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Q4 2018 Target Corp Earnings Call and 2019 Financial
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CORPORATE PARTICIPANTS

Brian C. Cornell *Target Corporation - Chairman & CEO*
Catherine R. Smith *Target Corporation - Executive VP & CFO*
John Hulbert *Target Corporation - VP of IR*
John J. Mulligan *Target Corporation - Executive VP & COO*
Mark J. Tritton *Target Corporation - Executive VP & Chief Merchandising Officer*
Richard H. Gomez *Target Corporation - Executive VP and Chief Marketing & Digital Officer*

CONFERENCE CALL PARTICIPANTS

Charles P. Grom *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*
Christopher Michael Horvers *JP Morgan Chase & Co, Research Division - Senior Analyst*
Craig Johnson
Edward James Yruma *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*
Edward Joseph Kelly *Wells Fargo Securities, LLC, Research Division - Senior Analyst*
Gregory Scott Melich *Evercore ISI Institutional Equities, Research Division - Former Senior MD, Head of Consumer Research Team and Senior Equity Research Analyst*
Kelly Ann Bania *BMO Capital Markets Equity Research - Director & Equity Analyst*
Michael Lasser *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*
Michael Allen Baker *Deutsche Bank AG, Research Division - Research Analyst*
Peter Sloan Benedict *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*
Robert Scott Drbul *Guggenheim Securities, LLC, Research Division - Senior MD*
Simeon Ari Gutman *Morgan Stanley, Research Division - Executive Director*

PRESENTATION

John Hulbert *Target Corporation - VP of IR*

Well, good morning, everybody. Thanks for coming. We're really happy to be with you here in New York again today. Brian's presentation will start in a couple of minutes. And in the meantime, there's a couple of important messages that we need to convey. The first is that 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. And the second is that in today's remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP measures to the most directly comparable GAAP measure are included in our financial press releases and SEC filings, which are posted on our Investor Relations website.

Brian C. Cornell *Target Corporation - Chairman & CEO*

(technical difficulty)

And I want to start by thanking you for being here today. I've seen that video a dozen times now. It's pure joy, it's pure Target, and it's why I've never been more excited to be part of this brand and to lead this great company than I am right now.

This morning, we announced our most successful year-over-year performance in well over a decade. Our comp sales surged this holiday season, fueled by unprecedented traffic gains, especially in our stores. We closed out Q4 with a 5.3% comp, our strongest finish since 2004, putting Target right in the center of the winner's circle. Across the business, we're growing market share in every major category. And our guests love what they see. Our team deserves all the credit. They are more passionate and committed than ever to delivering on our purpose, which is helping every family we serve, find joy in all of life's everyday moments.

So while I'm here on stage, holding up some of our strongest results in a generation, this performance isn't simply a reflection of a strong consumer environment. These results were years in the making, proof of the progress we've achieved against our multiyear strategy to transform our company; deliver strong, consistent and durable growth; and emerge as one of the industry-leading retailers for years to come.

Back in 2017, we laid out an ambitious investment agenda to reimagine our stores, reinvent our supply chain and fulfillment capabilities, to reposition our own brand portfolio, invest in our team. And I think we can all agree, at that time, the plan was not met with universal applause. I won't name names, but a few of you might have pulled me aside and said, "Brian, are you sure this is the path you want to pursue? Do you really want to bet the company on stores?" At that time, people were closing stores, not opening them. They were cutting



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costs, not investing in their teams. But we've never been a brand that falls in line with the crowd. Our guests aren't looking for red and khaki version of someone else. They expect us to be different. They expect us to innovate and inspire. They expect us to be Target. So with our guests as our guide, we kept our stores and our people at the center of our strategy, but committed to deploy them in a radically different way. Two years later, we redefined what it means to be welcoming, inspiring and rewarding in retail. Our teams are obsessed with finding new ways to make our guests' lives just a little easier.

When you look at the results and pick your metric, traffic, comps, Net Promoter Scores, guest surveys, it's clear, our strategy is working. We're delivering the right outcomes, and folks are taking notice. Take a look.

(presentation)

Brian C. Cornell Target Corporation - Chairman & CEO

I'm really proud of that work, and I'm really proud of our team. 350,000 people who get up each day dedicated to making those moments happen for our guests all across this country. Yet as much of them are encouraged by our success, I'm always the first to say we still have a lot of work left to do. You know this better than anyone. As the shakeout in our industry continues, the separation between those who can afford to invest and those who can't is real. The channel convergence between physical and digital has come full circle. And today, Target is leading the way. While we might be ahead of the pack now, this is no time to slow down, and I can promise you, we won't. As we look to the future, I think it's important to take a moment to step back and look at where we started.

So think back to this meeting in 2016, just 3 years ago. We're over at Chelsea Piers. I remember it was a beautiful day, and I started with an anecdote that was, well, at that time, an aspiration. I talked about how some day, not long in the future, a mom who works here in New York City would be able to plan a birthday party right from her office, shop for everything from her phone from the train and then pick up her order before shuttling her kids off to swimming lessons. The punchline was that in the future, the whole thing would go off without a hitch. Fast forward to today, we've got that use case down cold. We got there because we spent 2016 shoring up the fundamentals. 2017 was about laying out an investment agenda and developing new capabilities. 2018 was all about acceleration and innovation, so that in 2019, we can drive adoption and scale. Today, that same mom in the city has a multitude of choices, and the shopping experience has never been easier or more convenient. For starters, she could just make that Target run on her lunch hour. Three years ago, we didn't have one single store in Manhattan south of the park. Today, we have 4, And we've opened up 8 more across other boroughs and in Long Island. If she doesn't want to schlep the bags back to her office, we'll keep them and drop them off at her desk before she leaves for the day. With Drive-Up, she can keep the kids buckled up on their car seats. We'll put that order in her trunk at the closest store to her home. And with Shipt, she can order same day and will have everything she wants in her kitchen table within an hour or two. Her shopper will even text her before check out, see if she wants or needs a few extra candles for the cake. Whatever she wants, today, we've got her covered. In fact, as we enter the next year of our transformational strategy, we're doing so with the most comprehensive suite of fulfillment choices and also extensive coast-to-coast network of any retailer in the industry.

Today, Target is, hands down, America's easiest place to shop. But ease, reach and convenience are only one part of the equation. Our teams are also making process improvements to take cost out of every single transaction. They're improving speed to greater efficiency and maximizing our last mile advantages. What used to take days is now measured in hours. Costs that were once measured in dollars can now be measured in cents. So we're focused on driving awareness and adoption and helping the guest build these options into their weekly routines. And that's just one example of success in one aspect of our strategy. But what's even more important is that every piece of our strategy is working, and it's working together. Let's start with stores.

During the last 2 years, our property development teams remodeled more than 400 stores, outfitting them with new technology, fixtures, design, totally transforming how they look, feel and function. This year, we'll remodel at least 300 more and another 300 in 2020. We'll continue to add to our network. Today, we have almost 100 small format stores, and they are highly productive. Herald Square, just down 6th Avenue, does more sales per square foot than any other store of any size in the company, and we'll continue opening a couple of dozen new-format stores each year in cities and on college campuses across the country. Now of course, as you look at that map, you don't see a big red and white W hovering over Wisconsin. Yet I can assure you, John Mulligan and John Hulbert, that you know all too well, are the 2 biggest badger finance at Target, and they're all over this.



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This year, we also undertook our most ambitious redesign of how we operate stores ever. We're investing in technology to strengthen execution and maximize efficiencies in the back of the house so our teams can shift their focus to driving guest-facing service. We're also making industry-leading investments and wage, committed to raising our starting wage to \$15 an hour by 2020. Now not only does this move further burnish Target's reputation as a top destination for great talent, it sends a clear message that we value our communities. At a recent U.S. conference of mayors in Washington, there were a long line of city leaders eager to roll out to welcome Target, because a commitment like this shows we'll be good neighbors in every single community we serve.

Our digital progress continues to be a standout story. Once again, our digital sales this holiday season grew much faster than the industry, and we finished the quarter up 31%. Now it wasn't long ago that digital was a rounding error when it came to overall revenue at Target. In 2012, back in just 2012, our digital sales were just over \$1 billion. Today, digital is delivering more than \$5 billion in sales and still growing. In fact, this was the fifth year in a row that our comp growth topped at least 25%. And as John will show you in detail, digital growth of Target isn't coming at the expense of our stores. It's making stores more relevant, because as I said at the top, the convergence between physical and digital, well, it's closer than ever at Target. And that's because we invested to build industry-leading digital and technology teams. They've created a seamless and inspired user experience that's worthy of our Target brand. We've invested in infrastructure to support greater scale and speed and strengthen our core, and we've invested in building enterprise data and analytical capabilities to better understand our guests and make smarter decisions.

Today, our engineers are using voice, AR, AI, VR, to provide greater utility for our guests and integrate richer shopping experiences into their busy lives. And now that we've established the right foundation, we're able to move to the next phase of our journey. Our team is now building out an even more holistic digital strategy that reaches deeper levels of personalization and engagement across every guest-facing part of our ecosystem.

Personalization and engagement are also the cornerstones of our evolving loyalty strategy. As you all know, REDcard and Cartwheel worked really hard for Target. Guests who use these programs shop more often than our average guest, but they're also geared to our most engaged guests. So building out our loyalty strategy, we saw the opportunity that tap into a full range of shopper types, folks who visited us each week and those who might only show up once a year.

Last month, we announce the expansion of our new program, Target Circle. After testing in Dallas, we're now rolling it out to 5 new markets. This program rewards guests with a 1% rebate. It allows our guests to direct their philanthropic giving and offer special offers tied to key-like moments. The largest benefit is that its guests opt-in over time, we can better understand how they prefer to shop and serve them with more meaningful offers.

Now if you look back on the headlines over the last 2 years, one of the biggest news generators for Target was our plan to reinvest our own brand portfolio. We said we'd deliver more than a dozen new brands in 18 months, and true to form, our team over-delivered by a mile. We've introduced more than 20 new brands, and our teams are still growing strong. Fast company just put Target near the top of the list of the world's most innovative companies, specifically for this body of work. A few days later, we unveiled 3 new brands as part of our full reinvention of our sleepwear and intimates business. To top it off, we created a mountain of buzz with our latest partnership with vineyard vines, and the guests' response has been phenomenal. But introducing new brands month after month is not the goal. We're focused on growing market share, attracting new guest segments and finding whitespace opportunities in our portfolio.

So let's take Home, for example. Threshold by every measure has performed extremely well since we introduced it back in 2013. But instead of stretching Threshold to appeal to a broad array of guest's taste to drive growth in the category, we took a different path. We launched 4 new brands, Opalhouse, Project 62, Made By Design, and Heart and Hand with Chip and Joanna Gaines, which attracted more guests with different style needs and helped drive the most successful year-over-year comp growth we've seen in Home in well over a decade.

With TRU and VRU's exit, we saw an obvious opportunity to pick up market share, and our teams aggressively chase the business, making big bets on Toys and Baby. We finished 2018 with huge market share gains in each. Those guests are also looking for Target for inspiration and innovation in places like Apparel and Essentials. So we've recently launched new lines in our class in Cloud Island, and that's just a start. In the months ahead, you can expect to see a steady stream of newness and exclusivity across the assortment. New



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brand launches, new partnerships and a sharper focus on developing best-in-class brand management expertise across every category.

Finally, while it sounds like we're pleased with the progress we've made in our priorities, we know better than anyone. We can't take our eye off the ball, not even for a second when it comes to the pursuit of flawless execution on the fundamentals. Over the last few years, we reset our pricing and promote strategy, and we'll continue to fine-tune it. And in 2018, we set up dedicated teams to tackle persistent challenges in our business like [seesaw] merchandise transitions and in-store signage.

On a store-by-store basis, we must ensure we're spending payroll on things that add value for our guests. Because when you multiply it by 1,800, we're talking about huge opportunities to take cost out and move with greater speed and efficiency. One of the biggest changes in our operating model is in Food and Beverage, where we decided to bring the full spectrum of merchandising and operation functions in one team. Over the last several years, we made great strides insuring up our operating challenges, elevating the experience and building more specialized expertise. As a result, we've seen 6 quarters of positive comps in Food and Beverage, which translated in the market share gains in 2018. Channeling that momentum, we believe bringing our Food and Beverage supply chain, operations, merchandising teams under the leadership of Stephanie Lundquist will help us move faster and farther and consistently deliver more value for our guests.

So given all this progress, it's clear our strategy is working. We built a successful durable model, and I'm confident we're well positioned to continue to deliver strong sales and traffic growth in 2019 and for many years to come.

You saw that our guidance this morning, low to mid-single-digit comps, driven by increased traffic and continued market share gains. But I also know exactly what you're thinking. Brian, at what cost? Are we counting empty calories? Or are there going to be more money in the bank? So I'll head this off straight away. That way you don't have pull me aside after our presentations this morning. You want to know how we plan to continue to grow, scale and accelerate our investment agenda and deliver profitable growth and strong returns on invested capital. We said this morning to expect high single-digit growth in EPS. You want to know how we get there, and that's exactly what we want to answer for you today.

In a moment, I'll turn it over to Cathy Smith, who will take you through our financial model and how we're prepared for the next phase of our strategy, how we'll continue to generate strong cash flow and the ROIC that will fuel our performance in years ahead. Then John Mulligan will share how we build on this momentum, how we'll keep scaling our strategy, innovating across every aspect of our supply chain and elevating our service model. He'll talk about how we're incentivizing greater adoption of our services and fulfillment choices, how we're driving demand, how we're getting smarter, more savvy and more efficient on the back-end, and that will strengthen profitability and grow operating income. Then I'll come back and offer our guidance on our financial performance and expectations for the future.

And with that, I'll turn it over to Cathy Smith.

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

Thanks, Brian. One of the great things about working in retail is that every day, 365 days a year, we get a new report card from our guests. Most of the time this real-time feedback lets us know that things are working as planned.

In contrast, 2 years ago, those report cards were clearly showing that we needed to change. And based on last year's strong performance, this latest report card shows that we've been successful. But it's worth taking a look back to see just how far we've come. Here are couple of charts I showed you in the same room 2 years ago. These 2 annual report cards clearly showed the reversal in our performance between 2015 and 2016. With that feedback, we took a hard look at ourselves and how we fit into the retail industry, including our strengths and points of differentiation. We did an in-depth assessment of how consumers are evolving and shopping differently. That work confirmed, we were already focusing on the right priorities, but we weren't moving fast enough. The greatest hockey player ever, Wayne Gretzky, referred to this as skating to where the puck is going. We were headed in the right direction, but our guests were moving faster. Fortunately, we had the resources we needed to accelerate, strong operations and well-located stores, a fiercely loyal base of guests, robust cash flow and a strong balance sheet and the best team in retail. So here in this room 2 years ago, we laid out a bold new plan. We committed to make additional investments of both capital and operating margin to help Target deliver more for our guest



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faster. These investments were focused on delivering an ever-improving guest experience not just for today, but for many years to come; more than 1,000 store models by the end of 2020; new technology to make shopping easier for our guests and more productive for our team; a new supply chain model designed to support an unmatched suite of digital fulfillment options; and to take labor out of the store back rooms; more than a dozen new owned and exclusive brands; simpler pricing and promotions with a focus on being priced right daily; and importantly, our renewed commitment to our team, including new training, additional hours and meaningful wage increases. All of these investments were developed through a guest lens. We focused first on the things they already love about Target like our shopping experience, our brands and our team, and we asked ourselves if we could do more. That was just the start. We also committed to becoming the easiest place to shop in America because as much as our guests continue to love us, we knew we lose relevance and trips if we didn't make shopping at Target fast and easy.

Our multiyear plan was focused on building a durable model, positioned to thrive in an omni-channel world. 2017 would be an investment year, marked by a step-up in CapEx and a step-down in operating profits. In 2018, the year just ended, would be a year of transition when financial metrics would begin to stabilize, positioning Target for long-term profitable growth.

How did things turn out? Even though we had planned for a transition year, last year turned out to be one of the most productive in our history as our business generated the strongest traffic and sales growth in well over a decade. This growth is even more meaningful when you realize that over the last 10 years, our average store age has nearly doubled, and yet last year, we delivered the strongest growth in that entire 10-year period. The lesson is simple, the age of the stores doesn't matter as long as they're well located and you invest to keep them fresh and relevant.

On the bottom line, last year's adjusted EPS of \$5.39 established a new all-time record for the company, driven by strong comp sales, operating margins that began -- operating metrics that began to stabilize and the benefits of a lower tax rate.

Between the top line and bottom lines, let's look back at a few other details of our 2018 performance. Last year's gross margin rate was down about 40 basis points, and half of this decline was driven by sales mix. Even though we saw historically strong sales in our higher-margin Home, Apparel and Beauty categories, we also saw exceptionally strong growth in lower-margin categories like Baby and Toys. Beyond mix, the remainder of last year's gross margin rate decline reflected the price investments we made throughout 2017, along with the cost of rapid unit growth in digital fulfillment. As you'll hear later from John, these days, we're seeing the most rapid growth in the lower-cost fulfillment options, which we began to scale up last year. And this year, we're focused on driving efficiencies that will further reduce the unit cost of digital fulfillment.

Last year's SG&A expense rate of 20.9% was about 10 basis points higher than in 2017. This performance reflected the carryover of investments in hours and training we made throughout 2017 combined with continued pressure from wage growth. Among the offsets, our SG&A rate benefited from disciplined management of expenses throughout the organization and the natural leverage benefit of strong comp sales growth.

On the D&A expense lines, dollars were approximately flat last year, resulting in about 10 basis points of rate leverage. This performance was better than expected and driven by our careful work of our team to optimize the scope of our remodel projects. As a result, accelerated depreciation was lower than expected last year, even as we continued to see a 2% to 4% sales lift in our remodeled stores.

Below the operating income line, interest expense was down about \$200 million last year, reflecting both the onetime and ongoing impacts of our 2017 debt retirement and refinancing activities. In addition, like virtually all businesses in the U.S., we benefited from a lower federal tax rate. And finally, last year's EPS reflected a 3.1% reduction in average shares outstanding, driven by our continued disciplined approach to capital deployment.

This approach has been consistent at Target for decades. First, we invest fully in opportunities that meet our strategic and financial criteria. We then support our dividend and look to grow it annually, something we've accomplished every year since 1971. And finally, we return any excess cash beyond those first 2 priorities through share repurchase within the limits of our Middle A credit ratings.

Let's review how our capital deployment priorities have played out over the last couple of years. During that time, our business has



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generated nearly \$13 billion of cash from operations. With this cash, along with some overseas cash we repatriated following tax reform, we funded CapEx of \$6 billion, dividends of \$2.7 billion and share repurchases of \$3.2 billion. In addition, in 2017, we invested more than \$500 million in acquisitions, primarily for Shipt, and reduced our long-term debt portfolio by about \$1 billion. We also funded a \$900 million increase in last year's ending inventory position. This investment is intended to support strong sales growth, including a continued outsized opportunity in Toys and Baby. Beyond the sales line, last year's inventory investment supported better in stocks, which ended the year in the best position since we've been measuring them.

So now I want to talk -- I want to turn to after-tax ROIC, which measures our profitable -- our performance in terms of profitability and the capital required to generate that profit. Target's after-tax ROIC for the last 3 years and -- we're showing you right here, and you can see that we performed really well on this metric. But I also want to show what these numbers would have been without discrete benefits resulting from federal tax reform. With that additional context, it's really clear that our plan is working. After a temporary decline in 2017, driven by our higher investments in capital and operating margin, we saw a remarkable recovery in 2018. And given our momentum, we are positioned to improve on this already strong performance in 2019 and in the years to come.

One final note regarding 2018. When you're reviewing our financial results, keep in mind that the fourth quarter of 2017 included an extra week, one in which we generated about \$1.2 billion in profitable sales. So when you review our fourth quarter results, you'll see on the surface that both the sales and the operating income were essentially flat to the prior year. However, on an apples-to-apples basis, last year's fourth quarter and full year performance was much stronger on both metrics, an important fact that might not be obvious from a quick scan of those financial statements.

I'd like to finish my remarks by talking further about what a durable model should look like, one that will allow Target to thrive in this new and dynamic retail environment. At the high level, the goals are straightforward. The business model has to deliver continued relevance with consumers and sustainable long-term growth, and the financial model needs to deliver outstanding returns on the capital we've invested on behalf of our shareholders. On the top line, based on the capabilities we've built at Target over the last couple of years, our business is positioned to deliver growth at or above the growth rate of the addressable market in the U.S. And based on the size and breadth of our category offering, we think nominal GDP growth is a solid benchmark for the addressable market. More specifically in a typical year for GDP growth, Target is positioned to grow total sales in the low single-digit range or better, driven by comp sales growth combined with the contribution from new stores. And of course, like you saw last year, we are positioned to grow even faster in the face of unique opportunities like the Toys "R" Us liquidation.

As you'll recall in this meeting 2 years ago, we pointed out that many of our competitors' stores would likely be closing. That has certainly played out as expected, and it looks like the trend will continue. The reason is simple. In today's retail environment, those who have the resources to evolve are being -- those who don't have the resources to evolve are being left behind by their customers. And unfortunately, for them, that often means they need to close some or all of their doors. That is why 2 years ago, we explained why it's so important for Target to invest in fresh, vibrant stores, places where our guests can find fun, inspiration and genuine human interaction. The lesson of the last 2 years isn't that stores are being left behind, but the consumers have the freedom to choose only the best experiences like a Target run.

On the operating income line, our business delivered a 5.5% rate last year. This will serve as a good benchmark for the years to come, given the strong foundation we've built. Specifically, we believe we reached a point in which the operating margin rate, headwinds and tailwinds will generally balance. In terms of the tailwinds, we expect to see a benefit from strong sales mix in our high-margin categories; continued cost of good savings through collaboration with our own and national brand vendors; moderation in unit fulfillment costs, as John will discuss in a few minutes; labor savings from our work to change our store replenishment; overall expense discipline across the enterprise; and the leverage benefit of continued strong top line growth. We expect the aggregate benefit from these tailwinds will enable us to offset continued cost pressures on both the gross margin and the SG&A lines, most notably driven by the growth of our digital fulfillment and continued wage increases.

On the D&A line, we expect to see some moderate rate leverage in the years ahead. This is because, last year, we reached a run rate of about 300 remodels a year, which we expect to maintain through 2020. This will allow our D&A dollars to remain roughly flat as well, resulting in about 10 basis points of annual D&A leverage -- D&A rate leverage. When you put this all together, relative stability and the



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net of our gross margin and SG&A rates and about 10 basis points of annual D&A leverage, we are positioned to deliver about 10 basis points of operating income rate leverage per year as well.

On the income tax line, based on the current rates we're facing at both the federal and state levels, we expect our annual effective tax rate will be in the 23% to 24% range beginning in 2019.

Regarding capital deployment, we expect to have ample capacity to maintain CapEx at about \$3.5 billion over the next couple of years, deliver low single-digit growth in our annual dividend per share and return excess cash through share repurchases while maintaining our Middle A credit rating.

Based on the expected share count reductions from those repurchases, earnings per share will grow faster than operating income. These financial model -- these financial benchmarks for our new business model are reasonable and achievable over time. In fact, as I look back to 2018, our full year adjusted EPS of \$5.39 was near the top end of our initial guidance range. That performance reflects -- reflected several lines of our P&L that were notably different from our expectations at the beginning of the year. On the top line, our business delivered comp sales growth of 5%, stronger than our expectation of low single-digit growth. The primary driver of this upside was Toys in Toys and Baby where we captured greater market share than we had planned. This outsized growth in Toys and Baby created unexpected mix pressure on our gross margin rate causing it to be lower than our initial expectations. And finally, as I mentioned, D&A expense was lower than expected given our team's work to optimize the remodel program.

All together, our business delivered strong growth, market share gains and EPS near the high end of our expectations. This is the mark of a durable model, one that can respond to unexpected events and still deliver on both the top line and the bottom line. So while our journey to refine this new business model is ongoing, I hope you'll agree that last year served as a meaningful waypoint. And as Brian said, we're the first to say we have a lot more to do. But I hope it's also clear that we feel really good about our momentum.

Many of you were here in this room with us 2 years ago as we talked about this journey for the first time. At that time, it might have seemed hard to imagine that Target would ever deliver the kind of growth we saw this last year. So today, we want to thank you for sticking with us on this journey. And as we look ahead, we hope you'll continue with us as we embark on another promising year of profitable growth. Thank you.

John J. Mulligan Target Corporation - Executive VP & COO

Good morning, everyone. Two years ago, in this room, we laid out the major investments we're making in our business, including using our stores as fulfillment hubs to get closer to the guests. Last year in Minneapolis, we showed you the prototype for how those ideas were taking shape, and we told you we are making Target the easiest place to shop. Today, I get to show you how we've done that and how the investments you've heard about have become very real from the way we're remodeling our stores to how we pick, pack, ship and deliver out their doors.

It all starts with our store teams and the expertise and talent they have that brings new services and experiences to life for guests, and it's supported by our supply chain efforts that ease the operational workload in our stores. I'll talk more about those in detail. But I'm going to start with our fulfillment capabilities, because for our guests, that's what has really stood out this year. We scaled Shipt to nearly 1,500 stores in more than 200 markets in a matter of months, expand the Drive-Up to nearly 1,000 stores coast to coast and are delivering hundreds of thousands of items in 2 days or less.

We all know that operation's presentations don't start with a fancy highlights reel. And for years, our work was largely behind the scenes. And it's obvious why engineered processes and algorithms don't ever make the marketing cut. But for the past year, after launching -- both launching and expanding our fulfillment services and seeing guests' excitement for them, we've got a whole lot more sizzle to show. So here's a look at all the ways guests can get the Target run done.

(presentation)



John J. Mulligan Target Corporation - Executive VP & COO

For most of Target's history, guests have had one way to shop. They came into the store, walk to the sales shelf and essentially pick their own order and drive it home. In the late 90s, when we added an online business, we began shipping orders directly to the guest. At that time, that was a new and radical concept for Target. But today, it's a relatively mature fulfillment method for just about any retailer. Then about 5 years ago, we began offering in-store pickup. This started to change the game from the 2 extremes of guests shopping only in stores and Target shipping only from a warehouse. Guests liked placing order online and picking it up not far from their home that same day. Since then, we've quickly grown the options we offer our guests. It went next day, same day, in the car or at the door. We have a way to deliver. Whether it's same-day delivery shop by Shipt or newer service Drive-Up. Placing an order and waiting for it to ship is something consumers already know how to do. But having an order popped in your trunk just an hour after you order it is a pretty new concept.

As Drive-Up expands, we're helping guests experience a whole new kind of convenience. Take a look at how Drive-Up is making the Target run easier than ever.

(presentation)

John J. Mulligan Target Corporation - Executive VP & COO

We make close to 2 million of those parking lot deliveries last year, and nearly all of them took less than 2 minutes, many even less than 1 minute from parked car to product handoff. Guests love it. The Net Promoter Score repeat rates for Drive-Up are up -- are extremely high, and they tell us it's easier and more convenient than having a box dropped on their step.

Here's a look at an actual email we got from a guest on a cold night in January. And no, it wasn't during the week that was 30 below 0 in Minneapolis. It was just a regular night for a mom who didn't have much time. She'd been meaning to try the service and finally did, and in less than 2 minutes in our parking lot, she saw how Target really understood what she needed. And it's just one email, but it speaks to what we hear from guests whenever we enter a market. In fact, in Minneapolis, the first market to have the service, we've seen it grow more than sevenfold year-over-year. With that excitement and fast adoption in just one market, we expect to see a lot of growth in Drive-Up across the country as we continue to expand most of the chain.

Each of our fulfillment option satisfies a different need and serves a different kind of shopping trip. As guests are learning about these services and experiencing how convenient they are, they're choosing them more often. For example, we're seeing guests choose pickup instead of shipping, and we expect demand for our newer service to continue growing the fastest.

And what if I told you we can offer all those services in a way that makes us faster, lowers our costs and leverages existing assets to drive higher productivity and ROIC. Most of you would be pretty interested, right? That's the foundation of our stores as hubs strategy, using our more than 1,800 stores in neighborhoods across the country to handle online orders not far from the guest who bought them. Many retailers are just starting to talk about this concept, but we've been doing it. A few years ago when others said stores didn't matter, we doubled down on ours. We shared our plans to use them for both in-store experiences and digital fulfillment. And because of the investments we've made to put our stores at the center, Target has a delivery option to meet just about any guest need for speed and to make shopping even easier.

Understanding how our stores make us faster is simple. They're already in the city neighborhoods just miles from our guests' doorsteps, so we can ship online orders at least a full day faster than we can ship from an upstream fulfillment center, and we can deliver same-day orders within hours. Managing our fulfillment cost is much more complex. We do this in several ways. First, we reduce the distance of delivering fulfilled orders in stores where we already carry the items our guests want most, just miles from their homes. It's why we're shipping millions of orders at the back of 1,400 local stores, which is more than 40% cheaper per unit on average than upstream shipping. And we offer convenient services like Order Pickup and Drive-Up, which cost nearly 90% less on average than fulfilling from a warehouse.

We also manage the cost by offering different fulfillment models that add revenue and control cost. For next-day delivery of essentials,

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guests pay \$2.99 to fill a box with items like cereals, dish soap and paper towels. And we ship from local stores which lowers the cost of delivery.

Delivery From Store is similar. Guest shop the store and pay \$7 to have their purchases delivered home. These orders tend to be 5x higher than the average Target basket and full of high-margin categories like Home. In the crowd-sourcing technology we acquired with Grand Junction a few years ago, it matches our orders with local couriers who can hit our delivery promises most efficiently.

And there's Shipt, a same-day shopping and delivery service we acquired last year and rolled out to all major markets. For \$99 a year, guests can place an order through Shipt and have it delivered in an hour or two. Shipt earns additional revenue from that annual fee, and its 80,000 shoppers across the country are shopping for a growing number of retailers onto marketplace.

Finally, we find efficiency in our operations to lower overall cost to fulfillment. When we first launched Order Pickup in 2013, we were literally working from a folding table setup in the back room. It took us a number of years and lots of technology and process improvements to go from scrappy to smooth. When we had Order Pickup down cold, we took it to the parking lot, giving our guests the convenience of swinging by their local store without even getting out of their car. You saw how Drive-Up works and the technology and processes that we've built for our team to move faster and spend less time per order. Across-the-board, we've put some serious technology, equipment and automation behind our delivery methods to make us faster and more efficient. This operation could be anywhere, a warehouse in Phoenix, Colorado or Virginia, but it's a local store in Minnesota doing the work of a fulfillment center just behind the sales floor.

With these kinds of investments in every delivery method, we lowered our average unit cost of fulfillment by 20%, driven by our fastest-growing fulfillment methods like ship-from-store and Drive-Up. By fulfilling closer to the store shelf, adding new delivery options and optimizing our operations, we saved hundreds of millions of dollars in fulfillment costs in 2018. Two-day shipping is what guests know best, but our newer delivery services like Drive-Up that have lower costs and are more profitable are growing the fastest, because once guests try them, they love them.

Of course, the P&L is only part of the financial story. Using our stores as hub has allowed us to keep up with the incredible growth we're seeing in our digital businesses. In the past 2 years, guests bought twice as many units from Target.com, and all of that growth was fueled by stores, buildings we already own and where lights are already on. Our stores have shipped 4x the number of items out their back doors, and they managed triple the demand for Store Pickup services. This year, during our fourth quarter, stores fulfilled nearly 3 of every 4 orders, effectively doing the work of 14 fulfillment centers. That means we didn't have to spend nearly \$3 billion on new warehouses over the past few years to accommodate that growth. And with our store replenishment efforts that enable stores to fulfill a growing number of digital orders, we'll continue to have capacity over the next few years. Now something you would call that capital avoidance, but as you've seen in the investments we're making across our operation, we're not avoiding investing capital where it's productive. Using our stores to do the work of additional warehouses is the most efficient way to deploy our resources.

It's also important to note that while our stores are fulfilling more digital orders, it's not coming at the cost of in-store sales. Since 2016, we've made our stores more productive by using them as fulfillment centers. Our fulfillment sales per square foot have grown at an average 67% rate per year. Now, more than \$14 a foot as our stores increasingly support our digital business. At the same time, our in-store sales per square foot have grown at a 4% rate per year, which means our Target stores can support incremental growth from Target.com without hurting in-store sales. So our stores as hub strategy isn't putting our core business at risk, it's simply helping us grow faster.

While fulfillment refers to digital orders to guests, replenishment is all about sending store's inventory to replace what they sold. And a key part of enabling so much work in our stores is getting replenishment right. That means sending our stores only the inventory they need right when they need it and moving demanding operational work like unpacking boxes and storing up the product out of the stores and into our warehouses. To do that, the supply chain team is continuing to modernize our upstream supply chain to be fast, but precise. We're building a customer automation solution like the one you see here from our Perth Amboy facility outside New York City to better support our stores. This is the future, one warehouse doing work for a whole group of store backrooms, sorting product, organizing items by store aisle and picking an individual unit or case pack based on the store's demand. The robotics allow our warehouse teams to



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manage the really complex sortation of millions of units and to handle each one individually bound for different stores at different times. In the end, the warehouse team will use organized carts, stock with only the items the store needs and sort it by aisle onto a truck headed to a nearby store. Once it arrives, the store team grabs a cart, wheels it to the sales floor and fills the shelf literally in minutes. It's a far cry from the trucks we packed like a game of Tetris that take hours, if not a full shift, to unload. Instead, our team spends more time on the sales floor helping guests, using their expertise and talents in service to build the basket. And at the same time, as stores get a precise amount of product sometimes delivered several times a day, our out-of-stocks improve and will reduce working capital by cutting the amount of product just sitting around in the back. It'll take a while before we deploy this model across the country. We've prioritized the Northeast, areas like Boston and New York where our small format growth depends on it. You've seen these stores, and they're small. And with the real estate at a premium, we're using every possible square foot for selling space, leaving us with little to no backroom. So we keep the sales floor in New York and essentially move the backroom to Jersey. And for our stores, it's made all the difference. But don't just take it from me, hear it from them.

(presentation)

John J. Mulligan Target Corporation - Executive VP & COO

What we're doing in supply chain is the reason we're able to grow in dense, urban areas, where we can serve new guests. But it also makes it possible for our full-size stores to act as efficient local fulfillment hubs because the product it needs in-store guests and online orders.

In the past couple of years, we've lowered our out-of-stocks as a total company. Now we're focused on reducing out-of-stock variability between individual stores. To do that, we're improving how we transition merchandise from one season to the next and improving our direct-to-store deliveries, and we'll see even more out-of-stock improvement as we scale our replenishment model over time.

It all comes down to this, investing in how we replenish stores has given us a sturdy set of rails to serve those stores. And with a strong foundation in place, our fulfillment operation glides right on top, so we can offer our guests so much more ease and convenience from their local stores.

Digital fulfillment is a big platform for growth and is an enormous opportunity to serve our guests in new ways, but at the end of the day, an overwhelming majority of retail experiences still happen in the store. So make no mistake, our store teams have to nail it. Helping guests find what they need before they even ask, sharing their expertise to make recommendations, presenting merchandise in a way that's easy to shop and fun to explore. The point of our investments upstream is to put more team members on the sales floor, helping guests instead of in the backroom checking off tasks.

A couple of years ago, the stores team kicked off an effort to modernize the way we run our stores from how we use our talent to the many ways we invest in our team and all against the backdrop of our commitment to reach a \$15 minimum hourly wage by the end of 2020. We started training our team to be specialists so they could bring expertise to how we serve our guests in each area of the store. We improved the technology they have at their fingertips to make their service even better. Today, our team can help guests check out anywhere in the store or place an order for something not in stock all from their mobile device. It's all about continuing to elevate the guest service and experience.

So here's a video we use this fall at our annual company meeting. It's our team talking to our team about what we're doing inside our stores to serve our guests better than ever. Take a look.

(presentation)

John J. Mulligan Target Corporation - Executive VP & COO

We're modernizing both inside and out as we continue remodeling hundreds of stores across the country. The biggest difference, we've enhanced our experience with updated decor, lighting and color by opening sightlines that really let the product shine. Last year, we completed more than 300 end-to-end remodels, and the most we've done at any time in our history. The reaction and complete excitement from guests doesn't get old. They tell us they love what we've done with the place. But even better, they shop us more often.



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We consistently see an average 2% to 4% sales lift per store after a remodel.

We've moved at an unprecedented rate to touch a majority of our stores in just a few years. We'll do another 300 this year as part of our effort to have more than 1,000 remodeled stores by the end of 2020.

Beyond that, we'll continue remodeling the in-store experience across the chain but at a more moderate pace for the long term.

While we're investing in existing stores, we're also finding new sites to serve new guests. Last year, we opened more than 1 million square feet of sales floor in small format stores, entering big markets like New York and new markets like Vermont. In fact, some of our most recent openings have already become our highest volume small format stores, even as the traffic in our mature small formats has continued to rise. This year, we'll open doors in growth areas like L.A. and Washington, D.C., near college campuses in Seattle and East Lansing and also in new communities for Target like Cape Cod and Santa Barbara. These stores help us enter new neighborhoods, where a full-size store wouldn't fit and where we see a need we can fill. And they continue to show strong financial performance, beating our chain average of comparable sales growth and productivity.

To a building owner or a developer, Target's a strong brand and a sought-after tenant, which has positioned us well to capture great opportunities during a time when hundreds of empty retail boxes are suddenly up for sale. We'll continue to evaluate where we can meet new guests or better serve existing ones and maintain our pace of opening approximately 30 new stores a year over the next few years.

Target's confidence in stores hasn't changed. It's where everything we're doing for the guest comes together, to create experiences that are differentiated, inspiring and easy. We're using our stores as stores, stores as fulfillment centers, stores as the local connection to our guests even if they don't come inside for every trip. In our more than 1,800 stores, with the passion and talent of our incredible team, we remain at the center of how we deliver, grow and differentiate for years to come. Thank you.

Brian C. Cornell *Target Corporation - Chairman & CEO*

So clearly, a lot of incredibly exciting work is underway, and the future is just as bright. Since you've heard from Cathy and John, we're clearly focused on harnessing this success, using it to fuel, sustain growth across the business as well as reducing costs, improving speed and efficiency. We're building a durable financial model that will propel Target forward in any economic environment. It's a model that translates top line growth to bottom line performance. So in a typical year, you should expect to see low single-digit comps leading to mid-single-digit growth in operating income and high single-digit growth in EPS. The model is also built to deliver higher after-tax ROIC, pushing us further into the mid-teens during the next few years.

So let's walk through what this means for 2019, starting on the top line. You saw the detailed numbers in the morning's press release. For the full year, we're guiding to comp sales growth in the low- to mid-single digits. That will reflect the combination of increased traffic to our physical stores, strong market share gains in digital, greater adoption of our fulfillment capabilities and market share growth in every major category across both stores and digital.

Moving down to P&L. As you heard from John, we're acutely focused on controlling costs to offset increased pressure for our wage investment and fulfillment growth, generated by our growing digital business. With that discipline in 2019, we're planning to deliver moderate improvement in our operating income rate, which will translate into mid-single-digit growth and operating margin dollars. And combined with the benefit of a lower share count, this operating performance will translate into high single-digit growth in EPS.

As you heard from Cathy, for many years, Target has taken a consistent, disciplined approach to capital deployment. In 2019, we expect another year of continued robust cash flow, which we'll use to fund CapEx of about \$3.5 billion, which, on top of the investments from 2017 and 2018, will put our 3-year stack at nearly \$10 billion. We're also positioned to deliver a low single-digit increase in our quarterly per share dividend, a commitment we've upheld nearly 50 years running. And we expect continued capacity, return cash to shareholders through share repurchase within the limits of our debt rating. Altogether, this performance will translate into strong after-tax ROIC of nearly 15%. As for the near-term guidance, for the first quarter, we expect to deliver comp sales growth in the low- to mid-single digits, perhaps just a little stronger than we'll deliver for the full year, in light of the continued opportunity in our Toy and Baby business. We also expect to see a low single-digit increase in operating margin dollars but a small decline in rate, reflecting the mix impact of the



unusual strength in both Toys and Baby. And like for the full year, we expect high single-digit growth in our first quarter EPS.

So we've covered a lot of ground today, but the story in my mind is actually quite simple. During the last 3 years, while the future of the industry was anything but certain, Target laid out an ambitious agenda to reimagine our stores, to reinvent our supply chain and fulfillment capabilities, to reposition our own brand portfolio and to invest in our team. We did this so that we could transform our company, build a durable model that delivers strong, consistent growth that puts Target right in the center of the winner's circle in retail. Two years later, that's exactly what we've done. Today, Target is America's easiest place to shop and one of the world's most innovative companies. As we carry into 2019, you can expect Target will continue to deliver. We'll continue to adapt, evolve, innovate, invent. We'll continue to inspire, and we'll continue to succeed so that Target will continue to lead this industry for many years to come.

2018 was a great year for Target. But I'll leave you with a new headline: 2019 will be even better. So thank you for being here this morning.

That concludes our prepared remarks, and now we want to use the remaining time to answer your questions. We're going to try to get through as many questions as we can, so I'd ask you to limit your questions to one per person. I'd appreciate if you started by introducing yourselves and the organization you represent. And while I'll be here on stage, I've got several members of our leadership team that are ready to jump in and provide expertise on the various topics we'll cover today. So we've got [Mike Reiners] around the floor today. All the hands just went up at once. That's great. So maybe, why don't we start right here with you?

QUESTIONS AND ANSWERS

Simeon Ari Gutman *Morgan Stanley, Research Division - Executive Director*

Simeon Gutman, Morgan Stanley. So you're guiding to profitable growth, and you said this is the durable model going forward. I think on TV, you said, "We're getting to the path of stabilization." So I'm curious if there's anything that you're looking out that's maybe more subdued. Like, why that comment? And then second of all, given that the business now has this potential, was there any debate of guiding to flattish margin just so you have more ammunition to invest?

Brian C. Cornell *Target Corporation - Chairman & CEO*

Yes. It's a great place to start. And again, if you look inside of our Q4 results, we started to see that margin stabilization. And as we adjust for the 53rd or the 52nd week changes, we're starting to see that improvement, and we expect that to extend into 2019. So when you look at our focus on efficiency, on reducing costs, as you see demand shift to more profitable fulfillment measures, we expect 2019 will be a year where we deliver consistent operating margin improvement, coupled by very solid single-digit, mid-single-digit comp growth in the first quarter, single digit throughout the year, and that's going to translate into high single-digit EPS. So all the work we've been doing for the last few years is starting to come together. And I've talked about this a number of times, the great part of our strategy is it's not driven by one single element. It's all of these elements now coming together, maturing at scale. And importantly, the guest and the consumer is voting with their wallet and with their feet. So it's all starting to come together, and we're building that flywheel that will extend into 2019 and beyond.

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

It's Michael Lasser from UBS. You laid out several factors that'll drive gross margin stability. How much have you assumed you're going to have to invest incrementally in promotions and price to achieve your goal of gaining market share across every category?

Brian C. Cornell *Target Corporation - Chairman & CEO*

Michael, I'll let Mark jump in here in a second. One of the things we talked about in our prepared comments, and we've talked about it over the last couple of years, is this investment we made to enhance our pricing and promotional capabilities. And we've made tremendous progress, built real expertise. So we feel very good about our pricing position today, the value we're offering against our entire portfolio. And as we look to 2019, we'll make sure that we continue to be competitive, that we're priced right daily, that we offer great value to our guest. That's at the heart of our brand promise when you think about Expect More and Pay Less. That's going to

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continue, and we think that's going to be very durable as we go forward. So we're committed to being priced right daily, delivering our guests great value across all our categories, and I think we're well prepared for 2019 as we think about our pricing and promotional position. Mark?

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

Yes. I'll just add that -- to reiterate what Brian said. Last 2 years has been about creating a lot of stability in terms of price and promo as well as helping with our trips and traffic, and we've been outpacing regular price sales -- [visit] promo sales for the last 2 years and created great stability and trust with the guest at regular price as we manage price values. It's really working for us.

Edward James Yruma *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

This is Ed Yruma from Keybanc. You've made some management changes within food and beverage. It seems like you're putting some real muscle there. How do you dimensionalize the opportunity? Any kind of early findings?

Brian C. Cornell *Target Corporation - Chairman & CEO*

Why don't I go back to the progress we've made over the last several years? We've made major commitments to improving our Food and Beverage supply chain, our merchandising, our in-store operations. But we did make the decision earlier this year to bring all of those functions together under one leader, and Stephanie is here today. And as we looked at that business, we recognized it's very different from any -- many other parts of our portfolio. The products we sourced, the perishability of it, the cold chain environment, how we manage product from a store level. So we made the decision to bring all of those elements together under one leader. The functions will still -- were very closely with their counterparts in supply chain, in merchandising, in pricing, in marketing. But having one dedicated leader who thinks about Food and Beverage every single day and is connecting the needs in supply chain to merchandising, to store operations, I think, is going to yield significant benefits in the year to come. But we've been growing our Food and Beverage business for over 6 quarters now. 2018 was a year where we took market share gains in many of our key and essential Food categories. And I think with Steph's leadership, we're just going to continue to build on that in years to come.

Gregory Scott Melich *Evercore ISI Institutional Equities, Research Division - Former Senior MD, Head of Consumer Research Team and Senior Equity Research Analyst*

Greg Melich with Evercore ISI. So couple of years ago, you talked about investment and how that was going to invigorate traffic, and it's worked. As you look out now to the next couple of years and after that, where are we on that investment cycle in terms of in the P&L versus CapEx? So more specifically, sounds like remodels will peak the next couple of years, so maybe could CapEx start to come down again? Or will investment then go back into the P&L? And then on supply chain, do we need to now ramp up at some point in supply chain investment? Just where are we on the cycles of that would be really helpful.

Brian C. Cornell *Target Corporation - Chairman & CEO*

Greg, honestly, 2 years ago, we talked about the significant investments we were going to make in stores and reimagining our stores, the investments we're going to make in our brands, the investments we're going to make in fulfillment capabilities and our team. I think now we're at the point of maturing and scaling those investments. John talked about in great detail the work that we've done from a replenishment standpoint, a fulfillment standpoint. We're going to continue to build awareness and adoption of those fulfillment capabilities in 2019 and beyond. We'll continue to remodel stores, and we certainly like to see the lift and the return that we're getting with those stores. We think we've got a pathway to open up many more small formats. But many of the big investments we made are going to start to normalize over time. So I know one of the questions that's been on everyone's mind is: Is there another big, Brian, billion-dollar investment? Is there a need for additional CapEx? As you look at our guidance and you look at our plans today, the answer is no. We'll continue to invest in our stores. We'll continue to open up new small formats. John and his team will continue to scale and mature our replenishment in supply chain. Mark and his team will continue to develop and roll out exciting new brands. But many of the big capabilities are now in place, and you're starting to see the leverage in our guidance for operating income in years to come. So I know all of you have been waiting to ask that question. There is no billion-dollar surprise for today. There is no major new initiative. We're going to continue to execute the strategy that's in place, that's working today, that's being well received for -- by our guests for many, many more years to come.



Peter Sloan Benedict *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Peter Benedict at Baird. You talked about the new replenishment model that's going to be rolled out to some of the smaller stores. I'm curious what's the time line for getting that to start impacting the larger stores. And related to that or somewhat related, are there any marketing or pricing plans in place to incentivize customer use of the different fulfillment options that you have for digital?

Brian C. Cornell *Target Corporation - Chairman & CEO*

Yes. --I'll handle the back end. And then, John, why don't you talk about some of the timing? And Rick, why don't you jump in from a marketing standpoint? One of the things that we didn't talk about specifically today is the path and the journey we've been on with our fulfillment capabilities in building awareness. While we've been working on many of these for upwards of 5 years, pickup was something we started talking about almost 5 years ago. And over the last year or so, we started talking about the fact that we've gone from testing Drive-Up to scaling to almost 1,000 locations. It was December 2017 when we acquired Shipt. In that same time period in major metro markets, we started offering our same-day courier service, leveraging our Grand Junction capabilities. But it literally wasn't until the fourth quarter of 2018 that we started talking about it to our guests, actually starting to build it into our Target Run and Done campaign. So as we said earlier today, now it's about building awareness. Because what we hear time and time again, when our guest realizes that they can place an order, drive in our parking lot, and within 2 minutes, we'll put that order in their trunk, they love it. The Net Promoter Scores are the highest we received for any service. But in many cases, they just haven't been aware of it. Because we wanted to make sure we built the processes, we had the systems in place, we had the measures that we knew our guests were looking for before we started to really talk about it. As we go into 2019 and beyond, we're going to incorporate that into our Target Run And Done campaign, make sure that America knows we are the easiest place to shop and we give you all these choices. Over 1,800 great stores to shop. You can order from your desk and come by a couple of hours later and pick up that order. If you want to drive into the parking lot on a chilly day, leave the kids in the car, we'll put it in your trunk. If you want a personal shopper from Shipt to do the shopping for you and come by in a couple of hours, we can offer that. So we're going to continue to build awareness. But as we build awareness, we're getting a great response from the guest. And one of the things I talked about earlier today is the good news is as we think about order pickup or Drive-Up, while it's more profitable for us, as John showed you, it's also preferred by the guest. They love the convenience of knowing they don't have to wait several days for something to be left on their front door. They have the reliability knowing they can pull into our parking lot or walk into our store, and we'll have that order ready for them. So it's both more profitable, but importantly, looking through the guests' lens, it's preferred by our guests. So that's a great combination for us. John, you want to talk about the time line for advancing some of our replenishment capabilities?

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

Sure. So I'll go back to when I talked about it. I think we're starting in the Northeast. We need to scale Perth Amboy, first of all, and service the small formats, the significant number of small formats we've opened and will open in the Northeast to start with. Right now, the team is thinking about what retrofitting an existing building looks like. We've run an iteration, probably #3 of that right now. We need to get a little bit further into the Perth before we finalize that. I would tell you the thing we think about is we move cautiously to start, and the concern is we don't get to shut down a building because we don't get to stop selling for some period of time for the stores that are served by that building, and so we will move cautiously at the beginning. We want to ensure we don't have buildings that are disrupted during Q4 because we don't want to create problems there. So I think you'll see a start, a retrofit of an existing building. Probably early next year, get one of those behind us. And then, Peter, I think we have a much better idea how that goes. We'll obviously refine it and then how quickly we can scale across the rest of the country.

Charles P. Grom *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Chuck Grom from Gordon Haskett. On the Target Plus initiatives, one thing you didn't discuss this morning, so I was wondering if you could shed some light on that effort. I think it's probably been 10 years since I've asked a CEO this question. But -- on the number of store opportunities ahead for -- to the small format at Target.

Brian C. Cornell *Target Corporation - Chairman & CEO*

Great. Rick, do you want to talk about Target Plus?

Richard H. Gomez Target Corporation - Executive VP and Chief Marketing & Digital Officer

Target Plus is a new initiative that we are very excited about because it has the opportunity to grow our dotcom business in a profitable way, and what it is about is how we can expand our online assortment into new whitespace. It's Target's version of a marketplace, but it is different than our other competitors. And it's different because we are known for a curation, and our consumers, our guests expect that. So Target Plus will be invitation-only. It's not intended to be a catalog of a list of products and products and products. Rather, we're going to go very deliberately, very intentionally after the right categories, the right brands and then offer them on Target Plus and with third parties. And for us, it's a profitable way to grow our dotcom business because the third parties deal with the supply chain components of it. And then what we offer, which I think is a competitive advantage, is you can take your product, and if you're not happy with it and you want to return it, you can take it to a Target store, which is something that our competitors can't offer. But the one point I would just say is it's still in its early stages, but we think, long term, can be a profitable growth driver for us.

Brian C. Cornell Target Corporation - Chairman & CEO

Chuck, on the new storefront, we certainly think for small formats, we've got dozens and dozens of opportunities in front of us. And we've taken a very disciplined approach. Just a few years ago, we were still testing and learning how to operate in a smaller-sized store. Our merchants were learning how to curate the right assortment store-by-store. Our store teams were learning how to operate in a different environment. From a supply chain replenishment standpoint, we had to figure out how to deliver and replenish to those stores, where you can't pull up a 40-footer. So we've taken a very disciplined approach. The great part today is we now have demand coming our way. We have local communities that are putting up their hands saying, "We'd love to have a small Target store on our college campus, in our local neighborhood." So we're seeing an abundance of opportunities, and we'll continue to be disciplined as we move forward. But we see opportunities to open dozens and dozens of stores across the country in urban settings and on more college campuses in the years to come. And as I said earlier, they're our most productive stores in America, delivering some of the highest sales per square foot that we've seen across the country, and the demand for these stores continues to grow. So we'll continue to meet that demand over time.

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

Chris Horvers, JPMorgan. Can you talk about sort of what you expect in terms of share gains within a low to mid-single-digit comp and then sales a little bit better? What categories outside Toys, which you'll annualize Toys "R" Us after the first quarter, what the driver of that is and where is the opportunity? And then specifically on gross margin, do you expect it to be flat in 2019? Given that you're scaling the fulfillment options and Toys will create some pressure on 1Q, could we see actually gross margin start to improve later in the year and then into 2020?

Brian C. Cornell Target Corporation - Chairman & CEO

Yes. So Chris, why don't I start with our approach to market share gains? And I'll let Cathy talk a little bit about gross margin. But I'll go back to our results in 2018. While we're very excited, and Mark and the entire team did a sensational job of taking advantage of the TRU closure, the BRU closures, and we took significant share in those categories, in 2018, we grew share across every one of our major categories, in Apparel, in Home. We had a very strong year in Beauty. We grew share in Food and Beverage. All of our major merchandising categories are growing share right now. We expect that to continue in 2019. We expect our growth to be driven by traffic gains, like we saw this year, equating to market share increases across both our physical and digital space. So we continue to see market share opportunities across our entire portfolio. And obviously, as we see unique opportunities, we'll lean in to take advantage of opportunities category-by-category. But for this team, they expect to take market share across every one of our major categories in 2019 and take advantage of the opportunities we see in the competitive market. Cathy, do you want to talk about gross margins?

Catherine R. Smith Target Corporation - Executive VP & CFO

Yes. So let's start with operating income rate first because that's the better place to start. We said that we'll see moderate expansion there this year as we think '18, 2018 was a good waypoint as we think about going forward. So we've got enough insight into headwinds and tailwinds. It'll balance. So then when you move back up, we haven't been as specific between gross margin and SG&A, but we actually don't expect a big change, right? So we already understand where the business is at. We understand Q1 is going to be a little lighter on the margin side because of a little bit of the mix business that Brian talked about in his prepared remarks. So Q1, but then the rest of year, kind of expect the balance between gross margin and SG&A and a little bit of leverage on the op income line.

Robert Scott Drbul *Guggenheim Securities, LLC, Research Division - Senior MD*

It's Bob Drbul from Guggenheim Securities. I guess my first question is, around the new brands and the private brands that you've launched, I think 20 is the number, and you said there's more to come. Can you just talk about the rate going forward, what you've learned? Can you comp those businesses? And just how we should think about that aspect of it?

Brian C. Cornell *Target Corporation - Chairman & CEO*

So let me set it up, and then I'll turn it over to Mark. And I think, Bob, it's important to recognize the commitment we've made to our own brand portfolio and the work that's being done by our product development and design teams, our sourcing teams, our merchants, the role that Rick and his team play from a marketing standpoint and then the in-store execution and experience. We've made a major commitment to making sure that we use our own brands as a point of differentiation, that we bring great style and quality to our guests at a great value. But the path we've been on and the pace is going to slow. The team has made remarkable progress in a short period of time. And I've said this a few times publicly, the team has done 3 or 4 years of work in about 18 months to make sure that we took advantage of the opportunity. We're going to be more surgical now. We'll be focused much more around making sure we're managing those brands and building brand management expertise into our teams. But we'll continue to look for whitespace opportunities and the strength in our portfolio with great own brands that drive market share gains, drive traffic to our stores and more business to our site. But the team has done a remarkable job, and it's certainly been a big part of our market share gains and the change in guest perception as we bring great newness, great quality and value to our portfolio. Mark?

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

Yes. Change will be a constant, but the velocity will change. So as Brian said, a compacted amount of work as we moved into a reestablished and stabilized mode of our own brand portfolio and the redefinition and curation of our total portfolio offer. And so you'll see a velocity change as we move to stabilize and optimize that assortment. The question around can we anniversary that? Yes, we can. Yes, we have. And yes, we will. So good things lie ahead, but expect the change rate to be different.

Brian C. Cornell *Target Corporation - Chairman & CEO*

Mark, why don't you spend a couple of seconds to talk through the performance of Cat & Jack, which, in many cases, I remember standing here actually 3 years ago with many of you talking about our commitment to Baby, the Cat & Jack brand, the progress that we expected to make in that space. And obviously, Mark, that's played a big role in attracting more moms to our stores. It's been a big part of our success story in 2018, but I also think it's a great story of a brand that's continued to build support momentum on a multiyear basis.

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

Yes. It was a bold reinvent of a business in kids that was performing in low single-digit growth when the market wasn't. So we said, why change? And what we want to do is connect with our guests and deepen our relationship with them. Two years on, what we found is that that's a trusted and beloved brand across the U.S. And if you match that to the sense of authority that we want to create with moms, kids, babies, our most recent market share gains in TRU and BRU exit and the strength of our market share there, it really starts to build an ecosystem more authority with guest archetypes and relationships so we can be America's easiest place to shop. So Cat & Jack continues to build from strength to strength. We look at both category growth as well as year-on-year growth of existing space to really develop that strength. And what we see, even in the examples that Brian shared today, example in Home, where we had one brand and now we have up to 4 or 5 brands, the sense of the sum of the parts with the authority that we create in these individual spaces, Home, Baby, Kids, continues to be a key market share driver for us.

Kelly Ann Bania *BMO Capital Markets Equity Research - Director & Equity Analyst*

Kelly Bania from BMO Capital. Going back to the replenishment model, can you just give some more specifics in terms of the cost of the technology that you're putting into Perth Amboy? It sounds like maybe one of these are going to be added in next year. I guess that means 2020. And just some specifics on the financial impact on the P&L as you start to really ramp implementing those longer term. And has this been tested at any of the suburban, larger stores?

Brian C. Cornell *Target Corporation - Chairman & CEO*

John, do you want to take that one?

John J. Mulligan Target Corporation - Executive VP & COO

I thought Brian said one question. There's about 8 there.

Brian C. Cornell Target Corporation - Chairman & CEO

John, there were only 7, but we'll try to compact it down to one.

John J. Mulligan Target Corporation - Executive VP & COO

I'll start kind of in reverse. I -- we have tested a variety of things in multiple distribution centers across the country, all of them doing different things. Some of it automation. Some of it being done manually. There's one in Minneapolis that we have used as our kind of core test, and that is providing daily replenishment to a store, a large store in Minneapolis. Two things I would say. One, this is much beyond -- we showed the automation because that's -- it's easy to see, and you can take a video of it. There is so much more going on around this. There is a new warehouse management system. There is a new order management system. We change the way we do transportation. We change the way things physically move through that building. We changed the way things physically move for the stores. So the change here is significant when we start rolling out across the country. As far as impacts, I would tell you, it's in the guidance, the long-term guidance Brian talked about. It'll be in -- it's in our capital goals. It's in the way we're thinking about the operating margins going forward. So the balance of when we do this and the cost and the payback is all thought of within our current long-term guidance. So we feel good that that's in there. We have more work to do, like I said, to figure out the exact cadence, which will mean the exact timing of when capital comes. But we want to be thoughtful here given the magnitude of what we're changing across the supply chain.

Brian C. Cornell Target Corporation - Chairman & CEO

John, it might be helpful for us to spend a few minutes and make sure you understand the work that's going on really across the company from a replenishment standpoint. Because clearly, while, obviously, automation and robotics are part of the future, John, we're doing a lot of things changing how -- the sortation process in stores. It's driving immediate efficiency to how we replenish. It's impacting our in-stock position. It's reducing inefficient touches in our stores. So we might want to leave the group with a sense for the fact there's things happening immediately. Longer term, automation and robotics will enhance that, but we're not waiting for robotics and automation to drive efficiency in how we're operating our stores.

John J. Mulligan Target Corporation - Executive VP & COO

No, I think that's right. We've done many things much more manually. We've done things upstream in the distribution centers to help the stores. And as Brian said, even the way the stores work there, unload process today has changed almost 180 degrees from where we were a year ago. That has created significant efficiency for the stores. It has put more team members on the sales floor, which again is a big part of what we're doing here. We've done manual stuff in all the buildings, in how we load trucks, in how we sequence and where pallets are relative to case packs. So there's a lot of manual work being done, all of that headed toward walking down the path of where we ultimately want to get to as we bring the automation and the new order management and the new warehouse management and the new inventory planning system. All of that will come online as well in parallel. And so we're marching down the path. And again, it's cool to see the sexy automation, and that's just one piece of what we're doing from a replenishment standpoint.

Brian C. Cornell Target Corporation - Chairman & CEO

Yes. But the changes we're making from a process standpoint and a system standpoint, that's also fueling this operating margin income improvement that we're projecting in 2019 and beyond. So there's more to come, but some of the foundational work that we're doing more manually is also contributing to an improved operating environment. Right. Here we go.

Craig Johnson

Craig Johnson, Customer Growth Partners. Brian, you've made great progress beginning, right here, 2 years ago in making your offerings more relevant to how people live, work, spend their money today. A generation or 2 ago, people divided up, just spending about half between goods and services. Now it's 69% service, it's 31% goods. To what extent are you all looking at the services side, which is the dominant part of the wallet, as an opportunity for you all? And if so, if you're thinking about it, are you thinking to build, buy or partner?

Brian C. Cornell Target Corporation - Chairman & CEO

Yes. And Craig, we'll also -- we'll always look at ways to meet the needs of the guest. I mean, right now, our strategy is very focused, is very centered around the initiatives we've been talking about to date. We'll look at the appropriate role that services play, and we'll continue to make sure that our brand meets the changing needs of consumers. I think we go back to some foundational components, and I go back 2 years ago. Standing here 2 years ago, there were lots of questions about the role of physical stores. I think we know today that American consumers still enjoy shopping in physical stores, and upwards of 90% of the business is still done there. So we want to make sure we leverage our store assets to provide a great in-store experience. We continue to modernize the store experience. We invest in our teams to provide great customer service. In the future, we may complement that with other services. We want to make sure that fulfillment and that digital experience is really easy, really convenient. So we want to make sure that we're focusing on the needs of today's consumer but also always looking around corners to what tomorrow brings. So 2 years ago, many people were questioning whether investing in stores was the right thing to do. In the holiday quarter, our store comps grew almost 3%, and consumers continue to enjoy that shopping experience. We'll continue to make sure we look around corners and find out what's next. But we think we're on the right path, and we've got the flexibility, and I think we've proven to be flexible and adaptable to changing consumer needs. That will be part of our future as well.

Edward Joseph Kelly Wells Fargo Securities, LLC, Research Division - Senior Analyst

It's Ed Kelly at Wells Fargo. Brian, you've had about, I don't know, maybe 50 basis points or so of pressure on the gross margin over the last couple of years from a fulfillment standpoint on digital. It sounds like what you're saying today is that you expect that pressure to start to ease. Could you just maybe give us a little bit more color around what drives that? How should we be thinking about the incremental margin or the margin now on an incremental e-commerce sale and how that's evolving over time? And then the second question I had for you is around wages. So I think I heard you reiterate a commitment of \$15. That's expensive, I believe, right? So how does that play into the financial guidance? And particularly, how you're thinking about 2019?

Brian C. Cornell Target Corporation - Chairman & CEO

So Ed, starting with wages, that's built into the model we talked about today. We talked several years ago about the fact that we'd be on a path to get to a starting minimum wage of \$15. That's built into our plans for future years. We've talked several times today about the fact that the guest is now moving to fulfillment options that are actually more profitable for us. We expect that to continue going forward. And obviously, there's always short-term anomalies. As we thought about 2018, we didn't anticipate that TRU is closing and BRU would be closing. We made big investments to make sure that we were going to garner market share in those important categories. It's going to drive long-term benefits for us as families come to Target more frequently for Toys and items for Babies and Kids. So that was a long-term investment. Those were lower-margin categories, but it was the right thing to do during 2018. That'll moderate over time. So one of the things that we didn't talk about today but I think is so important to our overall plan is the balance of our multi-category portfolio, the fact that we had this very unique portfolio where we're growing market share across all of our categories, but they're still really balanced. 20% of our business in Apparel, a very high-margin category; 20% in Home; a hardline in Toy business, that's about 20% of our business; Beauty and Essentials being 20%; and then Food and Beverage. So we have this very balanced portfolio that I think provides us a pathway during good times and bad, where we have a durable model, where we can meet the needs of consumers no matter what the economic environment. So we expect the investments we made this year to stabilize over time. And along with the changes that we're going to make and the benefits that we'll see through new fulfillment capabilities, we expect that to strengthen our gross margin, our operating income over the years to come. So it is officially double 0 here.

We didn't get to the question right upfront. Why don't we just take one more? Because your hand's been up the entire time, and I'll feel guilty if I walk off without giving you a chance to ask a question.

Michael Allen Baker Deutsche Bank AG, Research Division - Research Analyst

Brian, it's Mike Baker from Deutsche Bank, and it's going to be one last question in 3 parts. And it's probably -- it's a financial question maybe for Cathy. But the EPS growth, which is through the midpoint of the guidance versus the adjusted EPS. It is a little bit slower in the first quarter, a little bit faster throughout the year. And I get what you said about the gross margin, but shouldn't the better sales

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from Toys and the like offset it? So why does it ramp throughout the year? And maybe related to that, in the first quarter, any impact from things like tax refunds, SNAP, even the late Easter? People are going to want to know about that. And lastly, and again, related to all of it, how should we think about the comps throughout the year as your comparisons get 2% to 3% harder each quarter? So one question, 3 parts, all about the pace of the year.

Brian C. Cornell *Target Corporation - Chairman & CEO*

All right. You packed a lot in there to wrap this up.

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

I'm happy to take it. But -- so as we said, we'll see a little bit of pressure on the op income line in the first quarter. But to Brian's -- the guidance we gave today, low to mid-single top line, and that was Q1 and full year. So you can expect -- and you guys know what our comps for this last year, so we can think about the 2-year stacks going there. But you can expect a pretty consistent -- there's -- we're not giving guidance for second, third and fourth quarter right now. But you can expect a pretty consistent pace there, if you think about low to mid in the first quarter and low to mid for the full year. It's not hard to figure that one out. And then to your point about the EPS side, same thing. If you look at the course of the year, first off, we have to start with sales. And if we expect sales to be not too big a swing in any given quarter, you should expect a similar path on the bottom line. So that's where I would go for now. Obviously, we've put that in our guidance in the first quarter and the full year. And then no, we don't actually see a big impact in our business on SNAP or tax refunds. We do always keep an eye on that, as you can imagine. But because of our multi-category assortment, because of our incredibly loyal base of guests, we see a pretty consistent business, and we don't see the impacts there typically.

Brian C. Cornell *Target Corporation - Chairman & CEO*

All right. Well, that wraps it up for today. Again, I really appreciate the fact that you joined us today. We got a lot of different choices. We appreciate the fact that you've been with us for the last couple of hours, and we look forward to seeing you again next year. So thank you.

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