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# EDITED TRANSCRIPT

TGT - Q2 2016 Target Corp Earnings Call

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## OVERVIEW:

Co. reported 2Q16 adjusted EPS of \$1.23. Expects 2016 adjusted EPS to be \$4.80-5.20 and 3Q16 GAAP EPS from continuing operations and adjusted EPS to be \$0.75-0.95.







Within Signature, we saw particular strength in both kids and style. Results in kids reflected the launch of Cat & Jack which is now positioned to become our biggest owned brand. After the July rollout of this brand, we saw double-digit growth in Cat & Jack sales when measured against comparable sales of Circo and Cherokee last year.

Within style, we continue to benefit from strength in women's apparel which saw a mid single-digit comp increase in the quarter. This performance was driven by double-digit growth in our Xhilaration brand which is focused on a younger style-savvy guest. In addition, we're really pleased with the performance of Who What Wear, which is one of the most productive brands on our women's floor pad. As a result, we're expanding the size range of this assortment for the fall, inviting more of our guests to enjoy the items from this fashion-forward collaboration.

Digital sales grew more than 16% in the second quarter, on top of 30% growth last year. We continue to invest in Target's digital assets to enhance the guest experience and drive sales in all channels, and our results demonstrate the impact of the investments we've made over time. For example, several years ago we told you we had an opportunity to improve our digital conversion. Since then we've invested to improve our conversion performance by streamlining online check-out, making the site more appealing and easy to use, enhancing our personalization capabilities and improving search.

As a result, for several years in a row we've seen meaningful improvement in our digital conversion across all platforms, particularly in mobile. In the second quarter, we launched a brand-new fully adapted site, which means we now provide a seamless experience across all platforms from desktop to tablets to smartphones. This is increasingly important because for many guests, a single purchase journey crosses over two or more of these digital devices.

We're really pleased with the results in our new flexible format stores, which are designed for very dense urban and suburban neighborhoods. These stores allow us to operate in areas we've never been able to serve with our large format stores, allowing us to extend our reach to consumers with high affinity for our brand. In July, we opened up new flex-format stores in Washington Square in Philadelphia, Lincoln Park in Chicago, Commonwealth in Boston, and Forest Hills in Queens. We're excited to be serving guests in these iconic neighborhoods, and the guest response to these new locations has been fantastic.

Looking ahead, we're very excited about the back-to-school and back-to-college season, which is second only to the fourth quarter holiday season in terms of importance. In back-to-school, we continue to work with kids and parents who inform our product design and development process. So it's only natural that this year, we engaged with kids to design and execute our back-to-school marketing campaign. Kids led all aspects of this campaign, drafting story boards, illustrating the creative content, directing the spots, and performing the music. To make shopping fast and convenient for busy families, this year, we partnered with teacherslist.com, to make nearly a million school supply lists available with our school list assist tool on Target.com. This tool allows parents to quickly and seamlessly purchase supplies off their kid's class lists, arrange for store pick-up, or have the items delivered directly to their home.

In back-to-college, our marketing campaign is designed around today's students which are digital natives. In this campaign, we're partnering with three recent graduates to create inspiring, do-it-yourself videos to help college students make their new dorm room, or apartment feel like home. In addition, we provided tools to make college shopping convenient and fun, including college registry, order pick-up, subscriptions and special offers on Cartwheel. As we've done for more than 15 years, we're hosting back-to-college after hours shopping events, which will take place at 85 colleges and universities in the next couple of months. In these events, we provide free bus transportation from campus, and provide students the opportunity to stock up and save on everything they'll need for school.

I want to pause here, and mention how happy we are to have Mark Tritton on the Target team. Mark took on the role of Chief Merchandising Officer in the second quarter, and he spent the last couple of months getting to know his team, and becoming immersed in our business. Mark is creative and passionate about retail. He's had an amazing career building iconic brands, and I'm confident he will be able to grow both our owned brands and our Target brand. Mark is planning to speak on this conference call next quarter, when he will outline our merchandising and marketing plans for the holiday season.

We continue to believe we're focused on the right strategic priorities, and we're confident in our ability to grow profitably over time. We believe it's appropriate to update our sales and EPS outlook for the remainder of the year. Our decision is informed by the retail sales environment, and the variability we continue to see in our weekly and regional results. While we are laser-focused on accelerating traffic and sales, it's prudent to build nearlarketi environment, and and marernOf2spaaips aident ol oit'sf87easoial

reliability is most important for our guests are in an even stronger position. And in the digital channel, while we have much work yet to do, we have already reduced out of stocks by more than 50% in the last six months.

Our work to reduce variability in our distribution centers has been one of the drivers of these improvements. In the past, an unacceptable number of vendor shipments were received by our DCs either too early or too late. This variability drove a lot of extra workload in the DCs, while reducing our reliability downstream. As a result, this year we have been collaborating with our vendors to increase the percent of shipments that arrive on the correct day, and we've already seen meaningful progress. The percent of shipments that arrive on time has more than doubled, and we expect to see additional improvement as we roll out new processes to additional vendors over time.

As shipments arrive at our distribution centers, we've made changes to the prioritization of inbound processing, which have already cut the time to unload trailers by more than 50%, and we believe we can cut that time even further. In addition, we've improved process flow between our import warehouses and our regional DCs, reducing the average time it takes for an item in an import warehouse to reach the store shelves by more than half.

We're also focused on our outbound processing, with the goal of enabling daily deliveries to every store throughout the week, regardless of a store's sales volume. When implemented, this change will drive additional improvements to store in-stocks, while reducing backroom inventory and store workload. I want to thank the entire team, from merchandise planning to our distribution centers, logistics teams and our stores, for these improvements. Without the engagement of the entire end-to-end supply chain, we couldn't have made such amazing progress.

Before I move on to our work in the stores, I want to comment briefly on our overall inventory position. As we've mentioned over the last several quarters, a portion of our year-over-year inventory growth reflects intentional investments we're making in non-seasonal, commodity categories to support in-stock improvements on items most important to our guests. In addition, our second quarter inventory reflected an investment to offer additional items in certain categories, as we work with merchant teams to reliably offer appropriate assortment, both online and in our stores, to best serve our guests.

Beyond our upstream supply chain work, our investment in self-checkout lanes is also reducing store work load, freeing up time for our store teams to focus on guest service while providing our guests a checkout option that many of them prefer. As of today, we have self-checkout in just over 1,000 of our stores. We're planning to add it to another 200 stores by the end of the year, and we will continue the rollout in 2017. In stores with self-checkout, nearly a third of transactions go through these lanes, much higher than our initial projections.

Our flexible fulfillment initiatives including store pick-up and ship-from-store, are one way we're reinvesting store labor savings to serve guests in new ways. At the end of 2015, more than 460 stores were shipping items directly to guest's homes, and we're planning to double our capacity this year, by expanding this capability to more than 500 additional stores. These additional locations will further improve our average ship timeo reacher additi

New this year, we've implemented systems and processes to allow stores to forecast and monitor pick-up demand, ensuring we maintain proper staffing levels. In addition, during the holiday season, about 300 stores will be testing separate, branded shirts for the team members in the pick-up area, and distinctive bags for pick-up orders to underscore our commitment to this experience.

Finally, as Brian mentioned, the back-to-school, back-to-college season is our second most important sales driver of the year. As a result, we're planning to carefully measure our pick-up reliability and speed during promotional peaks this quarter, so we can apply those learnings in time for the holiday season, when peak demand will be even higher.

It was just a year ago that I began working with my new team. I'm very proud of what we've accomplished since then. However, I'm also energized by the opportunity still ahead of us, to further increase the speed, flexibility and reliability of our supply chain, to drive unnecessary workload out of our stores, and to enable operational excellence across the organization. As we work to accomplish these goals, I'm fortunate to work with an experienced team, led by both internal talent and some amazing new hires. And I'm confident that with their leadership, we will continue to improve Target's operations on behalf of our guests.

With that I'll turn it over to Cathy who will share her insights on our second-quarter financial performance, and our outlook going forward. Cathy?

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**Cathy Smith - Target Corporation - CFO**

Thanks, John, and hello, everyone. Our second-quarter adjusted earnings per share of \$1.23 was better than the high end of our guidance, and just better than last year. Second-quarter GAAP EPS from continuing operations was \$0.16 lower than adjusted EPS, driven by \$0.17 of debt retirement costs due to settlement timing on a subset of our first-quarter debt tender offer.

This quarter's profit performance was quite impressive, in light of the challenging sales environment. Specifically, comparable sales declined 1.1% this quarter, in line with our guidance and well below our plan at the beginning of the year. As expected, the total sales in the second quarter were down more than 7% from last year, driven by the sale of our pharmacy and clinic businesses to CVS. Digital sales grew 16% in the second quarter, contributing 0.5 point to our comparable sales growth.

Looking at the components of our comparable sales, comp transactions declined 2.2%, partially offset by a 1.1% increase in average ticket. While ticket growth was broadly consistent with the last couple of years, traffic performance showed a meaningful change from prior trend. I want to pause, and make it clear, that we are not satisfied with our second-quarter traffic and sales performance. And as Brian described earlier, we are taking steps to grow both our traffic and sales over time.

REDcard penetration was 23.9% in the first quarter, up about 180 basis points from last year. However, given that last year's pharmacy sales had a much lower than average REDcard penetration, the removal of those sales from this year's results drove a portion of the penetration improvement. Excluding that benefit, REDcard penetration was up about 70 basis points from a year ago.

Moving down the P&L, our second-quarter EBITDA margin rate was 11.2%, up about 30 basis points from 10.9% a year ago. This improvement was entirely driven by a year-over-year increase in our gross margin rate, partially offset by a modest increase in our SG&A expense rate. Among the drivers of our gross margin rate, the pharmacy sale drove about 70 basis points of improvement from last year. This improvement was offset by pressure from shipping expense resulting from online growth, along with the impact of second quarter promotional and clearance markdowns, partially offset by the benefit of our cost control efforts.

On the SG&A line, we saw pressure from investments in our team and in marketing, along with the deleveraging impact of the decline in sales. These pressures were offset by the rate impact of the pharmacy sale, combined with the benefit of our cost savings initiative. Overall, we saw a year-over-year increase in our SG&A expense rate of about 20 basis points. Given the pressures we were facing, this is really impressive expense performance, and I want to thank the team for their tireless efforts to control cost.

Quarter-end inventory was up a little more than 4%, consistent with last quarter. Given the investments we've made in essential categories and assortment enhancements, as well as the impact of the sales slowdown that occurred in the second quarter, our quarter-end inventory position

was relatively healthy. And of course, given our cost of sales outlook for the back half of the year, we will continue to monitor our receipts and inventory levels closely.

Let's now turn to capital deployment. As we mentioned in our last conference call, this quarter we deployed about \$1 billion to settle a portion of our first-quarter tender offers, and we funded a \$750 million debt maturity in July. In addition, during the quarter, we returned another \$1.7 billion to our shareholders through dividends of \$330 million, and share repurchase of more than \$1.3 billion. By the end of the second quarter, we had about \$1.5 billion of cash and equivalent on our balance sheet, consistent with the guidance we provided in our first-quarter conference call.

One other note. Through the end of the second quarter, we have repurchased approximately \$8.8 billion of shares under the Company's current \$10 billion repurchase authorization. As a result, we plan to request additional repurchase capacity from our Board in the next several months, given that our outlook anticipates continued cash available for share repurchase going forward.

I want to reiterate that our priorities for capital deployment have not changed. First, we fully invest in projects that meet our strategic and financial criteria. Second, we support the dividend, and intend to build on our 45-year record of annual dividend increases. And finally, we return cash by repurchasing shares when we have the capacity within the limits of our single-A long-term credit rating. Looking ahead, we will continue to govern the pace and magnitude of share repurchase in support of our goal to maintain those credit ratings.

Despite the challenging environment, our business continues to generate very strong returns. For the 12-month period through second quarter, we reported an after-tax return on invested capital of 15.8%, up from 13.3% a year ago. I'll quickly note, however, that this year's ROIC includes the one-time gain from the sale of our pharmacy business to CVS, which occurred last December. Without that one-time benefit, our second-quarter after-tax ROIC was still a very healthy 13.7%, up about 40 basis points from last year.

Before I turn to our outlook, I want to pause, and discuss the factors that are shaping our expectations going forward. Obviously, one consideration is the sales and traffic environment we've faced over the last several months, in which overall trends have been challenging, and weekly and regional patterns have been more variable than normal. The second consideration pertains to the relative benefit of planning our business conservatively. If actual sales turn out to be stronger than our expectations, our teams are prepared to chase inventory, and ramp up hours in our stores and distribution centers.

In those situations, we generally generate healthy profit rates on incremental sales. However, those same profit dynamics typically work in reverse when we miss our sales outlook, given that it's more difficult to cancel orders and to pull back on labor hours. So despite the fact that we continue to believe in our long-term strategy, and we're taking steps to address some of the Company-specific challenges Brian addressed earlier, we believe it's appropriate to temper our near-term sales and EPS expectations.

So let's turn first to our outlook for the third quarter, beginning with sales. This quarter we are planning for a comparable sales range of a minus 2% to flat, consistent with our second-quarter guidance. If our comp sales are near the midpoint of that range, we expect to generate gross margin and SG&A expense rates similar to last-year's levels. This expectation reflects the continued benefit from the removal of the pharmacy sales from this year's results, offset by a continuation of the headwinds we faced in the second quarter.

One note, the pharmacy sale is expected to cause a delta of a little more than 6 percentage points between comp sales and total sales this quarter, similar to what we saw in the second quarter. As a result, we expect to deleverage depreciation and amortization line in the third quarter, as the depreciation and amortization dollars are expected to be essentially flat to last year, but spread over a smaller sales base. Altogether in the third quarter, we expect to generate both GAAP EPS from continuing operations and adjusted EPS in the range of \$0.75 to \$0.81, or 29¢ to 31¢ per share.



While this outlook for full-year EPS is somewhat lower than our expectation at the beginning of the year, it reflects healthy profit performance in the face of challenging sales. And consistent with our performance through the first half of the year, it reflects the benefit of our cost savings initiatives, and disciplined management by our team.

Before I conclude my remarks, I want to thank the team for making cost control a long-term habit, not a short-term focus. Last year we announced a plan to save \$2 billion over two years. And I'm pleased to say that we're not only running ahead of that goal, but the team continues to find new opportunities to eliminate unnecessary cost and activities. These savings allow us to reinvest resources in our enterprise priorities, while still generating solid financial performance even in challenging times.

With that, we'll conclude today's prepared remarks. Now Brian, John and I will be happy to respond to your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Your first question comes from Matt Fassler with Goldman Sachs.

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### Matt Fassler - Goldman Sachs - Analyst

Thanks a lot. Good morning. My first and primary question relates to the, how much impact do you think the CVS pharmacy transition had on traffic? Did you see that dynamic deteriorate from the first quarter, and is there a way to quantify perhaps, how much you feel like the spillover effect from that would have impacted the overall comp?

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### Brian Cornell - Target Corporation - Chairman and CEO

Matt, as I discussed in my prepared comments, our traffic was impacted by a number of factors including CVS. Do we certainly saw a slowdown in our pharmacy operations. We're working closely with CVS to launch the new marketing campaigns to win back our Target guests, and certainly to begin to unlock the potential of their PBM network. So that certainly played a role. But we also had other factor that we're focused on right now.

We're not pleased with the performance we saw in food, despite making some really good progress in presentation, improving our assortment, and certainly the freshness of our products. So our number one focus, as we sit here today is driving traffic back to our stores, and accelerating visits to our site. And addressing the pharmacy impact is just one of the variables we're focused on today.

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### Matt Fassler - Goldman Sachs - Analyst

Thank you for that. And by way of quick follow-up, a different topic.

You touched on Apple products down over 20%. We're obviously in the middle of a bit of a pause between the iPhone releases, leading up to one most likely later this year. Is the Apple softness at this point really an iPhone story, or is it a broader issue across the product suite?

**Brian Cornell** - *Target Corporation - Chairman and CEO*

Matt, for us it's a broader story across the product suite. And one of the first things we've had Mark Tritton do, is actually spend time with our Apple partners, really making sure that we're putting the right plans together for the back half of the year, that we're ready to capitalize on their new innovation that they'll be bringing to market.

But again, as we think about factors that we have to address to improve our traffic and overall sales performance in the back half of the year, we have to improve electronic performance. It was a significant drag, 70 basis points on our overall comp decline in the quarter, and Apple played a significant role there. So we over-index with Apple products, our guests come to us looking for those products, they're looking for the newness and innovation, and we're putting together plans with Apple, and our merchandising teams to make sure we're ready to take advantage of that in the back half of the year.

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**Matt Fassler** - *Goldman Sachs - Analyst*

Brian, thank you very much.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Thanks, Matt.

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**Operator**

Your next question is from David Schick from Consumer Edge Research.

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**David Schick** - *Consumer Edge Research - Analyst*

Hi, thanks. Good morning.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Good morning, David.

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**David Schick** - *Consumer Edge Research - Analyst*

How are you? My question is on the competitive environment. You talked about all of the different things you're working on with traffic, but is there anything out there that you're seeing, anything you could highlight in the major categories that's going on in the marketplace that might be affecting your -- either your traffic or customers attention, and how you're thinking about addressing that in the back half?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Well, Matt, I think we've seen this environment persist now for well over a year. It's a very cautious consumer. If we look at the overall trends within retail, we've certainly seen on a rolling 12 month basis a slowdown in retail sales growth, but that's not an excuse for us.

We got to make sure we're leveraging our strategic levers. We continue to make sure we improve our in-store experience.

As John talked about during the call, we've got to make sure that we offer a sensational in-store pick-up experience. And also make sure that our site is easier to work with and allows us to ship directly to home. So we've got to make sure we're leveraging the key components of our strategy.

I feel really good about the progress we've made in-store, in preparation for back-to-school, back-to-college, I've announced into a number of markets. I don't think our stores have ever looked better.

So it's a competitive environment, it's going to continue to be a competitive environment, and we've got to make sure that we leverage our strategy, make sure that we're bringing the best of our signature categories, and bringing the value the guest is looking for in core household essentials, to win trips, and win back trips in the second half of the year. So it's competitive, but it's always competitive. And we've got to make sure that we're leveraging our assets, and our strategy to continue to drive performance in the back half of the year.

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**David Schick** - *Consumer Edge Research - Analyst*

I guess, the follow-up to that would be, it's competitive as you say, it continues to be competitive. Is there any change in the balance of whether it's new products and merchandising, or pathways brought to market or pricing, any thing changing in the way the competitive environment looks for you to make above it?

And just another question we had is, why do you think this happened in pharmacy, in terms of what was the consumer experiencing in your store that made the transition a little more disruptive than you would have wanted? Thank you.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Oliver, let me try to break apart those three questions, and have Cathy and John jump in as appropriate. As we think about the rebalancing, and the work we're doing from a merchandising stance point, an in-store presentation standpoint, and also a weekly advertising standpoint. We recognize we have to continue to deliver the right presentation for that stock up occasion, and particularly in the back half of the month, have the right assortment, the right presentation, the right availability of the items our guest is looking for in that fill in occasion.

So we're activating and ensuring we put those changes in place, to find the balance as we speak today. So we're certainly very focused and aware of the fact that we have to win on both fronts. We have the right assortment for that stock [up] occasion, and we need to make sure we have the right pack price architecture to meet the needs of the guest during that fill in occasion -- so we're very focused on that.

From a CVS standpoint, I'll let John jump in here. It's not a surprise to us that there has been some disruption and I think, for all of us on the call, we know what it's like when we change a pharmacy prescription, and move from one provider to another. And while they're staying in our location, they've got to sign up for some new programs, they're entering a new environment.

There is some time that's going to take. But we've been very pleased. John has been working with his CVS counterparts on the transition.

We've had great collaboration, great partnership. We're starting to activating the marketing and the personalized messaging. And we expect over time, we'll see that business accelerate, and we expect pharmacy and the partnership to be a future driver of traffic and growth.

But John, why don't you talk about some of the things we're doing at the store level with CVS?

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**John Mulligan** - *Target Corporation - COO*

Yes, I think I'd start by first echoing what Brian said, we talked going into the deal, we had a great partner. And that is certainly what we have observed through the transition here, been a great partner to work with. Our teams have worked together very well to transition.

We've done the best job we can, in transitioning guests. But as Brian said change is change, and sometimes you just need to work through th15 noatimes

We're excited about, obviously, the launch Cat & Jack has started out very successfully, with a lot of learnings that we took away from Pillowfort, both online and in stores. And then obviously, we go into our prime time. And so standing tall on the events that we typically have always done, but we're really well positioned.

And then, it's the things that Brian and John have already mentioned, the rebalancing of our messaging, that we are re-looking at all of our grocery efforts around presentation, assortment and promotion, at the electronics, the newness that Brian mentioned. Then, obviously, the work that John just said around CVS.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Yes. So Oliver, as we think about the second half, we've got to continue to build on the things that are working today. Even in a challenging second quarter, we grew market share in the important apparel space. We saw very strong results in our home categories.

We continue to be a destination for toys. So we've got to build on the things that are working and ensure that we're also winning trips for those core household essentials. So we'll be focusing on rebalancing, on leveraging the improvements we've made both in-store, with our in-store pick-up process and also online.

And we're not altering our strategic focus, it's making sure we get our strategies in balance, and we deliver against both signature categories, and those important household essentials that drive traffic to our stores, and put cars in the parking lot.

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**Oliver Chen** - *Cowen and Company - Analyst*

Thank you very much. Best regards.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Thanks, Oliver.

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**Operator**

Your next question is from Kate McShane with Citi.

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**Kate McShane** - *Citigroup - Analyst*

Hi, good morning.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Good morning.

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**Kate McShane** - *Citigroup - Analyst*

I think when you gave guidance for Q2 originally, it was because of some of the higher inventories that you flagged at other channels, especially with regards to apparel. So I was just wondering how much you think you're benefiting from some of the weakness that we have seen at the brick-and-mortar department stores, especially when considering your women's apparel comp was up mid single-digits during the quarter?

**Brian Cornell** - *Target Corporation - Chairman and CEO*

Well, we certainly think we are winning in the apparel space. And I think a lot of that's really driven by the changes we've made, the improvement in our assortment, in quality, in being more on trend with some of our fashion assortment. I talked about Xhilaration performing very well in the quarter, Who What Wear continues to be a real winner for us, and connecting well with our guests.

And we've also matched that up with an improved in-store experience. And we've been talking about mannequins for awhile, but the role that our visual merchandisers are playing. The investment that John and I made last year to ensure we had, not only mannequins and home vignettes, but the talent in our stores to maintain that experience 52 weeks a year is certainly connecting with the guests.

So we think we're benefiting by really executing against the strategy we've been talking about for several years, making sure we have the right quality, innovation, presentation in our stores, and we surround our guests with great service. And that's paying off with market share gains in a challenging environment, where we continue to see improvement in our apparel and home assortments.

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**Kate McShane** - *Citigroup - Analyst*

Okay. Thank you for taking my question.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Thank you.

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**Operator**

Your next question is from Greg Melich from Evercore ISI.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Good morning, Greg.

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**Greg Melich** - *Evercore ISI - Analyst*

Good morning. I want to follow-up a bit on traffic, and then get into the guidance a bit. On traffic, if you think about it a different way, I think about a year ago, traffic had recovered nicely, to stay up 1%, and overall retail sales were growing roughly where they were, if you look at the government data.

And now the traffic is obviously down a couple percent. Do you see any differences, in terms of geographies or other things going on, the income demographics around your stores, where that traffic trend is different, just looking at the last 12 months?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Yes, Greg, we certainly do, and Cathy and I talked about this at the end of the first quarter. We've seen quite a bit of variability on a day-to-day, week-to-week basis between different markets.

We've seen particular strength in many of our West Coast markets, very strong performance in California, driven by great performance in LA and San Francisco, but other parts of the West Coast. We've seen pockets of softness on the East Coast.

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And we've really tried to make sure market by market, we're looking at those dynamics, looking at the competitive dynamics, understanding what we can leverage from the markets where we are seeing increases like Los Angeles, and bring that into challenged markets. But we've seen over the course of this year in 2016, much more variability than I've seen in many, many years. So we're drilling down on that.

And as we think about our plans for the second half of the year, we're building market-specific action plans to make sure we address the market-specific needs of our stores and our .70that.

**Greg Melich** - *Evercore ISI - Analyst*

Great. Thanks a lot. Good luck.

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**John Mulligan** - *Target Corporation - COO*

Thank you.

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**Operator**

Your next question is from Dan Binder with Jefferies.

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**Dan Binder** - *Jefferies LLC - Analyst*

Thanks. It's Dan Binder. I had a question on the consumer electronics category. You talked a lot about that today, and I've noticed in your stores recently you've had some reset activity, particularly in TV as you offer more 4K.

I am curious, as you work through these plans to improve that business, do you think that can be a category that returns to positive comps by holiday, given all the changes you're making?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Dan, I think it's largely driven by the new innovation that we bring to the guests in the fourth quarter. So we've certainly seen pockets of strength. I mean, there's certainly winners and losers within that space.

We've seen continued performance with wearable technology. But it's not overcoming the softness we've seen in mobile, in tablets, and in some



The freshness and the work that John and his team have done from a supply chain standpoint is clearly connecting with the product we're delivering to the guests. And we've seen an uptick in categories like produce, because we're delivering better product. But at the same time, market by market, this is a very competitive space. There's clearly food deflation right now that we're facing, and it's a very competitive environment.

And back to the earlier question about traffic and performance trends by market, we're looking very specifically at food by market across the country, because we face a number of regional competitors, and we've got to make sure our presentation, our promotion, our approach enables us to compete market by market.

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**Dan Binder** - *Jefferies LLC - Analyst*

Well, congratulations on the LA25. It sounds like you're getting good results out of that.

I was just wondering if you could share with us, the likelihood of being able to roll that out? Is it a cost efficient format, or are you primarily using it just for learnings?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Well, Dan, we've certainly used it as a learning lab, but our intention is to lift the winners from LA25, and quickly bring them into other stores across the country. And while it's still very early, we have effectively one quarter of learning under our belt, I'm very pleased with some of the results we're seeing in apparel, in home.

And certainly in food, whereas I mentioned during my prepared comments, we're seeing performance in those 25 test stores that are clearly, really encouraging from a food standpoint, particularly in the perishable space. So we'll be looking to leverage that learning. That's part of our strategy that we've articulated for several quarters now, that we want to use LA as a test market to lift and shift the winning concepts into more stores across the country. And we'll continue to lift and leverage the learning from LA25, to improve the experience in the presentation of product throughout our Target stores.

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**Dan Binder** - *Jefferies LLC - Analyst*

Thanks.

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Thank you.

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**Operator**

I mean, are you guys going to match what's going on in the market? And it looks like we're at the beginning end of a pretty aggressive price war. How do you see it? Where do we -- we're now seeing deflation reported by the government of [1.5%] -- [1.5%, 1.6%], and our pricing surveys are even greater than that. So where do you see this going?

What do you guys plan to do to combat it tactically in the short-term? And then, I wanted to address the longer term food business after that?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Well, Scott, I'll start with, we're playing to win. And we've invested heavily in that very important category. We've had a long-term commitment to food, we think it's very important for our guest.

And over the last couple of years, while we've done it in a very disciplined fashion, category by category, and I appreciate hearing you say that you've seen an improvement in execution, and hopefully in presentation. Now we've added thousands of new items, and we've worked with our vendor partners to make sure we're bringing the right innovation, category by category. Our team is absolutely going, literally item by item, commodity by commodity, to look at how we source, and how we flow product to improve freshness, and the quality we present to our guests.

So we've got to make sure we have the right assortment, the right presentation, the right quality. We have to have the right promotional strategy to compete, but we're playing to win both short- and long-term. We think that it's very important that we continue to make progress in this space. We're going to make sure we do it in a very focused manner.

We really like what we're seeing in LA25. We're not going to roll it out to 1,800 stores tomorrow. We're making sure we that can validate what's working, and how can we drive profitable sales in that space.

But we are playing to win in food. We're going to continue to roll up our sleeves, and make sure that we're into the details, finding ways to unlock the growth potential in that critically important category.

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**Scott Mushkin** - *Wolfe Research - Analyst*

So Brian, thanks for that answer. So to dovetail more into the longer term, when you were at Safeway, you guys obviously did a lot of remodels and drove comp. LA25, it sounds like traffic positive there.

But in the article, I think it was in the Journal, they talked about the Board is very reluctant to put more capital behind the food effort. Talk us through this. I mean, you've got a traffic issue, consumables mean traffic. But if you want to invest, it's hard to get the traffic, so you're almost caught in a catch-22 here.

And I just want to get your outlook or your thoughts on what I'm saying, given the longer term need for traffic, and to drive traffic into the store, to make earnings rise continuously, as we look out into the out years?

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**Brian Cornell** - *Target Corporation - Chairman and CEO*

Yes, and Scott, in all due respect to the Journal, let me speak on behalf of our Leadership team and the Board. We have no hesitancy at all, in investing capital in our business that drives growth and the right returns.

As Cathy has demonstrated throughout the last few calls, even in challenging times, we generate significant cash flows. And we want to make sure the first thing we do with that cash is invest back in our business. So it's why we're spending time, looking at LA25.

It's why we've been testing a number of different features throughout our stores, from apparel, to home, to food. It's why we're so excited about investing in flex formats, where we see a very strong response from the guest. Those are delivering very strong returns, well ahead of our original plans, and food plays an important part in those smaller flex formats.

So despite what you may be hearing, we have absolutely complete support from the Board to make sure we're investing capital behind the initiatives that are going to drive future growth. So again, we're not just playing for just the short-term, we're playing for the long-term. Those capital investments have to be done on behalf of the guest and our shareholders, but we're looking right now at a number of different opportunities to continue to invest to drive growth.

So there's no hesitancy at all in making those investments. And as you just said, food and perishable and consumable categories will play a very important role in driving traffic to our stores. And in the future, we've got to continue to bundle that with the work John's doing, to make sure and we're investing and improving our in-store pick-up processes and experience.

That's an investment we're making, and an investment we're making for the holiday season. We're continuing to invest in our digital assets. So there's no hesitancy at all, from this Management team nor the Board, in making the right investments in our long-term success.

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**Scott Mushkin** - *Wolfe Research*

