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TGT.N - Q4 2020 Target Corp Earnings Call & 2021 Financial Community Meeting

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OVERVIEW:

Co. reported 2020 YoverY comparable sales growth of more than 19% and adjusted EPS of $9.42.

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As I look back over the past year, a year when so much care and compassion was called for, I see purpose, coupled with capabilities as the essential enabler of our response. And the story of Target in 2020 is the story of a team that wanted nothing more than to take care of those around us, drawing on capabilities that were equal to that ambition after years of building an investment.

So I want to start today by publicly recognizing and thanking our team. I'm incredibly proud of the resilience, empathy, care and concern they've shown for each other, our guests and communities through a very challenging 12 months and counting. None of what we'll share today would've happened without them. Even before the dramatic challenges of last year took hold, our team had been busy building the retail platform of tomorrow. But 2020 accelerated everything and, as such, our guests are already benefiting from and loving that platform today. At the heart of the platform was the belief that consumers would continue to flock to our stores for multicategory one-stop shopping; a friendly, well-trained and knowledgeable team; and joyful experiences.

As we designed our strategy and invested accordingly, we relentlessly asked ourselves what products and services those stores should offer, where they should be located, how their operations should be tailored to meet neighborhood needs and ultimately, how to make our stores work together with all of our other assets as one shopping platform that would keep guests turning to Target however they want to shop. In answering those questions, we did 2 things at once: We placed the physical store more firmly at the center of our omnichannel platform and we created a durable, sustainable and scalable business model that puts Target on a road of our own.

Our goal was to use our proximity, nearly 1,900 stores within 10 miles of the vast majority of the U.S. consumers to offer the fastest and easiest digital fulfillment in retail. And the capabilities we built to become America's easiest place to shop also cracked the essential question of how to grow our digital sales exponentially, while maintaining the overall profitability of our business. When we began this journey, we didn't know we would be facing a global pandemic, mass quarantines, rapid unemployment and the need to limit the number of people in public spaces. And yet, when those threats emerged in 2020, we were ready. And without hesitation, millions of American families turned to Target like never before. That happened because of decisions we made 4 and 5 years ago. And today, Christina Hennington, our recently named Chief Growth Officer, along with John Mulligan and Michael Fiddelke, will join me in mapping out how our team's efforts in recent years created a new baseline from which we'll continue to climb higher for our guests.

And here's what I hope you'll take away from our story. First, that our team's ability to act and react in 2020 was years in the making. Without our multiyear roadmap to develop new capabilities and bring them to scale, 2020 could've exposed essential gaps in our business model. Instead, it proved beyond a doubt the durability of our model and it signaled our potential for continued growth in years ahead.

The second takeaway stems from a question I've heard frequently, especially in 2020, "Brian, what's the secret to Target's growth trajectory?" What you'll see in our presentation today is that the one thing that's driving our success is a focused commitment to several things: an integrated collection of strategies and capabilities that all work together, are very difficult to replicate and, ultimately, make Target unique.

I'll start today with a high level recap of our full year results. When we gathered virtually for this meeting last year, I shared how our revenue had grown by $5.4 billion since 2017, and that we were consistently gaining share in many of our core merchandising categories. In other words, we were already starting to see steady growth from our investments.

When we left that meeting, no one knew that COVID-19 would be declared a pandemic in the United States, only a couple of weeks later. In hindsight, it's hard to believe that we only receive one COVID-related question that day. But today, as we look back on 2020, the business highlights are clear: Our revenue during the year increased another $15 billion. We gained meaningful market share across all 5 of our merchandising categories, totaling about $9 billion. Oks,tely, how how how ho, A few consistent pillars have been and will continue to be at the heart of our playbook. The enormous investments we made in supply chain, store operations and technology capabilities are already powering exponential growth in digital commerce. They've enabled us to use our stores as showrooms and service centers, but also as hubs for digital fulfillment. Without these investments, we simply wouldn't have been able to satisfy the exploding guest demand for same-day services, represented by more than 600% growth in Drive Up.

Likewise, Shipt is an extraordinary capability that grew by more than 300% last year and will continue to grow as more guests recognize the power of having their purchases brought to their doorstep in as little as 1 hour. We have consistently invested in our merchandising strength, like our differentiated owned brand portfolio, our curated national brands, inspired limited time offering and strategic relationships that run the gamut from web only start-ups looking for omnichannel scale to premier partners like Disney, Apple, Levi's and Ulta Beauty.

We're continuously improving our physical and digital shopping experience, investing billions in store remodels, specialized store roles and service training for our teams, while continuing to open up new small formats in urban centers, major college campuses and iconic tourist destinations. Most importantly, we're continuing to invest in our team. Even before 2020's outsized incremental expenditures on team health and safety, Target was an employer of choice, an academy company for those looking for rewarding and purposeful careers. In addition to accelerating our $15 starting wage in 2020, we celebrated our team's exceptional efforts with 5 separate recognition bonuses, most recently in January when we invested another $200 million to reward each of our frontline team members $500.

As we develop capabilities, like Target Circle, or acquire them, like Shipt, we do so with a clear vision for how they'll work together in service to our guests. Ultimately, the value they create in our core business has to contribute to our retail offering that's greater than the sum of the parts. But when we look at these elements individually, it's strikingly clear how much value we've added in a very short time. In 2016, our digital transformation was only beginning, we weren't even a top 10 e-commerce provider, and we were just getting our same-day services off the ground. Today, we have the most complete suite of same-day fulfillment services in the industry. We're one of the leading e-commerce players. And for Click and Collect same-day services, we continue to deliver industry-leading growth and dollar volume as well as Net Promoter Scores over 80% despite record demand.

In 2016, we had about 30 small format stores. Today, we have 140 and we'll add another 30 to 40 per year over the next several years. If these stores were a standalone chain, their revenue would rival that of fast-growing chains with many more locations. In 2016, we launched Pillowfort and Cat & Jack, touching off an owned brand reinvention that has since resulted in more than 30 new brands, with more on the way this year. By the time we gathered for this meeting last year, Cat & Jack and 5 other owned brands were generating $1 billion or more apiece in annual sales, and that tally has continued to grow.

We cleared 2020 with 10 of our owned brands each generating $1 billion or more and 4 of those across the $2 billion per year threshold. Any one of these brands alone would be a sizable retailer and, as you know, their contribution to profits is outsized. Of course, owned and exclusive brands are just one component of our merchandising strategy, which has always drawn on curated national brands across our assortment.

As we've expanded capabilities in recent years, we've also steadily built our roster of strategic partners. Levi's is an excellent example of how we can build upon a longstanding collaboration and help strategic partners catapult into new product categories. We started partnering with Levi's years ago on the DENIZEN denim brand and that partnership grew to include Levi's Red Tab apparel and a build-out presence in hundreds of stores and on Target.com. Just this last Sunday, we launched the Levi's for Target collection, a limited time offering of home goods. This is the first foray by Levi's into this category and it's a great example of combining their strengths with ours, including our incredible sourcing and product design and development capabilities to forge new potential for both of our brands.

Meanwhile, our team is also gearing up to introduce Ulta Beauty at Target to our stores and Target.com, starting with the first 100 stores later this year. From this initial batch, we'll test, we'll learn and we'll expand hundreds of additional locations over time. This partnership combines Ulta Beauty's unparalleled assortment, category expertise and guest loyalty with our large high-growth traffic-driving beauty business and the ease and convenience of our fulfillment services. Together, we'll be able to offer guests access to established, emerging and prestige beauty brands as well as expert beauty consultation in an industry leading omnichannel retail experience.

As a standalone or isolated innovation, each of these elements I mentioned, has something in common with the other. Each was advanced based on how it would complement our other assets and capabilities and we tested each one with an eye towards scale. In fact, the ability to integrate and scale is a key component of our decision making. And to emphasize the critical importance of scalability, I simply think back to what we could've done in 2016 but didn't. At that time, conventional wisdom held that the only way forward was for retailers to build capacity, to send more packages to homes. Instead, we went our own way, built a fulfillment model with our guests' local store at the center and took the initiative on same-day. We could just as easily have constructed additional fulfillment centers and driven the shift to digital sales with more ship-to-home capacity. But as you know, the economics were terrible and we wouldn't have been differentiated.

In short, we didn't see the textbook solution as scalable or as likely to do what we've done, namely set the groundwork for years of guest satisfaction and brand loyalty, as represented by comments like this, "Thank you for providing curbside pickup. It actually was the determining factor in me buying from Target instead of one of those online retailers." Or this [see quote on slide 68], or this [see additional quote on slide 69] or this note from a guest who simply said, "Please always continue to do curbside pick up. It is such a help even outside of COVID. This is a wonderful service and I'll continue to choose Target for this very reason."

So where do we go from here? And how do we keep climbing from this strong new baseline? In the near term, we'll continue to generate incredible value by executing on our strategy. Throughout the pandemic, we've built deep trust and loyalty with our guests who clearly prefer the ease and everyday inspiration of shopping at Target, along with our relentless commitment to the safety and cleanliness of our shopping environment. This is a decades long commitment that was only emphasized by the pandemic, and it will continue to be a differentiator in the months and years ahead.

Our multi-category merchandise portfolio is a huge advantage, particularly as shoppers continue to consolidate trips. And we're absolutely in ways we never could have imagined. But how we responded at Target, empowering our teams, moving quickly and leveraging the power of our multi-category assortment, that's Target at its best. In fact, that's Target better than I've ever seen us.

So when I think about my new role in bringing together insight, strategy and innovation, plus planning, design, sourcing and buying functions, This kind of work is a big part of what makes Target special, and we're not stopping there. Just last week, in fact, we began rolling out a dedicated Apple experience, starting in 17 stores across the country and online. We're doubling the Apple footprint in these stores with new lighting fixtures and displays for Apple products, including an extended assortment of accessories. We have a new dedicated Apple landing page on our digital channels and we'll offer our guests more expertise with Apple trained team members in these stores and enhanced product videos on our app and website. This is really exciting because we're taking the work we've done with Apple over the last 15 years and making it even better.

In a normal year, we'd have spent months preparing for the traditional Q4 shopping spike. But in 2020, our peak season started in March. And after months of moving record volume, we had become increasingly efficient in how we managed high levels of demand. So when the holidays actually did arrive, we leaned into what was already working. We sent more inventory to stores than ever to prepare for an earlier holiday rush. We front-loaded those deliveries with the seasonal merchandise guests would expect so our stores would be stocked and ready, and we continued prioritizing essential products, like cleaning supplies and health care items, so we could keep meeting the pressing needs of our guests.

The flexibility of our supply chain set up our stores to play an essential role in our communities. Because we could restock shelves quickly, guests could count on Target for what they needed, whether they came inside or shopped online. And when our digital business picked up last spring, our fulfillment operation went into high gear. Up to that point, our same-day fulfillment services had already been rolled out nationwide. Millions of guests were loving them because they're fast and easy. We always love them because they're incredibly efficient. Without the shipping expense, these orders look much more like a store sale than a traditional online transaction, costing on average 90% less than if we'd shipped it from a warehouse. And at the start of 2020, our same-day sales were growing at a healthy clip. Come spring, when consumers saw the need for more contactless ways to shop, those services exploded. And we had the infrastructure in place to grow alongside demand.

Brian gave you the full year highlights on Drive Up, up more than 600%, and even Order Pick Up, which has been around for years, still grew more than 70%. Beyond our pickup options, the delivery capability we have in Shipt became even more important. It filled the need for guests who wanted an online order, especially for perishable items, but also for so many other essentials across Target, brought right to their front doors. It offered more personalization, reliability and speed than they could get from a packaged shipment. And as a result Shipt's target sales grew more than 300%. Of course, we continue to ship online orders from the back of our local stores, saving 40% of the cost of shipping from a warehouse, helping us manage high volumes during peak times. And we added thousands of Drive Up parking spots, so guests could get in and out even faster.

At the same time, Shipt more than doubled its shopper network to increase the number of delivery windows it could offer to keep up with soaring demand. It's worth taking a minute to emphasize that using our stores to support digital demand is only possible because of trust and collaboration across many teams at Target. It's not just a stores operation or a supply chain effort, it's the product of many teams strategizing around a common purpose to deliver for our guests. That one team mindset is what built the capabilities we have today and is what allowed us to adjust swiftly when the business accelerated unexpectedly.

We built an operation to handle the healthy digital growth we expected through the middle of this decade. The only surprise was that we got there last year much sooner than planned. Although we designed for that kind of flexibility and scale in the long run, our team hadn't planned for it to come all at once, and that's what makes their outstanding execution with no advanced warning, all the more remarkable. Advancing the business several years in a matter of months proves that our model is scalable and also prove we have the capacity to grow.

I'd remind you of what I've shared in several of our past earnings calls. A reliable way to assess our stores throughput capacity is to look at the sales we do per square foot. And you can see that productivity has grown a lot over the last couple of years for our average stores, but also for our top quartile. The fact that we continue to see more throughput in our highest-performing stores shows the capacity we have across the rest of the chain for even more growth in the future.

With all the expectations we have for our stores, the physical buildings themselves play a huge role in our strategy. We're as committed as ever to our years long initiative to remodel stores with an inspirational specialty store feel that makes shopping easy and convenient. At the beginning of last year, we'd started about 130 full store remodels. In mid-March, to reduce distractions in our stores, we decided to complete the projects we'd started. Then we pivoted to more targeted improvements that emphasize safety, like installing plexiglass dividers and reformatting our sales floor for greater distancing.

The timing for our small-format stores also shifted. After pausing construction in the spring, our teams accelerated the work through the summer and fall to finalize more than 2 dozen stores for new local guests. Despite stopping the work for part of the year, we still opened 29 small format stores, the most completed in 1 year-to-date. From the Las Vegas Strip to UC San Diego, our first store right on campus property, we tapped into new communities. And we continued expanding across markets like New York and L.A. With each one, Target brought a safe and essential shopping experience to even more guests, while positioning us to serve those neighborhoods for years to come.

Our construction and store design teams also adjusted following the demonstrations for racial justice this summer. One of our Minneapolis stores required an entire rebuild. Without it, the local community had nowhere nearby to get essentials like baby formula and fresh food. So we partnered with local nonprofits to distribute needed supplies while putting plans in motion to reopen fast. We leaned on the expertise we developed remodeling stores and opening small formats to meet the community's needs. We listened to nearby residents, worked with local contractors, personalized the in-store experience and reopened months later as a convenient shopping destination, but also as a better partner to the neighborhood. Take a look.

(presentation)

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

From that video alone, it's clear that our team is dedicated, tireless and incredibly compassionate when it comes to serving our communities. You saw it in the opening video and you've heard it throughout this morning. Our team is the heartbeat of Target. And even when faced with challenges, they bring their A game.

Several years ago, we implemented a new operating model in our stores to lift up that drive. It was a shift towards specialized roles to give our teams expertise, empowerment and a sense of ownership in how they serve our guests. With amiaputtinfs a cner to the opportunities to train our specialists in other areas like teaching a hardlines expert how to fulfill an online order. So they gain skills beyond their specialized position. Those investments in their development also add flexibility to our operation.

We've always known that supporting our team would have great returns and it has. In addition to the bonuses, time off options, wellbeing benefits and expanded nationwide starting wage that Brian mentioned, we also gave our team even more hours. With a greater investment in our trained and expert workforce, we saw turnover drop and guest satisfaction rise. It's a strong testament to what can be done when we empower our teams to use their skills and passions to serve our guests. The bottom line is that as our business grew exponentially, our operation flexed alongside it. And as we delivered for our guests, we built on the trust they put in us to meet their needs and make it easy.

Going forward, we're taking the capabilities that drove Target in 2020 and accelerating them to continue making Target, the safest and easiest place to shop. As we do, we'll invest in more capacity and greater efficiencies. So we're positioned to continue growing for the long term.

In our supply chain, that starts with expanding our network so we continue to have replenishment capacity that can support our future growth. In recent years, we accommodated steady sales growth through our existing supply chain network by increasing the productivity of our buildings. In fact, the average sales per foot supported by our distribution centers rose nearly 30% between 2016 and 2020, thanks to a series of process and technology improvements. During those years, we didn't open any new DCs to support replenishment. But after our business grew nearly 20% last year, with 95% of sales driven by our stores, it's time to expand our supply chain so we can support a much higher base of sales and continue growing.

This year, we'll open 2 distribution centers to support replenishment, 1 close to the New Jersey/Delaware state line and another in the Little Village neighborhood of Chicago. And we currently have plans for one on each coast in 2022. We're also continuing to simplify the unload process once product reaches the stores. In a nutshell, it all comes down to how we sort and organize millions of items before they arrive at the stores' loading dock.

We've shown you the robotics capabilities we're building to help us sort inventory to the precise amount a store needs and organize it by store aisle. When we do, replenishment in stores is fast. Team members grab a tote, walk to the aisle and stock the shelf. No sorting in the back room or finding places to stash cases of excess product. We have 2 solutions that help us do that. We showed you both of these independently last year: 1 called auto-rebin sorts individual items. This is most useful for slower moving inventory, when stores only need a handful of items to put back on the shelf. Auto-rebin started in one of our local Minnesota warehouses, rolled out to 2 more and we'll expand to another 2 this year.

The second is the robotic ship sorter we've been building at our Perth Amboy facility. This sorts everything, from boxes of individual items to entire cases of product. After the sort, robots sequence inventory so our team can load pallets in an order that saves stores even more time. Individually, these capabilities are hugely valuable, but they're designed to work together. This spring, we'll put both solutions in 1 warehouse to test how they bring more precision and speed to store replenishment. In Q4, we'll run them together at a small scale, doing what we always do to learn and iterate before we go bigger. Opening new warehouses and expanding our robotics capabilities are both about moving product more easily to stores.

But just as important is being ready to send what stores need before they even know it. This year, we'll continue expanding the rollout of our predictive inventory positioning capability across our assortment. This helps us more precisely order and position product close to where we anticipate guests will want it so we can react quickly when there's demand. In turn, it improves out of stocks and lowers backroom inventory levels. In 2020, when sales spiked, this capability allowed us to order and restock products 25% faster than using our old systems. This year, we'll use it to order and position even more items in our assortment, so we can replenish the majority of the store faster for our guests.

We've talked about how store replenishment feeds store fulfillment. This past year, our team was able to keep filling online orders because our supply chain was replenishing that inventory with speed and precision. While we continue refining our replenishment operation, we'll also build on our fulfillment capabilities to enhance the guest experience and make way for future growth. Today, the majority of our store assortment is available through our same-day services, but we're continually working to give guests even more choices. In coming months, we'll expand our pickup options further into categories like apparel and fresh food and roll adult beverage pickup to 800 more stores.

We'll also build on our stores' operating model by introducing a new standard of service to our teams. It's not a checklist, but a set of principles that define great service, like welcoming a guest and paying attention to what they need, which might be as simple as finding an item or as big as building an outfit. It's meant to give our team flexibility and empower them to do what's right for the guests in the moment. Without our team, everything else you heard today comes to a standstill. The Target team continues to be the most important part of our operation, and I want to say an enormous thank you to all our team members for all they do to serve our guests and our communities.

You've seen us make a lot of operational investments over the last few years, in our team, in our stores and in our capacity for long-term growth. In the most recent quarter, those returns were clear. We've created an operation unlike anyone else with our physical assets working together, centered on our stores and fueled by our team to serve our guests and grow for the long term. The capabilities we built not only allowed us to navigate the most volatile time in retail history but show that they can flex and grow to serve the ever-changing needs of the consumer. The work isn't done. We're constantly refining an operation that is efficient, fast and supportive of Target's durable and scalable business model. From an engineer by training and a finance guy at heart, I can attest that you can't get too efficient or relevant enough. There's no finish line for continuous improvement and innovation. We'll keep making bets on the capabilities that give us the flexibility to serve guests well into the future.

We have a lot of strength heading into 2021 and a lot of work still in front of us. But with a sound operational foundation and the talent and resilience of the Target team driving us ahead, I look forward to sharing our progress in the quarters and years to come.

With that, Michael, I'll hand it over to you.

(presentation)

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

All I can say is wow. Those news clips paint a vivid picture of the roller coaster our team and our business experienced throughout 2020. All in all, it was a standout year in which everything we've spent years developing and building came together to serve our guests like never before.

So today, after a year of record growth, I want to start my remarks by expanding on a point Brian mentioned earlier because investors often want to know, how much of Target's growth is being driven by specific strategies or specific assets. For example, they want to know if we can isolate how much of our growth is coming from Drive Up, from digital in total, our owned brand work, remodel program and any other way we can slice and dice the data. And I understand the impulse. Our internal team often wants to do the same thing. And of course, as a self described data geek, I'm inclined to think the same way.

But then I see data like we first shared with you last year. Guests who try Drive Up for the first time spend about 30% more on average compared with before, including an increase in conventional store shopping. And we see a similar change in behavior among guests who try Shipt for the first time. These findings demonstrate that the benefits of Drive Up and Shipt go far beyond the value of an individual trip. They're both capabilities that drive guest affinity, creating value that extends well beyond the services themselves.

That same thinking applies to our merchandise categories. If you focus only on the amount of sales or growth by category, you can miss how they all work together to drive guest affinity. I see how this plays out with my own family. Over the next few months, the cold weather in Minnesota will finally end, and my kids will need warm weather clothes. On the next Saturday morning Target run, we'll shop for those clothes, and we'll also pick up some food, a few office supplies, laundry detergent and maybe a prescription from CVS. We might wander over and purchase some spring decor. And we'll probably need some more earbuds since the kids seem to be inventing new ways to lose or destroy them. And on our way out, we'll probably stop at the Starbucks near the entrance so my wife and I can enjoy a coffee on the way home.

So now if you're going to analyze that basket, is there a way to know which category drove the trip? And beyond the basket itself, shouldn't we broaden the analysis even further since that trip depended on a conveniently located store that's clean, safe and fun to shop, featuring low everyday prices and a friendly and engaged team?

Over time, I've come to understand that guest engagement and financial performance are driven by everything we're doing at the same time, not any factor in isolation. Among the critical factors, of course, there are the tangible assets that show up on our balance sheet, including our stores, distribution centers and technology, but the list goes way beyond the balance sheet and includes our team, our reputation and the trust we've established with multiple stakeholders, which only deepened in 2020. Then there's the Target brand itself. Our owned and exclusive brands, of our guests and their changing preferences, helping us to connect them with the services, brands and categories that address those wants and needs.

So it's clear that we're entering 2021 with a lot of momentum and a really strong foundation with a lot more room to grow. As you heard from John, we still have a long runway to expand the available assortment for our same-day services, while we invest to broaden Shipt's reach by entering new markets while expanding in existing ones. When we acquired Shipt in late 2017, we were confident that same-day delivery was a capability every successful retailer would need to have, and we've spent the last 3 years integrating Shipt into our strategy and operations. At the same time, the acquisition has made it easier for Shipt to grow and achieve scale in new markets, given the volume that Target immediately brings to the platform.

And as John covered, we're investing to modernize our network and add replenishment capacity to support future growth. Obviously, we came into last year with a great deal of capacity, but we used up a lot more of it than expected. Here's one way to think about it. At our current average sales per store, last year's growth of $15 billion was equivalent to the addition of more than 300 new Target stores. If we had actually opened that many new locations, we'd have needed some additional upstream capacity, and that need is the same, whether growth is coming from a bigger store footprint or higher productivity in our existing footage.

While I'm on the topic, I want to pause and address the question of whether our stores are going to run out of capacity to grow digital sales. And I'd start with what John mentioned earlier, how our top quartile of stores demonstrate the continued potential for our average stores to handle more throughput. But I want to drill down into a really specific example to provide another view of our untapped capacity. And what we can do when an individual location reaches its limit. To do that, I'm going to go way back in history and talk about our experience at the Target store in

So first, as I think about implications for Target's top line in the months and years ahead, I think about the drivers at 3 levels of a funnel. At the widest part of the funnel are macro factors, including uncertainty about the path of COVID-19 and the speed and effectiveness of the vaccine campaign. How consumer attitudes and behaviors will evolve as we emerge from the pandemic. For example, there's an emerging consensus that the nature of work will permanently change as employers move to a more flexible model and allow for more work from home. This will likely have long-lasting implications for consumer spending. And finally, beyond changes in the consumer mindset, macro considerations include the health of the economy, the near-term impact of stimulus and how quickly various industries and communities will recover from the pandemic.

The middle stage of the funnel involves questions around potential industry trends in each of the categories we sell and every industry has its own story. And categories consumed mostly at home, including food and beverage, essentials, home and hardlines, industry trends have accelerated over the last year and could see some softness as we emerge from the crisis. However, the timing and extent is hard to predict and could be offset by permanent changes in consumer habits, including a higher percentage of work time spent at home and an elevated focus on cleanliness and health resulting from the pandemic.

locking in last year's gains, we expect to retain significant scale benefits compared with 2019. In addition, we expect to deliver continued efficiency improvements, driven by investments in our supply chain, technology and operating model, which will help to offset continued investments in our team. Altogether, we expect that our 2021 SG&A expense rate will also be lower than our 2019 rate of 20.8%.

On the D&A expense line, we expect to see moderate dollar growth in 2021 as we ramp up remodels and accelerate depreciation on the assets we replace. Of course, rate performance will depend on the total sales we deliver this year.

So as we consider how all of these rates come together on the operating margin line, we're facing a wide range of possibilities as we enter the year. I've already talked about the unpredictability of sales and how category and channel mix alone can impact our margin. But even with that uncertainty, we should continue to benefit from the leverage we gained in 2020. Altogether, our expectation is that this year's operating margin rate will move down from the 7% we recorded in 2020 but remain above our 2019 operating margin rate of 6%, with the most likely outcome in the lower half of that range.

So now for those of you hoping we'd provide a more precise view of our expectations today, I want you to know that I feel the same way. I know that it's difficult to model our business right now. Our team is facing the same challenge. In the face of this uncertainty, we continue to put a huge premium on flexibility and agility, which served us extremely well throughout 2020. After all, flexibility is a cornerstone of our business model, which features a uniquely diverse category mix and a store-based fulfillment model that can quickly adapt to changes in guest shopping patterns. With the benefit of this model, an outstanding team and a strong balance sheet, we're perfectly positioned to navigate any near term uncertainty, while we continue to invest in long-term growth. And while it may sound counterintuitive, our expectations for the next few quarters feel cloudier than our view of the longer term, when we're highly confident in our ability to grow profitably and build on recent share gains.

So now before I move beyond the P&L, I want to spend a minute talking about the prior year comparisons we're facing in the first 2 quarters of this year. As you'll recall, in the first quarter last year, sales accelerated meaningfully after the onset of COVID, but our gross margin rate for the quarter declined an astounding amount, more than 4 percentage points in light of the cost to rightsize our apparel inventory.

Also in the first quarter, we began making meaningful investments in the health and safety of our team and guests, which we'd maintained throughout the year. Altogether, our first quarter earnings per share were down more than 60% compared with 2019. Contrast that with the second quarter last year when our comp sales grew more than 24%, our gross margin rate also increased and we saw a jaw dropping amount of leverage on the SG&A and D&A expense lines, which more than offset investments in team and guest safety. As a result, last year's second quarter EPS grew more than 80% compared with 2019. That's a swing of more than 140 percentage points in our EPS growth rates between Q1 and Q2 last year.

So as we plan and analyze our performance in the first 2 quarters of 2021, we're going to lean heavily on comparisons to the much more stable environment we experienced in 2019. This will help all of us to look through the extreme volatility in year-over-year comparisons we'll be seeing throughout the first half of this year.

So now let's move beyond the P&L and turn to cash and capital deployment, and I want to reiterate that our priorities remain the same as they have been for decades. First, we look to invest in the business in all of the projects that meet our strategic and financial criteria. Second, we look to support the dividend and build on our record of annual increases, which we've maintained every year since 1971. One note, if we attain that goal in 2021, it will mark our 50th consecutive year of uninterrupted dividend increases, putting us in a very small group of companies who can make that statement. And finally, we look to deploy excess cash through share repurchases only after we fully supported the first 2 goals within the capacity of our middle A credit ratings.

As you know, last year turned out to be a very strong year for cash flow in light of our sales growth and strong operational performance. As a result, we ended the year with about $8.5 billion of cash, well beyond the amount we'd maintain in ordinary times. But as strong as our year turned out to be, we can't forget the volatility we just encountered and the environment today remains far from ordinary. It's in that context that we evaluate our 2021 capital deployment expectations.

Regarding CapEx, I already outlined our plan to invest about $4 billion this year. Regarding the dividend, later this year, we expect to recommend that our Board approve a robust increase in the per share dividend. But as always, this recommendation will depend on how our business is performing. Beyond those priorities, we've resumed share repurchases this year. And depending on how the virus, the economy and our performance progresses, could have ample capacity within the limits of our middle A credit ratings.

But I will quickly say, we'll continue to be cautious and maintain an ample amount of liquidity to carry us through a wide range of near-term scenarios. As such, it may be a multiyear journey before our credit metrics move fully back to historical levels, depending on the speed with which we see more normal volatility across the economy and our business.

So now I want to turn to our after-tax ROIC. As we've long emphasized, we rely on this metric to assess the health of our business and the effectiveness of our capital deployment over time. However, as is often the case, we sometimes need to look past near-term volatility and 2020 presents a great example. That's because last year, we delivered an astounding aftertax ROIC of 23.5%, up more than 7 percentage points from already strong performance in 2019. While this outcome is remarkable and a testament to our team and operating model, I'm going to quickly say that it's artificially high and likely to come back down over time. That might sound like a strange thing to say, but it's based on a number of factors that are clear today.

First, with unexpectedly strong sales, our inventory turns shot up last year, and we saw abnormally high payables leverage. While that had a positive near-term impact on working capital, we also saw really choppy in stocks, which isn't how we want to operate under normal conditions. In 2021, we're planning for full shelves and better in stocks, which will bring inventory turns and payables leverage back down to more sustainable levels. This will require a net investment of working capital for the year.

Similarly, as I mentioned earlier, we're leaning in to support a strong set of growth opportunities over the next few years. As we accelerate investment in stores, supply chain modernization and replenishment capacity in support of those growth prospects, we'll likely see an increase in the invested capital portion of this metric over the next few years. Bottom line, while I believe this metric will stay very healthy and compare favorably to other retailers, I expect it will move back down into the 20% range over time. This would represent very strong absolute and relative performance on a larger asset base than we've maintained in the past.

So as I get ready to turn things back over to Brian. I want to take you back to this meeting 4 years ago, when I was listening from our headquarters in Minneapolis. During my career at Target, I've been lucky to spend time working with our stores, and I've developed a deep appreciation for the value they can deliver. So when Brian and John stood up and said we'd be investing to put our stores at the center of everything we do, including both digital and physical shopping, I had a ton of confidence in that plan. It was a plan based on carefully listening to our guests, it was differentiated and we were fortunate to have the necessary resources to get there.

In the years following that meeting, our team worked hard, and we encountered many doubters but we continued to invest with a long view and last year's results showed the value of that focus. And as we sit here today, we remain committed to making future investments with that same long view. Rather than sitting back, taking a break and waiting for the virus to subside, we are focused on playing offense and investing in continued growth.

And just like 4 years ago, my confidence in the future starts with the team. So I want to acknowledge everyone on the Target team, from headquarters to our distribution centers, to our stores in all 50 states and our offices around the world for their dedication to our guests and passion for taking care of each other. Without you, we couldn't have delivered such an amazing amount of value on behalf of our stakeholders in 2020. And with your help, I'm confident we'll continue to deliver long-term value for all of our stakeholders in the years ahead. I can't say it enough. Thank you. Thank you. Thank you.

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

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

Thanks, Michael. As we wind down today's event, I'll leave you with a couple of thoughts. 5 years ago, we envisioned a future for ourselves, in which the key to guest preference and breakout growth lay in an unappreciated omnichannel asset called the store. Many were skeptical, which is why we said from the beginning that we were playing our own game and creating a category of one. Many thought the inevitable drift was for our store guests to become digital guests, and that the current only ran in 1 direction.

We saw something different. We saw a future in which even the most committed digital-only guests would find the best and easiest shopping experience at Target because of how we connect that experience to our stores. We knew that to make our stores function for the future that we envisioned, we'd have to build, acquire and bundle a unique set of capabilities. The technology, the supply chain inventiveness, the physical assets and operations and the team of trusted neighbors that millions turn to for friendly service and a bit of everyday joy.

We began to put all those pieces together like no one else had. And the experience was taking hold, on the timetable we expected. Then 2020 accelerated everything. And today, Target is as synonymous with same-day and safety as it is with style and swagger. That is a very strong position to be in.

And here's where we intend to go with it. First, we'll continue to focus on market share over the long term. We believe our experience, including our fulfillment options, inspiring assortment, ease, safety and personal service will convert more and more consumers into guests. And we'll also work tirelessly to engage established guests across more of our channels and offerings. With new guests choosing Target and established guests engaging with more of our platform, we'll be able to listen to them even more closely. And capabilities like Drive Up, Shipt and Circle will give us a wider window than ever into their preferences. Meaning, we can further improve the experience we provide in the near term, while continuously anticipating where we should go next.

Staying closely connected to our guests always points us in the right direction. That's what helped us see a future 5 years ago, that today is a reality. And it's why we're stepping up our investments to drive additional profitable growth. Unlike in recent years, when we needed to shore up our foundation or create new capabilities, today's investments will build on an omnichannel Target platform that is already working incredibly well. A platform that has raised expectations, not just among Target guests, but for consumers across U.S. retail. Few can meet those expectations like we can because what we've created is based on a unique combination of differentiated assets.

But this is just the beginning of our story on which we'll continue to iterate, innovate and continuously improve for our guests. So in closing, I want to express my complete confidence in this company's future. I'm confident in our strategy and in our capabilities. And above all, I'm confident in

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation 2021 Financial Community Meeting Q&A Session Conference

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

Yes. Chris, it's Brian. I think one of the things that we underscored throughout the pandemic has been the strength of our stores. And despite many of Americans really avoiding public places, we've seen very strong store comps, obviously, in excess of 7%. And we saw very solid store traffic. So I think we've continued to build trust. And I think coming out of the pandemic, our stores are going to be -- continue to be very relevant, very important. I think they go far beyond showcasing. We know our guests are inspired by shopping in our stores. They enjoy browsing. They enjoy seeing the combination of our owned brands and national brands.

And now I think we just punctuate that further with the addition of brands like Ulta Beauty, Levi's, the expansion of Apple. The work that we've done throughout the year to create a showcase of owned brands and national brands and continue to invest in building a trusted and safe shopping experience. So as we think to the future, stores are going to play a very important role. It's going to be a place where our guests enjoy shopping each and every day. And I think they're going to continue to enjoy our multi-category portfolio for years to come. So we are -- continue to be very bullish on the role stores play. And I think these new national brand partnerships will only accentuate the importance of stores and drive future traffic to our stores.

Operator

Our next question is from Karen Short with Barclays.

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

I also had kind of '21 question and then a bigger picture question. So trying the SG&A question a little bit differently. If I look at what I think your COVID costs were and expenses were in 2020, it was north of $1 billion. And I think I calculate around $750 million in wages for the 2 quarters in the back half of 2020. So in theory, that would imply you lose about $1 billion in SG&A dollars in 2021. Is that the right way to think about it? Because it definitely gets me closer kind of to 7% on the operating margins, obviously, depending on sales.

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

Karen, like similar to the answer I gave, Chris, I think there's going to be a lot of moving variables through the gross margin and SG&A lines. And to get overly precise today about where any one of them comes in, I think, would be a bit of an exercise in false precision. The biggest factor versus a couple of years ago on the SG&A line is going to be the benefit of scale, and we can put that to use in so many ways across the business. And we've got a long history of investing in our team. That was a big part of the journey we embarked on in 2017 and attracting and retaining the best team in retail has been a center of our strategy for the last several years. And we continue to put the team at the forefront this year, and that will continue as well.

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

Karen, I might as well take the guidance question upfront and kind of remove the bull's eye from Michael's chest, again, no pun intended. But as we sit here today, I think we all recognize this is a very uncertain environment. We're still speculating around what's going to happen with the economy, how employment rates start to recover. While the trends are encouraging right now with the virus, we're all battling COVID each and every day. And while vaccine distribution is accelerating, millions and millions of Americans are still waiting for their turn to get that vaccine. We're still wondering when children go back to school. And when we'll return to the workplace.

So we approach guidance, recognizing there's lots of uncertainty. But I'll go back to the fact that for most of the last year, we haven't provided guidance, but we have focused on execution. And I think our team has proven to be very flexible, very agile. We responded to the environment and we've been focused on delivering a trusted and safe experience for our guests, whether they're shopping in our stores or online. That focus on execution will continue in 2021. And I wouldn't confuse guidance or the lack thereof with our confidence to continue to take market share and outperform in the coming months and years.

So I recognize the frustration of not being more precise, particularly on the top line as we think about sales, but I can guarantee you, our entire leadership team and every part of this organization is focused on retaining and growing market share no matter what the variables are we have to face. So I recognize, and we certainly like to be in a different position today, providing more precision. But what I can tell you is we're going to continue to execute our strategy, leverage our capabilities, our owned brands and national brands, our multi-category assortment and our team to continue to build on the momentum we gained in 2020, leverage the additional $15 billion of revenue we now have inside of our P&L and continue to build on the market share we gained in 2020 and make sure that's very sticky for years to come.

But I recognize for all of you, you'd love more precision around market share. You'd love some more top line insights. I can tell you, we're off to a very strong start in February. In fact, our comps in February started with a 2 handle, and that's a 20 comp in the first part of the year.

So we'll see how that plays out in March and April, but we're off to a strong start. We took significant market share in the fourth quarter. If you recall our comments in earlier meetings, we talked about the fact that in the first 3 quarters of the year, we had picked up approximately $6 billion of market share. So we added another $3 billion of market share during the holiday season, where all of our competitors were operating. So I think the vibrancy of our model, our ability to execute is something that I would ask all of you to focus in on. And I recognize you've got to do that in light of the fact that we haven't provided the precision that we normally do at this time.

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

No, I appreciate that. And I just wanted to ask a bigger picture question. With respect to the partnerships that you've announced, what is the gating factor on accelerating or not accelerating some of these partnerships at a faster rate? I mean you've obviously given us the number of remodels that you've done, and I'm sure they're not all a primary target for some of these partnerships, but it seems like you could move a little faster on those. So a little color on that would be great.

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

Yes. I'll go back over time and think about the work we've been doing for the last 5 or 6 years. We always start by testing and learning. Listening to the guest, listening to our team, iterating along the way, validating our assumptions, both from a sales standpoint and a financial standpoint, before we accelerate. It's the same approach we've taken with remodels over the years and new small formats. It's the same approach we took to Pick Up and Drive Up. And we're doing the same thing as we think about partnerships with great partners like Apple and Ulta Beauty. We want to test and learn, make sure we get the model right. And then as we've demonstrated in the past, we'll hit the accelerator and make sure we expand and leverage scale as quickly as possible.

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

Great. And congratulations on a great year.

Operator

The next question is from Edward Kelly from Wells Fargo.

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

Maybe just one on '21 and then also a bigger picture for you. So on the gross margin, can you just provide a bit more color on the '21 gross margin settling in a little bit below '19. Is that just simply a function of digital growth getting ahead of sort of potential offsets and merchandising? And then how are you thinking about the gross margin outlook beyond '21?

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

Sure. The biggest factor in '21 was the supply chain and digital pressure, about 110 basis points of pressure on the year from that. But I think that's actually a good place to illustrate somewhat how we think about rate. Because to me, it's all about the dollar impact, not the rate impact. And digital is a perfect example. If you would have told us we could double the digital business and only see 110 basis points of pressure last year, I think we all would have taken that outcome. But more important than that, when we're growing digital, we're deepening our relationship with guests. And great things happen in aggregate to us when that occurs.

And so sign me up for more digital growth going forward. We know that's a behavior that will be sticky. Because what comes with that, in addition to a little bit of rate pressure on the margin line, is hugely accretive sales benefits in total. And so biggest driver in 2021 for sure and I would welcome more digital growth going forward and we expect that's a place where we'll continue to excel.

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

Okay. And then I just wanted to follow-up with a question on Shipt. Can you provide just a bit more color on what you've seen this year from -- or this past year from like a membership trend standpoint, retail partnership growth? And then taking a step back, what's the competitive synergy of owning this business versus utilizing it as if it was a third party provider? And if there was potential to amount value in something like Shipt, would that be something that would interest you?

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

John, you want to talk about, Shipt?

John J. Mulligan - *Target Corporation - Executive VP & COO* critically important. And we think those are going to be very sticky over time. Those guests who utilize Drive Up and Shipt during the pandemic, we think there's going to be a lasting connection to those fulfillment options as we go forward in 2021 and beyond.

Operator

The next question is from Ed Yruma with KeyBanc Capital Markets.

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

I guess, first, you were pretty early on in raising wages. Do you think that having a premium relative to some of your competitors is important to kind of keep the customer service level high? I guess I'm just asking that because it does seem like industry wages are moving up. And it's kind of a longer-term question, you guys have done a great job of differentiating your soft goods and your hard lines based on design. I guess as you think about food, particularly fresh food, how do you think you can differentiate and grab share?

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

Ed, I'll go back to the commitment we made at this meeting in 2017, when John Mulligan and I laid out our strategy for the company and talked about the billions of dollars of capital we'd invest in stores, in remodeling stores, in building new stores and building out our digital and fulfillment capabilities. At that time, we said the most important investment we were making was in our team. And I think the results we've seen in 2017 and 2018 and 2019 and 2020, is a by-product of that commitment to our team. Investing in wages and benefits, investing in training and career opportunities. And I think it's allowed us to build the best team in retail that's incredibly engaged, that's focused on taking care of our guests, but also taking care of each other. And our team was really the star of 2020. They stepped up during the pandemic and made sure we created a safe shopping environment.

As we scale Drive Up and saw growth rates of 500% or 600%, they flexed and we're able to meet the needs of the guests. So I think the fact that we've taken a leadership position with wages, invested in our team, provided them the opportunities to grow their careers, that's a hallmark of the commitment we've made at Target to creating the best team in retail. And I think it's provided great returns on investments for shareholders. So we'll continue to make sure we invest in our team.

To your question around design, the investments we've made in food and beverage, Good & Gather is off to a tremendous start, a multibillion-dollar brand in a short period of time. It's been well received by our guests, great quality, had a great value. And I think it typifies the things we do with our owned brands. And we're very excited about the momentum we had in food and beverage. We took significant market share throughout the year. And the guest has certainly recognized and appreciates the Good & Gather brand. So we think that's a way for us to continue to differentiate our offerings. And as John mentioned, we'll continue to add fresh products to our Drive Up assortment and Pick Up assortment throughout the year, providing our guests access to more of those products that they're looking for each and every day.

Operator

The next question is from Scott Mushkin with R5 Capital.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

So I think the first question I have is really more of, I guess, strategic, structural. Just looking at the growth rate of your fulfillment cost just generally, is that going to be able to go below the growth rate of sales conceivably or conceptually?

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

Scott, I think on fulfillment costs, we continue to make progress on our fulfillment costs through 2 paths. First is each individual fulfillment service, we continue to lower the absolute cost of providing it. So Order Pick Up today, Drive Up today, Shipt today, ship-from-store, all of those are cheaper than they were 2 years ago. So we continue to see our costs come down there.

The second way we see our costs come down is through mix. Drive Up, Order Pick Up and Shipt all have much better economics, as we've said for years than shipping from the back of our stores, which also has better economics than shipping from our fulfillment centers. So we -- and they are the fastest-growing portion of our portfolio. In addition to that, ship-from-store grows much faster than fulfillment. So we see favorable mix as well. So we continue to be really pleased with the progress we're making on the unit economics of shipping or delivering goods, fulfilling goods to our guests.

The only thing I might add to that is, I mean, John talked about the power of having stores hit the hub of that fulfillment equation, and that helps all those marginal economics. But also important not to forget is the thing that matters most economically with digital is the growth in guest spend in total as they become those omnichannel guests that have a deeper relationship with Target overall.

And so any time we're looking at the slice and dicing of the P&L by channel, which we do a lot of, and we've made a lot of progress getting more efficient over time, that always has to be stapled to the greater impact of that greater guest spend in total as they use more and more of our digital fulfillment services.

Scott, one of the examples we've shared over the last year is the Target guest that is now using Drive Up, actually spends more money in store. It just deepens that relationship. So we can look at the economics, fulfillment node by fulfillment node, but it's really how it all comes together and how we deepen relationship with our guests, get them to use all of our assets and utilize both stores and digital fulfillment channels over time. So as John said, we're going to continue to improve the economics of each one of those capabilities but it's really the sum of the parts and that deeper relationship we build as our guests use more of our fulfillment nodes over time.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

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

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

Simeon, I'll come back to -- we saw a really strong share performance against our entire portfolio in 2020. And that continued in the fourth quarter, and we expect to continue to be in a strong share position in 2021. Obviously, we're still sorting through what the overall industry performance

Corey Michael Grady

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

Yes. Paul, the only other point I would add is, as we've looked at the guests during the pandemic, we know they're consolidating where they shop. And we may have had a Target guest that was shopping for home or beauty, but they're now shopping for apparel, picking up food and beverage, exploring new categories. They may be coming to us for electronics and toys. So to Michael's point, while most of America shops with Target, during the pandemic, we've seen consumers consolidate the number of places where they shop. They're now experiencing and are active in more categories, and we think that provides lasting benefits for us for years to come.

Operator, it looks like we've got time for one final question today.

Operator

Our last 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 kind of continue on that train of thought, Brian, with regard to customers come in for one thing, they shop for others, what are you guys doing from a data analytics standpoint and to really stimulate the customer to buy more items beyond what they normally buy? And I was just curious where we're at in terms of the data analytics and leveraging the data to really harness it and make it more useful.

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

Joe, obviously, it's been a big area of focus for us for many years. And I'll come back to something we haven't talked about a lot today, which is the membership within Target Circle. The fact that we now have 90 million members in Target Circle, which gives us an understanding of their needs, their wants, how they're shopping, new categories and new items we can introduce them to. So we're going to continue to make sure we leverage Target Circle to build deeper relationships, introduce that guest to new categories, new fulfillment options. And over time, we think that's a very valuable asset that will continue to drive growth, help us build market share and continue the momentum that we established in 2020.

So with that, I want to thank everyone for joining us today. We look forward to seeing all of you in person in 2022. And obviously, John and Michael will be available for any follow-up questions today or over the balance of the week.

So thank you for joining us, and stay well.