CORPORATE PARTICIPANTS
John Mulligan Target - CFO

CONFERENCE CALL PARTICIPANTS
Adrianne Shapira Goldman Sachs - Analyst

PRESENTATION
Adrianne Shapira Goldman Sachs - Analyst

Target has been a long-time presenter at the Goldman Sachs conference, and new to the podium is John Mulligan. He’s the new (inaudible) CFO of Target. He’s not new to Target. He’s been there for 16 years. And the good news is Target has been on a roll all year. Year-to-date comps up 4%. They beat earnings in both the first and second quarters. That's driven nice stock performance, up 23% year to date versus the S&P. It would seem to be highly coincident with a new CFO. (Inaudible). They are planning some exciting new stores this year with City Targets opening in Canada. So, with that, I'm excited to have John Mulligan, CFO, and, with him, of course, is John Hulbert.

John Mulligan Target - CFO

Thanks, Adrianne, and thanks for all of you being here today. I recognize you have all had a long day. And, likely, the only thing between all of you and a cocktail is me. The same is true for me, so I think it's in our collective best interest that I move this apace and will do so.

Before we start my presentation today, there will be some forward-looking statements. Those should be taken in the context of our financial filings with the SEC, which are also available on our Website.

And, now, on with the show. So, our agenda today. I'll start with a business update, a little bit, just very briefly, on our progress toward our long-reach financial plan, and then we're going to spend a little bit of time here in a little bit of detail -- we're going to drag you through the muck a little bit to walk through the household-level financials of 5% REDcard rewards. So how do those actually play through our financial statements we’ll spend some time on today.

So, first, our business update - at the beginning of this year, we laid out a plan for 2012 that fully supported our long-range goals, which are to have $100 billion or more sales, $8 or more of EPS by 2017. With a lot of very disciplined execution throughout the year, as Adrianne said, we're well on our way. A great start to the beginning of the year. And we want to talk about our progress year to date versus our 2012 plan.

Starting with the US retail segment - our comparable store sales - while we certainly planned for the beginning half of the year to be front loaded as it related to comp store sales performance, given the relatively easier compare Q1 to Q1 and our point of view on holiday sales in the fourth quarter, we're still very please with the 4.2% year-to-date comp through the first six months versus our plan for three; so, a really good start. Similarly, EBITDA margin we said about flat for the year, and, through the first six months of the year, that's essentially right where we are.

And, finally, REDcard penetration increase - we said up 300 basis points or perhaps a little bit more. Year to date through the first six months, up 410 basis points.

So these really critical metrics for our retail segment we feel great about.

Credit card segment - we thought going into the year that our risk metrics would start to find equilibrium about where they were at the end of last year and we'd, with that level of performance, generate a spread to LIBOR about 7%. We've seen continued good news in net write-offs, continued good news in delinquencies. And so the combination of good news in write-offs, some reserve releases because of the delinquency good news, leads us to a spread to LIBOR of 9.3%. So, again, very strong performance in our credit card segment.
Canada - we continue to invest in the team, technology, supply chain. Ultimately, in second quarter, we began to take control of sites, and those are undergoing remodeling. So we began that process as well. All that investment together led us to believe $0.50 of dilution this year from the Canada segment. And, through the first six months, we’re right on track with that.

Finally, a little, quick view of our deployment of capital - CapEx plan in the US is $2.5 billion; Canada $800 million, right on track.

Share repurchase - we said $1.5 billion or more, right on track. And, actually, here, we got off to a great start. The first half of the year, we actually bought back $1.15 billion of shares in the first half of the year. And then, in second quarter, we increased our quarterly dividend by 20%, and this puts us right on track to have our 41st consecutive year of annual dividend increases later this year.

So our 2012 performance off to a very strong start. And I want to put the 2012 -- our outlook for 2012 in a little bit of context around our long-range plan. As I said earlier, our long-range plan, $8 of EPS. $7.20 of that will come from the US, $0.80 from Canada. Last year, we started reporting a metric, adjusted EPS, and, really, that’s the EPS from our US operations. And our intent was to provide you clarity about how our US businesses were performing, given all the dilution that’s going on in our P&L, given all the Canada investments. Shown here is a smooth path between $3.86 in 2010 and $7.20 in 2017 of adjusted EPS, or where we need to be to achieve our long-range plan. The data points in between are not necessarily guidance but are more benchmarks so that you guys can track -- are we on our way to $7.20, each year as we go along. As you can see, in 2012, $4.61 is the benchmark. And our adjusted EPS outlook for the year right now is $4.65 to $4.85. So, even if we achieved the low end of that range, we’re right on track to achieve our long-range plans.

All of this put together, we feel really good about the first half of the year and are excited where we’re headed with our business right now.

Now, as I said, we’re going to go into a little bit of the muck of our 5% rewards program and do this in a little bit of detail. The intent here isn’t to overwhelm you with numbers but to give you a much better sense of how this plays throughout our P&L and, ultimately, how we get economic returns by investing that 5% mark-down on our sales. There’s nothing new here. We’ve just kind of constructed it all in one place, so we can walk you through it all at once.

We start with our stylized example here. Household spending $1,000 a year at Target. The P&L for this household is exactly the same as the P&L for our retail business in 2011, which we reported. The other note I would make is this is a household that doesn’t use a REDcard today. They’re using a third-party credit or debit. Here, we’ve assumed a third-party debit card. So there’s a little bit of interchange embedded in SG&A, which will go away as we switch to the REDcard.

A guest signs up for REDCard, the first thing that happens is we take 5% off everything they’ve already been buying from us. We lose $50 of sales. We lose $50 of gross margin. Our EBITDA rate drops to 6.3%, and EBIT goes down to 3.2%. And, of course, this, if this is what we saw in Kansas City, we wouldn’t be here today having this conversation. This is not what we saw. So, moving forward, this becomes our new baseline for our household. And, of course, the baseline here is much less profitable than it used to be.

But, we layer on incremental sales. And we said debit or credit product doesn’t matter. We see in excess of 50% sales lift. So, to get back to $1,500 of sales, which represents 50% sales lift, we add $550 of sales. Those incremental sales have a gross margin rate of 25%. That’s the 5% markdown plus just a tiny bit of mix bad news; so, a little bit more grocery and electronics, but really unimportant in the big scheme of things.

SG&A rate - here, we look at a marginal SG&A rate on these incremental sales. We said between 7% and 9%. Here, we chose 8.5% to be on the conservative side. And, again, a little bit of good news, because we have no interchange.

It gets us to an EBITDA rate of 16.5%. And, importantly, you see leverage across D&A. And that’s because there is no investment here to drive these incremental sales. So we pick up good news in EBIT rate, as well, at 16.5%.

Put the whole picture together. Now the combination of the baseline plus incremental sales -- we’ve picked up $500 of sales. Margin rate is down. SG&A rate is down. EBITDA ends up right back where we started, 10%. And then we pick up a little bit of leverage across EBIT from D&A.
And here's the two shown together, the starting point and the end point. And, again, we pick up $500 of sales. $50 falls to the EBIT line. And we pick up some rate to 8.1%.

Taken to its illogical conclusion, if all of our sales go on the REDcard, this is what you'd see in our P&L. We'd drive incremental sales. We'd have a much lower gross margin rate, which many people would be writing about. But the number I'd be focusing on is the EBIT rate of 8.1%, much higher than our current forecast if you look at our long-range plan.

So, to tie this all together, how does this fit with our long-range plan projections? Long-range plan -- one of our key goals is driving sales in our existing stores. Here, sales are up 50%. There's no incremental investment. We're not building stores. We're driving sales in our existing business.

We said gross margin rates would be down 100 basis points or more as we get to 2017. Obviously, this is driving gross margin rates down. We said we'll offset that with leverage in SG&A. You can see the offsetting leverage in SG&A and the interchange avoidance in that P&L.

Flat EBITDA margins around 10% by 2017. This delivers flat EBITDA margins.

And then, finally, EBIT margins expanding to around 7.5%. Here you can see we've expanded our EBIT margin rates as we get leverage across the depreciation and amortization.

Putting this all together, you can see why we remain pretty excited about 5% rewards. It's not just about driving sales, which it obviously is doing, but also is beneficial to our P&L and driving significant profits for the corporation.

And, with that, I thank you for your time, and I'm happy to take some questions.

QUESTIONS AND ANSWERS

Adrianne Shapiro - Goldman Sachs - Analyst

Thanks, John. So, we're asking everyone the same first three questions, and we'll open up to Q&A. There is no breakout. We'll just stay here and ask questions, so fire away.

The first question as it relates to the back half. Give us a sense of what you're looking for relative to the first half. Better, same, or worse? And any early thoughts on 2013?

John Mulligan - Target - CFO

I talked about a little bit our expectation, first, externally, in the environment. We think the environment looks a whole lot similar today to what it did six months ago -- honestly, to what it looked like a year ago. Certainly, for our guests, it looks very similar. They continue to be very -- Gregg's used the words cautious and resilient, simultaneously. So they're very disciplined in their shopping, but they continue to shop our stores, which we feel great about.

As we thought about this year, we thought the first half of the year would be stronger than the second half, a lot of that driven by our view of fourth quarter, the holiday season, and the ultra-competitive nature of that season as it relates to driving sales. And we've said we want to strike a balance here between being there for our guest and having the merchandise that she wants at a good value during that period. But we're not interested in driving sales at all costs. And so striking that balance. And so, as we thought about the year, that played in. So the first half of the year a little bit stronger, but we're comfortable with where we're at.

2013, that seems a long way away. There's a lot between now and then. There's an election. There's a fiscal cliff. All that creates uncertainty. And so we'll be happy to talk more about 2013 a little bit down the road.
Adrianne Shapira - Goldman Sachs - Analyst

A second question as it relates to capital allocation. If you could, prioritize buyback, dividends, debt pay down. And, when you think about CapEx for the next year or two, up, down, flat?

John Mulligan - Target - CFO

Well, this would be one for any of you who followed Doug for a long time. The answer will stand staggeringly familiar. There's not much room between he and I on this or me and Gregg or the board. And all of us have a similar view. We start with the priority is investing in the business. And we'll do so up to the point that we think it makes economic sense.

So return on invested capital -- a net present value approach to investing. Five years ago, that was -- in the US, approached $5 billion a year. This year, $2.5 billion. So I think it shows that we're very disciplined as we think about how to invest capital.

The next step we think about is dividends are next. I mentioned earlier we're on track to have our 41st year of consecutive increases in dividends. The last five years, as our CapEx has come down in the US, we've increased our dividend meaningfully to 20% compound rate. If you look at where we're headed, if we get to $8 a share, we expect dividends in the $3 range. That would, roughly, be another 20% CAGR for the next five years. So taking care of the dividend becomes our second priority.

Balancing the equation becomes share repurchase. And we intend to do that while still maintaining our current investment-grade credit rating.

From a CapEx perspective, really, two stories here going on. In US last year, $2.5 billion and this year $2.5 billion. As we look out over the next several years, $2.5 billion is a pretty reasonable run rate for the US, maybe growing slightly as we get out toward 2017. The mix of that investment will change pretty meaningfully. It's been very focused on PFresh. Last year, well over $1 billion. This year, less than $1 billion. It will come down again next year. What's taking its place? Supply chain this year. We're building three food DCs right now. PFresh has given us more density, the ability to bring that business in house in an economically positive way. And then technology and multi-channel will start to consume more capital as we look out.

Canada? $1.9 billion last year, primarily driven by the acquisition costs. This year, $800 million. Next year is certainly north of $1 billion as we retrofit stores. And then, after that, 2014, you'll see that comes down markedly. So, in 2014, you'll see our capacity for share repurchase increase significantly as we leverage Canada. It becomes profitable. We leverage that profitability. And CapEx has come down simultaneously.

Adrianne Shapira - Goldman Sachs - Analyst

Great. And the last question. You alluded to it. How do you think your customers are bracing for the upcoming election? What sort of impact might that have in terms of their shopping behaviors and as it relates to the impending -- the pending fiscal cliff?

John Mulligan - Target - CFO

Hard to pinpoint exactly how consumers will respond. I think, from our perspective, all of that just creates more uncertainty. And uncertainty, we don't think, is good for retailers. So more uncertainty is a bad thing. I think, from planning our business perspective, over the last couple years, we've planned our business pretty conservatively, inventories pretty conservatively. And we're -- We think we have the ability to chase business and sell into our inventories if we need to, much like we did in first quarter this year.

So we'll see where the consumer goes. But our business will be planned relatively conservatively, and we think that's appropriate, given what's going on in the world.
Adrianne Shapira - Goldman Sachs - Analyst

Great. There's a mike out. So, if you have a question, please, raise your hand. There's a question here up front. As the mike is getting there, maybe, John, just talk about -- the fact is comps have been incredibly consistent; I mean, as you've been saying, sort of the 4% year to date. But I'm just wondering. Is this now -- ? We came off of a tough holiday season. You've characterized it ultra-competitive and kind of talked to us about being smart about the holiday season. But is this -- the comp rate that you're seeing more reflective of what the stores can do now that PFresh, the REDcard -- you know, everything is gelling and it just took a while for everything to fall into place and the consumer to kind of change their buying pattern?

John Mulligan - Target - CFO

I think -- 4% I don't know about. We said kind of 3% is what we're thinking. But we do feel good that, now, we're in the third year of PFresh, and we've got stores in all the cycles, year one, year two, year three. We are seeing our guests -- they clearly get the grocery aspect right away. But we're seeing them start to understand the rest of the store. 5% rewards -- similarly, we're seeing penetration growth, and that really just takes time. You guys -- everyone here gets inundated with offers for credit or anything else. And getting through that to have people understand the simplicity and the power of that offer has taken some time.

And the great thing we think about is we've now got this platform of stores that are as fresh as they've ever been in our history. We remodeled three-quarters of them in the last three years. And a merchandise assortment that's as compelling as it's ever been for our guests -- Combine that with PFresh, which is driving them into the store also. We have a combination of -- excuse me -- 5% rewards. 5% rewards and PFresh bringing them into the store more often. And, as Kathee Tesija, our head merchant, would say, if they're in the store, they'll see what we're doing in home. They'll see what we're doing in apparel. So we have this great platform now to build on that we really feel great about.

Adrianne Shapira - Goldman Sachs - Analyst

The question in the cheap seats, John.

Unidentified Audience Member

As you head into Q4, you're up against some easier comparison. Can you talk about what you've done online to fix some of the problems you had last year and whether you expect that to actually move the needle from a comp perspective? That's the first thing.

And then the second thing is -- overall, as it relates to holiday, November, December, again, you're up against weaker comparisons. Is that just the mix goes against you, or is there stuff that you're doing that you think can actually get you back to being more in line with the other months of the year from a comp?

So, online and the (inaudible).

John Mulligan - Target - CFO

So, online. We spent the first six months of this year -- I think Kathee talked about this on the call -- working on speed of the site. And we're going to spend the next couple months and we've had a couple releases already working on shopability of the site. A combination of those two, we think, will allow the dot.com business to start growing again.

As far as having a meaningful impact in Q4, it's, for us, right now -- it's not big enough to have a meaningful impact. It wasn't a meaningful drag in the first half of the year. We expect it to become more positive as we go throughout the year here and get through the rest of the end of this year. But it won't be a meaningful comp indicator as we get into Q4. And it was not last year either. The miss last year for us was driven by the store.
As we think about Q4, November/December, the compare will be easier, for sure. But, as I said, we are -- we've planned our business pretty conservatively, and we're not interested in driving sales for the sake of sales. So, if people are going to do what they did last year and more, you might see us lag competitors again as it relates to comp sales increases. But we'll do so -- we will be aggressive in areas that are important to our guests, and that means the guests that are coming back in January, February, March, April. And we'll be appropriately priced for the value that she's looking for at that period of time.

John made a great point. The other thing I think we've thought a lot about at the end of the last holiday season is -- how do we compete effectively our way? How do we bring what Target does well to the holiday season? And that really was the impetus. We had been talking to Neiman Marcus for a couple of years. It became much more compelling for us to do something with them, bring the designers in, and bring something that's about fashion and differentiation, which is really at the heart of how we compete in the marketplace. And we're excited about that and a couple of other things we're going to do at the holiday period. That's a little bit different and not focused so much on the lowest price of a 44-inch television.

Unidentified Audience Member

Two questions. One, Canada. Second, US distribution.

In Canada, how much can you flex your strategic expansion plans into the western provinces because of the tremendous growth beyond the Zellers store base?

Second, on US distribution, will you be self sufficient, given that you've got close to 2,000 food, drug, and discount stores, to self-distributing food by 2018 to 2020? Thank you.

John Mulligan - Target - CFO

On Canada, we -- even with the announcement of Zellers, we have been looking for greenfield sites for a long period of time. And that's -- actually, given how difficult it is to grow on a greenfield base in Canada, that's what led us to say -- You know what? We need to do something much more meaningful. You're right about the growth in western Canada. Our property development team is looking for sites all across Canada. You'll see the -- there's a couple of greenfield sites next year. That will grow in 2014. And we think somewhere around 150 or so by 2017. Part of it is, certainly, we have the desire. It takes time up there. They have limited growth policies and regulations in place that we need to work through and we need to respect as a retailer. So we're working through it, but we're pretty excited about our opportunities to continue to grow in Canada.

Food distribution? As I mentioned, we're building out three food DCs right now. When those three are in place, we'll be -- I don't know -- somewhere between 70% and 80%. And we think that's about the right place for us. There are some places we still don't have enough density. We've got a couple great partners that do great work for us. So we feel good about where we're at right now, at least for the foreseeable future.

Unidentified Audience Member

I'm wondering about how you're driving such significant increases in your same shopper sales through REDcard. I've got to expect it's more than just the 5% discount that you're probably -- are you personalizing using the analytics to engage that particular customer in a more meaningful and significant way that's driving a better relationship? It's a relationship, not a transaction.

John Mulligan - Target - CFO

I think there's a couple answers. I think, first, this is a story of correlation is not necessarily causation. So, certainly, by the time somebody takes the step of getting a REDcard from us, they've decided they're going to be pretty engaged with Target. And the 5% is enough to get them over the hurdle. The 50% increase -- interestingly, that goes back a long, long period of time. When we converted people in households to Target Visas ten years ago, their sales would go up 10%. What's different with -- 50% -- excuse me. What's different with 5% rewards is that we had a lot of people
who were one and done on the previous offer. They take the 10% off coupon, buy a television, and never use our card again. With 5% rewards, we've created an offer that's very compelling for them. It keeps the card top of wallet when they're in our store. So we see that 50% increase on a much larger number of the people who are getting our card.

I think, as it relates to the data and analytics, I think that's absolutely true. But that's true beyond people who have REDcards. Anyone we can identify as a guest, which means people swiping plastic in our stores, we can identify and tie together and provide much more compelling offers. And you're exactly right. Once we understand you and your shopping patterns, what's important -- the offers can narrow down very quickly and become quite compelling. But that's not tied to the REDcard so much. That's more about whether we know who you are -- not personally, just that we can identify you.

Adrianne Shapira - Goldman Sachs - Analyst

Great. John, can we talk a little bit about the categories? You mentioned home. And it's been a while since we -- I guess it's been about a year that you've re-assorted home. And it still shows fits and starts. What does the category need to get on sort of solid footing?

John Mulligan - Target - CFO

I think -- back up and talk about discretionary in total first, home and apparel together. You were probably sitting around this table ten years ago asking Doug about apparel because home was rocking and apparel wasn't. And, when we're healthy, our discretionary categories are going to run a little bit slower than store comp. Non-discretionaries are going to grow a little faster. That's where we are today. So that feels okay.

Now, having said that, home's not where it should be. That's certainly true. I think, there, some of the businesses have performed reasonably well. The seasonal businesses perform well, housewares. The big area where we struggled -- home decor and domestics. And I think -- when I think about it, what's worked really well in apparel, we have focused brands that are clear to our guest what she's getting when she's buying those brands. She understands C9. She understands Merona, Mossimo.

In home, we struggle with that a little bit more. Two years ago, we did Room Essentials. That was the good, the entry-level brand. That worked well. I think what we're excited about is, now, we're introducing Threshold. That will replace Target Home, which is really a mish-mash of styles and aesthetics, getting focused on a brand, the packaging, the product, the aesthetic all fitting together and bringing that to our guest in domestics and across the whole home category. We think that's a real opportunity for us, again, to mimic what we've done in Room Essentials and in the apparel categories by actually managing the brand like a brand, which we have not done in Target Home. So we think that's an opportunity for us. That's starting to roll out in this quarter and will roll out over the next nine months or so. And we think that's an impetus for (inaudible) home business.

The reality for us is the external factors are real. Household formation in the areas where we're strong, young singles, young couples, and young families, has not been strong. That's something that would help provide a little wind at our back. But, certainly, there are some things we need to continue to work on.

Adrianne Shapira - Goldman Sachs - Analyst

Staying on the category conversation, consumer electronics has obviously been a category that's been tough between deflation, online migration, and, yet, it's the category that you continue to add products and services. So kind of help us think about how you're thinking about the category in store and how we should be thinking about that evolution.
John Mulligan - Target - CFO

I think consumer electronics is an important category for us because it's important to our guest. For mom, it's important for the things that she comes to us for. Gaming is really important to her, so that has to be important to us. Children's books in another area where we have a very successful little book business dedicated -- not little -- a book business dedicated to children, because that's important to mom in our business.

But back to electronics, we need to continue to provide an assortment of goods there because that's important to her. Over the past five or six years, we have significantly shrunk the space there. And, while that has driven negative comps in that business and, certainly, some of that has gone elsewhere, the business itself is highly productive for us on a sales and margin per foot basis. So I think our merchant teams have done a great job shrinking the space.

There are some secular things that have gone against us. Gaming, there has been nothing new in years. That's an important category for us. And some of that's been replaced by iPods and iPads, which are also important to us and important to our mom. But an important category for us, and we'll continue to refine it to serve her needs going forward.

Unidentified Audience Member

Can you talk a little bit about your inventory planning for back half and through 2013? You guys have done a better job kind of managing your inventory, I think, than pretty much anybody else in retail right now. Can you talk about the sales kind of in the back half below that 3% or around that 3% comp level -- kind of continue to drive inventory down on a year-on-year basis? When do those two kind of meet up, or not at all?

John Mulligan - Target - CFO

I don't think we'll drive inventory meaningfully down. It may -- there was a couple of big things we did with second quarter we did. Some of that was timing. Some of that was more permanent. But I agree with you. I think part of that is how -- one, I think our merchandising teams have done a really good job chasing business and managing receipt flows. But, two, how we're positioning the business overall, a lot more conservatively and comfortable that we can sell down into our inventories and then chase and refill if we need to. So I think you'll see that continue to play out. We feel, given the environment, that's absolutely the right approach for us from an inventory planning perspective. And so you'll continue to see us do that.

Unidentified Audience Member

Given the recent struggles of Radio Shack, at what point do you guys take back ownership and management of the [mobility] center? And, given your supply chain prowess, do you guys still need Radio Shack as a partner to run that part of the store?

John Mulligan - Target - CFO

Radio Shack has actually been a great partner. We were -- we did some of the cell phone business ourself, not quite as well as we should have. They came in and have really helped us. They bring all the relationships that we don't have to worry about managing with them. And so Radio Shack's been a great partner. And we always look at businesses to see the best way to operate it, just like we brought them in three, four, five years ago, whenever it was. So we're always evaluating that. But they've been a really good partner for us.

Unidentified Audience Member

Between your 5% REDcard and the additional gift cards you promote with a lot of Apple products, it's not lost to me and probably a lot of your other guests that you're by far the lowest price for a lot of Apple's hottest products and, to some extent, the only place you can get a real discount on them. I was just wondering what kind of effect that has on your sales and gross margins.
John Mulligan - Target - CFO

Well, we have a great, great partnership with Apple. They've been fantastic to work with. They're one of the companies we point to that does an outstanding job of channel management. And we're happy to do more. We're testing stores today with them.

As far as the 5% rewards, we view that more as a prepaid credit card reward. I mean, today, if you buy an Apple product with somebody else's card, ultimately, there's a reward coming back to you. Ours is visible because it happens right at point of sale, in the moment. So it's not that we're discounting Apple products. It's more about us just having the rewards program happen instantaneously in the check lane.

Adrianne Shapira - Goldman Sachs - Analyst

John, you were part of the team that came up with the $8 in earnings power in 2017. But now you're the guy that we're going to be looking to to deliver it. So, when you think about --

John Mulligan - Target - CFO

(Inaudible).

Adrianne Shapira - Goldman Sachs - Analyst

That's right. That's convenient, John. I like that. So, when you think about the $8, kind of walk us through the puts and takes in terms of where you think there's opportunity and where there might be some greater risk (inaudible).

John Mulligan - Target - CFO

I think the opportunity -- we have said that we have not built in a lot of good news in the economy. If the economy looks like this in 2017, we feel like our chances are pretty good. If it gets worse, obviously, it will be tougher. But I think, if it gets better, we think that's a little bit of wind at our back, and that's probably the one big opportunity I see.

The pressure point -- honestly, the one we focus on and work hardest on constantly -- I showed you the gross margin pressure related to 5% rewards. There's gross margin pressure related to PFresh. We have historically, for 15 years, had mix gross margin pressure in our P&L. Our merchants work hard to offset that. When you consider online and the pricing pressure that perhaps might come there, I think gross margin rate is the one that we are going to work hard on. We've shown and we have a long history of overcoming that. If you look at our EBITDA rates through time, very, very stable in the Target business. But gross margin rate is the one that we will work really hard on and that I know our merchandising teams work very hard on.

Adrianne Shapira - Goldman Sachs - Analyst

Great. John, let's talk a little bit about competition. Obviously, it's always dynamic and volatile. We had Wal-Mart here today. They're feeling good. They've now had four quarters of positive comps.

John Mulligan - Target - CFO

We've had eleven.
Adrianne Shapira - Goldman Sachs - Analyst

Who's counting?

John Mulligan - Target - CFO

Who's counting?

Adrianne Shapira - Goldman Sachs - Analyst

But, on the flip side, J.C. Penney, not so good. So kind of help us think through where you see piles of opportunities and share up for grabs and where maybe things are getting a little bit tougher.

John Mulligan - Target - CFO

I think, any point in retail, there’s somebody really struggling and somebody doing a little bit better. Wal-Mart, you mentioned, actually is performing really well. You’re right about that. Costco is performing well, like they always are. And a few other companies are performing well. You have Best Buy, Penney’s, who are struggling right now a little bit. We think we’re performing well. And some companies in the middle. I think part of this is we tend to think of this a little bit like a zero-sum game. A dollar moves from here to here and here to here. It’s hard for us to track that exactly. Penney’s is interesting. Certainly, the first half of the year has been a challenge for them, sales down meaningfully. Where that’s all gone isn’t entirely clear. And so part of it is maybe the market moved a little bit and people just shopped a little bit less. Hard to know.

But I think, for us, what’s important is we pay attention to that. I think, as it relates to competitive, we pay a lot of attention to what’s going on from a pricing perspective. And that -- Wal-Mart, always aggressive on price but appears to be rational right now. Kohl’s has talked about opening price points. Others are talking about pricing. That’s going on today. So we pay a lot of attention to that. Beyond that, we’re really focused on -- what does our guest need from us, and how can we deliver that? And, if we’re focused on that, we feel good about our chances in the long term.

Adrianne Shapira - Goldman Sachs - Analyst

Then, following on that, in terms of the intensity of pricing in the back half, many, yourself included, should see some margin tailwinds because of deflation this year. So, as you’re thinking about positioning into the holiday, do we see that as some margin opportunity or price investment?

John Mulligan - Target - CFO

I think, one, you guys all know Wal-Mart. They largely don’t let you hold on to price deflation. And what we’ve seen historically is, and we said this last year, inflation went up. We did some things to mitigate it but also raise some price points. We saw units come down. We got to about the same amount of sales. When we see the price deflation, it’s a competitive marketplace. And Wal-Mart certainly ensures and forces a competitive marketplace. And so we see prices come down. We don’t think there’s a lot of margin opportunity. We think we’ll get to the same sales. Units will probably come back a little bit with prices coming down. We think we’ll get to same sales overall, but not a lot of margin headwind from that. We have not experienced that historically in our business.

Adrianne Shapira - Goldman Sachs - Analyst

Great. Let’s talk a little bit about City Targets and, obviously, two or three open.
John Mulligan - Target - CFO

Three.

Adrianne Shapira - Goldman Sachs - Analyst

Three. But, when you think about longer-term potential and how -- where that fits in terms of the US, Canada, City Targets, kind of share with us the opportunity.

John Mulligan - Target - CFO

Well, we're three weeks in. We're pretty excited with three weeks of results. Obviously, we model our stores a little longer than three weeks, so a little bit of distance to go. But we feel good about where we are. I think the opportunity for City Target, if we could get all the land we wanted -- could we open up 100 or 200? Sure. Maybe, if things go like we think they might.

But I think the most important thing as it relates to City Targets is this, much like Super Target, forced us when we went into food in a real way -- this is going to force us to operate differently. A much smaller format, which means a different supply chain and a different store operating model and a different assortment. And, for us, learning that -- segmenting stores has not been a strength for us. We're working hard on it, but it's never been a strength for us. We're very centralized so that you get that same, consistent experience. But learning to operate these stores differently is something we can bring to the chain. And, ultimately, do we get smaller formats? That's the, perhaps, learning down the road.

So, for me, this is about how do we learn to optimize our existing chain, to optimize Canada, and then look at ultimate formats down the road. And I think that's the real value of City Target for us.

Adrianne Shapira - Goldman Sachs - Analyst

And, then, let's talk a little bit about Canada. Here we are getting ready to launch there. As you think about the market, think about the assortments, as you see maybe the competitive response before you enter, has anything changed meaningfully in what your expected financial model is, in that you said from the get-go you're expecting those stores to be more productive in Canada and the US. So has anything changed that thinking?

John Mulligan - Target - CFO

No. I think we're very excited by the response we've gotten in Canada. Our potential guests there seem very excited to have us there. We've said those stores -- as we modeled them, we modeled them a lot like the urban stores that you would see out here on the east coast -- more investment, higher sales velocity, a little bit better margin because of sell-through, a little bit higher expense because of what goes on here. Net/net, the economics work out very similar to what we see everywhere. That's largely what we've been as we've continued to refine Canada.

We've had some puts and takes as we've learned more in Canada, some things were a little bit more than we thought. Some things went better than we thought. And I would tell you when we underwrite to about a 13, after tax, IRR. I always forget to say that part. And we had a pretty wide distribution about where that might end up when we first went into this. We still think 13 is about the right range, but we've narrowed down a little bit. And the one variable now is sales and how quickly sales grow. Do we open up really strong and we get a little bit softer comps? That would be great. Do we open up a little bit softer and we get stronger comps? I think we're pretty confident about those fifth-year sales. We've shown in the US through time we're really good at fifth-year sales. We're a little bit less accurate in year one about what will happen on an individual store basis. So we'll get to those fifth-year sales. It's how quickly we get there. And so we've just kind of stopped modeling, but we feel good about where we're at right now.
Adrianne Shapira - Goldman Sachs - Analyst

Great. And, then, could you update us on the potential sale of the credit card portfolio – what sort of financial implications if a sale went through and the amount of dilution management is willing to absorb?

John Mulligan - Target - CFO

Sure. So, we've said for what seems like a very long time - right partner, appropriate terms. And we're very focused on that. Right partner here is really important. They'll be underwriting the loans, and we want to make sure we have the right partner that we'll be servicing the guests with and that we work well together. So that's important for us. And then appropriate terms means the right economics. Last January, we had this very new 5% rewards portfolio. We had a view of where that might evolve to. Our potential partners had a different view. And we thought we'd trade too much economics to close that gap. Now we have another holiday season behind us. We have 18 months, approaching 24 months, worth of data on that portfolio that's very different than our Visa portfolio. So we feel like we're in a good place to get it done. We have high-quality assets. Financial institutions certainly are in a position of looking for high-quality assets.

As it relates to the sale, we've said the purchase price probably somewhere right around par for a variety of reasons. And we would use those proceeds in a credit-rating-neutral manner. It means the preponderance of it would go to retire debt, some portion equity. And that will be a minority of that. And, with that, we would intend to just repurchase shares.

Dilution? The first thing I'd say -- strategically, this is important for us to get done. But $8 a share in 2017 -- sell the receivables, don't sell the receivables, not meaningful on that number. In the short term, though, there would certainly be some dilution. We think slight dilution. I get asked what does slight mean. Our answer is we'll tell you when we get there. But it certainly does not mean $0.50 like Canada. Year two, year three, as we get the benefit of that share repurchase, mildly accretive, slightly accretive, whatever we want to say. And, again, that's not a massive number. This is much more important strategically for us to get done and to have those receivables funded on a balance sheet that is made to fund receivables.

Adrianne Shapira - Goldman Sachs - Analyst

Great. If there are no other questions, please, join me in thanking John and John.