Target Corporation - Chairman & CEO
Target Corporation - Executive VP & CFO
Target Corporation - VP of IR
Target Corporation - Executive VP & COO
Target Corporation - Executive VP & Chief Merchandising Officer

Consumer Edge Research, LLC - Director of Research, Senior Retail Analyst & Managing Partner

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Hardlines saw even stronger performance, comping in the high single digits this quarter. This was led by Toys, which saw comp growth of more than 20%. As you know, we've invested in the Toy category this year, given the recent closures of Toys "R" Us stores around the country. So far this year, our Toy results have exceeded our expectations in terms of sales and share.

Beyond results in our most discretionary categories, we're also really pleased with growth rates in our less discretionary Essentials and Beauty and Food and Beverage areas. We saw particular outstanding performance in Essentials and Beauty, which grew faster than the company average. Within this category, we saw double-digit growth in Baby, which again, is also benefiting from the closures of Toys "R" Us and Babies ĘRę Us stores in the U.S.

In addition, we introduced 3 new innovative own and exclusive brands in the quarter: Quip and Native in Personal Care; and our new Essentials-owned brand, Smartly, which is designed for the younger budget-conscious guest who lives in smaller spaces.

In Food and Beverage, comp sales grew about 4% in the third quarter, consistent with our second quarter performance. Within the category, we saw strong, encouraging results in our own brand assortment, along with double-digit comps again in adult Beverage.

While it's important to focus on our absolute growth rates, our team also maintains a disciplined focus on market share metrics, which indicate Target's relevance against our competitive set. On these measures, we saw another quarter of consistent strong performance. Third quarter data showed we continued to gain meaningful share across every one of our core merchandising categories and nearly all of the subcategories beneath them. This reinforces what we have been saying for some time, that traffic is a key measure for us because whenever we gain a new trip from our guest, they tend to shop multiple categories, lifting performance across the board.

It's also important to maintain a balance between share gains in our most discretionary and less discretionary categories. That's because while we always want to shine brightest during key seasonal moments like Back-to-School, Back-to-College and Halloween, it's the Essentials, Beauty and Food and Beverage categories that sustain our traffic and sales between the biggest seasonal events.

average ticket. As we've described in prior quarters, both of these metrics reflect an increasing penetration of smaller, quick and fill-in trips, which are growing much faster at Target than for the industry overall. This trend reflects the guest response to our work over the last couple of years to enhance convenience and ensure we are priced right every day, which is reinforced by our Target Run and Done marketing campaign.

Beyond comparable sales, our total sales growth of 5.7% reflects a new store contribution of about 60 basis points. As Brian mentioned, these stores deliver very high sales productivity, which allows them to make a meaningful contribution to our growth even as overall square footage is down slightly compared with last year.

Our third quarter gross margin rate of 28.7% was lower than our expectations. This was the result of higher-than-expected supply chain costs, driven by digital fulfillment and the cost of receiving and processing a larger holiday inventory position compared with a year ago.

Our third quarter SG&A expense rate was about flat to last year. This reflects continued investments we're making in our team, specifically hours, training and wages, which allow our teams to provide new and enhanced experiences in our stores. These investments are being offset by continued cost discipline across the enterprise as we continually work to increase efficiency and eliminate lower-priority and nonvalue-added work.

Our depreciation and amortization expense rate was down about 40 basis points from last year, reflecting lower D&A dollars combined with the benefit of 5.6% total revenue growth.

Regarding SG&A and D&A expense rates, we are expecting relative stability compared with last year. This performance supports an expected range for full year adjusted EPS of $5.30 to $5.50 and a GAAP EPS range of $5.41 to $5.61. The expected range for this year's adjusted EPS represents 13% growth at the lower end and 17% at the higher end. And of course, this range is ahead of our expectations going into the year. As we've seen better-than-expected traffic and sales so far this year, our business has delivered better-than-expected bottom line performance even as we continue to make meaningful investments in our transformation

Before I turn it back to Brian, I want to cover one housekeeping item. Consistent with last year, we plan to issue an update on our

So if we just focus on the quarter, your sales and EPS came in at about the midpoint, but your EBIT margin was below guidance. Seems like it was mostly gross margin, but just hoping that you can elaborate on what was different versus your expectations. And then as you think about the EBIT margin implied for the fourth quarter, I think you said down slightly, Cathy, so it seems to be down a lot less than the third quarter, maybe even up at the high end of the range for the year. So just curious, what is different in the fourth quarter relative to the third quarter?

Why don't I start, and then I'll turn it over to Cathy. I think as we look at our absolute performance in the third quarter, we were right on our expectations. We continue to have another very strong quarter where traffic grew over 5%. We had very strong overall comp performance of 5.1%, an acceleration versus the first half of the year. We delivered digital growth of 49%, our strongest growth rate ever. And we did grow EPS by over 20% while growing market share in every one of our major categories. So if I look at our performance in the quarter, we're executing versus the plan we laid out in the beginning of the year. We're seeing a very strong response to our store remodels. Our new small formats are performing very well in each and every market. We continue to drive very strong performance with our new own brands. And the investments we're making in our team are driving exceptional responses from the guest. So as we look at our performance in the quarter, we're right where we expected to be and we're set up well for a very strong holiday season. Cathy?

Yes. So Seth, as we said, we expect a small rate decline in the fourth quarter. First off, was we expect a 5% comp, so we should start there. And then a small rate decline in the quarter. And as you said, we pointed to -- we expect continued pressure in gross margin, but not to the same extent we saw in Q3. The biggest difference is our -- while we still expect great sales, we obviously already anticipate the mix that we'll be seeing in that business, just like we did last year's fourth quarter. And we'll see strong digital sales like we would've seen strong digital sales last year's fourth quarter, so the year-over-year changes are a little less, as you can imagine. And then lastly, we're moving -- we moved a lot -- received a lot and moved a lot inventory in the third quarter in anticipation of the fourth quarter, and so we would expect those cost to not be as strong.

Okay, that's helpful. And then just, Brian, you highlighted a number of positives, particularly on the sales line and there are clearly cost to achieve that, right, and drive that higher share that you're seeing. So can you just help us better understand some of the initiachiev often these consumers are actually choosing to use Drive-Up or Shipt? And can you give us a sense of how many of these people are now customers? Or are they existing customers? Are you getting people who normally make 12 trips to Target a year doing a 13th or 14th? Or they are doing like more 16th or 17th trip, 4 extra trips, because they're now using Shipt?

offer the full suite of fulfillment options, we think guests are going to choose some of those that are a little bit more convenient, they can come by our stores and the economics are better. So that's one. But -- so one is we'll see the year-over-year digital growth isn't quite as big a change that we're expecting in the fourth quarter. But more importantly, we'll still see those merch initiatives and we are starting to see some of those, the cost of goods sold, coming through there in the fourth quarter. So those are the biggest changes. And then lastly, the amount of inventory we moved in Q3. Obviously, we're here and ready for the holidays, come shop and shop often in Target. So we're going to have a really good fourth quarter and holiday.

And did China tariffs play any role in bringing in more inventory in the third quarter? And maybe you could update us on how you're thinking about tariffs for the fourth quarter and for next year.

Yes. Let me start, Robbie. We clearly were planning well ahead for a very strong fourth quarter. We wanted to make sure we had the inventory in our system to meet the very strong demand we're anticipating for the fourth quarter. And there's really no update on the overall tariff front. We continue to watch it each and every day, as I know you do. And we're looking at what levers we can pull to make sure we minimize the impact for our guest. So we'll watch it very carefully. Obviously, it's a very fluid topic right now. But our focus is on executing in the fourth quarter. And we've got the inventory and the plans in place to make sure this is a very strong fourth quarter for Target.

The next question comes from David Schick with Consumer Edge Research.

Brian, a couple of times in your initial discussion and then even in Q&A, you're talking about the very early stages of these investments that the consumer is enjoying with choices, with merchandising, delivery choices, et cetera. But I guess, if you look at the history of retail, oftentimes, this high level of investment is made when there's weaker major players that you can sort of finish off and enjoy a better margin over a longer period of time. How do you think about that long-term aspect of the spending curve, given the capabilities and the competition between major players, including yourself?

Well, in some ways, you've answered the question for me. We certainly have been talking for several years now about the opportunities that are in the market as many of our competitors shrink or liquidate and go out of business. And we think there's sizable market share opportunities as we continue to see the rationalization of the retail landscape. But the investments we're making are still in the very early stages. While it feels like we've been talking for years about remodeling stores, the fact of the matter is, over the last couple of years, I guess to continue that, good luck in the all-important drive starting...

Thank you.

Thank you.

The next question comes from Edward Yruma with KeyBanc Capital Markets.

I know that on the second quarter call, you talked about being light on inventory. Obviously ended in a different inventory position in the third quarter. Were you short of inventory intra-quarter in the third quarter? And do you think that impacted sales? And then second, you've talked a lot about how some of these urban stores are helping you reach a new consumer. Can you give us some color on the profitability or the trends you're seeing on some of these locations?

Maybe I'll start, if it's okay, Ed, with the new small formats. And then John, maybe, can add into the inventory question. So on small formats, yes, first off, we really like that we're able to access guests that haven't had access to Target in the past. And so that has been terrific. We continue to like what we're seeing out of the small stores. They have great sales productivity, as we referenced in the call earlier. And we do see really good returns. So we measure them against the same IRRs and same hurdle rates we do all of our investments, and they have really good returns. So we'll continue to see that. You'll see us continue to open new small-formats.

On inventory, we have felt good about inventory really the whole year long about where we've been on inventory. There's been some businesses we've chased into, like Toys, we have aggressively chased into; and Baby, which have the result of what's going on in the marketplace there. But I wouldn't describe our inventory ever as light. I think we were well positioned at the end of second quarter. We feel really good about our position right now. We knew we would peak inventories relatively early, given when Black Friday falls this year. And of course, you saw that on our third quarter balance sheet. But overall, we feel really good about where we've been positioned on inventory throughout the year.

And if we go back to the new small formats, I think it's important to point out, this is allowing us to reach a guest that, in the past, we hadn't been able to serve. So when you think about recent quarter and approximately 60 bps of revenue contributed by these new small formats, that's largely incremental. These are neighborhoods and catchments where we haven't been participating before. It's a guest that wasn't able to shop with Target on a regular basis. So not only are they already contributing to our revenue, it's opening up a door for a new guest to shop at Target. And the reaction, as Cathy's referenced, has been very positive. We're seeing incredible productivity out of these stores, and we're reaching a guest in neighborhoods where we've never completed before.

The next question comes from Peter Benedict with Baird.

Just to circle back quickly on the gross margin. The fulfillment cost pressures, I guess, from digital in the third quarter, I mean, safe to assume that they were a little more than what you saw sequential -- or in the third quarter, which I think third quarter was around 60 basis points. Is it fair to assume it was more than that?

everyone be a part of the relationship with Target. So we're excited about where that's going. We'll continue to test that this next year. But all of the indications are very, very positive. We're seeing really good sign-ups and engagement with the Red program.

John, you want to wrap this up with an update on Shipt?

Yes. With Shipt, we remain really excited, really proud of how the team has scaled that throughout this year. They have -- we're in over 250 markets now in a very short amount of time. We continue to see very strong response from consumers. I think the metric I look at that gets me most excited, if you look at mature markets, so markets that have been open for over a year, still continue to see triple-digit growth in sales, in GMV. So guests continue to engaged more and more, even in markets where we've been there a long time. The other thing I'd add, Greg, to get to your question is, the impact on digital growth is relatively modest because we're not reporting GMV, we're only reporting our revenue, which, of course, is quite modest relative to the GMC -- GMV sales that go through Shipt. So the impact there is relatively modest, but we're very excited with Shipt and the opportunity now as we begin testing Shipt deliveries on target.com and the opportunity to scale that next year.

If I could, I love just a follow-up on that. Just given the strength in traffic, have you guys been thinking about ways to monetize that traffic with digital advertising, in particular, just given what Kroger's trying to move in that direction; Amazon, certainly, with $7 billion of advertising revenue. How are you guys thinking about using all that data and traffic that you have and maybe outside the traditional avenues?

Greg, it's something we're thinking about each and every day. And it probably leads us to wrap up today and invite all of you to join us in the spring for our updated Financial Community Day. So it's something that we're very focused on, continue to build loyalty with our guest.

But for today, I think, operator, we're going to wrap up our third quarter call and invite every one to join us again in the spring. So thank you.

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