t afford to invest in their store experience or build capabilities or drive differentiation, and they’re giving up share. So there’s clearly winners and losers. We certainly think we’re migrating to the winners column. And we're driving not only traffic, but as Mark and Cathy and John have talked about, we're taking market share in all of our major merchandising categories. And the investments we're making to make sure that Target is a long-term winner are being rewarded right now by the consumer and our guests. So we’ve got to continue to make sure we focus on executing our strategy as we go into '19, continue to take advantage of some market share opportunities that are out there. And I'll go back to our February 2017 investor conference. And one of the things we've talked about in our overall management thesis is there are going to be billions of dollars of retail market share up for grabs, and we're going to position ourselves to take more than our fair share of that. We're seeing it happen. As companies like Toys “R” Us and Babies “R” Us exit the market, as others close stores, we're picking up market share in those important categories, in those key geographic catchments. And we'll expect to continue to do that in '19 and beyond, and it's what gives us confidence that we're going to be able to lap these strong numbers in 2018 with continued strength in '19 and beyond.

Operator

Our last question comes from Joe Feldman with Telsey Advisory Group.

Joseph Isaac Feldman - Telsey Advisory Group LLC - Analyst

I wanted to go back to something, I think, John was talking about with the labor and some of the changes maybe in the way you’re hiring people and kind of the way you’re allocating labor in the store and some of the transformation in the back room. Can you just give a little more detail on that and explore that issue?

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

Sure, Joe. I think, internally, you probably heard us talk about the store modernization, and it’s really Ken and the store team doing a great job just stepping back and saying what it is we’re trying to accomplish in the store. And certainly, there’s the work we have to do moving product out to the sales floor and checking people out and all the things that just happen because they have to happen in the store. And our goal there is to become more efficient and to become more efficient not just for efficiency’s sake, but to provide the fuel so that we can invest in more talent and better expertise on the sales floor and in particular, in those areas where it matters the most. So think Beauty, Electronics, with our visual merchandising in both Home and Apparel and then in Food. Those are areas where we have gone out and actively hired for expertise, and that’s where things like the wage investment are so critical. They’ve allowed us to differentiate in who and how we hire people. And so those team members finding ways to bring that expertise in and then keep them on the floor so that the Beauty team member is in Beauty all the time and they’re able to help the
guest and they also keep track of what’s going on in that part of the store relative to in-stocks and inventory flow. And so rather having a team of generalists doing price change one day, checking out the next day and maybe moving freight on Wednesday, these individuals are accountable for their part of the store. They’re out there, they get to know the guest and provide a very different level of experience. And then we’ve invested in tools and a significant amount of training to help them. And this has been a journey we’ve been on for a couple of years, and we will be on it for a couple of more years as the team continues to evolve and build capabilities. But we think it’s something incredibly important to our long-term success.

Brian C. Cornell - Target Corporation - Chairman & CEO

John, thank you. And operator, thank you. That concludes our Q2 earnings call. I appreciate everyone joining us today, and we look forward to talking to you again when we talk about our Q3 results. So thank you.