



## CORPORATE PARTICIPANTS

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

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

**John Hulbert** *Target Corporation - VP of IR*

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

**Robert Frederick Ohmes** *BofA Merry7s829 Tfh.oTf1 0 0.2n(R0.6 onsf1 0h Analyst of Consumer Hars - )Tj1 arah McCan 1 36 589.95 Tm(Mark J. Tri3.2)Tjrrs -*

With that, I'll turn it over to Brian for his thoughts on our first quarter performance and our outlook for the rest of the year and beyond. Brian?

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

Thanks, John. We're really pleased with our first quarter financial performance, which reflects continued progress on the strategic initiatives we began rolling out more than 2 years ago. Since that time, we've seen a meaningful acceleration in our business. In fact, the first quarter marked Target's eighth consecutive quarter of comparable sales increases.

In the first quarter, comparable sales growth of 4.8% was a bit ahead of our expectations. As Mark will cover in more detail, this was driven by broad strength across all our merchandising categories, particularly in Toys and Baby. We also saw strength across channels in the first quarter. Store comparable sales were up 2.7% while comp digital sales were up 42%, adding 2.1 percentage points to the company's comp growth.

Before I turn to the outlook, let me comment briefly on the topic of tariffs. As you know, the trade situation has been fluid for some time, and we've been carefully monitoring negotiations to assess potential implications and our point of view has been consistent for some time. As a guest-focused retailer, we're concerned about tariffs because they lead to higher prices on everyday products for American families. Our team continues to monitor

can shop target.com on their desktop or mobile device, and we'll deliver their order to their front door in 2 days or less. There's no annual fee, and we don't charge a delivery fee if you have a REDcard or meet a \$35 order minimum.

team, but this new model allows them to focus on their passion rather than serving as a general athlete across multiple categories. In other cases, we're hiring category experts, who have gained experience at other retailers and who are excited to come to our team and participate in our growth. And all these changes have been enhanced by our commitment to reach a national minimum wage of \$15 an hour by the end of 2020.

Only a couple of years ago, Target's national minimum was \$10 an hour. That has already increased to \$12 today, and we announced that we're moving to \$13 next month. While this decision obviously involve some cost pressure, we have successfully controlled expenses to manage the P&L impact even as we've added guest-facing hours in our stores.

Looking ahead, our work on store replenishment will deliver additional cost savings as we move store backroom activities upstream into our distribution facilities and those facilities where we realize scale efficiencies and automate a portion of those tasks. Over time, this work will enhance our inventory allocation, delivering higher in stocks while reducing safety stock across the chain. And it will free up additional space in our stores to accommodate further growth in digital fulfillment. These replenishment efforts are still in the early stages, and it will take years, not quarters, to roll out this new model across the chain. But we are very encouraged with the results we are seeing in our test of this new model in Minneapolis and our Perth Amboy facility. And we'll continue to test and learn as we expand this model to more of the chain over the next several years.

So before I turn the call over to Mark, I want to pause and thank our team for all the amazing results we're seeing across the business. These results were years in the making, and a lot of our teams' efforts were behind the scenes. But those efforts were necessary to create the strong foundation that's enabling everything we're seeing today. Clearly, our guests are happy with the results, which was evident in our strong performance on both the top line and bottom line in the first quarter. Mark?



Store comparable sales growth of 2.7% drove just over half of the total company comp, while comparable digital growth of 42% contributed another 2.1 percentage points. Among the components of comparable sales, first quarter traffic growth of 4.3% was the primary driver, combined with an increase in average ticket of 0.5%. Our first quarter gross margin rate of 29.6% was about 20 basis points lower than last year. Among the drivers, digital fulfillment and supply chain costs accounted for about 50 basis points of pressure, which was offset by about 30 basis points of benefit from merchandising initiatives implemented by Mark and his team. Our first quarter SG&A expense rate of 20.8% was about 30 basis points better than a year ago. This rate improvement was better than expected and driven by a number of factors, including a small benefit from the timing of marketing expense compared with last year, along with cost efficiencies in our technology operations.



model is successfully delivering relevant growth and profitability. I'd like to thank our team for their work to enable this strong performance and to everyone on the call for continuing to follow us on this journey.

Now I'll turn it back over to Brian for some closing remarks. Brian?

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

Thanks, Cathy. In a moment, we'll move to your questions, but I want to spend a minute and wrap-up with what we covered today. And what I hope you've heard today is that we're really happy with the path we're on, a path again well over 2 years ago. And today, our business is generating strong performance across the board from traffic and sales to operating income and EPS.

To get to where we are today, we decided to make some bold changes over the last couple of years, but I want to emphasize something important about those decisions. When we made them, we explicitly focused on taking a different path than our competitors. We said we would open stores when others were closing them. We said we'd invest billions of dollars in our shopping experience and in our team when others were pulling back. We said we'd use our stores as digital hubs because it delivers speed and convenience for our guests, and it aligns with our digital strategy. We said we'd invest in differentiation when others were simply looking for scale. And we said we'd maintain our balanced, multi-category assortment, one that's unique in U.S. retail.

So when we get asked today why aren't you doing what others are doing? The answer always starts with the fact that we're not trying to be like everyone else. At Target, we perform best when we're pursuing our own path, not when we are chasing someone else. And our first quarter performance is a clear example of the benefit of that approach.

So with that, I want to thank you for your time today. And now we'll move to your questions.

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## QUESTIONS AND ANSWERS

Operator

## MAY 22, 2019 / 12:00PM, TGT - Q1 2019 Target Corp Earnings Call

**Sarah McCann** - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Sarah McCann on for Ed. We were just hoping to click down a little bit more on where you saw the cost savings and the tech expense bucket that drove some of the SG&A leverage in the quarter. And then how do you score your ability to offset those digital fulfillment and supply-chain costs going forward this year?

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

Sarah, I'll quickly answer that. This is Cathy. As we said on the -- in the prepared remarks, we did see some favorability in our tech operations. As you know, they continue to be working on just the most important things and then being really effective and efficient in their work. So that's providing some benefit. We saw some general cost control across the entire company. We saw some marketing timing, and we saw that being offset by some of the wage pressure we were seeing. All of that said, plus 30 basis points improvement in year-over-year SG&A.

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

And Sarah, why don't I have John Mulligan spend a few minutes talking about the benefits that we're seeing as fulfillment moves to some of our same-day services.

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

Yes, I think the thing we're most excited about in the digital business, Sarah, is that just guest preference, as we observe it, the fastest-growing things -- the fastest-growing services we provide are in same day, that's Order Pickup, Drive-Up and Shipt. Those are also our most profitable services that we provide through the digital channel. So as they continue to grow meaningfully faster than the rest of digital, we expect our digital profitability to improve. So we're really excited because the guest preference is meeting up with exactly the capabilities we have, and they happen to be the most economically feasible for us going forward.

**Operator**

The next question comes from Chuck Grom with Gordon Haskett.

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

Congrats on a good quarter. Just to follow up on that. John, the digital fulfillment cost have been kind of running in the roughly 50 bps -- 70 basis points of pressure over the past few quarters. Would you expect that to begin to abate given that the penetration of the more profitable parts of the digital business are going to start to grow?

And then, Cathy, just as a follow-up, could you just review the second quarter margin assumptions again for us? I know you're saying slight leverage on the operating margin line, but I didn't hear the exact components across gross margins, SG&A and depreciation.

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

Yes. Let me start. So for second quarter, we said that we would see slight leverage in our operating income margin, so just a little bit there, and relatively small changes in all 3 of the subcomponents, so think gross margin, SG&A and depreciation. So pretty much just a pretty consistent quarter where we're already expecting to be supported by that top line of low to mid-single digit. And then it'll end up in a mid-single-digit increase in op income dollars. So pretty much consistent with what we just said.

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

And I think, Chuck, stepping back from perhaps the basis points of gross margin. I think we've been very consistent in saying that we see great benefit in using the stores as hubs. I think that's where we see we're able to bring great speed to our consumers. Same day, we just talked about that. Next day, 2 day, whatever it is, we can do all that through the stores. It's faster and it's more efficient for us from an economic perspective. So we feel really good about the path we're on. We feel great that same day is growing much, much faster than digital and the benefits that will bring to us economically. So we think we've got a really good path forward to continue to build on what we've already built from a capabilities perspective.

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

Yes. Chuck, let me add on. I think you should expect to see our Q1 performance really serve as a proxy for our performance over the balance of the year. Low to mid growth in comps, mid-single-digit improvement in operating income and high single-digit improvement in EPS, and I think that's going to be kind of the pattern for the balance of the year.

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

I think to summarize there, too, we just grew digital at 42%. And we grew op income dollar and rate both expanded.

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**Operator**

The next question comes from Edward Kelly with Wells Fargo.

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

Nice quarter. I just wanted to -- I want to start with comps. Can you just give a little bit more color on cadence of comps throughout the quarter, especially the choppy start and the better finish? What you're seeing so far in Q2?

And then I wanted to ask about second quarter guidance and how you're thinking about this comparison. Low to mid singles is an acceleration even at the low end, and you left the possibility of the high end open, which is, I guess, remarkable to know. Can you just maybe talk about the optimism behind that as well?

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

Well, I'll go back to some of the points that John made during our March Investor Conference. As we move digital fulfillment from upstream DCs to stores, we see a significant reduction in expense, and we talked about a 40% reduction. When we go from an upstream DC to some of our same-day fulfillment offerings, like Order Pickup and Drive-Up, we see a 90% reduction in costs. And as John talked about, those were the fastest-growing parts of our digital fulfillment during the quarter, and we expect that to continue. That's clearly where we're seeing the guest preference. We saw tremendous amount of growth in Order Pickup despite the fact that we've been offering that for almost 5 years now. We're seeing dramatic acceleration in the Drive-Up offering and very strong performance from Shipt. So those were much more favorable from an expense standpoint, and they're preferred by the guests. So as that continues to mature and grow, we're going to see some of the benefits flow through our P&L.

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**Operator**

Our next question comes from Robbie Ohmes with Bank of America.

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

Great quarter. I'm actually going to ask 2 questions, one was just a follow-up, Brian, on your answer there. The -- I get this question all the time. As you keep shifting digital fulfillment to the stores, how are you -- how is the store SG&A not exploding or offsetting? Just maybe a little more color on how you're getting those dramatic savings, the 40% and 90% reductions. And then I'll just tell you. The second question is on the second quarter, I'm just curious how you're -- let me say it this way. Some of your competitors are not doing as well as you might have done, and they might have a lot of excess inventory in things like apparel. I'm just curious what you think the environment is going to look like with a lot of your -- some of your large competitors not in great positions right now.

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

So why don't I let John start by talking about some of the process improvements we've made in store and the way we're leveraging technology and systems to drive even greater efficiency as we fulfill those orders. And then I'll come back and talk about the competitive environment.

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

Yes. Robbie, I think the first thing I'd say is we are investing payroll into the stores to take care of the fulfillment that is going on. The one thing we don't want to do, and we have been clear about this, is pull payroll off the sales floor to take care of what's going on in the backroom. So we have ppt. GO t dustnroln in the backrrs. arecm(xpenent tt dustnr TatioeclassferoorandrocM - iitibecau thi thating arts of the fulfillmm a exp. CEO)Tj80.025 Tw1

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

And Robbie, if we turn to the overall retail environment, we're seeing a very consistent and healthy environment across the U.S. I think what we're seeing right now is the bifurcation of winners and losers, and I think our performance now speaks for itself. We're on eighth consecutive quarters of growing comps. We've seen consistent market share gains across all of our categories, and we're performing both from a store standpoint and a digital standpoint. So we feel really good about the progress Mark and his team made from a merchandising standpoint, the reaction we're seeing to our own brands and the execution that we're seeing in store. So we think we're well positioned to continue to grow share in this environment. And I think what you are just seeing is you're seeing the emergence of winners who have been investing in their business, that are adapting to this new omnichannel environment and unfortunately, those that are ceding share that have not been able to invest and evolve to the new consumer environment.

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**Operator**

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### Operator

The next question comes from Michael Lasser with UBS.

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

Two questions. One, how will you factor in the move to 25% tariff on the current lift into your guidance? And how will your guidance change if we go to 25% tariff on an entire set of products that are imported from China?

And my second question is, given all this traffic that you're seeing from in-store fulfillment and same-day pickup and Shipt, how are you converting more items into the basket for those guests that are coming into your stores to pick up orders? And what can you do to improve that conversion?

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

So Michael, I'll start with the topic of tariffs. And as I said in our prepared remarks, obviously, we've been monitoring this very carefully. It has been a fluid situation for quite some time now. Our point of view hasn't changed. And as we think about tariffs, we reflect on the impact it could have and will have on American families that are going to be paying higher prices.

But I think our teams have done a very good job of trying to mitigate the impact in the short term. And as I think about where we sit going forward, one I'll start with our multi-category portfolio is a huge advantage in this environment. And our ability to flex our focus from category to category is something that's somewhat unique to Target versus single-category retailers.

We also have, Michael, a very experienced and talented sourcing team that works in over a dozen offices around the world that focuses on this each and every day. They work with some very sophisticated vendor partners that for years now have been working to diversify their manufacturing base. And those are big advantages for us going forward.

I'm going to let Mark and John talk about the fact they were actually with those vendor partners just last week making sure that we're constantly looking at evolving our plans to anticipate some of the changes in the environment. So we're watching this very closely. But we have the advantage of a multi-category portfolio, a very talented and experienced sourcing team that operates around the world and sophisticated vendor partners that have been looking at ways to diversify their manufacturing footprint for years now. Mark, you were there last week, as was John. Any feedback from those meetings?

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

Yes. Michael, I'll share with you. But John and I and others were in Asia last week meeting with our global vendors, not just China, our Asia-based vendors, and clearly tariffs was a point of discussion. Our current actions are not reactive. They're responsive, and we've been planning these for some time looking at the level of potential change and working with our deep vendor base, we have trusted partnerships and leveraging our current strength of performance to build opportunities to diversify, to work through price changes, and again, as Brian said, a very sophisticated and elevated team who have been anticipating change. And I think when you look at our Q1 results, where we've been able to effectively mitigate those risks from prior announcements, I think it bodes well for how we look to manage this moving forward.

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

Michael, this is Cathy. Maybe I'll just answer, too, to be clear that the anticipated 25% increase that will go in place in June is contemplated in our guidance. So to be clear there. And then you had asked the question, and Brian and John should answer, too, but on converting our basket or converting those same-day services. And as we shared, we're seeing a lot of incrementality in those same-day services. And as the kind of fact that's pretty amazing is the 80% increase in Order Pickup while we're well into that journey. That just shows that we're deepening our relationship and being more relevant for our guests so that they're choosing Target more often as we provide convenience and ease.

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

I think Cathy hit on it, Michael, that certainly, when people come in for pickup in-store drives traffic. A percentage of them go on and buy something else in the store. But our focus really is on being true to the mission that they have. If it is Drive-Up, we give them bag and they're on their way, and we're not going to bother them with a sales pitch. If pickup, they want to get in and out, that's great, too. And then when they come to store, and they get their Starbucks and they work the whole racetrack, we'll provide a great set of experiences there. So we want to meet them wherever they are, and to Cathy's point, continue to drive that engagement with Target.

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

Michael, it gets back to our focus on being America's easiest place to shop. To John's point, we want to make sure we meet the guests on their terms, make it really easy and convenient for them to shop with us. And we know some days, they're going to be pulling in our parking lot and hoping to be out of there in minutes. Other days, they're going to come in, grab that cup of Starbucks and enjoy walking the racetrack and seeing what's new and exciting this week at Target. So we've got to make sure we're playing on the guests' terms and I think our strategy right now is meeting the guests right where they want to be.

**Operator**

Our next question comes from Kelly Bania with BMO Capital.

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

Just maybe a quick one on the guidance for the year just given the strong start. How much of maintaining that just has to do with conservatism, conservatism in Q1, tariffs or maybe any other factors you're seeing in the business?

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

Kelly, I think, again, I think we were really clear back in March that we felt very good about 2019. I think our first quarter validates our guidance for the full year. And we feel very confident about the fact that we've got guidance that's realistic. We're going to continue to focus on execution each and every quarter. So no change in our guidance. We've got confident that we're going to deliver, as we said, low to mid-single-digit comps, mid-single-digit expansion of operating income throughout the year, and that's going to flow through to high single-digit EPS with very strong return in invested capital. So we feel really confident about our outlook for the second quarter and the full year, recognizing it's still early. We're sitting here in May. But we're off to a very good start. The guest is responding incredibly well to our merchandising offerings, our owned brands, our fulfillment options. And we're going to continue to stay very focused on execution each and every week of the year.

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

Okay. If I could just add one follow-up, just on your ship-to-home model. Obviously, a lot of competitors in the market moving more towards a next-day ship-to-home model. And obviously, Target, having a lot of success with the same day and pickup and Drive-Up and -- but just curious, and I guess you have seen next day with restock, but do you feel like you need to match this service more broadly on a wider assortment? And can this be done, if so, from your stores? Or does this need to be done from an FC down the road?

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

I'll go back to some of the point that John Mulligan's made. Clearly, as we talk to the consumer, we talk to the guest, we know how important convenience and speed is, and that's why several years ago, we made the decision to put our stores at the center of our fulfillment strategy. And

you're seeing that pay off right now. Obviously, we're seeing a growing desire for our guest to take advantage of some of our same-day services and very strong growth with order online, pickup in store, Drive-Up, take advantage of over 100,000 Shipt shoppers that can bring that order to your home within hours. But -- and as we look at the benefits of shipping from our stores, even today, on any given day, upwards of 50% of our orders are delivered next day, and it's using our stores and their proximity as that advantage in our overall strategy. So we think we're very well positioned today. We're leveraging the fact that we're so, so close to the guest with our 1,851 locations, and ease and convenience as a big part of our strategy. So John, I don't know if there's anything else you'd add. But I think our decision years ago to put our stores at the center of our fulfillment strategy is paying off with accelerated growth up over 42%, tremendous growth in order online, pickup in stores and dramatic acceleration in areas like Drive-Up.

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#### **Operator**

Our last question comes from Seth Sigman with Crédit Suisse.

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#### **Seth Ian Sigman** - *Crédit Suisse AG, Research Division - United States Hardline Retail Equity Research Analyst*

I wanted to follow up on a couple of points. I guess just first looking at the comp trends, transactions growth, very strong. Over the last couple of quarters, your ticket growth has been less of a contributor to comps. And you have a number of initiatives that you talked about throughout the call that, in theory, should be supporting bigger baskets. And I think some others in the industry have also talked about a little bit of inflation coming through. So just curious how you guys are thinking about the drivers of ticket. And how we should be thinking about that?

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

As we sit here today, we're very, very pleased with the overall basket performance. But what's happening is we're seeing acceleration in traffic. The guests are simply shopping us more frequently, and we're meeting more of their needs each and every day. So I think the most important barometer



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