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EDITED TRANSCRIPT

TGT.N - Q4 2022 Target Corp Earnings Call

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OVERVIEW:

Co. reported 4Q22 results. Expects 2023 comparable sales to be in a range of a low-single digit decline to a low-single digit increase and 2023 GAAP and adjusted EPS to be $7.75-8.75. Expects 1Q23 comparable sales to be in a range of a low-single digit decline to a low-single digit increase and 1Q23 GAAP and adjusted EPS to be $1.50-1.90.

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At that time, we just passed a crucial milestone. We had just become a $106 billion company. For the full year 2022, which we're reporting today, we placed another $3.1 billion of revenue growth on top of that growth. We grew traffic by 2.1%. We gained unit share across our core merchandising categories, which means that consumers who were constrained by inflation and have to be very selective about where they shop and what they buy, continue shopping and buying at Target. And despite difficulties throughout the year, we closed the books on 2022 with our 23rd straight quarter of comp sales growth. However, the path between last year's Times Center meeting and this one was anything but predictable.

When we last gathered here, New York was still under a mask mandate. And though -- although consumers had started moving towards postpandemic behaviors, with families returning to travel and restaurants and shifting some dollars at a retail, we are just beginning to see how volatile and uncertain 2022 would become as spiraling inflation forced families to put discretionary purchases on hold and focus most of their spending on necessities. And there was a rapid escalation to the most expensive operating environment we've seen in decades, all of which was made worse by the spike in fuel prices caused by Russia's war on Ukraine. Those variables and many others continue to have a profound effect on the retail landscape.

So this morning, we want to take stock of that situation. We want to speak clearly of how Target is planning to stay on our growth path for the years ahead. We're keeping this morning's agenda very focused on our strategy, operations, growth investments and financial expectations. We see this as a time to combine steady leadership with our long-term strategy and a continued focus on agility and strong focus on retail fundamentals.tizis plann

Meanwhile, our team has built on our position of strength in owned brands, adding 17 of them since 2019. That includes 2 more $1 billion-plus brands in Good & Gather and All In Motion. But we're not slowing down with owned brands. In fact, just the opposite. As you'll hear from Christina, we're planning a steady cadence of newness in owned brands and national brands across our multi-category portfolio in the year ahead.

What else was in the 2019 strategy? Well, that was a year we introduced Target Circle. At that time, it was a powerful new asset for guest engagement, personalization, loyalty and sales that quickly attracted 50 million users. Since 2019, the user base has doubled and is still growing meaningfully. And Circle has become the heart of our increasingly connected loyalty ecosystem.

Since 2019, our media company, Roundel, has grown significantly with great additional growth and profit potential on the horizon. It's sought after by advertisers for its relevance and reach, and it's growing each year because our guests appreciate the engagement and the value it delivers. Roundel makes for more deeply engaged guests and partners. And because it gives us better understanding of our guest preferences, it makes us an even better and more profitable retailer. So we intend to place additional emphasis and investment towards Circle and Roundel in 2023, given the growth potential they'll unlock.

So let's pause here, and I'll start to put all this together. While I'm deliberately drawing a connection between 2019 and the year ahead, there's one giant difference, we're starting 2023 on a revenue base of $109 billion, not the $78 billion we had back then. There are other big differences, too. Today, we're reporting a full year comp increase in the low single digits, similar to 2019, and unit share gains across all 5 of our core merchandising categories. But unlike 2019, our 3-year revenue growth is $30-plus billion, not just $8 billion. And our digital penetration now stands at nearly 19%.

During the pandemic, guests became more attached to Target. And as we deepened engagement with guests, more moved into the ranks of our most engaged, measured by spend, trips and cross-category purchases. Guest engagement is also reflected in a significant increase in transactions since 2019. In fact, those increases started as far back as 2017. And we're positioned to keep growing engagement levels across our guest base even as we focus on expanding that base overall.

So standing here today, my sense is that if a new normal is on the horizon, it will be much more like 2019 than the last 3 years. And as we plan prudently to invest in 2023, we see a return over time to solid and consistent growth with operating income margin rates that should move towards and then begin to move beyond our prepandemic rate of 6% in the next few years.

Today, we'll show you our work for how we arrived at that conclusion. But a spoiler alert, it starts with the strategy. You've seen it many times before, and while the facets on this slide haven't changed, we're prioritizing to accelerate key growth drivers and making changes that will help us respond to the short-term environment, while continuing to advance all elements of our strategy. They all work together to keep our growth trajectory rolling.

Christina will cover that in greater detail, including the focus this year were placing on the magic of Tar-zhay, on affordable joy and on digital growth, Target Circle, Roundel and our enterprise sustainability strategy, Target Forward. Then John will cover what we're learning from an ongoing operational evolution, what we're testing, what we're in the process of optimizing, what benefits we see from the standpoint of efficiency as we continue to scale. Michael will describe how we're planning cautiously, and we believe appropriately, given the economic challenges we anticipate this year.

But caution doesn't mean cut off from continued growth and progress. In fact, some of the most exciting progress we anticipate will be translating our newfound scale into simpler, more efficient ways to run Target. The difference between an enterprise-wide efficiency mindset and a cost-cutting program starts with what questions you ask yourself. For us, the question isn't, what can we cut? It's how do we make things easier for our team to more efficiently deliver a guest experience, that continues to live up to our brand promise. So we'll invite Mike O'Neil, the leader we tapped to coordinate these efforts across Target, to offer his perspective on efficiency, what it is, what it isn't, how we can drive continuous improvement and what we can unlock with this focus.

We're looking forward to the next hour or so. We recognize that the landscape is unpredictable, and there are plenty of near-term challenges on the horizon. We believe 2023 will be a year in which the durability of our model allows us to flex up the categories and the value proposition that are most relevant to our guests today. We'll double down on execution, so our guests get all they've been promised every time they turn to Target.

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And we'll stay focused on gaining share across our portfolio, underpinning all the work we're doing around efficiency, to provide fuel for longer-term growth. We're optimistic about what this team can deliver and realistic about how 2023 will keep challenging us to be agile, resilient and responsive for our guests, our communities, for each other and for our shareholders.

Before we leave here today, our goal is to take you along. So you can see exactly what we're seeing. And with that, let's get going.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Thanks, Brian. Despite the challenges of the past year, Target's differentiated position in retail has never been stronger. With a great assortment, compelling value, an unmatched suite of fulfillment options and a joyful shopping experience, Target continues to drive preference with American shoppers in the face of a turbulent economic and consumer backdrop.

We have continually adapted to the environment around us, delivering ease, value and inspiration to our guests, all at a time when daily doses of joy are needed more than ever. And amidst this volatility, we continue to hone the foundational elements that it takes to be a long-term winner in retail.

Fourth quarter comparable sales grew 0.7% on top of nearly 9% last year. And for the full year, comparable sales grew 2.2% on top of nearly 13% in 2021. While our business has been generating growth on top of growth for years now, the mix of last year's sales looked vastly different than what we had expected.

Throughout 2022, changing attitude towards COVID, followed by the pressure from persistent inflation, caused demand for discretionary categories to slow meaningfully. With this in mind, we've taken a cautious approach to this year's inventory commitments in many of these categories. And we're focusing on the agility of our operating model to adjust should sales trends exceed our expectations.

In light of the volatility we've experienced, I often get the question, what did Target learn from the past year? What I'll share with you today are some of the lessons learned. In short, we've learned that our strategy is working. At the same time, we've come to further appreciate the importance of strong day-to-day execution, combined with the agility required to react even quicker to changing consumer trends. And of course, last year, reinforced the importance of providing every guest with a great shopping experience.

Most of what I'll share today likely won't sound all that different from the playbook we've used for the past few years. That is intentional. For example, our multicategory assortment continues to resonate with our guests, even as consumer demand continuously evolves. The unique balance we've achieved across all five of our core merchandising categories continues to be a key differentiator in the market, with each category serving at times as a trip driver, at other times as a basket builder, and often times as both.

Throughout 2022, we saw and continue to see incredible growth in our Food & Beverage and Essentials & Beauty businesses, offsetting a meaningful pullback in discretionary categories like Home, Apparel and Hardlines. But despite this pullback, these discretionary categories still delivered around $55 billion in sales last year.

In both our Food & Beverage and Beauty categories, 2022 delivered the third consecutive year of double-digit sales growth, stemming from increases in both traffic and average ticket. And while we're thrilled to have driven unit share gains across all of our major categories last year, we saw the strongest gains in these rapidly growing frequency categories, a proof point of the relevance and value found in these assortments.

In Beauty, we continue to be a market leader, delivering the highest growth rates of any category we sell. We've been seeing outsized growth across the entire portfolio from everyday beauty assortments to new and exciting offerings like those we've added through our partnership with

Of course, we don't build an assortment for a given snapshot in time. Rather, we flex across our categories as consumer demand shifts. And even in tough times, our discretionary assortment provides a unique opportunity to connect with guests in key moments, from major life changes, to seasonal celebrations and everyday moments in between.

Now I want to be clear that despite our cautious inventory position in discretionary categories, we're still focused on delivering newness throughout the portfolio and placing select bets in businesses where we believe market share opportunities are strongest. That's because despite continued volatility the past year reinforced to us that Target guests are attracted to all things trendy and new. We believe our commitment to newness is a key reason why we continue to generate traffic growth, and why we drove broad unit share gains last year.

Our focus on balance can be found within each category as well, where we continue to offer both industry-leading national brands and high-quality affordable owned brands that are unmatched by our competitors. Our owned brands have long been a source of pride and differentiation for Target, offering great style and quality, all at incredible value. So it's no surprise that our owned brands have continued to outpace total enterprise growth and why we have plans to launch new or extend assortments in more than 10 owned brands this year.

Recently, a study listing the 10 fastest-growing private label brands in 2022 included three found exclusively at Target. Target was the only retailer to have more than one brand on the list, and two of them were the only nonfood brands to make the cut.

Many retailers were not focused on newness in 2022, but the opposite was true at Target, where we continue to excite our guests with innovative and trendy products. For example, we launched Future Collective, a first-of-its-kind apparel owned brand, featuring collections in partnership with a rotating roster of diverse influencers. This innovative approach blending the strength of Target's owned brands with the excitement of our limited-time partnerships and collaborations has been a huge success, particularly with Black guests, furthering our commitment to ensure all guests see themselves reflected in our assortments.

Most recently, we launched a new line with actor and influencer, Tabitha Brown. Tabitha's energy and passion absolutely shines in this new line, and our guests are loving it. Tabitha serves as the latest example of the endless possibilities that comes from bringing together the incredible talents of diverse designers and the power of Target's multi-category portfolio.

Take a look and see what I mean.

(presentation)

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

The passion of these designers is so inspiring, the emotion and pride is palpable, and we love the way the Tar-zhay magic of these partnerships cut across categories, including last quarter's launch of Marks & Spencer and Tabitha's recent extension into food.

And while these collaborations offer joy for our guests, recent history has reinforced that focusing on the basics of retail is just as important as the latest innovation or new offering. In fact, nailing the fundamentals is the bedrock of a successful retailer, from the overall shopping experience to ease and convenience, relevance, everyday value and more.

Of these fundamentals, we know that a strong and reliable shopping experience is the surest way to build trust and affinity. So we aim to provide a consistent, joyous and easy experience, both in stores and online, making Target a shopping destination, not just a means to an end. To do this, we've invested heavily in new stores, our remodel program and our same-day fulfillment services, as John will highlight shortly. We led the way in comprehensive pay and benefits, attracting and retaining the best team in retail, allowing us to provide a level of service unmatched by our competitors.

We've invested in one-of-a-kind brand partnership experiences like those with Levi's, Apple, Disney and Ulta Beauty. And while some of these partnerships are newer, we've featured Starbucks in our stores for decades, proof that when we work with iconic brands, we build lasting relationships.

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like hiring the right people, offering the right products and delivering the right experiences to our guests, underpin our stores as hub strategy and contribute to our larger story of growth.

Same-day services like Drive-Up are a great example. They grew nearly 7% last year as more shoppers appreciated the convenience and speed with which they can check off everything on their list. And because we own our same-day capabilities, pickup and Drive-Up are much more economical and flexible than other forms of digital fulfillment. In fact, our average fulfillment cost per unit has come down 40% over the past 4 years as our same-day services have grown to account for over half of our digital sales.

Again, these results don't happen overnight, and they aren't achieved in a vacuum. They are the product of steady investment and listening to our guests. Take our stores, which sit at the heart of our stores as hub strategy and play a dual role of shopping destination and fulfillment hub. Our stores are not only beautiful, with open floor design, plenty of natural light and design elements that reflect the communities they serve, they'reybuiltto o

huge strides in recent years to connect with our guests through our stores. The momentum continues to build, and I look forward to sharing progress with you and our guests in the quarters to come.

Michael, I'll turn it over to you.

We'll also focus on strengthening our balance sheet. In 2022, our business was a net user of cash for the first time in many years. This was driven by a host of unique factors, including unexpectedly low profitability, higher-than-expected CapEx driven by inflation and project costs and a rapid slowdown in inventory turns due to excess inventory and longer lead times in global shipping.

This year, we expect each of those factors to become more favorable. More specifically, we're expecting an increase in profit dollars and a somewhat slower pace of CapEx. And given our cautious inventory positioning and rapidly improving lead times in global shipping, we're planning for faster inventory turns in 2023, driving higher payables leverage and recovery in working capital as we move through the year.

In the near term, until those expectations play out and our cash generation increases, we're not planning to repurchase any shares, consistent with our goal to maintain our middle A credit ratings. Over time, as our cash flow recovers and our debt metrics improve, we expect share repurchases will play a meaningful role within our broader, long-term capital deployment priorities. But as always, those repurchases will only occur after we fully invested in our business and supported our team, after we've supported our dividend goals and within the limits of our middle A ratings.

Now I want to share some thoughts on our 2023 outlook, and I'll start with our expectations for the first quarter. Given the current conditions we're facing, we expect our business to generate first quarter comparable sales in a wide range, from a low single-digit decline to a low single-digit increase. This reflects our expectation for continued strength in our frequency businesses, offset by softness in discretionary categories.

On the operating income line, we're expecting a first quarter rate in the 4% to 5% range, higher than what we saw in the fourth quarter, but down somewhat from the 5.3% our business generated in last year's first quarter. While there are a number of factors driving this expectation, I'd note that our first quarter SG&A expense rate is expected to be about 1 percentage point higher than a year ago, reflecting continued investments in

On the CapEx line this year, we're expecting to invest between $4 billion and $5 billion. While this range is somewhat lower than last year's CapEx,

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Mike, when you took on this role, we spent a lot of time talking about what this work's about and what it isn't. Can you share a bit about the reasons we've initiated the work and what we're looking to accomplish?

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Yes. I think I'll start maybe with what it isn't. This isn't about sacrificing long-term growth for short-term profits. A typical tactic here is to look to shrink your cost base in the face of declining revenues. Well, that's not Target, right? We are growing, continue to grow. In fact, this work has come out from the growth we've seen over the last 3 years. We've grown $30 billion -- over $30 billion since 2019. That's more than 14 years prior. And that creates a tremendous opportunity to step back and reimagine how do we operate this business at a larger scale, but more importantly, how do we position Target for future growth.

And so as we're looking for efficiencies, we'll look for ways to simplify the work, to streamline processes, to reduce redundancy, all with the mind of how do we make it easier for our team members to deliver a great guest experience. In doing so, our initial scoping says, we'll deliver $2 billion to $3 billion of cost savings over the next 3 years.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Mike, I want to clarify one thing briefly. After Brian and I mentioned this effort in our last earnings call, we got some questions about whether that $2 billion to $3 billion number includes the natural recovery from the headwinds we experienced in 2022. Can you help clarify that?

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Sure. I've got a couple of those questions as well. And I would say, I reiterate that this is not about the work over -- or what's happened to us over the last 12 months. It's about the growth that we've seen over the last 3 years. And so no, what's not included is anything that will come, the natural recovery from the headwinds of last year. This work is the designed to deliver fuel beyond that, both to deliver on our -- both our top line and our bottom line goals.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Mike, when we asked you to lead this project, we spent a lot of time thinking about the guardrails. Now obviously, there's big opportunities that we want to capture. But there's also things we never want to compromise. Do you want to talk about the opportunities versus the guardrail of let's say, "We'll never head in this direction?"

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Yes, I think that's a really important question. And the things we're not willing to sacrifice start with a team member and the guest experience. We're not going to take away anything given the investments we've made in our team over the last couple of years, and spending that time in human resources during those early days of the pandemic had an appreciation for all our team did to run our business and to serve our guests. And so I look at our team members and the investments we make as an investment in the best team in retail.

Similarly, on the guest side, our shopping experience is a key differentiator for Target, and we're not looking at anything to take away from that. In fact, our guiding principle around this work is, how do you make it easier for our team members to run our business and in doing so, deliver a great guest experience? And so we do that, we think we'll see benefits to both the team and our guests.

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Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Mike, since we first announced this work, I've had a bunch of investors ask me where they should expect to see the results of this work show up in the P&L? Can you share your initial thoughts?

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Sure. I think it's -- you're going to see it across the full P&L. So I'm not sure you're going to be isolating it to one single component. What excites me about this work, though, as we think about running the different scale, I think there's top line opportunity. And so it's going to start with sales.

And so that growth, combined with that complexity, makes a tremendous opportunity to step back and say, how do we run this business at a larger scale and how do we position it for future growth? And so we're focused right now on driving simplicity, speed and consistency across the entire pair of value chain. And in doing so, we expect to see benefits from assortment planning, to supply chain, all the way down to guest fulfillment.

And the benefits will be across the P&L. We'll see it in lower markdowns, we'll see it in increased productivity -- labor productivity, and we'll see it in top line sales. And so I love that example because it gives you a chance to step back and say, look, we've seen this growth over the last 3 years. How do we look end-to-end across the value chain to position it differently? How do we simplify for the work for our guests? And in doing so, we believe we'll see benefits across the P&L with the most important one being top line sales.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

So Mike, I love the way you framed this up. This is all about fueling future growth, driving simplicity, reducing complexity, never compromising the guest experience and the role our teams play. Are there any other components as you think about this, that you want to touch upon?

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Well, I'd say thanks for letting me come up to share just a couple of examples. I would say -- I'd reiterate is this starts with growth. It starts about how do we make it simple and easier for our team members to deliver a great experience. And that work is going to be a multiyear journey, and this will require end-to-end problem solving across the value chain. But when we do that, we focus on making a better team member experience. We'll see a better impact to our team, our guests and our P&L.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Well, Mike, I want to thank you for joining us on stage here today. We're really excited about the opportunities that are in front of us. You've heard a few examples today, and we'll continue to provide updates along the way.

So Mike, thank you for joining us.

Michael O'Neil - *Target Corporation - SVP of Enterprise Efficiency*

Thanks, Brian.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Michael, I'll have you back here in a second.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Great.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

So as we get ready to hear from you and take your questions, I thought I'd briefly recap some of the themes you've heard today. First, our commitment to our guests is as strong as ever. Second, our strategy, our multi-category portfolio, our stores as hub model will provide the flexibility we need to keep growing because we're going to stay closely connected to our guests. Finally, there have been some fundamental changes at Target over

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the last 3 years. We're more than $30 billion bigger. We set the omnichannel standard with stores as hubs. We'll continue to build and innovate in that realm. We'll set the pace in supporting and developing the very best team in retail.

Perhaps the most important takeaway is something that hasn't changed, and that's our ability to shift our business and our categories in step with our guests. If they need to prioritize food and essentials, we'll lean into those categories. But as you heard from Christina, in a year when discretionary spending was down, our discretionary categories generated $55 billion in sales. Our guests today are responding to newness. They're celebrating seasons as we just saw with Valentine's Day. They're eager to be out in our stores and enjoying that guest experience, and we're seeing it in our traffic growth. And we know they really value affordable joy.

So we remain fully committed to our multi-category portfolio, to essentials and to our discretionary categories. And as our guests lean back in discretionary categories over time, we'll be ready to flex into those trends, building substantially on the near-term plans we share today.

We know that will happen. But in the meantime, we're moving forward thoughtfully. We're doubling down on retail fundamentals. We're finding fuel for further growth through efficiency. And while we're emphasizing prudence in our near-term performance, I am incredibly positive about the long-term potential and our ability to translate both into positive outcomes for all stakeholders, including shareholder returns over time.

So I want to close by thanking our team as they tune in from around the globe, and thanking all of you for staying with us on this journey.

And with that, I'll ask Christina, John and Michael to come back, and we'll open it up for your questions.

QUESTIONS AND ANSWERS

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

All right. I see hands already going up. We've got paddle runners around the room. As I call on you, I might ask you just to pause, introduce yourself and ask your question. So why don't we start right here. Michael?

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

It's Michael Lasser from UBS. A few questions. Number one, last year at this meeting, you had talked about an 8% operating margin. So what has changed this year to -- last year to this year structurally with the business to make it a lower operating margin business?

Two, what is it going to take to get to the 6% operating margin by next year? And third, Brian, sorry, did you look at the experience over the last few quarters and say, hey, we missed what we expected it to do. So let's take a more conservative, cautious view on how we're planning this year, leaving potential room for upside?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Michael, why don't I ask you to start, and then I'll come back and answer the back half of that question.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. So we've got a journey in front of us on the profit front, and 2023 plays an important role in stepping back to where we expect to get over time. When we guided to a wide range today, even at the low end, we expect over $1 billion in net income growth year-over-year. And we want to execute that plan, that's first and foremost. Under the right set of conditions, we think we can get to 6% in 2024. And then we'll take it from there. But we've got the next couple of years squarely in focus because we've got work to do to recover our performance from last year.

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As we think about what's optimal over time, I'll go back to what I said in remarks, we want the optimal rate that maximizes profit dollar growth over time. And I think there's still a few variables that will click into place between now and when we have that conversation in the quarters and months to come. But we want to be focused on dollars, in dollar growth, philosophically, that's the thing that we'd leave the group with today.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

And Michael, back to lessons learned from last year. We've used the term uncertainty quite a bit today. We recognized last year that the consumer

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Yes. John, I think one of the things we've learned over the last 3 years, and we watched it carefully as we expanded Drive-Up and Pick Up and started delivering right to your home with Shipt, we said, all right, is this going to impact the guest engagement in store? It's quite the opposite. As guests use all of our capabilities, they actually spend more dollars in-store and just reward us with more trips. So it's been an important learning that we'll build on. And I think we'll just deepen that engagement as we give them another easy solution for returns.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. Just -- at risk of piling on. We care about economics at the transaction level. We care about the economics at the category level. We care about the economics at the fulfillment path. But the thing that we thought differently about over time is cutting the economics by guests. When we take friction out of the process and make it easier for guests to just fall more and more in love with Target, that's the most powerful economic relationship to be focused on. I think we've learned that time and time again, and Drive-Up is a perfect example.

On the free cash flow question, we're not guiding to free cash flow specifically, but we expect material improvement from a free cash flow basis. And I touched on some of the drivers. The first is better profitability. The second is we expect working capital recovery. I mean our turns slowed, our supply chain times were longer this year and that came with working capital investments to make sure we're getting product here early enough with a volatile supply chain. And so we were running at suboptimal working capital levels through the bulk of 2022. As we move through 2023, I

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Sorry, Brian. I'd add on as it relates to capacity, particularly because you brought up fulfillment, we've seen our sales productivity in the store increase by 37% over the last 3 years, Brian mentioned that. We still have -- so an average store has gone, call it from $40 million to $55 million over the last 3 years. We still have stores that do over $100 million and do well over $100 million. The top quartile does significantly more than the median store.

So we have tons of capacity sitting out there unused in our stores and the ability to turn faster, again, back to we need to improve how we move inventory and how quickly we move inventory, which we're on the journey on, but our stores have significant capacity to continue to drive both in-store sales and our digital business.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Why don't we go in the back?

Unidentified Analyst

Brian, I'd like to talk a little bit about the trade down impacts you're seeing. Are you a net gainer or donor on the trade down? And to the extent you are losing some share there, do you have -- does your customer database allow you to adopt win-back strategies targeted to those people who may have traded out?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Okay. Christina, do you want to talk about what we're seeing as far as guest shopping behavior?

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Right. Maybe I'll just -- I'll jump in. Greg Melich. I got the mic. I'll just do it.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

You got the mic. The power of the mic, Greg.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Really two questions. John, maybe -- well, maybe, Michael, if you could help us on some of the other margin drivers that you see, particularly shrink, you called out is still a headwind. What do you do to actually fix that? I'm also thinking credit profitability now that some of the delinquency rates and other charges are changing.

And then maybe bigger picture, Brian, how important is keeping traffic? You've gained so much traffic and customer engagement. How do you think about pulling that lever versus promotion and margin and expect more, pay less? Is it critical that traffic keeps growing no matter what? Or could it slip 1% or 2% just given your mix? How do you think about pulling those levers as we go through this uncertain year or 2?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Michael, why don't I start with the focus on traffic. And as we sit here today, and you've heard me talk about this for years and years now, we think one of the most important indicator of a retailer's health is the traffic indicator. And that's why we feel so good about the fact that we've had 23 consecutive quarters where we've seen comp store sales growth, and it's all on the back of traffic. We're getting more footsteps into our stores, more visits to our site, greater engagement. Our guests are spending more with us. They are rewarding us with more trips and they're shopping more categories. And we think that's critically important.

To John's point, while we've seen a significant lift over the last few years in our sales per square foot, we know there's still potential to go further. And as we think about capabilities like Target Circle, our ability to connect with those guests and deepen their relationship, introduce them to newness in our assortment in other categories, we think we have a tremendous opportunity in front of us.

But sitting here today, I continue to believe looking at trips is critically important. And in an inflationary environment that we're working in today, it's why we're so laser-focused on unit share improvement because those things are going to be really important as we move to a more normalized

though. I mean we're anniversary-ing a level of markdowns in salvage that was extremely typical for us, and we want to make sure we recover that. We've seen some improvement in supply chain and freight. And so as we anniversary some of the peaks from last year, that should be a good guy on the margin line. And so it's all of those variables that we factored into the guidance we gave today.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Okay. Why don't we go back there.

Ivan Philip Feinseth - *Tigress Financial Partners LLC, Research Division - Director of Research*

Ivan Feinseth, Tigress Financial Partners. I have two questions. Could you go into some detail on how Roundel contributes to revenue growth? What percentage of your vendors are on it? And how you demonstrate your value proposition to them?

And then my second question, this morning on your interview on CNBC, you spoke about your strength in toys and your growth in home goods. What other category opportunities do you see that, going forward, you could lever and become a retailer of choice in those categories?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Right. Well, Christina, I'll let you talk a bit about Roundel and just how important it's been for our vendor partners and deepening engagement. But the second question is something we talk about all the time. And sitting here today, you and I both know, while we have built great momentum and added over $30 billion of growth, we know we still have category opportunities all around us.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. So first, Roundel, like I mentioned in my prepared remarks, is an incredibly important part of our ecosystem. It gives our vendors an opportunity to target the guests that they see as most likely to be intrigued by their new products and the quality of merchandise that they're bringing to market. It allows us to highlight those products and give them real-time insights about how it's selling because of the closed loop reporting that we can offer.

And so this has been a huge part of the demand generation for a lot of our businesses. We are very engaged with a broad spectrum of vendors across the entirety of the portfolio, and believe that Roundel is going to be an important part of the future, partly because of that guest-centricity that we bring to the model, but also because our guests want to know what's new and relevant, both across owned brands and national brands and how it fits into their lives.

So maybe I can pivot to that second question and really talk about what opportunities we have. Well, we have a broad portfolio. And we think the strength of our multi-category portfolio is a differentiator in the market. We don't build an assortment for a snapshot in time. So having a healthy business across every dimension, allows us to flex as market conditions change.

Right now, we're flexing into Essentials & Beauty and Food & Beverage. But a couple of years ago, it was Home and Hardlines that took the center

excites them, like our Apparel floor pad right now, if you haven't been in our stores or on our site lately, go check it out. The colors, the styles, the aesthetics are right on and it's absolutely grabbing the attention of our guests.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Yes. I want to go back to the heart of your question. Do we have opportunities to continue to grow share? And it's something that Michael and I talked to many of you about all the time. Despite the growth we've seen over the last few years, adding well over $30 billion of top line growth, sitting here today, we represent 3% of the retail market. So as a leadership team, we see opportunities to grow across our entire multi-category portfolio, continue to leverage growth in store and from a digital standpoint.

So while we've seen tremendous progress and we're proud of the way we've transformed the business, we still see a significant runway to take share across every one of our major categories going forward, leveraging that great in-store guest experience and the digital experience we offer, that great combination of inspiration and ease that makes Target such a great destination for guests across the country. So we see tremendous opportunities for years to come to continue to bolster our share position.

Let's come back to the front row. I know your hands have been up for a while.

Edward James Yruma - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Ed Yruma from Piper Sandler. It sounds like Beauty has been a real strong category for you. Can you click down a little bit more on Ulta, maybe the difference in performance there versus non-Ulta stores? And maybe why not move faster? And then just as a quick follow-up on the $2 billion to $3 billion in efficiency gains, do you have any of that baked into '23?

Brian C. Cornell - *Target Corporation -*

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

On the $2 billion to $3 billion, there's a piece of that, that shows up in 2023. But a large chunk of that is multiyear in nature. And you think about the apparel example that Mike shared, I think that's just a perfect example. That's a business that grew so fast over the last few years and our teams did an amazing job to protect the good guest experience as we grew.

But when we step back and look end-to-end across a business like apparel, we just see how much opportunity to simplify. Make things easier for the guests. Make things easier for our team. And changing some of those core processes won't happen overnight. That's why the multiyear nature is important. But we expect those benefits to be significant.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Great. Let's go to this paddle right here.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Chris Horvers, JPMorgan. So my first question is you sit at these apex of different general merchandise categories that were major COVID winners. So as you peel away and look at the unit trends that you saw in the fourth quarter, are there signs of any stability, whether it's TVs or computing or decorative home or athleisure? Is there anything that has given you some encouragement to say like maybe we're getting to the bottom of the curve?

And then my second question is around the first quarter operating margin guide versus what's implied for the fiscal year. It doesn't look like the implied is maybe like 4.5 to 5 on the fiscal year. It's not much better than the midpoint of the first quarter but yet, they're bigger quarters. You're going to lap all these headwinds from the freight side, which should be coming down, the markdowns, the salvaging. So why isn't -- and presumably consumables inflation comes down so that relative performance improves, why wouldn't you see better operating margin performance over the year relative to 1Q?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Christina, you want to unpack some of the trends we're seeing in discretionary categories?

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. The most consistent theme is where there's innovation, there's still relevance. And so consumers are finding them. Social media, of course, is a great way for consumers to become connected to new products and new ideas, and you'll be surprised things will spike quickly.

And sometimes we don't see them coming. In other times, we're well prepared. But I would tell you that there are pockets of those in every business. And so right now, we're planning the discretionary categories at an aggregate level more cautiously, but we're certainly leaning into market share opportunities where we see them. We believe that there's opportunity in the Home business, and we'll be launching more brands in the back half of this year, both on the national and owned brand side that have the potential to grow share in that category.

We're seeing it definitely in Apparel, where you get the right fashion moment and the right fashion trend. It doesn't matter that they bought a lot of performance wear over the last couple of years, they're still interested in buying new. And so that's been the most consistent correlation.

With that said, we're also introducing that level of newness and interest in categories like Food & Beverage and Essentials. Our favorite day brand

profiles, the way that they brought the items to market have really shown that the guests will engage across the board if we give them a reason to.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Chris, if we go back to discretionary categories. You heard us talk today, Christina highlighted the fact that in 2022, despite some of the softening trends, we still generated $55 billion of revenue in discretionary categories. One of the things I highlighted this morning during my CNBC interview is I go back to 2019. We've grown our discretionary portfolio by almost $14 billion.

So we're going to move forward from a much bigger base and much more relevance in those categories. And to Christina's point, we know they are going to return to growth over time It's going to be led by newness and innovation in the near term. But we're in a much different position going forward than we were prepandemic. And I think we have much more relevance and credibility in the space than ever before.

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

Yes. I think we're both at, what, 20 years or so at Target, Christina? We've seen ebbs and flows across the categories in our assortment over that time. And to us, the long-term winners will be the ones that build engagement in the moment now. That's why we're so focused on traffic. Apparel and Home will have their time in the sun again, and we'll be well positioned when they do.

On the first quarter versus the balance of the year, I think I'd go back to just some of the broader themes. I think the biggest variable, that's a tough one for any of us to predict right now, it's just what's the path of the consumer during the year. We planned the first quarter reflective and mindful of the discretionary trends that we saw in the fourth quarter. And we'll learn a lot, I think, together as we move through the year, and that will inform what the balance of the year plays out at. But we think an appropriately cautious approach based on the trends we've seen is the right place to start and we'll unpack it as the year progresses.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

I'm trying to scan through the room to see hands that have been up for a while that we haven't gotten to. Let's come back over here.

Karen Fiona Short - *Crédit Suisse AG, Research Division - Research Analyst*

Karen Short from Credit Suisse. So a couple of questions I wanted to ask. We know what your tail -- or headwinds were for '22 in terms of dollars. You're at kind of the $1 billion-plus mark. And obviously, we know what you're guiding to on operating profit dollars for this year.

But I guess the question that I would have is, it seems like maybe you've set a low bar. And so the real question is, if there's upside to the top line. Is that something you would choose to flow down to the bottom line? Or would you be more inclined to lean into continuing to, I guess, invest to maintain that kind of 5-plus percent operating margin for '23?

And then the second question I would have is just on the $2 billion to $3 billion, if you could just give a little bit more on the buckets of where those are coming from? And then it sounds like there's some capture in '23, but most of it is '24 and beyond?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. It's a good question, Karen. And I guess I'd go back to just kind of philosophically how we think about the business. We're in the maximizing dollars business. And so we'd read and react through this year to make the right choices that we think maximize profit dollars both for 2023 and position us well for beyond.

I'd love nothing more than in the quarters to come and to say, gosh, some trends played out stronger. The consumer was stronger in the back half of the year than maybe we thought. And if that's the case, then we'd happily have that conversation and be thrilled to outperform.

But I think the reality is, as we sit at the start of the year, it's an uncertain environment. And we want to plan cautiously in that. And that isn't just kind of on paper caution, that's making sure that we're positioning the business right. It was important to start the year clean from an inventory perspective. We feel like we've accomplished that goal. And we'd like to lean appropriately cautiously in our inventory buys in the discretionary categories with a ton of flexibility to react if things would turn out better, but we think that's prudent for the volatility that we see right now.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

All right. Looks like we've got time for one more question. I see a paddle up in the back.

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

Great. Pressure is on here. Peter Benedict at Baird. I guess first question would be on gross margin, down a little more than 500 basis points since 2019. Assuming mix doesn't get any better the next couple of years, just curious, Michael, how you think about the recapture of a portion of that? Where are the opportunities there? What would you think? Again, without mix getting dramatically better.

And then my second question would just be, in the event that sales this year end up tougher than expected, your confidence in your ability to deliver still that $1 billion of improvement in EBIT, how much flexibility are you thinking on that front?

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