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TGT - Q4 2019 Target Corp Earnings Call and 2020 Financial Community Meeting

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Again, I want to thank you for your flexibility and look forward to an engaging conversation with all of you this morning.

And with that, let's get started.

(presentation)

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

By any measure, 2019 was another strong year at Target. You've seen that in our financial results and in the media coverage. But it's this chart that really tells the story. Trace those bars back to this very meeting 3 years ago. That morning, we said we'd invest more than $7 billion in capital to reengineer our supply chain, to reimagine our stores and to reinvent our own brand portfolio. We said we'd take $1 billion in operating income and invest in our team and our pricing. And we said this while many others were headed in the opposite direction, closing stores, cutting jobs, trying to save their way to success. But we've never been the kind of company that follows the herd, and this was no time to start. But we also weren't placing bets just above conventional wisdom. We had every reason to believe this would work because we've been doing our homework, testing these bets and listening to our guests. And for them, stores weren't dead; they were just boring and uninspiring. Our guests still loved our brand. They just wanted us to do more. And it was this dose of tough love that inspired our team to redefine the Target Run and change the future of our company.

We started by unpacking the big questions. What would it take to combine the hallmarks of the physical experience: discovery, inspiration and service, with the ease, convenience and personalization made possible through digital? In an age of AI and robotics, where do people fit in? When everyone's talking endless aisles, what's the role of curation? In an on-demand world, could digital ever become more than a drag on the P&L? There are lots of theories, but nobody had the answers, and there certainly wasn't a playbook. So we started writing our own. We set off on a different path. We used our purpose as a guide, and the rest is now history.

Today, nobody is doing what Target is doing. Nobody. Target is a category of one. In 3 years' time, we've redefined the Target Run. We've built a durable financial model that consistently drives top line sales and strong and sustainable bottom line growth. And today, Target's among the top performers on retail's leaderboard, a competitive position we intend to keep for many years to come. While our teams love to win, they'll tell you the same thing. We're proud of what we've accomplished, but we've got to stay humble, and we're going to stay hungry if we want to stay ahead. That means ensuring our winning strategy continues to evolve as we test, as we scale, as we refine our multiyear initiatives, constantly challenging ourselves to develop new pathways for growth and innovation. If you look at our playbook, we've done just that by elevating the shopping experience and winning with high-touch service, by curating at scale across our multi-category portfolio, a great mix of our guest-favorite national brands and Target exclusives, and of course, by delivering ease and convenience with the most comprehensive set of fulfillment capabilities in the industry. Each piece of the strategy is working, creating value for our guests, differentiating us from our competition and delivering profitable growth and consistent returns for our shareholders.

So I thought I'd start today talking about our progress, where we're investing and what's next. John Mulligan will share a deeper look at how we're driving stronger operational performance. And then you'll hear from Michael Fiddelke, our new CFO, who will share his perspective on the business and our outlook for the year ahead.

While I had a brief opportunity to introduce Michael during our Q3 call, you should know, like John, he's an engineer by training, whose heart belongs to finance. In his 16 years with the company, he's worked in every part of the business, tackling many of our most stubborn challenges, conquering them all with a rare combination of logic, curiosity and grace. I'm confident, as you get to know Michael, as I have, you'll see he possesses all the qualities you'd want in a leader for a role like this. And with that, let's dig a little deeper into the business.

So you've heard me say many times, we're putting our stores at the center of our strategy. In the last 3 years, we've spent more than $4 billion remodeling our stores, completing hundreds each year, transforming them into showrooms, fulfillment hubs and service centers. With these projects, we're seeing an average sales lift between 2% and 4%. And we're getting smarter with each cycle, enhancing the shopping experience, driving operational improvement and driving down cost through efficiencies of scale. I can't tell you how many times I've heard guests say how much they love the broader range of merchandise in all the new categories we're putting in these stores. The truth is we're not adding categories.

We're not adding SKUS. In fact, in many cases, we're taking them away. But it's the way we've cross-merchandised product and the improving presentation that's making these stores more inspiring and easy to shop.

We've also continued to grow our store network, opening about 30 new small-format stores each year in key urban markets and college campuses.

Perhaps the most game-changing element of our store-centric strategy is our approach to fulfillment. It wasn't that long ago that a Target Run invest to fuel this momentum and propel our strategy forward. And without stealing their thunder, I'll tell you, because of our results, because our strategy is working, we're going to keep investing in each piece.

For example, in addition to our remodel work, we're going to start testing new ways to reimagine the front-of-store experience not only to create a more engaging and inspiring first impression but to enhance guest service. With small formats, we're starting to explore new ways to shrink the box even smaller, half the size of our smaller stores, so we can fit into even more spaces around the city. With same-day, our teams are going to work around the clock to optimize the experience for ease and convenience. Today, Target can put a gallon of milk in your fridge but not in your trunk. In 2020, that's going to change as we start to test our fresh Pickup and Drive-Up capabilities and scale as we go.

When you think about curation, you'll see more investment in our brand management capabilities. We'll continue creating new brands when white-space opportunities arise, like you saw with Open Story, but we'll also focus on building equity in our more established brands and ensuring they continue to thrive, continue to expand our assortment across key categories in Good & Gather or ensuring Cat & Jack, which is now in year 4, continues to evolve with the trends. In electronics, a category dominated by a few global players, brands really matter. So we're rolling out plans to transform the physical environment to give them a bigger stage. We'll create more interactive experiences that allow our guests to play and explore.

As we think about curation, in the digital space, we'll also continue to expand our digital offering through Target Plus. But we're taking a very different approach with this third-party marketplace than others in the industry. As a brand built to serve busy families, our guests have a good

By leaning into our stores, we've emerged as an omnichannel leader with competitive fulfillment options and a differentiated store experience. This year, we'll take it to the next level and use our foundational capabilities rooted in our stores to serve guests in new ways. We'll get closer to new guests, continue to elevate the store experience and redefine ease and convenience to serve guests in ways no one else can.

Remember when we opened just one small-format store back in 2014 and then opened only a few more the next year? We took it slow to learn and build the right foundation so we could scale those stores successfully. We refined how to find sites to balance population density and local needs. We built a process to localize the assortment for each neighborhood but at scale. And we reoriented our supply chain to replenish these stores as the backroom space got smaller and smaller. Because of those learnings, we keep growing. We plan to open about 30 of these stores a year for the foreseeable future. And this year, we'll open nearly 3 dozen, making 2020 our highest year ever for small-format growth. We'll keep expanding in key markets like New York and L.A. and will reach new guests on campuses, making shopping even easier for Boilermakers and Georgia Bulldogs. And for our resident Hawkeye fan, Michael Fiddelke, we'll open our doors right off the Ped Mall in Iowa City.

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

Just 6 months in, this new model has shown tangible proof in guest satisfaction. During our busiest time, the Net Promoter Score for our Black

Using our stores as local hubs continues to be the right strategy for us. You heard Brian say that our stores today are handling about 80% of our online volume. And for Target, that's the sweet spot. As our digital business keeps growing at a rapid pace, our stores still have a very long runway of capacity. I'll reiterate how the productivity of our top stores today demonstrates just how much more our average store can handle.

Last year, on average, sales per square foot in our top quartile of stores was more than $100 higher than our chain average. And the math says that for every additional $1 billion fulfilled by our stores, the sales productivity goes up by $4. That's only just over a 1% increase in productivity of an average store. So it makes only a marginal difference for our operation and our teams. It means our stores still have the capacity to manage many, many billions of additional sales with our current footprint. At the same time, with all the growth we've seen and still see ahead of us, we need to

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

Good morning, everyone. We're grateful that you've taken the time to listen to our remarks today, and I'm looking forward to having many more in-depth discussions with you in the months ahead.

Today, I'm going to share a little bit of my perspective on our business, how we've worked to create a healthy and sustainable model and how we plan to build on that success over time. But you shouldn't expect any big surprises in my remarks today because our long-term financial algorithm remains the same as we first shared with you a year ago. Specifically, we have built a business and financial model that's positioned to generate low single-digit growth in comparable sales, mid-single-digit growth in operating income, high single-digit growth in earnings per share and continued expansion of Target's after-tax return on invested capital.

But before I get to the model, I want to share a little bit about my experience here at Target and how it's informed my perspective on our business. As Brian mentioned earlier, I began my career in finance, and that's always been my passion. However, I've also been able to benefit from several experiences outside of finance, which helped me to gain a deeper understanding of our business and operations. Now that I'm back leading the finance team, I plan to leverage those insights in support of the organization as we help our business partners solve problems and evaluate trade-offs. And we face potential trade-offs all the time: focusing on our quarterly numbers or investing in the future, focusing on profit rates or profit dollars, minimizing the cost of a single transaction or maximizing the lifetime value of a guest relationship, investing in promotions or in everyday prices or managing the cost of labor on the P&L versus making deliberate investments in the team, the company's most important asset.

Analysis of all these questions involves in some way the question of whether to focus on the short term or the long term. And if every choice was completely binary, we would naturally choose the option on the right-hand column. But that perspective is too narrow. We should always ask if we can replace the word or with the word and. If we can do that successfully, we will generate superior performance today and over time. Put another way, we should always focus first on the long term but deliver it through strong execution 1 quarter at a time.

When I think about the long-term trajectory of our business, the one thing that's clear is the need to focus first on strong top line growth. When a retailer is growing, there are so many more levers to pull, more ways to build a model from the top line to the bottom line that makes long-term financial sense. The benefits of growth go well beyond the straightforward reasons like fixed cost leverage. Growth makes Target a more attractive partner for our vendors, which helps us control costs and attract new partners. Growth makes us a more desirable member of a retail development, which opens up more potential sites for our small-format stores. And most importantly, growth is confirmation that we're deepening our relationship with guests, keeping Target top of mind when they decide where to shop.

So for instance, when I think about the potential trade-off between profit rates and top line growth, I'm very mindful of the risk that occurs when companies focus only on expanding rates. Now obviously, if we can generate healthy growth in traffic and sales while some rate expansion comes along for the ride, that's an ideal outcome. It's what happened in 2019, and it explains the outstanding year our business just delivered. But as we plan for the future, we have to be careful not to take our primary focus away from relevance and growth. We've all seen it: companies who focus too much on rates and then realize only too late that growth is slowing, traffic is stagnating, and customer loyalty is beginning to evaporate. The message from that experience is clear: the best path to long-term profit dollar growth is healthy top line growth. And if our priority is growth first, the only path is to focus on our guests. If we work to learn more and more about them and find ways to deepen our relationship with them, they'll reward us with more trips and more sales. That creates the right foundation for a sustainable business and financial model. It's what we've created over the last few years and the reason we're in such a healthy position today.

I think it's worthwhile to pause and take an example from our own history and look back at our journey in digital. 10 years ago, Brian hadn't yet joined our team, but John and I know firsthand we were very hesitant to invest in digital. Like today, we were fortunate to have great stores and a great team. And like today, we had millions of loyal guests who loved Target. We thought that was enough, but it wasn't. Even though our guests still loved us, they began shopping at Target a little less often and elsewhere a little more because we stopped winning on convenience. It happened slowly, but we lost a trip here, another trip there, and growth became harder and harder to generate. The good news is we realized the need for change before it was too late. Beginning 5 or 6 years ago, we committed to being a leader in digital and began investing. It took patience and dollars. And we took the time to develop a strategy that makes sense for Target given our assets, our assortment and our brand. And now as you've seen over the last several years, with the right strategy and renewed growth, we've built a business model that's delivering strong top line and bottom line performance.

Once we committed to investing in digital, new fulfillment possibilities emerged, and we proved something that wasn't obvious 5 years ago. It turns out that digital isn't just about delivering cardboard boxes to your house. It's really about ease, convenience and reliability. Sometimes that can mean a box on your front porch, but more and more guests are telling us that our same-day services are the new model of convenience. Brian covered the statistics on repeat usage earlier. Our same-day guests are making a choice. After all, they're intimately familiar with how to order a box for delivery. And we're still happy to provide that service when it's preferred. But in many cases, our same-day services are faster and more

A second and important factor in our gross margin performance is the mix of our sales. In 2019, with unusually strong growth in our apparel encountered some temporary headwinds to our financial performance, and we chose to continue to build on our record of annual increases. Today, following renewed growth in our profitability over the last couple of years, our dividend payout ratio has moved back down toward 40%. And given that we are now operating near our goal payout ratio, we expect to begin growing the annual per share dividend at a somewhat faster rate in the years ahead.

Regarding share repurchases, you've seen our pace change a lot over the last 5 to 10 years based on variations on our cash flow and level of Capex. As we look ahead, our plan anticipates additional capacity for share repurchases compared with the last few years, beginning this year. This ability to reduce share count will allow us to deliver high single-digit growth in earnings per share on a mid-single-digit increase in operating income. I want to stress that we'll continue to govern the pace of our share repurchases in support of our goal to maintain our middle A credit ratings. Those ratings ensure we have the financial flexibility to invest when there are opportunities in our business even in challenging times.

And finally, before I get to our 2020 guidance, I want to consider the implications of our long-term algorithm for our return on invested capital. I can tell you that ROIC has long been an important metric at Target because it reflects both our operational performance and the effectiveness of our investment decisions. Because of this long-term focus on ROIC, our business is already generating very healthy performance at 16% on an after-tax basis. That's a high bar to clear. But if we deliver performance in line with our long-term algorithm, we will continue to build on that ROIC performance over time as we grow Target's operating income on a relatively stable base of invested capital.

So now before I turn it back over to Brian, I want to briefly cover our guidance for the first quarter and full year 2020. But first, I want to address the question of whether we've accounted for any known or anticipated impact related to the coronavirus. And the answer is that as of today, we haven't seen a large impact on our business or outlook. Of course, we are monitoring our import programs down to the purchase order, and we've already made some slight adjustments to our plans to ensure we are well positioned throughout the year. But because of our size and the flexibility that comes from our multi-category portfolio, we haven't seen anything so far that would cause our financial expectations for 2020 to deviate from our longer-term algorithm.

Regarding recent sales trends, we experienced solid results across the month of February, which support our expectations for the first quarter. As you'll recall, when we announced our holiday performance, we came out of the holidays with very low levels of clearance inventory, which held back our January comps due to a lower-than-average level of clearance sales. However, that same lack of clearance sales played a key role in our fourth quarter profit performance, which was strong despite the shortfall in sales. Since then, we have seen the strengthening of sales trends we expected to see broadly across categories and across multiple weeks of the month of February.

So back to the question of what's reflected in our outlook. The answer is that we've included everything that we know about today. Obviously, in every quarter, there is some uncertainty about trends going forward, and that's only exaggerated by the fluid situation regarding the coronavirus. So to reiterate, we've built in everything we know today, but we haven't incorporated a placeholder for anything we haven't yet seen.

So with that as context, I'll provide our current guidance, starting first with the full year. We are planning for a low single-digit increase in comparable sales. Total revenue is expected to grow nearly a full percentage point faster driven primarily by the contribution from non-mature stores. We expect our gross margin rate will be essentially flat for the year, in line with our longer-term algorithm. We expect a moderate increase in our SG&A expense rate based on our bottom-up forecast across all of the items within SG&A. This increase is being driven by anticipated labor cost increases, reflecting investments in store service and training combined with the continued growth in average wages across the country. On the D&A line, we expect to see a small amount of favorability for the year, consistent with our longer-term algorithm. Altogether, we expect our operating margin rate will be flat to up slightly in 2020, resulting in a mid-single-digit increase in operating income dollars. And for both adjusted EPS and GAAP EPS from continuing operations, we expect performance in the $6.70 to $7 range. Performance at the midpoint of this range would result in high single-digit EPS growth on top of mid- to high-teens growth in 2019.

For the first quarter, our expectations look very much like our view of the full year. We expect to generate a low single-digit increase in comparable sales. Total revenue should grow more than 0.5 percentage point faster driven by the expected contribution from non-mature stores. We expect a moderate increase in our first quarter gross margin rate driven by favorability in clearance markdowns compared with last year. We expect this gross margin favorability will be offset by an increase in our first quarter SG&A expense rate. This expected increase will be driven by continued growth in labor costs along with pressure from remodel expenses driven by the timing of projects compared with a year ago. On the D&A line, we expect to see a small amount of rate favorability, similar to our view of the year.

Altogether, we expect a small increase in our operating margin rate for the first quarter, resulting in a mid-single-digit increase in operating income dollars. And for both adjusted EPS and GAAP EPS from continuing operations, we expect performance in the $1.55 to $1.75 range. The midpoint of this range would result in high single-digit growth on top of last year's first quarter when our business delivered record-high EPS performance.

After working at Target for nearly 16 years, I have developed a strong appreciation for our culture and our people. And one thing our entire team has in common is a lot of pride in working at Target. We're proud of our brand, proud of what we do and proud of the positive role we play in our guests' lives. I've seen it throughout my career, during both the good times and the challenging ones. That's why it's been so amazing to have played a part in the turnaround of our business over the last few years. Because we care so deeply about this company, we all work hard to ensure that Target stays healthy and continues to thrive well beyond each of our individual careers.

Today, we're growing again. And all of our stakeholders are sharing in the benefit, from our guests to our team, from communities to vendors and, of course, our shareholders. It's our job to build on this success and ensure Target generates sustainable, profitable growth both this year and for many years to come. And we're confident we have the right plan in place to do just that.

So now I want to thank you for your time today, and I'll turn it back over to Brian for some final remarks. Brian?

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

Thank you, Michael. By now, I hope you have a sound understanding of the strategic choices we're making. I hope you have a keen sense of our disciplined investment agenda, and I hope we've made clear all the ways our durable financial model and industry-leading capabilities position Target to capture more market share, deliver more profitable growth and earn more love and loyalty from the tens of millions of guests who we've asked to expect more from our brand.

But before we turn to Q&A, I want to underscore what I think is the most important point: Target is different. We've always been different. That's what our guests love about our brand. We're not like everyone else; we are Target. And it was that simple fact that inspired us 3 years ago when the fate of the industry was far from certain. We asked our guests, what more could we do? What mattered most in their lives? And then we took what they told us and we reimagined our company with them, putting them first in every decision we made. That meant leaning into our purpose, pursuing our own path, writing our own playbook, betting on our brands, our team and the millions and millions of guests who shop Target every day. 3 years later, it's clear: that was the best bet we could have ever made because today, our guests are choosing Target more than ever before. They're depending on us to bring a little bit of joy every time they shop.

And look, I know you read the headlines and keep close tabs on our competition. Because our strategy is working, others are taking note and applying some of our pages to their own playbooks. But for us, the whole is greater than the sum of the parts. It's our stores and our digital channels plus our approach to high-touch service; our expertly curated assortment plus our scale plus our balanced multi-category portfolio; it's Drive-Up plus Pickup plus Shipt; it's ease plus convenience plus inspiration; it's families plus joy that make us who we are, that make us Target. We are a category of one. Our competitive position, we intend to keep for a long, long, long time to come.

And with that, we're going to take a 10-minute break to allow some of you to dial into a conference line for the Q&A portion of this meeting. John Hulbert will provide more detail shortly. But before we transition, I know you have questions about the coronavirus and the potential impact we see to our business and our team. Michael has already addressed how we're considering this situation in light of our guidance. Like all of you, we're category and by factory, even at the PO level, to ensure we're on top of it and able to plan accordingly. We feel confident in our plans to manage through this situation. And most importantly, I want to thank our team members around the world for all they're doing to take care of our guests.

So now I'll turn it over to John Hulbert who will cover a few logistical details before we take a 10-minute break. John?

John Hulbert *- Target Corporation - VP of IR*

Before we break, I wanted to pause and make sure everyone understands what's going to happen. And the good news is that most of you can simply stay on this webcast, and you'll hear the Q&A session beginning in about 10 minutes. However, if you received a conference call invitation and you want to ask a question during Q&A, you will need to leave this webcast and dial into the number for the conference line, which was sent with your invitation. But again, even if you received the invite but don't intend to submit a question, you want to stay on this webcast to listen in.

With that, we can begin a 10-minute break. Thanks.

(Break)

QUESTIONS AND ANSWERS

Operator

(technical difficulty)

gentlemen, thank you for standing by. Welcome to the Target Corporation 2020 Financial Community Meeting Q&A Session Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Tuesday, March 3, 2020.

We are ready for our first question from Christopher Horvers with JPMorgan.

went into January with very little clearance inventory. We're going to make sure that we rebalance inventories as we go into next year. We're excited about some of the newness in electronics, some changes we'll make in our home cadence. But overall, we're already working on our plans for the fourth quarter of 2020 and feel very confident that we'll certainly learn from this year and build some exciting plans for our guests as we think about the holiday season of 2020.

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

Got it. And then from a long-term perspective, the third-party assortment that you have online, you called out 250,000 SKUs. Is that inclusive of your SKUs online? Or is that incremental? How large do you see this potentially going? And then on the fulfillment front, is this a drop-ship arrangement from the vendor? Or are you stocking these items now? And just really big picture, how do you think about that opportunity over the long term?

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

Chris, we're going to continue to carefully curate our Target Plus assortment. I'll continue to emphasize the fact that it's an invitation-only. We're carefully working with vendors that we think meet our criteria. We will expand that selectively over time, and that is an arrangement where those vendors ship directly to our guests. So we're very pleased with the early reaction. We'll carefully build curation and assortment over time, but the reaction has been very positive.

Operator

Our next question comes from Mike Baker with Nomura.

Michael Allen Baker - *Nomura Securities Co. Ltd., Research Division - Research Analyst*

In terms of the comps throughout the year, should we expect any variation by quarter? It sounds like February is off to a good start. You have a tougher comparison in the first quarter on a 1-year basis, but it's not as tough when you look at it on a 2-year basis. Just anything we should think about in terms of the pace throughout the year?

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

Yes. As Michael discussed during the prepared comments, we expect a very consistent level of performance throughout the year: low single-digit comps, mid-single-digit operating income expansion, high single-digit EPS. There'll be some fluctuation month-to-month, but you should expect a very consistent performance over the balance of the year. We felt very good about the start of our business in February, and we expect to deliver very consistent results throughout 2020.

Michael Allen Baker - *Nomura Securities Co. Ltd., Research Division - Research Analyst*

Fair enough. And one follow-up if I could, and if you said this or if I missed it, I apologize, but I don't think I did. How do you expect your digital sales to grow in 2020? As you said, it's 6 straight years of 20% or even 25% or higher. What should we think about for 2020?

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

Yes. I think we should see a very consistent pattern with digital as we continue to invest in our same-day fulfillment options and the guest continues to gravitate in that space. So we've got a very consistent track record over the last 6 years. I think you're going to continue to see that perform quite well as we go into 2020 and beyond.

Operator

Our next question comes from Oliver Chen with Cowen and Company.

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

Brian, Drive-Up has been a really positive and amazing process and momentum there. What are your thoughts on how that will evolve in terms of automation in-store? And what will happen as this continues to ramp up and to engage the customer there? I would also love your thoughts on managing promotions and your thoughts on what you can do with promotions as well as in-store automation and what will happen over time as you look to AI and robotics as well.

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

Sure. Oliver, thanks for joining us. Why don't I let John talk about some of the changes and enhancements we'll make to Drive-Up? And I'll let Michael talk about some of the changes that we have on the promotional front.

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

Sure. On Drive-Up, I think the big changes you're going to see this year, we talked about, we want to add fresh or temperature-controlled products. That is -- it is the #1 request from our guests, to add a little bit a selective portion of our assortment there so that they can round out their Drive-Up trip. You'll also see us add adult beverage. That is also a request directly from our guests as we continue to get feedback on that.

I would say directly on the automation, our -- we may be going in a little bit different direction than some others. I think -- we think the store experience is based on interactions with our team member. And we think the differentiation, much like we see with Shipt, is the opportunity to provide that human connection between our team and the guest. From our perspective, the value of the automation today is upstream. And so we look to take work out of the store, consolidate it upstream and then working with our distribution teams to automate some of that to make it more efficient. And the goal there is to free our teams up in-store to interact with our guests and, again, provide that human connection. And that includes as it relates to Drive-Up. And so that's the direction we've gone, as you know, for many years, and we'll continue to work against that.

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

Yes. Thanks, Oliver. On the promotion front, I think you'll see us continue to make sure we've got that right balance of great promotion and strong everyday price. And there are certain times of the year where we lean in more into promotion appropriately. But I think you'll see us consistent in trying to balance both of those, promotion and everyday price, in the right way.

I also might add, that's why I get excited about a program like Circle. That gives us a great foundation to even personalize greater -- to a greater degree of fidelity, the right promotion to the right guest. And so the launch of Circle in October gives us another arrow in our quiver when it comes to getting the right promotions in front of guests.

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

Okay. Our last question is on next-day. It's a question we're receiving. What are your thoughts on how that will continue to be important and how you'll competitively position your fulfillment with -- be it in mind?

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

Yes. I mean, Oliver, we've been really clear, as we talk to our guests and as we think about our strategy going forward, we'll continue to focus on same-day. And we really think that's the point of difference for Target. Whether it's order online, pick up in-store, Drive-Up or having a Shipt shopper come to your own within hours, we really think that's the most important area for us to focus on. And you'll continue to see us lean into our same-day fulfillment options in 2020 and beyond.

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

Congrats, best regards.

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

Oliver, thank you.

Operator

Katharine Amanda McShane - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And if I could just ask one follow-up question, you have made mention that you're getting some national brand wins in some of your categories. Is that something that we can expect across the whole store in 2020 over the longer term?

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

Well, Kate, obviously, as we continue to invest in growth both in-store and online, we're seeing a number of new vendors knocking on our door. Certainly, we've seen that in categories like apparel with Levi's and what we've done in the space with Disney, but we're also seeing new brands knocking on our door in categories like beauty. We were really excited this week to announce the new partnership with Boar's Head in food and beverage. So I would expect that's going to continue to happen over time. And we'll carefully select those new partners that fit our brand standards and are right for our guests.

Operator

Our next question is from Michael Lasser with UBS.

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

The first question is on the coronavirus. Are you seeing any indications today from your vendor partners that you're going to have supply disruptions in the coming months? And are you altering any decisions or doing any contingency planning for an extended consumer disruption? For example, might you be even delaying share repurchases because it could impact your stock price in the coming weeks and months?

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

Michael, like others, we've been carefully monitoring the situation and the impact on our business, our team and our guests. We've been working closely with our overseas vendor partners, both our own brand partners and our national brand partners, to understand the state of play. We've set up a team over the last month that's literally meeting daily to monitor POs, to understand the state of production in China, to understand the rate of workers returning to work, understanding the state of the ports. So we've been looking at this from all possible dimensions.Opioinden delsts. Wu'ro

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

So I'll start with some of the Q4 margin piece of that, Michael. The 2 things I would call out in Q4 that really helped us on the margin side, we are really proud of the profit performance we were able to deliver in Q4. And it came in part from some of the categories where we really saw strength. Apparel grew strong and gained share, and that's always beneficial to the gross margin side, both the gross margin naturally in that business, and then we ended the season really clean. And that saves us clearance markdowns on the back end. The second callout is actually the second part of your question. The same-day service growth is healthy for our profit. Compared to shipping a box long distances, those same-day services are way closer to the economics of an in-store sale. And that's helpful on the bottom line, too.

Operator

The next question is from Joe Feldman with Telsey Advisory Group.

Joseph Isaac Feldman - *Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst*

I wanted to ask, can you share a little more color on -- like you talked about the electronics category, redesigning it. Like, what are you guys envisioning there for that department and if you've maybe tested it anywhere and if there's a significant cost to do that?

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

Yes. Joe, we're still in the early stages of testing some new redesigns. You should expect that to appear in about 200 locations this year, start to envision TVs at a much lower level as you would actually see them in your home, an emphasis on more interaction with our team members to provide insights into how to bring these products home and install them in your home, certainly elevating some of the focus on the key brands in that space. And we know that brands are really important in that space, so the focus we'll place behind brands like Apple and Samsung. So really trying to make sure it's a more inviting environment where we can have better interaction with our guests, where our teams can provide the professional services that our guests are looking for in that space.

So we'll continue to test and learn and iterate as we've always done with changes in-store. But we really want to make sure that we bring the guests a much more inspiring environment within electronics where our team members can provide the expertise that they need each and every day.

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

And the only thing I'd add, Joe, on the cost side, if you think about doing this in the context of a store remodel where we tear up a fair bit of the store through the course of that remodel, the marginal capital here is relatively modest and certainly far better than doing it on its own and going

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

Joe, I think you're going to see us spend a lot more time on brand management. And I'll use Cat & Jack as an example. Cat & Jack's been part of our collection for 4 years now. It's now a multibillion-dollar brand. But our teams will need to continue to bring newness, make sure that, that brand is on trend, make sure that we continue to bring a refreshed assortment to our guests each and every quarter and understand when we need to make changes and pivot some of these brands to make sure that we constantly stay on trend. So over the course of time, some of the brands we have introduced, they might go away and be replaced by some new brands. But I think more and more, we're going to be making sure we're managing the life cycle of those brands, bringing newness, bringing great insights, refreshing the collection, making sure the aesthetic is on trend for what our guest is looking for and continue to strengthen and invest in the brands that we have in place today.

So Cat & Jack is just one of many of examples of where we know we've got additional opportunities to build even stronger relationship with our guests and make sure those brands are even more relevant in years to come.

Operator

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And just one final question is on dividend growth. How should we think about that then in terms of the growth rate going forward?

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

Yes, sure. As I shared in my remarks, we've kind of been tracking toward a dividend payout ratio of 40%. As we get to that mark, you could expect us to increase dividends at a more aggressive pace going forward. Something in the mid-single-digit range for this year in total is probably about right. In the long run, holding that ratio would imply dividends per share growing at a similar rate as earnings per share.

Operator

Our next question is from Robbie Ohmes with BofA Global Research.

Robert Frederick Ohmes - *BofA Merrill Lynch, Research Division - MD*

Actually a follow-up on Drive-Up maybe for Prof. John Mulligan. I was wondering if we could get maybe a little more detail on the move into fresh, frozen and alcohol and the early responses that you've seen in the Twin Cities test. And maybe kind of walk us through what the barriers are to rolling that out quickly or sooner rather than later and what the profit impacts are on Drive-Up when you start including things like fresh and frozen.

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

Sure. Professor is probably a strong word to describe me. I think we've been testing this in the Twin Cities with team members for a few months now, several months. I think like I said, the guest feedback broadly is that they want to add a few more items to their Drive-Up basket, something like milk, eggs, whatever, bread, whatever the kind of staples are that they need or bananas. And so we feel good that, that will be -- this will ultimately be adding a few more items to what is already a Drive-Up order. And from that perspective, we think ultimately, we'll get to a good place on the economics.

Clearly, we have work to do to scale the business, to work through the operating -- operations for the stores. We want to ensure that we have the chill chain wired and all of that. And I think that's where you'll see us make sure we can do it at scale. We've done the operating tests with our team members, so we understand how it should work. But then we want to get to a place where as that demand grows, as we introduce it, which we've seen with every one of the things we've introduced from a fulfillment capability perspective, the demand grows relatively rapidly, and we want to be sure we're built for it.

The final piece that perhaps changes the cadence a little bit is we do need to go back in and ensure we have capacity in the store to handle the temperature-controlled. The one thing we will not trade on is the speed and efficiency with which Drive-Up occurs today. A 2- to 3-minute promise is incredibly important. We think it's a -- we know it's a differentiator in the marketplace. And so ensuring that we have frozen and refrigerated capacity close to the front of the store so that our team members can continue to deliver on that pace requires some buildout. And so you'll see us work through that as well. Put all that together, us wanting to learn, some buildout time, and that's why we get to the scaling that we're talking about for this year.

Robert Frederick Ohmes - *BofA Merrill Lynch, Research Division - MD*

And then my follow-up question would just be on Target Plus. And as you're -- as Target is bringing in more brands -- national brands, what is the economics on that? Are you pursuing brands that you just think will drive traffic to your website? Or are you getting alternative profit stream benefits from bringing on those brands?

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

Yes. Kind of to Brian's comments earlier, we're really focused on curating the right sellers to complement what we already sell in-store and online. And we feel like that's an additive benefit to the guest experience and assortment choice in total.

Operator

Our next question is from Edward Kelly with Wells Fargo.

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

I wanted to ask you about Capex. So the 2021 and beyond CapEx guidance came up. What's driving that? And can you just provide more color around where you're going to be spending capital that's -- that wasn't anticipated prior?

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

Sure, I can take that. Our overall expectations for the level of continued investment in the business are actually about the same. I think what you're seeing are some puts and takes by year as we've refined our expectation on the specific timing of certain projects. For example, the timing of when we bring a distribution center online can move around a year versus what we thought before, and we're continually revising those out-year plans. We'll be about $0.5 billion light of where we thought we'd be in 2019. 2020 is unchanged at $3.5 billion. 2021 is a little higher based on the retiming of some of those projects, but $3 million to $3.5 billion. And the out years are still at $3 billion or just a shade less.

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

Paul Lawrence Lejuez - *Citigroup Inc, Research Division - MD and Senior Analyst*

I'm curious, as we look back at 2019, what were your biggest surprises? Maybe if you can maybe throw out one positive, one negative thing that

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

You guys have covered a lot of ground. I'll try to add to it. In 2019, if you step back and look at that year compared to our long-term algorithm, low single-digit comp growth, mid-single-digit operating income growth, high single-digit EPS growth, it was a year that exceeded that algorithm meaningfully. And our ability to translate top line strength into bottom line profit is a real standout for me. And then the capper is to see ROIC at 16%. Back to the investment question and CapEx question earlier, we've got a balance sheet that we've built intentionally to afford ourselves the capacity to invest in growth. And to see those investments pay off with strong ROIC performance is always good from the chair I sit in.

In terms of opportunities, a little bit more inventory at the end of the year would have been nice. We've touched on that already. And then as I think about 2020, I'd go back to the multi-category model both in the -- through the lens of strengths and opportunities. I think we've really shown over time that model affords us the ability to lean in and be aggressive and take share across a number of categories when the opportunity presents itself. And when I think about risks, it's the stuff that we can't see coming as we sit here today that's probably going to be what we're talking about as the year progresses. But the benefit of a multi-category model is it buys us a lot of diversification of that risk. And our ability to flex within that model to overcome whatever is thrown at us is really strong.

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

Yes. So Paul, I'll come back to kind of 2 other highlights as we think about the year and I think about even the fourth quarter. While we were disappointed with our comp sales in the fourth quarter, only growing by 1.5%, we were able to take market share across many categories. But importantly, because of the work that we've done in-store, the disciplined approach we've taken in our supply chain, our ability to manage category mix and the fact that on a comp growth of 1.5%, we grew operating income by 7.3%, EPS up over 10%, is something that I think our team is very proud of.

And I would end by going back to the team. And for several years now, I think our team has demonstrated that we have built a sustainable, durable financial model that -- one that's going to perform continuously over time. And I feel terrific about the talent we have at Target, the diversity of our team, the leadership that we have in place right now. And obviously, at the end of the day, it always comes down to people. And this is a fabulous team that I think is prepared to face any of the challenges in front of us but puts the guest first, is thinking about what's right for our business, right for our shareholders. And I think that's one of the things that we all feel really good about as we go into 2020.

Operator

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

Yes. Greg, I'll start. And as I think about where we ended up and the choices we made, it's not about changing our incentive structure. Our incentive structure is really well connected to the overall financial objectives of this company. Next year and actually throughout the year, you're going to see us focus on fewer items in a much bolder way to make sure we're delivering a great experience for our guests. But you'll see us curate even tighter as we go into 2020, make sure that we stand behind those key items that we know are on trend, that are going to drive demand, that are going to delight our guests and bring them joy when they're shopping our stores or shopping online.

So it's not about changing an incentive structure. It's about saying, all right, here's items we're going to stand for. We're going to make sure we're bold and deep as we make those buys. And we're going to make sure that they're the right items that deliver upon our brand promise and make sure that we're delivering both a great experience and great quality and style and terrific value throughout the year.

John J. Mulligan - *Target Corporation -*