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TGT - Q3 2013 Target Corporation Earnings Conference Call

EVENT DATE/TIME: NOVEMBER 21, 2013 / 3:30PM GMT

OVERVIEW:

TGT reported 3Q13 comparable sales growth of 0.9% and GAAP EPS of $0.54. Expects full-year 2013 GAAP EPS to be in the range centered around $3.52 and 4Q13 GAAP EPS to be in the range centered around $1.26.

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PRESENTATION

Operator

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

(Operator Instructions)

As reminder, this conference is being recorded Thursday November 21, 2013. I would now like to turn the conference over to Mr. Gregg Steinhafel, Chairman, President, and Chief Executive Officer. Please go ahead, sir.

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

Thank you. Good morning. Welcome to our 2013 third-quarter earnings conference call. On the line with me today are Kathee Tesija, Executive Vice President of Merchandising, and John Mulligan, Executive Vice President and Chief Financial Officer. This morning, I'll provide a high level summary of our third quarter results and strategic priorities for the remainder of the year, and Kathee will discuss category results, guest insights, and plans for the holiday season. And finally John will provide more detail on our financial performance, along with our financial outlook for the fourth quarter and the year. Following John's remarks, we will open the phone lines for a question-and-answer session.

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

Target's third quarter financial results reflect continued strong operating performance in the US, despite an environment in which traffic and sales remain challenging. Comparable sales increased 0.9% in the quarter, near the low end of our guidance, and our US operations generated adjusted earnings per share of $0.84, near the midpoint of our expected range. We continue to manage our business thoughtfully, investing to maintain our relevance over the long term while we focus on disciplined execution to drive current performance. We continually work to anticipate and respond to the ever-changing needs of our guests, as we monitor the economy and the competitive landscape.

GDP continues to grow at a painfully slow place while household income and consumer spending remain constrained. In particular, lower and middle income households are shopping cautiously, as they work to stay within tight, very tight household budgets, which has seen additional pressure from this year's payroll tax increase. And consumer confidence, which has been generally recovering since the recession, took a dramatic step backward in October during the government shutdown. This decline was particularly evident in lower and middle income households, and we saw lower than expected sell-throughs on Halloween merchandise. Not surprisingly, in this environment our competitors have become increasingly focused on promotions, both to gain the attention of value-conscious consumers and to clear heavy inventories of discretionary categories. Our results show that guests continues to consolidate trips, as evidenced by a slight decline in our third-quarter transactions, which was offset by an increase in average ticket.

Given their focus on value, guests continue to respond to initiatives that connect them with Target and allow them to save even more off our already low prices. We are very pleased with the rapid growth of 5% REDcard Rewards, as penetration grew beyond 20% in October, and averaged just below 20% for the full quarter. And the response to Cartwheel, our digital coupon portable, has been remarkable. Cartwheel now has nearly 3 million users, most of whom access it exclusively on their mobile device. Even though we launched Cartwheel only six months ago, guests have already saved more than $14 million.

We continue to generate strong operating margins in our US segment, which is especially notable in an environment where sales growth is slow and consumers and competitors are focused on promotions and value. Inventory and in-stock levels in the US remain healthy, and expenses remain very will controlled. Teams throughout the organization are contributing to our expense optimization efforts, finding innovative ways to reduce expenses which we can reinvest to drive future growth. In addition, our stores' teams has done an excellent job increasing productivity while delivering a great guest experience.

In the third quarter, we opened our eighth CityTarget, and we continue to be pleased with the results from this new format. We opened our first CityTarget stores more than a year ago, and we're seeing very strong comparable sales growth in these locations as we raise awareness of our frequency categories and communicate the breadth of our assortment and the great values we deliver across the store.

In Canada, we are nearing the end of this year's unprecedented market launch. Earlier this month, we opened an additional 31 stores, our largest cycle so far, and with 2 remaining stores opening tomorrow, we will reach our goal to open 124 Canadian Target stores in 2013. The Target Canada team has shown remarkable energy and perseverance, allowing us to open a record number of new Target stores across Canada less than three years from the announcement of our agreement to purchase leasehold interest from Zellers. With this final cycle of openings behind us, the team is completely focused on improving operations in run state, enhancing systems and processes to better deliver the full Target experience to our new Canadian guests.

The Target Canada team is energized and prepared for the holiday season, and preparing to enter 2014 with improved in-stocks and a much better inventory position. We continue to see a very strong mix of our higher margin home and apparel categories in Canada. However, third quarter gross margin rate in Canada was unusually low as the team worked diligently to eliminate excess inventory and enhance flow throughout the supply chain. This activity led to heavier third quarter mark-downs and higher than expected dilution of $0.29 in our Canadian segment. Process improvement efforts and inventory clean-up will continue in the fourth quarter as well. As we gain experience in operating Canadian stores and accumulate sales histories by item by location, inventory flow and allocation will become much more reliable and accurate, setting the stage for improved sales and operating efficiency in 2014.

Given that this is our first holiday season in Canada, we will focus on delivering everything that is special about the season while continuing to emphasize that our prices in Canada are unbeatable. Over time we are confident that the Canadian consumers well recognize that Target's combination of low everyday prices, compelling discounts in the flyer, price matching policies, and 5% REDcard Rewards savings offer an unbeatable value in the marketplace.

While our initial sales and profits in Canada have not met our expectations, we remain enthusiastic about the Canadian market and confident in the long-term success of these stores. They are located in densely populated, vibrant trade areas, and based on 50 years of experience building stores and entering markets in the US, we continue to believe that our Canadian segment will contribute meaningfully to Target sales and profits over time. We also believe the sales shortfalls and earnings dilution from excess inventory and start-up costs will moderate next year, leading to significant improvement in the Canadian segment profitability in 2014.

In the US, it is clear that the holiday season will be highly promotional and that consumers will be laser-focused on value. In past holiday seasons we have consistently offered compelling value, investing billions of dollars in low prices. Yet we believe we have an opportunity to communicate this focus on value more clearly to the marketplace. As a result, this holiday season we will be much more overt in our price messaging across our marketing vehicles, stressing our unbeatable combination of everyday low prices, deep discounts on promotions, our price match policies, and our 5% REDcard Rewards program. And, while we are entering the season with guarded expectations for sales, we feel very good about our inventory levels, merchandising and marketing plans, and we expect to deliver profitable fourth quarter sales while offering unbeatable value for our guests.

While we all know about the loss of six shopping days between Thanksgiving and Christmas this year, at Target we are entering the holiday season with cautious optimism, as we annualize over last year's election and consumer uncertainty surrounding the fiscal cliff Based on our results a year ago, we are investing our merchandising and marketing resources with a stronger focus on key holiday categories like toys and electronics. In particular, given our market share in video game hardware and software, we expect to benefit this holiday season from the most meaningful platform launches in more than seven years.

In addition to fourth quarter merchandising and marketing plans, teams across the Company have been preparing for the full-chain rollout of in-store pickup, the first of multiple efforts to deliver flexible fulfillment for our guests. The team has moved quickly to roll out this capability, growing from a limited second-quarter test with Minneapolis team members to all of our stores earlier this month. The initial response from our guests have been encouraging, and we are looking forward to measuring their response throughout the holiday season, providing valuable insight as we prepare to roll out additional capabilities in 2014.

We entered 2013 with an ambitious agenda, as we committed capital [and expense] to transform the Company and create value over time. Throughout this year of transition, both in the US and Canada, our team has been remarkably resilient, energetically embracing every challenge as they work to position Target for long-term success. Our entire team is focused on developing Target's multi-channel capabilities while offering merchandise and experiences to create loyalty and position Target to deliver strong performance in any environment. Now, Kathee we will provide more detail on our third-quarter results and outline initiatives for the fourth quarter and beyond. Kathee?

Kathee Tesija - *Target Corp - EVP Merchandising*

Thanks, Gregg. We are pleased with the ability of our team to manage the business in the third quarter, maintaining profitability in a soft sales environment while we continue to develop digital capabilities that allow us to connect with our guests in new ways. Across our merchandising categories we saw a relatively balanced mix of third quarter sales between lower margin and higher margin categories. Among the lower margin categories, need-based areas like food and healthcare continue to outpace our overall comp. And electronics had a greater -- had a great quarter, driven by sales and mobile devices and video games. Our discretionary higher margin apparel and home categories both saw small declines in comparable sales. In apparel, third quarter trends were strongest in jewelry, accessories, and newborn/infant/toddler. In home, sales trends were strongest in domestics. In our digital channels, we saw very strong growth in apparel, hard lines, and beauty.

Early in the quarter, we were pleased with the comparable sales results in our back-to-school categories, which outpaced both the industry and our overall results. Results were particularly strong in supplies, which saw a big increase in penetration of our up & up brand. Performance in back-to-college was also stronger than average, both in-store and online. In September, our collaboration with Phillip Lim was one of our most successful to date. Sell-through levels were very strong overall, and particularly high in our digital channels. The most popular items in the collaboration included handbags, men's shoes, and women's dresses. In October, this year's calendar shift benefited comparable sales as a portion of Halloween-related sales moved into the month from November last year. However as Gregg mentioned, in conjunction with the government shutdown and pullback in consumer confidence, we saw a slowdown in our sales trends, leading to the lower than expected sell-throughs on Halloween merchandise at the end of the quarter.

We continue to see remarkable guest engagement with Cartwheel. In response to guest feedback, we moved quickly to integrate Cartwheel into the Target app for both Android and iOS in time for the holiday season. Now guests can find Cartwheel deals in four places, on their shopping list, on the product listing page, on the product detail page, and the what's-in-store content section. Beyond Cartwheel, we are very pleased with the progress we're making in our digital channels. We continue to see double-digit growth in overall digital traffic and triple-digit growth in mobile. This is notable because mobile is a much higher percentage of our digital traffic compared with some of our closest competitors. We're also seeing improved conversion on both the traditional site and on mobile as we continue to benefit from investments to improve search and navigation.

As we survey our guests and monitor the overall consumer environment, we continue to see anxiety regarding the economy and the ability to stay within household budgets, particularly among lower and middle income consumers. In October, a very high percentage of our guests were aware of the government shutdown and concerned it would hurt the economy. In addition, a meaningful portion indicated they were changing their shopping behavior in light of their current financial situation. This was evident in our guest metrics. In the third quarter, we were pleased to measure a year-over-year increase in the number of guests shopping with us, but this increase was offset by a decrease in their average shopping frequency. We even heard from some guests that they were cutting trips for fear they would be tempted to spend too much, a behavior we first observed in the recession. In light of this environment, we are entering the holiday season with a cautious outlook for sales and a very liquid inventory position. Specifically, at the end of the third quarter our average inventory per US store was up only 1%. We believe this position is appropriate as it protects against the downside in a tough environment, knowing that our base inventory is large enough to enable sales well beyond our fourth quarter plan if the season turns out to be unexpectedly strong.

As we look ahead to the rest of the holiday shopping season, we are excited about our plans to deliver on both sides of our Expect More, Pay Less brand promise, beginning with our plans for next week. On Thanksgiving, we are excited to open at 8.00 PM, based on the response to our Thursday opening last year and the higher number of families who shop together, making Target part of their family tradition. This year we have pushed our opening time up by one hour to help accommodate our guests and remain competitive in the marketplace. Of course, on Black Friday we will offer hundreds of door buster deals, including some of Target's lowest prices ever on electronics, toys, home decor, fashion, and more. These deals will be available while supplies last in store and at Target.com from Thanksgiving Day though Saturday.

We've also integrated Cartwheel into our plans. When guests redeem any Cartwheel offer this Sunday through Wednesday, they will unlock one additional offer card to select the Cartwheel deal of their choice. Also next Wednesday, Cartwheel will feature Black Friday-like deals on about 30 items, including some of the seasons hottest toys and electronics.

And no matter how, where, or when they want to shop, guests will find Black Friday deals in stores and at Target.com with even more deals available throughout Cyber Week. Target.com will feature 15 online-only daily deals for two straight weeks, beginning Sunday November 24. The only exception will be Thanksgiving Day, when hundreds of Black Friday deals, including almost all of the in-store deals, will be available starting in the early morning hours. Also, on the two days before Thanksgiving, Target.com will be running a special REDcard preview sale with 25 exclusive offers for REDcard guests in items ranging from electronics and entertainment to toys and housewares. Guests can also use Target's mobile app throughout the holidays to review the weekly ad, make shopping lists, check item availability at nearby Target stores, find store maps, and more.

To raise awareness of our outstanding offers, we are increasing media weight over last year and concentrating efforts during the entire week of Black Friday with TV, digital, cinema, and radio support. This will be the most digitally-enabled holiday campaign in our history, with an enhanced presence in the channels where we know our guests are most engaged. And finally, next week we will be testing a special offer in Northern California stores where all apparel and accessory items will be 40% off from the time we open on Thanksgiving through close of business on Saturday. This offer will be available in 89 stores, and will include women's, men's, kids', baby apparel, along with jewelry, accessories, and shoes. The only exclusion is clearance items. We will monitor results from the test to determine whether to extend a similar offer in other markets in future years.

In electronics this season, we are very excited about the highly anticipated platform launches from Sony PlayStation and Xbox, bringing newness to a category which hasn't seen meaningful change in many years. We're also featuring the hottest new headphones from Beats by Dr. Dre and wireless speaker systems from Sonos.

For this year's toy catalog, we will feature more than 500 items. We are offering more than $100 of coupon savings. In addition, we are offering free shipping on every item in the catalog until November 27. These savings are on top of the 5% guests receive when they use their REDcard.

In beauty, we recently launched a complete line of bath and body products from our long time beauty partner, Sonia Kashuk, including four beautiful scents created by Sonia in collaboration with French perfume house Robertet. The line is available in stores and online, and will include gift sets for the holiday season.

In home, guests continue to respond to the unique affordable designs from Nate Berkus. New for the season, we have rolled out exclusive Nate Berkus holiday collection in bedding, gifts, and decor available in stores and Target.com. Also new in home this season, we are excited to feature high-end kitchen items from Vitamix and Nespresso.

In entertainment, we continue to offer guests exclusive content from a wide spectrum of artists and genres. In October we launch exclusive albums from artists including Mary J Blige, The Head and The Heart, Paul McCartney, the Avid Brothers, and Kelly Clarkson. In November we added exclusives from Celine Dion, Avril Lavigne, and James Blunt. On December 3 we will release the Target exclusive version of country star Jake Owens' new album, Days of Gold, which includes four bonus tracks.

In grocery, we are following up on the recent success of Target exclusive pumpkin M&Ms with a wide variety of big brand holiday treats, including exclusive items from M&Ms, OREO and Hershey.

Beyond the fourth quarter and the holiday season, our team continues to develop services and multi-channel capabilities to delight our guests and keep Target relevant over time. We are pleased with the initial response to our store pick-up program, which became available in all US stores on November 1. Early results indicate that guests are using the service to reserve high-ticket items, such as iPads and weekly ad items, to ensure they get the item before it sells out. Top categories for in-store pick-up include baby, furniture, and electronics, and our strongest markets have been New York, Chicago, and Seattle.

Following the strong guest response to our Chicago test of our baby 360 layout, which features added service and an enhance presentation, last month we extended the test to an additional 20 stores across the country. We will continue to monitor sales and registry trends in these stores to determine future rollout plans. We're also excited about results from our beauty concierge program, which we extended this month to another 95 stores in new markets across the country including New York, New Jersey, San Francisco, and Dallas-Fort Worth. This program is exceeding its sales goals, and we're seeing particular strength in core categories like cosmetics, skin care, and hair care.

While Target Ticket is still new, since its launch a little over a month ago, we have driven millions of page views to the site. Visits consist of a blend of new and existing users who come back to review the new movies and TV shows that are continuously added. The number of Target Ticket accounts has exceeded our expectations to date, and we are excited to continue introducing this service to new guests as it expands and evolves in 2014.

In late September, following a three-month team member pilot, we rolled out a subscription service that allows guests to order baby diapers, training pants, wipes and formula to their doorsteps on a recurring schedule. Target subscription service has unique advantages, including free shipping and easy in-store or online returns, 5% off subscription purchases when using a Target credit or debit card, and a compelling assortment that includes national brands and popular own brand products like up & up diapers. Based on the initial guest response, we plan to expand our subscription service to more categories by the end of year to learn more about guest interest in this type of service. For example, we'll be adding a limited assortment from categories like coffee, personal care, paper towels, and toilet paper.

And finally, last week Pinterest added tools which allow us to highlight the most pinned items. We will be integrating top pins on Target.com in two ways. We will feature top pinned items on key category pages, and as guests click on a link to a product that is no longer available, they will see top pinned product alternatives in the same category. And in our stores, we will use signing to highlight top pinned items throughout our assortments.

While we are cautious about the near-term sales outlook, we are confident in our fourth quarter plans and believe we are taking the right steps to position our business for long-term success. Our guests rely on Target to help them save money and stay within their budgets, but they also expect us to surprise and inspire them in new ways. That is the essence of our Expect More, Pay Less brand promise, which guides our efforts every day. Now, John will share his insights on our third quarter financial performance and our outlook for the fourth quarter. John?

John Mulligan - *Target Corp - EVP & CFO*

Thanks, Kathee. Our third-quarter financial performance reflected continued strong execution in our US segment and higher than expected dilution in our Canadian segment as we continue to refine operations and clear excess inventory. This morning we reported adjusted EPS of $0.84, near the midpoint of our guidance, despite comparable sales near the low end of our planned range. Our GAAP EPS of $0.54 was below expectations, reflecting $0.29 of dilution from our Canadian segment. In the US, comparable sales trends were fairly consistent throughout the quarter. As Kathee mentioned, trends were softer than expected in October as consumers witnessed the dysfunction in Washington. However, on a reported basis, this weakness was offset by the calendar shift, which moved a meaningful amount of Halloween sales into the third quarter.

Our sales continue to be driven by a small decline in transactions, which is being more than offset by an increase in average transaction size. In the third quarter, this increasing basket was entirely driven by an increase in average retail per item, driven largely by electronics, which as Kathee mentioned, saw a much stronger comp in the third quarter that we saw earlier in the year. Sales penetrations on our REDcards continue to grow as more and more guests understand the compelling value of our 5% Rewards program and decide to deepen their relationship with Target. We continue to see a consistent response to households who apply for and activate a new REDcard, increasing their spending at Target by about 50% on average as they respond to the ability to save with REDcard rewards.

Third-quarter US segment EBITDA and EBIT margin rates were consistent with the guidance provided at the beginning of the quarter. Among the drivers of EBITDA margin, we saw a moderate decline in gross margin rate, reflecting the rate impact of 5% Rewards and a small mix impact from our remodel program, combined with underlying rate pressure, driven largely by seasonal mark-downs. A portion of these mark-downs were driven by the calendar shift, which moved Halloween clearance sales into the quarter, with the remainder driven by lower than expected sell-throughs on Halloween merchandise.

Third-quarter US segment SG&A rate was somewhat better than expected, at about 70 basis points higher than last years revised US segment rate. Among the drivers of this increase, the credit card portfolio drove about 60 basis points of pressure, consistent with results from the first two quarters of the year, reflecting a smaller portfolio, last year's reserve release, and this year's profit-sharing arrangement with TD Bank. And, consistent with our prior quarters, we experienced about 20 basis points of pressure related to this year's change in vendor agreements.

This means that outside these two factors, the underlying US retail business generated a small amount of SG&A expense leverage on a 0.9% comparable sales increase, overcoming ongoing pressure from investments in technology and supply chain to support our multi-channel efforts. This is outstanding performance, better than we'd expect over time, and reflective of the Company-wide expense optimization efforts, which we have been discussing with you throughout the year.

In our Canadian segment, we opened another 23 stores in the third quarter, even as we continue to work to refine operations and improve performance. In the quarter, the team made a lot of progress in their efforts to begin to rationalize our inventory position, update item counts in stores and distribution centers, and improve network flow. As a result of these efforts, and recognition of incremental inventory reserves at the end of the quarter, we saw a much lower than expected gross margin rate in the Canadian segment of about 15%. Clearly, this is not the rate we expect over the long term, particularly as we continue to see a much richer mix of sales in our higher margin home and apparel categories in Canada.

However, we do expect pressure on Canadian segment gross margin to persist in the fourth quarter as we continue to do whatever it takes to enter 2014 with improved operations and a notably better inventory position. Obviously, expense rates in Canada are unusually high due to start-up costs, incremental activity to clear inventory, and lower than expected initial sales. While expense rates are expected to improve over the next several years, we expect meaningful improvement in 2014. As we move past first-year start-up costs, we gain efficiencies through systems and process improvements, and we drive sales increases through our efforts to drive shopping frequency.

Turning to consolidated metrics, third-quarter interest expense declined $27 million, or 14%, from last year as we continue to benefit from the debt retirement following the receivables sale. We returned $271 million to shareholders through dividends in the third quarter, marking our 184th consecutive quarterly dividend since we became a public company in 1967.

You have likely noted that we did not repurchase any of our shares in the third quarter. While we remain committed to share repurchase over time, we have consistently maintained that we will govern the pace of repurchases with the goal of maintaining our strong A credit rating. As a result, in the third quarter we took a pause in our share repurchase activity in light of the incremental dilution we are currently experiencing in the Canadian segment. Looking ahead, we will continue to monitor our results while maintaining a dialogue with the debt rating agencies, and we will resume the program when conditions are appropriate. I should emphasize that given the compelling increase in free cash flow we expect next year, we believe we will have the capacity within our rating objectives to return up to $4 billion through share repurchase in 2014.

Now let's turn to our expectations for the fourth quarter and resulting metrics for the full year. In the US, we are planning for approximately flat comparable sales, given there are six fewer shopping days between Thanksgiving and Christmas, the current state of the consumer, and the expectation for a very promotional and competitive environment. As Kathee mentioned, we have ample base inventory to generate much stronger sales than planned if consumer demand turns out to be stronger than expected. While most of the season is still ahead of us, I can tell you that so far in November sales have been right on our forecast, supporting our expectations for the quarter. Notably, the pace of our digital sales growth so far this month has been on plan and much stronger than we have seen so far this year.

Fourth quarter US segment EBITDA margin rate is expected to be down slightly from last year. On the gross margin line, we expect to see year-over-year improvements, reflective of the comparison against last year's unusually high seasonal mark-downs, this year's change in vendor payments and the comparison to last years 53rd week, which added a relatively low gross margin week to the quarter. We expect the fourth quarter US segment SG&A expense rate to be a full percentage point above last year's revised rate of 17.3%. About half of this increase, or $110 million, is related to the credit card portfolio, driven by its smaller size, comparing against a small reserve release last year, and this year's profit-sharing arrangement with TD. The remaining expense pressure in the US segment reflects the change in vendor payments, investments in technology and supply chain, and a lack of leverage on flattish comparable sales growth.

In the Canadian segment, we expect another meaningful acceleration in sales dollars, reflective of the stores we opened in the third quarter, additional openings this quarter, and the surge from holiday-related sales. We expect gross margin expense rate pressures to continue as we move beyond a record year of store openings to refining operations and clearing inventory in preparation for 2014. Our forecast is for the Canadian segment dilution in the range of $0.22 to $0.32 in the fourth quarter. ¶ In the US, we expect fourth quarter adjusted EPS in the range of $1.50 to $1.60. As you will recall, last year's 53rd week added $0.05 to $0.10 to adjusted EPS in the fourth quarter and full year. Adjusting for this benefit, this year's expectation would keep us flat to down slightly from last year's performance on an apples-to-apples basis, despite an expected $110 million headwind from the credit card portfolio.

Combining our expectations for adjusted EPS, Canadian segment dilution, and a $0.02 impact from the reduction in the beneficial interest asset, we expect fourth quarter GAAP EPS in the range centered around $1.26. For the full year, our expectations are for adjusted EPS in the $4.59 to $4.69 range, down slightly from last year's performance of $4.76, reflecting outstanding operational discipline when you consider that it reflects more than $400 million in lower expected earnings from the credit card portfolio, driven by a smaller asset base, annualizing last year's reserve reductions, and the profit-sharing arrangement with TD. It reflects more than $200 million of expense pressure from incremental investments in technology and supply chain to support our multi-channel efforts. It's comparing against last year's 53rd week, which added $50 million to $100 million to last year's pretax earnings. Combining these factors, we faced a headwind in the neighborhood of $700 million this year, of which we've offset a meaningful portion in a tough environment with expected comparable sales of less than 1% for the year. As a result, we are very pleased with the operating discipline reflected in our expected 2013 results for the US segment.

In Canada, we have accomplished a great deal and remain confident in the long run potential for these stores. In the near term however, dilution has been higher than expected as the team works diligently to refine operations, enhance inventory flow, and position the segment for meaningful improvement in profitability throughout 2014. For the year, our expectations are for Canadian dilution in the range of $0.95 to $1.05. Combined with the net accounting impacts from debt retirement, the credit card sale, and nonrecurring tax benefits, our outlook in the US and Canada leads to an expectation for full-year GAAP EPS in a range centered around $3.52.

While the economic environment for the next year remains quite uncertain and beyond our control, we feel good about our plans for 2014 for a number of reasons that are within our control. In Canada, we will move past start-up expenses from this year's market launch, and we are confident in our plans to rationalize inventory, drive sales, and improve operations. In the US, we've demonstrated our ability to continue to manage the business with discipline, regardless of the economic environment, including our continued focus on expense optimization. We feel very good about our plans regarding capital deployment, as we expect to have a dramatic increase in share repurchase capacity, driven by a reduction of Canadian CapEx of more than $1 billion, meaningful improvement in Canadian segment EBITDA, and continued strong cash flow generation by our US business, with US CapEx essentially flat to 2013.

As of today we expect the combination of factors will allow us to repurchase up to $4 billion of our shares in 2014 while continuing to grow the dividend and maintain our A credit rating. With that, we will conclude today's prepared remarks. Now Gregg, Kathee, and I will be happy to respond to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Greg Melich with ISI Group.

Greg Melich - *ISI Group - Analyst*

I wanted to start right with REDcard and traffic. That's a trend this year that has gotten locked in at this down 1% to 1 1/2%, and you gave some goals a few weeks ago where comps would be 2% or better over the next few years. How do you get to the 2% over time if traffic is still down 1% to 1 1/2%? What initiatives with REDcard or anything else do you have to really get that traffic stabilized?

John Mulligan - *Target Corp - EVP & CFO*

I will start, Greg.

I think a couple things. One, I think first of all, the stress on low-income consumers is certainly playing a role. We've seen all year long. The payroll tax increase has been a portion of that, for sure. I think we get to cycle past that in January, and we will get better information about what that looks like going forward.

But beyond that, and the things that we actually control, as you said, we continue to see meaningful growth in REDcard. That continues to drive 50% lifts in sales, all of that driven by traffic. Kansas City is above 25% penetration now. So it continues to grow hundreds of basis points a year.

Then beyond that, I think it's all about our multi-channel initiatives, and everything we are doing there. And as I said, we are starting to see strong digital sales growth. That, combined with the flex fulfillment activities that we are implementing now, piloting a little later this year, and we'll begin to roll out next year -- we think all of that put together will continue to drive meaningful traffic increases.

Kathee Tesija - *Target Corp - EVP Merchandising*

The only thing that I would add, Greg -- this is Kathee -- is just that, as guests are consolidating their trips and they're coming less frequently, it's really important for us to get them to shop around the store and to buy more. And you do see in our basket that we have been able to accomplish that for the past several quarters as well. So we will stay focused on how do we ensure that we get more of their wallet when they do come.

Greg Melich - *ISI Group - Analyst*

A direct follow-up to that. I know that with all the multi-channel initiatives -- and you outlined them all in the call -- how have you changed how store managers and associates are incentivized so that they give the level of service to the online guest that is coming to pick up in-store? Do they get credit for that? Or how should we look for that to be changing going forward?

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

Yes, they do. They get total credit for anything that is bought online, picked up in-store, or things that are in store where there is an extended aisle sale. So we are incenting this. Actually, we have a parallel environment where both teams -- both our dot-com team and our store teams -- get credit for growing the business in a collaborative way.

Greg Melich - *ISI Group - Analyst*

Is that --

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

There is no penalties, or there is no internal conflict at all as it relates to who is going to get that credit for the sale. We are double crediting everybody from an internal standpoint, and then we take it out at the enterprise level to make sure that it all washes through on a consolidated basis.

Greg Melich - *ISI Group - Analyst*

Is that true if I have it shipped to my home?

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

If it's shipped to your home from the store, yes.

Greg Melich - *ISI Group - Analyst*

Great, thanks a lot.

Operator

Wayne Hood with BMO capital.

Wayne Hood - *BMO Capital Markets - Analyst*

Kathee, just on the average ticket side -- Greg was talking about transactions, but just to get to the ticket -- there has sequentially been a pretty nice acceleration in AUR throughout the year, and you talked a little bit in the third quarter, electronics impacting that with the UPT being down.

As you plan the business into the fourth quarter, would you still expect your AUR to be up 3% and UPT to be down? Or how should we think about the dynamics that's driving average ticket? And also that points to, if AUR is up -- which points people are maybe buying up, you are moving them up -- how do you square that with the consumer that is constrained?

Kathee Tesija - *Target Corp - EVP Merchandising*

Most of what is driving it up for the fourth quarter will be those hot categories like electronics that are most popular in the holiday season. And there is a lot of newness there that drive up the average selling price. Think of iPads; think of all the new video game consoles and games, which Target does very well with. And we are really excited about that business for the holiday season. I would anticipate it will continue into the fourth quarter.

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

Think of it more as a change in the mix of what we are selling at this time of year versus trading up within category.

Wayne Hood - *BMO Capital Markets - Analyst*

Got it.

And my question related to this, Kathee -- and it gets back to the trip issue. With what you have seen with Cartwheel, what trips is that group -- you've seen an extra trip, and how do you really jump on that at a faster rate to drive trips the way you did with REDcard?

Kathee Tesija - *Target Corp - EVP Merchandising*

First, I would tell you it is pretty early. I think we've got about six months in with Cartwheel; but as we mentioned, very excited. We've got over 3 million users right now that are very engaged. I think it is helping trips. I also think it's really helping basket, because they are using Cartwheel in the store on their mobile device, looking for deals on things that they want to buy and they are adding more to their basket.

It is still really early to see trends, but we are very excited about it, and are talking about it more and more. We are going to be using Cartwheel as one of our vehicles to help drive value this holiday season. And hopefully more and more people will hear about it and sign up for it. But we think this is a big success story for us that we can continue to grow.

Wayne Hood - *BMO Capital Markets - Analyst*

Thank you very much.

Operator

Sean Naughton with Piper Jaffray.

Sean Naughton - *Piper Jaffray - Analyst*

Great, thanks. I have a couple-part question here on Canada. I think most of them are related.

John, I think you talked about the gross margin being impacted by some inventory issues in Canada late in the quarter. Can you just give us a little bit more color there on what happened there?

And then maybe also outline where are some of the pockets of excess inventory that you are looking to move through? And then, secondly, are there any signs of hope in the business, or glimmers of hope that you can point to, whether it's by region or category, that are going better than expected at this point in that market?

John Mulligan - *Target Corp - EVP & CFO*

There is always hope, Sean. We are highly confident (laughter) it is going to be successful.

Your inventory question -- we talked a lot last time about, given the sales shortfall and the fact that we planned inventories to protect on the upside; given all the excitement, there's a pretty large inventory overhang. As the teams have worked hard over the past 90 days assessing the best way to handle that -- and it depends on the various categories about the best way to handle that -- we have clearly seen some markdowns come through. We're taking advantage of that, actually, to drive value messaging in Canada and get across how sharp our prices are.

And then we are also assessing what of the inventory do we think we're going to sell ultimately below cost or end up salvaging because there's just flat out too much of it. And that is the inventory reserves that we assess at the end of the third quarter. We do that every quarter anyway as a matter of course, and we will do that again at the end of the fourth quarter. But that was a large piece of what happened at the end of the third quarter.

I think as far as lumpiness of inventories -- as you would expect it's the long-lead categories where we tend to be lumpy. The stuff that turns quicker or that is domestically sourced we can obviously shut down receipts much quicker. But stuff that is long-lead -- and we will see this continue actually a little bit into spring -- and here think about categories like bikes, where those are a long-lead items, and it just -- we can't get out of the receipts once we have made commitments. Those are the type of items that will take us a little bit longer to clear through.

I think on signs of hope -- we wouldn't call it hope -- but on signs of our execution starting to improve, we are seeing -- and I think this is consistent with what Gregg said -- as we start to get sales histories, we can start to replenish stores more accurately, balance our inventories, and meet guest need when they need that. We are starting to see success there. As we look at our current results, we're pretty much hitting our current forecast, but we are seeing much stronger results in the cycles that have been open longer. Cycle one, cycle two, cycle three have actually begun to exceed our expectations a bit.

We're a little bit hopeful -- not hopeful; we are optimistic that we are seeing the right trend with those cycles improving. And we believe we will continue to see that as we get more age behind the cycle four and cycle five stores.

Sean Naughton - *Piper Jaffray - Analyst*

That is helpful, thank you.

And then just secondly on the, in terms of expense optimization in the US business, looks you guys did a great job of controlling that there in Q3 -- maybe even below what you would expect moving forward. Do you feel like you're in the right position now there? What type of comp do you feel like you need right now to leverage that SG&A moving forward, maybe in Q4? And then the first half of 2014? Thank you.

John Mulligan - *Target Corp - EVP & CFO*

I think our efforts on expense optimization continue to be very successful. The teams are very engaged across the Company and continuing to look for new ideas of ways that we can reduce expense. And I think part of this is about lowering our center of gravity that you are referring to.

But a big part of it, too, is reinvesting that in other parts of the business. You have really seen that this year. We had significant incremental investments in technology, supply chain. That will happen again next year, particularly around technology and flexible fulfillment. We will make SG&A investments, and expense optimization really allows us to offset that. I think leverage probably hasn't changed a whole lot -- somewhere between that 1% and 2% range -- but it gives us a lot of capacity to invest in the business as we continue to grow our multi-channel capabilities.

Sean Naughton - *Piper Jaffray - Analyst*

Thank you.

Operator

Matthew Fassler with Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

Good morning. My first question relates to Canada.

What kind of insight can you give us into the average number of stores opened over the course of the quarter as it relates to timing of openings? Just to give us the ability to measure an accurate sales productivity number. We have (inaudible) to try to get sales per store and sales per foot, but the growth is moving so quickly on such a small base that it is very easy for those numbers to get distorted.

John Mulligan - *Target Corp - EVP & CFO*

We agree with the last part of that comment, and we have continued to say it's very early here, and we are going to see it move around again in the fourth quarter, given we see the surge in holiday sales. I don't have the exact weighted average on the store timing, Matt, but John Hulbert will get that to you -- we can get that to you today.

Matthew Fassler - *Goldman Sachs - Analyst*

That would be very helpful.

Second question I would ask relates to the electronics business. Clearly, the video cycle is here and is very prominent, and I know that mobile is still a relatively new business for you. If you look at the legacy consumer electronics businesses, and you mentioned tablets -- I know you had a fairly high profile promotion recently, and TV, and other businesses that have less industry-wide going on year on year. What has your experience been in those categories? Or what was it for the third quarter and what's your sense of the promotional environment here in Q4?

Kathee Tesija - *Target Corp - EVP Merchandising*

Matt, I would say it's strong overall. Certainly that varies by category, but there are a lot of great trends in our business in electronics. I mentioned a couple that we are excited about for Black Friday and going into Cyber Monday and the rest of the holiday season.

Things like Beats by Dr. Dre -- the whole headphone category had been fantastic, and that's a lead item. Speaker systems like Sonos have been fantastic. So there are many different categories that are performing well. Some are little bit softer, like cameras, but in total, a really strong business in electronics right now.

Matthew Fassler - *Goldman Sachs - Analyst*

Okay, thank you so much.

Operator

Chris Horvers with JPMorgan.

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

Thanks, good morning.

Wanted to follow up on the Canadian and gross margin, and just your thoughts about how that proceeds going forward. I think originally you had talked about the Canadian gross margin being above the US. I always interpret that as maybe a couple hundred basis points above the US rate. But you have these competing factors right now where the markdown pressure is a negative, but the mix factor is a positive.

As you look into the crystal ball, how do think -- how might -- are your gross margin expectations shifting, based on those two competing factors over what the long-term opportunity could be, relative to the your original expectations?

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

Hi Chris, this is Gregg.

Over the long term our expectations haven't changed at all. What we're experiencing now, and as John talked about it, it is those long lead time businesses that are mark-down sensitive, particularly home and apparel, that we have to exit and it is costly to do so.

Remember, the first cycle stores did not open until April, and the second cycle followed shortly after that. And that was only a handful number of stores. By the time we really got a good clear indication in terms of where the sales were going to level out for this year, in our long-cycle businesses -- and think six, seven, eight months -- these receipts were already planned and in production and on the way.

It's really the lump of inventory that we've got to work through, and once we do that, we are very confident that we are going to be back in the mid-30%s like we talked about in terms of the overall gross margin, because the mix continues to be strong, and we are very pleased with that. We don't see any signs of that abating.

It might come down a little bit as we get more aggressive in terms of building that trip frequency. And we will start those efforts in earnest when we turn the corner in 2014. But on an absolute basis, we are really pleased with where we are in home and apparel, and we've got to get through this next quarter and the early part of the beginnings of 2014 until we really get that sales history developed by item, by store and eliminate some of the huge variability that we have in the supply chain so that we can get a more even balance between receipt flow and what we are selling. And at that point in time, we fully believe that we are going to be back to where our initial expectations were from a gross margin standpoint.

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

And then you mentioned that some of the early-cycle stores were starting to exceed your expectations a bit. I had a really interesting chart at the Analyst Day that talked about where the expected ramp in the stores initially versus where it is sitting now.

Could you just reference for us what you mean by exceeding your expectations a bit? Is that versus your original expectation on first-year sales versus what you rethought?

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

These are against the new, most recent level-setting expectations that we shared that at the Analyst Day that said they are not where they were when we originally planned the business, but now that we have had enough experience, we see where they were and we established and rebooted, essentially, our expectations for Canada.

So against that new, most current forecast, what we are seeing is encouraging signs out of those earlier-cycle stores. They are exceeding these newer, revised forecasts more than the later-cycle stores because they have had a chance to operate on their own. They are six months into it now. The inventories are flowing better; in-stock levels have improved; the guest is getting used to our stores; they are converting from more of a browser to a shopper. It is still very early, but we like what we see in some of those early-cycle stores. And so at this stage we are just encouraged by the fact that they're performing better against most revised, revised forecast.

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

And then one quick last one -- can you share with us what your share in the gaming category is in the US?

Kathee Tesija - *Target Corp - EVP Merchandising*

I don't know that number off the top of my head. It is definitely higher than our typical market share, but we can get back to you with that number.

John Mulligan - *Target Corp - EVP & CFO*

Yes, it's much higher than our aggregate store or electronics market shares.

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

Okay, appreciate it, thanks.

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

We will get back to you on that one.

Operator

Jason DeRise with UBS.

Jason DeRise - *UBS - Analyst*

Can I ask about the comps? I just want to get your thoughts on a few of these items, if you would quantify them. So one is how much of the shift from the timing of the calendar between Q3 and Q4 in your reporting benefited the current quarter that was reported and pulled forward from Q4?

And then get your thoughts about, if you think there's any impact on comps from SNAP, whether that is directly in your food sales or your general merchandise sales? If you'd quantify what kind of uplift you expect from video games? And also one thing that didn't come up yet -- but lower fuel prices, how you're thinking about that?

John Mulligan - *Target Corp - EVP & CFO*

That's a lot of questions.

On the third quarter, I think clearly Halloween moving into the quarter benefited. I would remind you that we also said at the end of last quarter, our back-to-school week moved out of the quarter into second quarter. That benefited second quarter. Net/net, probably a wash, maybe 10 plus/minus --10, 20 basis points, I don't really know -- but net/net a wash.

WIC -- any time there is a decrease like that, there is an impact. But for us, grocery, food is about 20% of our business roughly; and it's a very different kind of trip for us than most grocers. So certainly there is an impact. But for us, meaningfully, that is just not -- again, this is a small impact relative to what we might see at other retailers who sell significantly more food as a percentage of their business than we do.

And then electronics -- what was the question in electronics? I'm sorry.

Jason DeRise - *UBS - Analyst*

I guess the video game cycle itself. What kind of comp uplift you would expect just from that? And the last part of that was about fuel prices coming down -- if you see that as a benefit for yourselves or not?

Kathee Tesija - *Target Corp - EVP Merchandising*

We don't necessarily talk about categories and how big they are. But with two new console releases and all the games that will go with them -- as you know it has been a declining category for several years, given the maturity. It's been over seven years since we had a new console. So having two in the same year is very meaningful for the category. It is also very meaningful for electronics in the store. So we think its going to be one of the biggest gifts gifting categories of the year, and we will certainly benefit from that.

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

And then on fuel, there is no question that in a time when, particularly lower income consumers have very constrained budgets, having to spend less on fuel, it helps in some way. For us, I will tell you, through time we have looked at this many ways and it's really hard to quantify fuel price moves in our sales. There are times when fuel prices are going up in a good economy, and that is good for everybody, which is different than today. It's hard to quantify, but overall, lower fuel prices is definitely good for consumers. It just puts more money in their pocket.

Jason DeRise - *UBS - Analyst*

If I can ask one more about comp trends. The apparel part of the business -- it sounds like the branded stuff is going well for you. Can you talk about your private label trends in apparel? Is that maybe where some of the weakness is? What you're doing to try to turn that around?

Kathee Tesija - *Target Corp - EVP Merchandising*

Apparel, I think, was -- most of what we have is own brand product and exclusive designer partnerships that we do. So that is the bulk of our business. Certainly we do a lot of basics with branded manufacturers -- Haynes for example.

But our comp in apparel was down slightly. It was much stronger online. So we are seeing some shifting happening there. We are pleased with the new releases that we have had. Phillip Lim was probably our best designer launch ever -- very clean sell-throughs, both in stores and online. Our launch of our holiday product is off to a good start, while it is still early.

We're feeling pretty good about apparel overall. I would say that the softest part of apparel has been in kids. And we are working on ways to make sure that we can drive that business and have the right price/value relationship for our guests to help drive better market share gains. But the rest I feel pretty confident in.

Jason DeRise - *UBS - Analyst*

Okay, thank you.

Operator

Paul Trussell with Deutsche Bank.

Paul Trussell - *Deutsche Bank - Analyst*

Good morning.

Just looking at the US business from a gross margin standpoint. If we exclude the vendor agreements accounting shift, I think gross margins would have been down about 50 basis points year over year. Can you prioritize, or rank for us the impact from markdowns versus category rate pressures and other factors? And just how we should think about that going into the fourth quarter, given the promotional intensity?

John Mulligan - *Target Corp - EVP & CFO*

The 50 basis points is about right. And I would say about half of that was due to the ongoing pressure we have seen for several years now related to REDcard and the store remodel program.

The other half, like we talked a little bit about, was really related to markdowns we took, given the Halloween sell-through that we saw. And we saw sales soften up, like we said, in the middle of the quarter, given everything that was going on with consumer confidence and in Washington. We saw sales soften up a bit, and really just some promotional markdowns to sell through our Halloween inventory. I think as we think about fourth quarter, as we talked about, it's going to be very promotional; there's no doubt about that. But the primary driver of our performance versus last year is, last year we took significant clearance markdowns last year, and that's what you'll see be the primary variance year over year in our gross margin rate.

Paul Trussell - *Deutsche Bank - Analyst*

Okay, so improved performance on gross margin in 4Q versus 3Q experience?

John Mulligan - *Target Corp - EVP & CFO*

Yes.

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

Absolutely.

Paul Trussell - *Deutsche Bank - Analyst*

Got it.

And then lastly, on Canada, you mentioned that there was a lot of markdowns in inventory. Is some of the gross margin hit also related to price investments being made in certain categories? If you can just give us an update on that, along with a reminder, John, on what the drag was from start-up expenses in Canada this year.

John Mulligan - *Target Corp - EVP & CFO*

We haven't disclosed the drag from start-up expenses all year long. So we haven't really talked about that a whole lot. As it relates to price investment and markdowns, I think it is all -- we view that as all one big bucket, really; and it's really the total value message we are able to give to the guests in Canada right now. As I said, we have a little bit of excess inventory. We will take advantage of that. To be sure, we are giving a great value message.

But beyond that, as we look at our pricing in Canada on like items, we are right on where we want to be. We are locally competitive and right on the price leaders in Canada. So we feel really good about our pricing in Canada on like-for-like items.

Paul Trussell - *Deutsche Bank - Analyst*

Thank you.

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

Great. That concludes Target's third-quarter 2013 earnings conference call. Thank you all for your participation.

Operator

Thank you. This concludes today's conference call. You may now disconnect.
