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EDITED TRANSCRIPT

TGT.N - Q2 2020 Target Corp Earnings Call

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OVERVIEW:

Co. reported 2Q20 GAAP EPS of \$3.35 and adjusted EPS of \$3.38. 2Q20 YoverY total sales growth was 24.8% and comp sales growth was 24.3%.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation second quarter earnings release conference call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, August 19, 2020.

I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

John Hulbert - *Target Corporation - VP of IR*

Good morning, everyone, and thank you for joining us on our second quarter 2020 earnings conference call. On the line with me today are Brian

team, the way they've risen first to the pandemic, then to social trauma touched off in May here in Minneapolis is unlike anything I've seen or I'm likely to see again in my career. And I say in all humility that it has been a huge privilege to work alongside this team in this moment.

The results we reported this morning are truly unprecedented. On the top line, we delivered second quarter comparable sales growth of 24.3%, the strongest we've ever reported. Equally remarkable on the bottom line, we generated adjusted EPS of \$3.38, a new record high and strong enough to offset the significant profit headwind we faced in the first quarter. These results are a testament to our team and their passion for our guests and the increasing trust our guests are placing in our brand.

Our performance also reflects the meaningful investments we've made in recent years, building a business model that is durable enough to perform in any environment, incorporating flexibility in both our merchandise assortment and the fulfillment options we offer to our guests, while articulating a unified purpose to help all families discover the joy of everyday life. In our last earnings call, we described how our business and operations adapted quickly and seamlessly to rapid changes in consumer behavior. As our guests reacted to the implications of the emerging pandemic, we encountered multiple abrupt changes in shopping patterns throughout the first quarter, both across categories and channels. Near the end of that quarter, we returned to growth in our store sales and once again saw growth in categories like apparel. This improved sense of balance in both channel and category mix continued through the second quarter, and we didn't see the dramatic swings we experienced in the first quarter.

In terms of channel mix, we saw very healthy growth across the board, with store-originated comparable sales growing 10.9% and digital comp sales up nearly 200%. It's worth pausing to acknowledge that at just under 11%, this store-only comp stacks up as one of the best in our history and yet, it happened at a time when American consumers are adopting digital shopping like never before.

In addition, as I've mentioned in previous calls, channel numbers don't tell the full story because they don't measure the benefit of our work to position our stores as hubs at the center of our digital fulfillment. When you look beneath the surface of the reported numbers, you find that our

At a time when every retailer is facing increased uncertainty and unforeseen challenges, we have chosen to continue investing in our business and particularly in our team. Following hundreds of millions of dollars in team investments in the first quarter, in June, we announced that beginning July 5, we would permanently raise our starting wage for U.S. team members to \$15 per hour. Additionally, we announced a onetime bonus of \$200 to our frontline store and distribution center hourly workers in recognition of their efforts throughout this extraordinary year.

We also announced free access to virtual doctor visits for all team members through the end of the year, regardless of whether they currently subscribe to a Target health care plan. And we announced additional extensions of our 30-day paid leave for vulnerable team members and free backup care for family members. As I've mentioned before, the return on these team investments may be hard to quantify in a spreadsheet, but I am confident that they have been among the most important investments we've made over the last few years.

In late May into June, our team had to navigate the challenges presented by the killing of George Floyd and the civil unrest that it sparked nationwide. While we all experienced the heartbreak caused by the murder itself, our initial focus was on the safety of our team. As a result, in areas affected by unrest, we closed locations or reduced operating hours, affecting hundreds of our stores across the country. Most of these stores were able to safely resume normal operations in a matter of a few days, but a handful of locations sustained more significant damage. All but 2 of those stores have already reopened, and we're hoping to have those locations reopened by the end of the year. Through it all, I'm happy and grateful to say that none of our team experienced physical harm through the unrest.

But beyond physical safety, our team is passionately demanding equity and justice for our black colleagues and guests. We are united in that passion and committed to supporting our team while playing an active role in addressing the persistent racial injustices that have sparked protests around the world. Beyond our team's volunteer efforts across the country, we have dedicated \$10 million, half from corporate giving and half from our foundation towards Twin City rapid response needs, local rebuilding efforts and national social justice initiatives.

We've also formed a committee called REACH, consisting of senior leaders who have come together based on their experience and expertise. Together, they represent a broad enterprise view, and their work is focused on advancing racial equity for our black team members and guests across all areas of Target's business. To deliver the most impact across our business, REACH is aligned around 4 key areas of focus: team, guests, communities and civic engagement and public policy. With their help, we're putting our influence to work in our hometown and in the country, bringing together our team, our neighbors, other businesses and community partners to determine actions and resources that will move us towards a more inclusive, equitable and just society.

Now let's turn to our plans for the third quarter and beyond. Our research tells us that guests still want to celebrate seasons and holidays even as they acknowledge that things will be different in this new environment. To help our guests adapt to these changes, we're building flexibility into our merchandising and operations to allow our guests to celebrate the season in new ways. Knowing that many parents about the country are still facing uncertainty about whether their children will be attending school in person or virtually, we'll be featuring our Back-to-School assortment for an extended period this year, allowing parents to delay shopping until they have more certainty on their school district plans.

In Back-to-College markets, we'll be moving in-store shopping events outside into our parking lots and highlighting contactless options like Drive Up. Across the chain, we'll be promoting the wallet feature within the Target app as a fast, contactless alternative to paying with a physical card. And for Halloween, we'll continue to feature costumes and decor to celebrate the season. But we'll be adjusting our candy merchandising in anticipation of a reduction in trick or treating this year. In addition, we'll be giving away surprise boo bags to our Drive Up guests in October, featuring surprises along with tips and suggestions for celebrating the season. Also this fall, we'll roll out the third and final phase of our Good & Gather assortment, adding more than 600 items to bring the total number of items to nearly 2,000.

The Good & Gather brand is clearly resonating with our guests and delivering on our Food & Beverage vision to enhance the Target experience by making it easy for families to discover the joy of food. We launched this new flagship brand less than a year ago, and it has already generated more than \$1 billion in sales. With the momentum from this new brand, our own-brand Food & Beverage business has been growing more than 30% so far this year, significantly outpacing the market and growing market share.

Beyond Good & Gather, we continue to benefit from an unmatched portfolio of owned and exclusive brands that spans our entire assortment. Together, these brands whose sales have outgrown national brands so far this year, offer guests quality and style at an unmatched value while enhancing Target's differentiation and delivering attractive gross margin rates.

In June, we launched Casaluna, a collection of more than 700 quality bedding and bath items featuring elevated natural and sustainable materials like linen, hemp, silk, cashmere, all at an amazing value. And of course, it was only in January that we launched our new activewear brand, All in Motion, and the timing couldn't have been better. All in Motion was designed with a commitment to quality, sustainability and inclusivity at incredible Target prices. As guests across the country have moved to working from home, they embraced the quality, comfort and value provided by this new brand, driving sales well beyond our original expectations.

Also this quarter, Target Circle will be celebrating its 1-year anniversary of its national rollout. At more than 75 million members, Circle has exceeded our expectations in its first year. To celebrate, we'll be highlighting Circle in our marketing with a focus on driving acquisition and engagement in advance of the fourth quarter shopping season.

And finally, as we look ahead to the fourth quarter, we're focusing first on guests and in team member safety, developing plans to reduce crowds and spread out demand throughout the season. Specifically, we'll be spreading our best-priced holiday offers over a longer time frame, beginning in October, so guests can shop safely and conveniently without worrying about missing out on deals that usually come only late in the season. We've also announced that we'll be closing stores on Thanksgiving, sending a clear signal to guests that they won't need to stand in line and crowd into stores to get a great deal.

In addition, we'll be making thousands of additional items available via same-day services this holiday season, including more gifts, essentials and everything in between. In addition, as John will describe in more detail, we'll offer fresh and frozen grocery items, via Order Pick Up and Drive Up at more than 1,500 Target stores this fall.

As I said in the beginning, I'm incredibly proud of our team and the performance they've delivered on behalf of our guests. As we focus on transforming our business over the last few years, we began with a focus on our guests and how we could better serve them by leveraging our strengths. We emerged from that effort with a durable business model, differentiated from our competitors and designed to perform in a variety of environments.

When we contemplated the range of environments we might face, I don't think anyone could claim that they knew what we'd be facing today. Yet in the face of unprecedented changes in the environment, our business is doing what it's designed to do: It's delivering convenience, reliability, safety and value, driving increased engagement and trust among our guests. It's supporting and rewarding our team, the best team in retail. It's playing a positive role in the communities where we live and work. It's generating strong, sustainable business results in the support of our shareholders and is accomplishing these results by relying on our stores when many others are walking away from their physical locations.

As we look ahead, we're prepared to navigate through a host of potential challenges, including the ongoing threat from the coronavirus and economic headwinds resulting from high levels of unemployment. Yet, as we said in our last call, we have never been more confident in our differentiated strategy and our long-term potential. Throughout this crisis, we have deepened our relationship with American consumers and introduced millions of them to our digital fulfillment services. As a result, we've seen unprecedented growth in market share, a trend that we expect to continue.

With a strong business and deep financial strength, we feel well prepared to weather any near-term economic headwinds and continue to serve and delight our guests. Our team is ready and eager to seize the opportunity in front of us.

Now I'll turn the call over to John, who will provide an update on operations and our plans going forward. John?

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

Thanks, Brian. If the overall theme of our first quarter was unexpected change and rapid adjustment, in the second quarter, it was an increasing sense of normalcy. I will quickly say things today are far from the old normal. In fact, hardly anything feels the same today as it did 6 months ago. And while second quarter trends were much less volatile than the first quarter, the team still had to navigate through a great deal of variability, something they've done exceptionally well throughout this crisis. But at this point, the team has gained significant experience with new routines, all centered around safety, and we've returned to many of the routines we paused during the first quarter.

Now that our new cleaning routines are fully established, they are operating successfully in a run-state condition. We continually hear from our guests that safety is even more important than ever, and they appreciate that cleanliness and safety are visible priorities for our team across every aspect of what we do.

In late April, we began accepting in-store returns again, following a 5-week pause. Soon after, in May, we began a phased reopening of the Starbucks locations in our stores. As the quarter progressed, many other activities resumed, including a steady reintroduction of the Weekly Ad in select markets and a resumption of a more normal cadence for handling clearance, promotions and merchandise transitions.

In our Super Target locations, we initiated a contactless form of sampling in June, along with a phased-in plan to resume deli and bakery production. Across the chain, we reintroduced product samples into our pickup and Drive Up bags and began moving store hours back to their pre-pandemic levels.

After opening 3 new store locations in March, we took a pause in our new store projects as uncertainty from the pandemic emerged. Since then, we have been ramping up our new store construction activity, and we are now on track to open up to 27 more stores this year. Nine of these new locations are slated to open this month with another 16 to 18 expected in October. We continue to be pleased with the performance of our new small format stores, and our pipeline is expected to support 35 to 40 of these new locations annually in future years.

Perhaps the most vivid example of our progress is the fact that we've resumed our plans to add fresh, refrigerated and frozen items to our pickup and Drive Up services. Going into the year, we had planned to roll out this capability to half or more of our stores this year. However, in March, given the severe swings we were seeing in store traffic and the onslaught of new routines we are asking our store teams to perform, we paused on this rollout to provide our team more time to focus on safely serving our guests.

By the time of our first quarter call in May, we had already resumed the rollout. And since then, we have made more progress than we had originally planned for the full year. In fact, we are already offering an extended food assortment for Drive Up and pickup in more than 1,500 of our stores, far exceeding our original goal. By this holiday season, we expect to have this capability in nearly 1,600 stores. In addition, we've added adult beverages to our pickup and Drive Up assortments and more than 300 stores in selected markets. And we'll continue the rollout of both perishable items and adult beverages to additional locations next year.

Our teams and systems are successfully handling the additional complexity that comes with these expanded assortments, and our guests are happy as well. They're telling us they appreciate the ability to receive these items without shopping our sales floor, providing them a contactless option when that is their preference.

Following the introduction of an expanded assortment into markets, we see a steady increase in usage week after week as more guests learn about it. Our guests tell us they're eager for us to make even more items available, and we'll be exploring further assortment enhancements over the remainder of the year and beyond.

Beyond assortment, we continue to implement process enhancements to our digital fulfillment services, driving both efficiency and speed for our guests. New this quarter, we introduced improvements to the Target app, allowing guests to toggle their fulfillment choice between pickup and Drive Up orders up until the point the guests arrives at the store. This option provides additional flexibility for the guests to update their fulfillment option as their plans change.

Given the explosion in demand we've seen this year, we've been adding additional Drive Up spots in locations across the country. This additional capacity was contemplated in our original plan, but with the recent growth, we are adding these extra spots earlier than originally anticipated. The process is straightforward as we add 2 to 12 additional spots, depending on store-specific needs, repainting the parking stalls and using additional temporary signing to highlight the change.

For our ship-from-store capability, we continue to roll out process improvements for processing orders and packing boxes, increasing efficiency and reducing waste. And we've also enhanced prioritization algorithms to ensure that the orders with the most time-sensitive items, including COVID-sensitive categories, are prioritized earliest for packing and shipping.

While digital orders inherently involve more handling and more cost compared with conventional store transactions, we've been realizing meaningful improvements in average fulfillment cost per unit, reducing the impact of digital growth on our operating margin rate. These efficiencies are driven by multiple factors. First, as we continue to roll out new tools and processes, we have been seeing increased efficiency across each of our digital fulfillment options. Second, we are benefiting from favorable mix within digital fulfillment. As our same-day options continue to grow faster than overall digital growth, average unit costs go down because these options are much less costly compared with shipping to home.

Third, we are seeing meaningful leverage on digital fulfillment given the unusually high-growth rates we've seen this year. Some of this leverage is more subtle than conventional fixed cost leverage. For example, as a store's Drive Up order volume increases, more and more of the time, our team is able to pick multiple orders together, gaining efficiency in the pick process. In addition, we realized a similar benefit in the parking lot where our teams are increasingly delivering multiple orders at a time, reducing the cost per order of that delivery trip to the parking lot. And finally, as we've seen meaningful trip consolidation this year, we realize a benefit as fixed order costs are spread across more items.

Aggregating all of these benefits, our second quarter average unit costs for digital fulfillment was approximately 30% lower than a year ago. This provided a significant offset to the cost pressure we would otherwise be seeing from our unusually high rate of digital sales growth.

While we'll always focus on driving efficiency and reducing costs, we embrace digital transactions because they drive guest engagement, which ultimately benefits every part of our business. Our most recent data indicates that a multichannel guest spends 4x as much as a store-only guest and 10x as much as a digital-only guest. Our research also continues to validate that after a guest tries Drive Up for the first time, we see a nearly 30% increase in their overall spending, including an increase in their conventional store shopping. It's particularly notable that this increase in store shopping is occurring despite the unusual environment in which consumers are minimizing time spent in public places. However, the data certainly provides some additional context for the unprecedented growth of more than 10% in conventional store sales we reported this quarter.

As we gain new digital guests in unprecedented numbers, we are also seeing higher engagement from these guests than we've seen in the past. Specifically, among our new digital guests in the first quarter, we've seen nearly double the rate of repeat purchases within 7 days compared with a year ago. And the rate of repeat purchases in the intervening 90 days has been fully double what we measured a year ago. Given that we've added 10 million new digital guests in the first half of the year, we feel good about our prospects for building on their elevated level of engagement over time.

Now I want to spend a minute talking about our current inventory levels and in-stock performance. While we made a lot of progress in the second quarter, we are still facing challenges across multiple parts of our assortment driven by a couple of distinct factors. First, in many of our frequency categories, our vendors continue to face capacity constraints as they work to accommodate unexpectedly high demand across the U.S. While these

And finally, I want to address the nagging questions we continue to hear regarding our capacity and ability to further scale our store-based fulfillment model. I've addressed this question multiple times in prior earnings calls, and I would think that our recent results would dispel these worries. But

In addition, we saw about 50 basis points of benefit from the change in the sales return reserve estimate that we held at the beginning of the quarter. Among the headwinds, digital fulfillment and supply chain costs accounted for a rate headwind of about 130 basis points, while category mix drove about 70 basis points of pressure.

On the SG&A line, the second quarter results included \$400 million of investments in team member pay and benefits and measures to protect the health and safety of our guests and team. However, these investments were more than offset by the leveraged benefit of exceptionally strong sales growth. And as John mentioned earlier, the benefits of this leverage extended well beyond strictly fixed costs, leading to an astounding reduction in our SG&A expense rate of about 180 basis points in the quarter. On the depreciation and amortization line, we also saw healthy leverage on a

it was only 90 days ago that we reported a quarterly profit decline of more than 60%, highlighting how volatile the environment has been and may continue to be. Moreover, as we look ahead, there are many potential challenges on the horizon, including uncertainties surrounding COVID-19, economic headwinds from historically high unemployment, uncertainty surrounding government stimulus and a contentious November election. So while we have very strong confidence in our long-term prospects, our ability to continue to expand market share and grow profitably over time, we believe it's the prudent, long-term decision to preserve liquidity in the current environment, giving us the flexibility to safely navigate through any near-term headwinds.

So finally, I will close this section with a quick comment on our after-tax ROIC, which grew to 17.2% this quarter, up from 15.2% a year ago. Even though we report this metric on a trailing 12-month basis, it has been unusually volatile this year given the dramatic changes in performance we've seen. Specifically, at the end of the first quarter, this metric was nearly 4 percentage points lower than today at 13.4%, driven by the steep profit decline we faced in the first quarter. So while this metric may continue to move around during this period of heightened volatility, we will remain focused on making the right long-term investments in our business, allowing us to deliver higher after-tax returns over time.

Now I want to turn briefly to our outlook. And consistent with last quarter, I won't be providing any precise guidance. However, I want to reinforce what I was just saying earlier, which is that we are moving through a period of unusually high uncertainty and volatility. And while John was correct that we felt a much stronger sense of normalcy in the second quarter, volatility continued to be elevated. Specifically within the second quarter, May was by far the strongest month with a 33% comp, followed by June at 21%, and July at about 20%. And so far in August, due largely to softer sales in our Back-to-School categories, month-to-date comp sales have been running in the low double digits.

Now let me be clear, a double-digit increase is still quite strong in the context of history, but a 20 percentage point spread between our May and August to date comps is an incredibly wide swing within a few months, highlighting the difficulty of forecasting our business right now. So given that our Q1 performance was not a good predictor of our second quarter results, our Q2 results should not be viewed as a predictor of our performance going forward. And given that we can't eliminate uncertainty in the environment, we continue to place a premium on flexibility in our plans. This will allow us to quickly pivot when we see changes in our business, as you've seen us do successfully multiple times this year.

So now I want to conclude my remarks in the same way I did 90 days ago by saying that a single quarter's financial results are not the basis for our long-term confidence. That confidence springs from the fact that we continue to focus on investing for the long term because Target's long-term prospects have never been brighter. We have a durable business model with flexibility in both our merchandising assortment and the fulfillment options we offer. We're building on an already deep relationship with our guests as they trust us like never before to conveniently and safely fulfill their wants and needs. And with a strong balance sheet and robust cash flow, we have the capacity to navigate any near-term challenges and play offense, just like we have over the last few years.

But most importantly, we have an amazing team across our stores, headquarters, distribution facilities and offices around the world. We have all rallied around a common purpose: to serve our guests, serve our communities, fight for racial equity and to support each other. All of us who work

Among the priorities we covered in this call 5 years ago, becoming a leader in digital, having just introduced our ship-from-store capability, defining our category roles and reasserting our authority in style categories like apparel and home, and ramping up our test of the small-format stores in dense urban areas. Also in the quarter 5 years ago, we sold our pharmacy business to CVS and announced that John Mulligan will become the company's first Chief Operating Officer with a goal of modernizing our supply chain and operations.

As in every upward journey, our progress over the last 5 years has not been a straight line. Along the way, we reached some plateaus and sometimes even lost some altitude before resuming the climb. That's why it's sometimes helpful to look back over a longer distance to get a true picture of the progress.

But unlike the ascent of a mountain, our journey will not end up with a climb back down. Success will be defined by further growth with a constant eye on what consumers want and need. To meet those ever changing needs, we'll need to continue to reinvent ourselves, changing our operations along the way.

Yet, some things will sustain over the longer term, like our culture, values and our team's commitment to one another. These strengths have defined this great company for decades, and our commitment to maintaining them has never been stronger.

With that, we'll move to Q&A. John, Michael and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Karen Short with Barclays.

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

Congratulations on a great quarter. I want to -- I don't want to take away from the success of the quarter because it obviously was outstanding.

Those will be key levers as we look ahead going forward. But like we said before, predicting them is an exercise in imprecision at this point.

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

Okay. That's helpful. And then you gave us, obviously, a lot of color on your digital and fulfillment capabilities. But I was wondering if you could just give a little more color on the new 10 million customers that you've gained. Anything you could point to on demographics, behavior, ticket type of behavior relative to your more regular customers?

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

John, anything else you want to add?

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

Yes. Karen, I'd say, the great thing is, is that from a behavior perspective, they behave just like the rest of our guests. When we convert someone to a Drive Up order, historically, we've seen them become more engaged with Target, see 30% more sales. That's exactly what we see with this 10%.

Probably more encouraging from our perspective is that from a repeat purchase perspective, we've seen that increase. 7-day repeat purchases are higher than we have seen historically. 90-day repeat purchases on digital are higher than we have seen historically. So it appears that, at least to start with, they're much more engaged with us. And we know that the deeper they get engaged, the more they use our services, that the more they will be engaged and the more they will use our services. So from our perspective, very encouraging results as those guests have come on to Target.com.

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

And Karen, the only thing I would add is we continue to see the most valuable and profitable guest to Target is the guest that uses all of our channels. And we continue to see stickiness as store guests discovers Drive Up or discovers the benefits of Shipt and also digital guests that are now coming into our stores because of the investments we've made and the trust we're building. So we'll continue to report more about those new guests in quarters to come. But certainly, we're very excited about what that means to our future.

Operator

The next question is from Edward Kelly with Wells Fargo.

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

I was just curious on the August comp, obviously, impressive results quarter-to-date given stimulus rolling off Back-to-School. I was hoping that you could provide a little bit of category color in terms of what you're seeing in August.

And then as it relates to Back-to-School, I guess, what are your thoughts on how the season is going to end up? I mean obviously, we're getting off to a late start in a lot of areas. Just curious as to what you think the impact to the comp will end up being this quarter?

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

Ed, why don't I start. And I commented earlier today that our August comps are off to a very solid start with low to mid-teen growth at this point in the month, and it's been broad-based. So we're continuing to see the kind of performance we saw in the second quarter continue into Q3: strength in food and Essentials, continued strength in electronics, continued to strength in home. And certainly, we've seen some adjustments in categories that are very school related as consumers look for greater certainty around when they're going to start the back-to-school season. But I think, again, the most important indicator right now, as I look at our August performance, is the consistent market share growth that we're seeing across our entire portfolio.

And each and every week, as we look at IRI and NPD performance, we continue to see a lot of green boxes and continue to pick up market share across the board and across our entire multi-category portfolio.

Obviously, we're all looking at Back-to-School and Back-to-College trends. And each and every day, there's new information. As we sit here today, and I think the number is there's something close to 56 million students in the K-12 bracket that are waiting to go back to school. And as of this week, it looks like well over 60% will start school remotely. And we'll look for more information. We don't know if those students will be welcomed back into a classroom in September or October. Many may wait actually until January. So we've made the decision to be flexible. And we'll extend the season and extend our assortment because we know at some point in time those students will need backpacks and uniforms. They're going to need school supplies, so we've got to make sure that we continue to flex. And I think it's been the hallmark of our performance throughout the first 2 quarters of this year, our ability to stay agile, stay flexible, meet the needs of the new environment, and we'll continue to take that approach with back-to-school season and with the back-to-college environment as well.

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

And then maybe just to follow up quickly. I had some comments around holiday and sort of stretching out holiday. Maybe just a little bit more color on what you're looking to do there. Do you think shopping patterns, consumer-wise and traffic, will actually follow that? Just a little bit more color in terms of how you're thinking about holiday at this point.

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

Ed, we do think it's going to be a longer holiday shopping season. We're certainly preparing to start earlier than ever before in the October period. We're going to make some big changes. We announced recently that we'll be closed on Thanksgiving. And we certainly expect it's going to be a different rhythm to the shopping season. Obviously, we're going to put a big premium on ease and convenience, delivering great value, but we'll emphasize safety. And we'll also make sure that our guests knows that those top items and that great value is going to be available throughout the season and give them the option of shopping, obviously, in a well-managed, safe Target store or taking advantage of our same-day fulfillment options to give them the certainty that they can get those great gifts, those great items whenever they want.

So we think it's going to be an extended holiday shopping season. We think it plays well to our multi-category portfolio and the flexibility of our stores and our convenient same-day offerings. So we'll prepare for a very different holiday season. We'll have to stay nimble. We'll have to adjust. But again, I think the team has demonstrated the flexibility and the adaptability to this new environment, and we expect to continue to build market share and delight our guests throughout the holiday season.

Operator

The next question is from Paul Trussell with Deutsche Bank.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Congrats on stellar results. The -- reflecting on your omnichannel business, first, just curious of the cadence of the channel mix. Just interested in seeing if there was an acceleration of in-store taking any moderation of the digital sale as the quarter progressed and economies reopened?

And then second is, obviously, the same-day services are quite robust. I'm just curious what are some of the learnings that you have over the last few months as it relates to Order Pick Up, Drive Up and Shipt. And how are these businesses, therefore, evolving and improving from these learnings?

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

So Paul, why don't I start. And I'll go back to our comments during our first quarter call. We certainly saw, literally starting in the middle of April, a resurgence of traffic to our stores, and that certainly continued in the second quarter. I commented earlier today when I was speaking with CNBC that despite the tremendous top line growth of 24.3% and digital growing at almost 200% during the quarter, the real star of our performance was the performance we saw in stores, where our store comps were up 10.9% despite an environment where we've seen unprecedented digital shopping. So we certainly saw that guests returning to stores throughout the second quarter, and that was consistent from May into June and July. And we continue to see guests shop our stores. And I think the investments we've made in safety, the investments we've made in our team, the investments we've been making for years and years, putting capital into remodeling our stores and creating a great shopping environment, that's certainly connecting with the guest during the pandemic.

So we continue to see very strong store traffic. We saw excellent traffic overall during the quarter, up almost 5%. And John can comment on some of the learnings from our same-day fulfillment. I would tell you, I think the biggest learning is just how adaptable and flexible our teams have been and how quickly they've responded to a surge in something like Drive Up that grew over 700% during the quarter alone.

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

Yes. Paul, I think Brian hit right on. Probably the core learning is the ability of our team to be incredibly agile. And we went in a matter of weeks from normal digital sales to volumes that exceeded Q4 last year for many weeks in a row. So the ability of our teams to do that very quickly where typically, planning for Q4 takes us several months. We have a detailed plan. But the teams understood what we were doing, how they needed to execute, we -- the tools that the store teams have built to help them execute proved very scalable and very efficient. And so our ability to do that was outstanding.

The other side of that, I would say, again, to point to how well the teams executed while taking care of the guests in store, as Brian pointed out, our NPS scores remained very, very high the entire time. Drive Up growing over 700% and still having an NPS score in excess of 80 is just outstanding work by our teams.

I think the last thing that had kind of changed our thoughts on the thing we've worried about -- only worried being not quite the right word, but thought about a lot is the stores are busy in Q4 serving guests in store. And so how do we continue to balance that with our fulfillment? And what we've seen over the past 3 months is that's not a problem as long as we give them the right tools, staff the stores appropriately, we can take care of running a 10 comp in the stores and running a 20 comp on digital, both of those together. And so we feel really good about the model we've built and the team has built over the past several years, and I think that's probably the biggest learning over the past 3 months. [wasT6 204e7rs,7rs,7r](#)

with our same-day services. So again, a big tribute to the team, the leadership they provided to recognize that, that was going to be important to our guests. And as opposed to waiting until 2021, we're going to get that back on our road map and begin to stand up those capabilities in the second half of the year. And I think that's going to be just one more aspect that will be appreciated by our guests when they shop Target in the third and fourth quarter.

Operator

The next question is from Matt McClintock with Raymond James.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

May I also say congrats to the broader Target team, outstanding execution this quarter and, honestly, all year.

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

Thank you, Matt.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

John, my question actually is for you. I want to take the supply chain from a different angle. You did talk that you're in discussions with vendors right now. You mentioned that some categories have had some out-of-stocks probably because they're just longer lead time categories. I'm not really sure. But I want to -- given the massive volatility in your sales, as Michael talked about, how are your thoughts changing or evolving towards demand forecasting? And how are you thinking about just sourcing in general from those vendors that maybe have long lead times in manufacturing themselves?

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

Well, it's a good question. And I would start in a place where demand forecasting is difficult right now, both for us -- and we import a lot of our goods, as you know, directly and from -- for our vendors who have long lead times as well. I think the thing we're working on with them is, we would call it joint business planning, just being sure we're both aligned and that we've built flexibility and agility into what we want to do. There are ways. You can set up sourcing strategies. We do this where we get an initial set order, and then we have very quick ways we can chase into demand through other avenues if we need to.

So -- and then the same is true domestically. For our vendors that are continuing to build capacities, who have us on allocation, having conversations with them about what we see in demand and what demand we're leaving on the table because we perhaps don't have the inventory we need.

So to me, this is mostly about conversations and then agility and being flexible when we see the data coming in because it is moving rapidly. And we know when we -- and we talk about it. When we write down a forecast, the only thing we know is that it is wrong. And so how we adjust to that as we see the data coming in is important toing rhaps don't have the inventory we need.

on the most important items that are in demand with our guests. So we're continuing to learn along the way, and I think we'll become even more efficient going forward.

Operator

The next question is from Oliver Chen with Cowen.

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

Congratulations. Regarding the assortment, it's all been performing so excellently. What do you see as opportunities ahead in the assortment? What are you most focused on in terms of areas that we'll see further innovation? And I would also just love your take on Target Circle and the next step in that program as well as your thoughts around the marketplace model and the -- on the e-commerce platform?

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

Oliver, you've got quite a few questions in the queue. And I'll start, and I'll certainly let Michael and John also jump in. I think as we think about our strategy from an assortment standpoint, I'll go back to something we've talked about for years now. We're at our best when we're a curator and balancing a curated assortment of our own brands and great national brands. And I think you'll continue to see that focus from Target going forward. And as I think about the work and the great work that our merchants have done, it all comes down to being great curators. And they've done that both with our in-store and our online assortment, and I think that is a huge point of difference for us. It served us well. It allows us to meet the growing demand in the digital channel because those items that we're fulfilling the same day are largely coming out of our core store assortment. So you'll see us focus on being great curators.

As we think about something like Target Plus, we're also taking a very different approach. We're inviting people in. It's an invitation-only platform. And we want to make sure that even in that environment, we're constantly curating, making sure we're delivering the right extension for our assortment and for our guests. So we'll continue to take a very different path, focused on curation in this environment, both with our physical assortment and digital assortment. And we think that's a hallmark of what makes Target such a unique company, and it really complements our multi-category assortment.

Oliver, on the Target Circle front, we noted that we now have over 75 million members in Target Circle. And obviously, going forward, it's another opportunity for us to deepen our relationship with the guests, to make sure we're even more relevant in their lives and that we continue to enhance the trust that I think we've gained throughout the pandemic. So we're very excited about the opportunity. And I think about the 10 million new digital guests that we've invited in over the last few months, 75 million and growing Target Circle members, it's just one more way for us to continue to meet the needs and delight the guests who shop Target each and every week.

Operator

Our last question is from Michael Lasser with UBS.

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

So would you attribute all of the slowdown that you've seen in August to the Back-to-School categories? Or would any of it be attributed to some of the enhanced unemployment benefits going away as well? And the question really gets at the heart of once we get past the back-to-school season, shouldn't you see your sales accelerate? And then I have a follow-up.

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

Mike, honestly, we're watching it carefully. And a lot of conversation around the impact of stimulus, what this means going forward. We certainly hope there's a second round of stimulus for small businesses and American consumers. But as we look at our trends right now, I think it's largely adjustments in some of the Back-to-School categories. But we continue to see strength across our portfolio. We continue to see strength in our stores and our digital channels. We continue to grow market share and see momentum within our business. So we'll watch it carefully.

Obviously, as Michael and John have stated several times, it's a very challenging environment for us to provide guidance. We've got the pandemic in front of us. We've got uncertainty about Back-to-School, Back-to-College, the state of the economy. We do have an election coming up in November. So lots of different dynamics that we have to try to sort through, and we're putting a premium on being really responsive and really flexible. But it's just hard for us to provide an outlook beyond a couple of weeks at a time.

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

My follow-up question is that you provided a lot of helpful statistics about how the average unit cost to fulfill an online order is now 30% below last year, yet the -- because the digital growth is so strong, that led to 130 basis points of gross margin pressure. So if we assume that some of the incremental sales that you're generating right now recede when consumers go back to traveling and eating out, and yet consumers have really gravitated to these digital fulfillment options like in-store pickup and Drive Up, and those stick around and that digital penetration remains where it is, should we think that this gross margin pressure of about 100, 130 basis point sticks? Or do you have offsets on the horizon that can reduce that pressure?

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

I can take that one, Michael. I think that the -- well, we don't know exactly what those numbers will look like for the back half of the year, and so I'm not going to attempt to predict those. I think what you see in the first half of the year is the durability of the model overall. And as you've heard us say many times, that growth in digital is way bigger to us than just the sales or profit on that one digital transaction because it deepens our relationship with the guest, and that pays off in spending in aggregate. And I think you can see evidence of how that flows through the durability of the model even in the first half of this year amidst all the volatility. If you would have told me before this year that digital would be up over -- almost 200% on the year, and that we would have had a point or more of pressure in gross margin from category mix, but that our operating income rate would be within 30 basis points of the year prior, I'd have taken that outcome in a heartbeat. And so I think that just shows how if you zoom out from the specifics of just one digital transaction, you get a sense of the durability of the model in total.

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

Yes. Michael, I'll just finish up and perhaps to wrap up the call. Well, I think all of us on the call, and I know our entire Target team is looking forward to the day when the pandemic is behind us, when we're spending time with family and friends, we're traveling again, kids are back in school. One of the things that I think will stick around for us is the consumer who's going to continue to consolidate their purchases, is going to appreciate value, is going to look for a safe shopping environment. And we know digital is going to be critically important. And I think what's going to stick around for us is the growth we've seen in market share, the relationship we've built with the consumer during the pandemic and the growing trust that we've formed with the guest who shops our stores or shops with us online each and every day.

So we're excited about the future. And I think sitting here with Michael and John, we've never felt better about the prospects for the company. And we've certainly advanced our digital maturity by several years. But I think we've really matured our overall operating capabilities during the pandemic. And I think that's going to provide returns for us for years and years to come.

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