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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation 2021 First Quarter Earnings Release Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, May 19, 2021.

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

John Hulbert - *Target Corporation - VP of IR*

Good morning, everyone, and thank you for joining us on our first quarter 2021 earnings conference call.

On the line with me today are: Brian Cornell, Chairman and Chief Executive Officer; Christina Hennington, Chief Growth Officer; John Mulligan, Chief Operating Officer; and Michael Fiddelke, Chief Financial Officer.

In a few moments, Brian, Christina, John and Michael will provide their perspective on the first quarter and their thoughts on our outlook for the second quarter and beyond. Following your remarks, we'll open the phone lines for a question-and-answer session.

This morning, we're joined on this conference call by investors and others who are listening to our comments via webcast. Following the call, Michael and I will be available to answer your follow-up questions.

And finally, as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our most recently filed 10-K. Also in these remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on the first quarter and his perspective on our outlook. Brian?

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

Thanks, John, and good morning, everyone.

The first quarter felt like a first step towards a post-pandemic world. And our team and operating model continues to walk alongside our guests and communities, serving them well through another chapter of growth and healing. From our unique mix of categories, to our unmatched set of fulfillment options, our business is delivering what consumers want and need each and every day.

The results we delivered in Q1 are nothing short of outstanding. Comparable sales grew by nearly 23%, making our fourth consecutive quarter in which comp sales grew more than 20%. Maintaining that pace this quarter was especially notable, given that we were comping over double-digit growth a year ago.

Over the last 2 years, comp sales have grown about 36%. And total sales expanded by $6.5 billion in the first quarter alone. This year's sales growth reflected more than $1 billion in market share gains, a clear signal of how relevant guests find our experience even though they have many more shopping options available compared with this time last year.

In a quarter featuring many things to celebrate, I'm most proud of the performance of our stores. With vaccinations rolling out across the country and consumers increasingly comfortable venturing out, we've seen an enthusiastic return to in-store shopping. Guests are happy to come back to our stores because they love the environment we've created and invested in over time.

As a result, our store comp sales increased 18% in Q1, driven almost entirely by higher traffic and accounting for the vast majority of our growth. Contrast that to a year ago when the channel mix of our business was changing rapidly, with guests leaning heavily into our digital fulfillment options, essentially our same-day services in the midst of a nationwide lockdown.

A year ago on this call, we were highlighting a digital comp of 141%, driven by growth in our same-day services of more than 275%. These 2 contrasting scenarios clearly demonstrate the flexibility of our operating model. But they also show how our stores and digital channels complement each other to drive guest engagement.

Even though digital stole the headlines a year ago, our store comps actually increased about 1% in the first quarter last year. And this year, while store sales accounted for most of our growth, first quarter digital comp sales also grew 50%, on top of last year's enormous numbers. This is the power of 'and'. Guests turn to Target because of our stores and our digital options, not one versus the other. And for us, the distinction between a store sale and a digital sale is largely irrelevant.

Because of our unique stores-as-hub model, more than 3/4 of our first quarter digital sales were fulfilled by our stores. That means, in total, more than 95% of Target's first quarter sales were driven by our store assets, store inventory and store teams. This store-driven growth is translating to outstanding bottom line performance.

Our first quarter adjusted EPS of $3.69 established a new all-time high for the company. Compared to 2020 when profitability took a temporary dip, this year's performance represents an astounding increase, more than sixfold. If we look back to first quarter 2019, this year's adjusted EPS was more than 140% higher, demonstrating how far our business has advanced in a short time.

I want to pause here and thank our team members across the world. They have consistently demonstrated incredible passion, commitment and focus to serve our guests and take care of each other. I am grateful and proud to serve with this outstanding team and to share the incredible business results they're delivering quarter after quarter.

It's also important to highlight how the category mix plays a key role in the flexibility of our model. For instance, with guests venturing out, we've seen an incredible rebound in apparel sales, with Q1 comp growth of more than 60%. On the other hand, and as expected, we experienced lower growth in Food, Beverages and Essentials, as we annualized the peak stock-up period a year ago. Most notably, we saw continued strength in our

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Thanks, Brian. As we enter 2021, we knew it would be a year like no other. That's because we're coming off of 2020, which was, by far, the most unusual year any of us have ever experienced. As such, we knew there'd be a wide range of potential outcomes for our sales, both by category and in total. And so far, with one quarter behind us, results have been extremely positive across every dimension.

In the face of this strength, we've seen an incredible response from our teams across the board, from our stores, to our merchants, to the supply chain, who've all worked together in service of our guests. While there are many ways to measure the impact of those efforts, guest loyalty and market share are the 2 most important measures of success in this volatile time.

Consequently, it's incredibly gratifying to see that across every one of our guest segments in the first quarter, we measured an increase in average trips per guest and a larger average basket. This led to more than $1 billion of additional market share in the quarter, on top of $1 billion gain a year ago.

In terms of category performance, we saw the strongest growth in our Apparel business, which delivered comp growth in the low 60% range. As Brian mentioned, we saw a temporary dip in apparel sales last year, when first quarter comps were down around 20%. Following this year's strong increase, first quarter apparel sales have grown approximately 29% over the last 2 years.

Home also delivered incredible growth with an increase in the mid-30% range, on top of a high single-digit increase a year ago. Within Home, growth was strong across the board, with the most robust performance in our decorative home and seasonal businesses.

Hardlines also delivered huge volume, with comp growth above 30%, on top of a 20% increase a year ago. Results were led by sporting goods and toys, which both saw comps above 40%.

Beauty comped in the high teens, on top of a high single-digit growth a year ago. Within Beauty, the skin care, sun care and bath categories delivered comp growth in the mid-30% range, with cosmetics growing in the low 20s.

Finally, our Essentials and Food categories both delivered comps in the low to mid-single digits. To see healthy growth on top of last year is remarkable as you'll recall that a year ago, guests were aggressively stocking up their pantries, fridges and freezers, and we sold virtually every unit of paper goods that we owned.

Beyond category strength, I want to pause and also highlight that sales on Target's owned brands grew approximately 36% in the first quarter, the strongest increase we've ever recorded. Because of our unique capabilities in product design, development and sourcing, our owned brand products offer an unbeatable combination of design, quality and value. These brands aren't something that our guests pick up while they're at Target, they're a big reason why they shop at Target, which is why we continue to invest in them.

We frequently talk about performance by category and our brands because it's important that our entire portfolio is healthy and well positioned to meet our guest needs. But it's also important to realize that they create value for our guests beyond simply the sum of the parts. Rather, it's the combination of all our offerings, including categories, brands and services across our distinct multichannel experience, that allows Target to serve our guest needs today and over time.

Last year, as guests focused more on enjoying time at home, that had implications not just for our Home category, but also for Hardlines, Food & Beverage and Essentials. And their focus on health and well-being affected trends in activewear, Beauty, health care, Food & Beverage and more.

The same is true for our sales channels. As guests last year focused on social distancing, they leaned into digital, including our same-day services. And this year, as they're looking to get back out in public, they're flocking to our stores, based on the trust we've established over time, which was further reinforced by last year's investments.

So as we plan the remainder of the year, both in total and by category, we continue to listen closely to our guests to understand how they're thinking and feeling. And when we talk to our guests today, they tell us they want to maintain some of the new habits and routines they formed during the pandemic, including an enhanced focus on the joy of home and health and well-being of their family.

At the same time, there's a rapidly emerging emphasis on style and mobility as guests feel increasingly safe in public spaces. That trend is playing out in an explosive demand for dresses and cosmetics as well as luggage and categories based on being active like sporting goods and Performance Activewear. This reinforces the concept of 'and'. Target can fulfill our guests' needs as they focus on home and health and when they look to venture out. We can welcome them back into our stores and continue to serve them with the same-day services they've recently tried and now love.

So after a record-setting first quarter, we're keeping our foot on the gas, based on our guests' desire to bring rejuvenated life and energy to their homes, celebrate seasonal moments with loved ones and step out in public. I could not be more excited about the ways we're ready to inspire and energize our guests.

Just last week, we launched our latest limited-time collection, Hilton Carter for Target. Off to a great start, this collection features live plants, faux greenery and unique plant accessories for experienced and novice gardeners alike. Not to be outdone by their parents, younger kids want to make their spaces their own. And our popular kids brand, Pillowfort, will continue to help them do just that. For its 5-year anniversary, Pillowfort is celebrating with hundreds of new items that can grow with them and be used in any area of the house.

As our guests begin stepping out, they're focused on looking and feeling their best. With this rekindled passion for fashion, our guests will be overjoyed with the latest installment of our designer dress collection. Featuring designs by Christopher John Rogers, Alexis and Rixo, this assortment offers more than 70 original and affordable dresses in bold, bright patterns and statement silhouettes. And of course, with our continual focus on inclusivity and celebrating every body, this collection features affordable prices in a range of sizes from XXS to 4X.

We've long focused on making Target a destination for holidays and life events, and we just wrapped up a huge Mother's Day season. We had solutions for mom across the store, from apparel, gifting, beauty, flowers, candy and more. And now we're gearing up for Father's Day in June. We've got a great assortment of gifts for dad, from All in Motion attire for golfing, hitting the gym or just hanging out, to a line of shave, skin care and hair care products from Goodfellow.

Of course, June celebrations aren't exclusive to dad. With so many in-person celebrations canceled last year, we're ecstatic about our fabulous new assortment for Pride as we celebrate love with our LGBTQIA+ guests, team members and neighbors.

Later in the summer, we know families are excited to celebrate the 4th of July with a long-awaited neighborhood cookout, a road trip out of town or an intimate backyard barbecue with a few fireworks. With great deals and the perfect owned and national brand assortments, it doesn't matter if the celebration is big or small, Target has everything you'll need to fill a cooler, pack a beach bag and fill up with friends, family and fun.

And before we know it, it's time to head back to school, and we're planning for one of our biggest back-to-school and college seasons ever. Of course, we'll have great deals on all the traditional school supplies, but we'll also have the new normals on the school supply list, like hand sanitizer universities. And this summer, both in-store and online, we are adding more items to our Black Beyond Measure assortment. I'm so proud of these efforts and everything we do to help all families discover the joy of everyday life.

I also want to give a quick shout out to our store teams. I recently had a chance to visit stores in the New York City market. And after more than a year in which most of my meetings have been virtual, it was an incredibly energizing experience. I visited new small-format locations across the city, from Manhattan to Queens to Brooklyn. Every location was a unique reflection of the local neighborhood, from design, to assortment and the team members serving their neighbors. Based on the energy and passion I could feel from these teams, it's clear why we're seeing such strong sales in our stores across the country.

As the first Chief Growth Officer at Target, I couldn't be more enthusiastic about the opportunities still ahead of us. As you saw throughout 2020 and now in 2021, we have a long runway to continue investing in and growing our core business. At the same time, we'll continue to develop innovation pipelines and explore new initiatives, maintaining a balance between fundamentals and execution and the exploration of new opportunities. As we plan for future growth, we'll continue to listen to our guests and apply those insights to prioritize their work. With this guest-first approach, we're confident we can continue to build relevance and market share, both today and over time.

With that, I'll turn the call over to John.

Within our store network, we've begun ramping up our remodel program, following the pause we implemented last year. We have just over 30 full remodels slated for completion in the second quarter and more than 100 planned for the back half of the year. Based on past experience, we expect these remodeled stores will generate an incremental 2% to 4% sales growth in the year following completion, with another 2% incremental growth in the second year.

Beyond the direct impact on sales, these transformations create an ideal platform for all of the merchandise innovations and service enhancements that we'll launch over time. In addition to full store remodels, we're planning other store investments this year, including more than 100 Ulta shop-in-shops slated to launch in the back half of the year, as well as our enhanced Apple layout in Electronics in select stores across the country.

Among our store services, we've long known that our same-day fulfillment options would be popular with our guests. But their growth over the last few years has been far above our expectations. This is most evident in our Drive-Up service where first quarter sales volume was nearly 21x higher than it was 2 years ago, amounting to nearly $1.3 billion of incremental sales volume over that period.

In the face of this incredible growth, there are emerging opportunities in high-volume locations to invest in capacity and efficiency in support of our same-day services. Specifically, in more than 100 locations this year, we're investing in small projects to optimize the front ends of these buildings, freeing up additional capacity for continued same-day growth, while making the layout more efficient and safer for the team.

We also continue to enhance the assortments available for all 3 same-day services, adding more perishable food to our pickup and Drive-Up services and more general merchandise like apparel to the assortment available through Shipt. And we just announced that in the second quarter, we'll have adult beverages available through pickup and/or Drive-Up in more than 1,200 stores and available for same-day delivery in more than 600 stores across the country.

Beyond activity in existing stores, we're expanding our new store opening plans to more than 30 additional locations across the country this year, as we continue to find compelling opportunities in urban and dense suburban markets and on or near college campuses. In recent years, these custom formats have typically been less than 50,000 square feet. However, given local real estate conditions in dense suburban markets, we're also finding compelling opportunities to open somewhat bigger stores, between 50,000 and 100,000 square feet, which weren't available in the past. As a group, these new stores are generating higher-than-average sales productivity, above average gross margin rates and strong financial returns, and we see a very long runway to open more of them over time.

And finally, after store comp growth of 18% in the first quarter, driven almost entirely by traffic, we're confident that we're already benefiting from a differentiated service model in our stores. But that's a lead we can't take for granted. So we're continually looking for ways to get even better. So this year, our store teams are rolling out an enhanced service model, focused on consistency of every interaction to ensure that our guests will always feel welcomed and appreciated. And if they need help, there will be team members who can find solutions to enhance their experience.

This new engagement model is strongly connected to our company purpose, culture and values. And we're supporting it with enhanced training and tools across the chain. It's designed not to be a one-and-done effort, but a sustainable model that's integrated with our operational goals, not something separate that's added on to everyday tasks.

So as I turn it over to Michael, I want to once again thank the entire team for the incredible things you've already done and your passion to continually raise the bar. This year, I'm celebrating my 25th year at Target, so you might be tempted to think I've seen it all. But when I step back and realize what this team has accomplished in the last year under the most challenging of circumstances, it's clear that there is no limit to this team's potential, and there's no doubt that we have the best team in retail.

Now I'll turn the call over to Michael.

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

Thanks, John. When I think about the underlying themes of our recent performance, the most dominant one by far has been the unprecedented growth and share gains we've seen over the last 5 quarters.

On the P&L, the leverage resulting from growth has more than offset all of the unique headwinds we faced over this challenging period, resulting in really strong performance. Target's total sales grew 23.3% in the first quarter, reflecting comp growth of 22.9%. Given last year's double-digit growth, first quarter sales have expanded more than 37% over the last 2 years, driven almost entirely by higher comps. Unlike last year, when consumers were consolidating trips and shopping less often, this year's comp growth was driven primarily by a traffic increase of more than 17% combined with a 5% increase in average ticket.

As Brian mentioned, store comps were the growth engine this year, while digital was the primary driver in Q1 2020. As such, over the last 2 years, both our stores and digital channels have expanded their first quarter sales by more than $3 billion. This balance highlights the relevance and complementary nature of both channels in serving our guests' needs.

Our first quarter gross margin rate of 30% was 490 basis points ahead of last year when we faced a number of temporary headwinds, including markdowns and other costs to rightsize our apparel inventory. Compared with 2019, this year's first quarter gross margin rate was about 40 basis points higher, which is notable given that digital sales penetration more than doubled in that time, from 7.1% in 2019 to more than 18% this year.

In terms of the year-over-year gross margin drivers, mix had a positive impact of about 150 basis points, reflecting the dramatic increase in apparel sales and continued strength in our home category. The remaining favorability was driven by core merchandising, as we continued to benefit from low promotional and clearance markdown rates, and we annualized last year's costs to rightsize our apparel inventory. The rate impact of supply chain and digital fulfillment costs was approximately neutral compared to last year, as the costs of outsized digital growth were offset by the benefit of a stronger mix of same-day fulfillment and our ongoing work to control unit costs across our entire suite of digital fulfillment options.

Our first quarter SG&A expense rate was 18.6% this year, down more than 2 percentage points from 20.7% a year ago and 20.8% in 2019. In terms of drivers, leverage benefits have more than offset all of the extra costs we've absorbed over the last 2 years, including meaningfully higher pay and benefits for our team and other investments to protect the health and safety of our team and guests.

While D&A expenses have grown in each of the last 2 years, this year's first quarter D&A expense rate was about 40 basis points lower than a year ago and about 80 basis points lower than 2019.

Altogether, our first quarter operating margin rate increased an astounding 7.4 percentage points compared with a year ago to an unprecedented 9.8% this year, from a temporary low of 2.4% rate a year ago. However, even compared to a very healthy 6.4% operating margin rate in the first quarter of 2019, this year's rate was more than 3 percentage points higher. In terms of dollars, first quarter operating income has more than doubled over the last 2 years.

On the bottom line, our business delivered first quarter GAAP EPS of $4.17, up more than 600% from a year ago and well over double our 2019 GAAP EPS. On the adjusted EPS line, which excluded the gain from the sale of our DermStore business, we earned $3.69 this year, more than 500% higher than a year ago and well over double our 2019 adjusted EPS.

As you know, our capital deployment priorities remain the same as they've been for decades. We first look to fully invest in our business, in projects that meet our strategic and financial criteria. Second, we return cash through our quarterly dividend, which we've maintained every quarter as a public company and grown every year since 1971. And finally, we return excess cash over time through share repurchases, within the limits of our middle A debt ratings.

In the first quarter, we invested just over $0.5 billion in capital expenditures to support our business. We continue to expect our full year CapEx will be approximately $4 billion, but the bulk of those expenditures will be more backloaded in the year, given the timing of this year's projects.

We paid dividends of $340 million in the first quarter, up slightly from a year ago, as growth in the per share dividend was partially offset by a decline in share count. And finally, we resumed share repurchases in the first quarter, following a temporary pause in 2020, and deployed about $1.2 billion to retire 6.1 million shares at an average share price of just under $191. And in February, we completed the sale of our DermStore business, which contributed just over $350 million to our first quarter cash flow.

Altogether, we ended the quarter with about $7.8 billion of cash and cash equivalents on our balance sheet. This was down about $700 million from the beginning of the quarter, but still well above where we expect to operate over time. With this cash, we'll be funding approximately $3.5 billion of additional CapEx in 2021 and we'll be recommending a robust increase in our quarterly dividends to the Board later this year. Beyond these uses, we should have ample capacity for continued share repurchases, and we'll continue to govern the magnitude and pace of repurchases in support of our goal to maintain our Middle A credit ratings. And given where we are today, it will likely be a multiyear journey before our debt metrics move fully back to where they've been over time.

Now I'd like to turn briefly to our return on invested capital, which reflects both our operating results and the investments we've made to generate them. In the first quarter, our trailing 12-month after-tax ROIC moved up to 30.7%, which is well over double the 13.4% we reported a year ago. While we've indicated that this measure will likely be volatile in the near term and could revert to a very healthy number, near 20% over time, the fact that our business has generated such a high after-tax return over the last 12 months is a testament both to the strength of our model and outstanding execution by our team.

Now let me turn to our sales outlook. We learned a lot in the first quarter, and notably, got our first look at how our business is successfully comping the comp, with impressive growth on top of last year's strong surge in sales. Also, and importantly, we've continued to gain market share on top of last year's dramatic share gains. Based on these results, we're now planning for our business to deliver a mid- to high single-digit comp increase in the second quarter. This expectation is in line with the 2-year growth rates we saw in the first quarter.

And while we only have a couple of weeks in the quarter behind us, the results we've seen so far this month are consistent with this outlook. The range for second quarter operating income remains wide, but should remain strong, far ahead of our 2019 rate of 7.2%, but perhaps not fully as high as last year's unprecedented rate of 10%.

In terms of the specific puts and takes in the quarter, we'll be comping over last year's reversal of the return reserve estimate, which added about $110 million to last year's operating income. In addition, this year, we're making purposeful investments in store labor hours to ensure we deliver outstanding service and stronger in-stocks than a year ago, when sales grew far beyond our expectations. Of course, we'll continue to benefit from meaningful sales leverage, given that we're planning for healthy growth on top of last year's record-setting increase. Putting that all together, we expect to see continued strong performance on this line.

In the back half of the year, the range of possibilities for comp growth is also quite wide, and we'll gain more insights as the year progresses. As of today, based on our recent results and confidence going forward, we expect to see positive single-digit comps in the back half of the year, on top of last year's unprecedented performance.

Regarding our full year operating margin rate, following an exceptionally strong first quarter, we have increasing confidence in the consumer and industry backdrop in the back half of the year. As such, the range of outcomes for our 2021 operating margin rate has moved significantly higher. So despite the anticipated headwind from higher markdown rates following last year's historically low rates, we believe that our business is positioned to deliver a full year operating margin rate that's well over last year's rate of 7%. More specifically, we believe this year's operating margin rate could reach 8% or perhaps a little higher. We'll continue to refine our view throughout the year.

As the team looks ahead to the rest of the year, they're focused on staying agile in what continues to be a volatile environment. Rather than placing all of their bets on a single forecast number, they're focused on contingency planning, creating flexibility that will allow us to react to unexpected changes, and importantly, take advantage of opportunity when we see it.

We're also excited about the investments still ahead of us and the growth they'll create: hundreds more remodels; dozens of new stores; new Ulta and Apple shopping environments; and supply chain investments to support both replenishment and fulfillment. Given the performance we're seeing today, which is the product of the investments we've made over the last few years, we're eagerly leading into future opportunities to enable more profitable, high-return growth over time.

Before I turn it back over to Brian, I want to add my voice and thanks to the team. The value our team members are creating for our business, communities, shareholders and each other goes far beyond what we can measure in a P&L. Thanks for making Target an even stronger company on behalf of all of our stakeholders.

Brian?

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

Well, why don't I let Christina spend some time talking about what we're seeing with categories, some of the highlights between our own brands and national brands. Obviously, Christina highlighted the fact that despite our overall robust performance in the quarter, owned brands grew by 36%, a record performance for us. So we're clearly seeing great performance in both our own brands and national brands.

But Christina, why don't you build on some of what we're seeing in the different categories?

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Absolutely. Bob, thanks for the question. As Brian was just sharing, we really are excited about the strength across the board. Apparel was certainly a stand out in this quarter with growing over 60%, and that came from a range of brands in every segment of the business.

But the reality is the 3 trends that I talked about in my prepared remarks are benefiting our multi-category approach across the board: joy at Home and the opportunity to celebrate everything that brings the guests to their home, eating, being with their families, and the investments that they've made over time in their home; health and well-being, the opportunities that our guests are taking to invest in proactive health care and fitness at home and activewear.

And then the newer and more emerging trend is really style and mobility. As guests are going out, they are looking for a fresh look. So our newest collections of dresses by Christopher John Rogers, Alexis and Rixo couldn't have been more perfectly timed to really help guests look their best in what they're wearing and certainly also across their beauty trends.

Operator

And the next question is from Paul Trussell with Deutsche Bank.

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

Outstanding results. Congratulations to the team. I guess my question is on, first, same-day services, which obviously continues to really showcase robust growth. I'm just wondering if you can talk a little bit more about how the business has evolved. What are the additional learnings? And what are the actions that have been taken to really improve efficiency and profitability of that particular business and service?

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

Well, Paul, thanks again for joining us this morning. Why don't we let John Mulligan talk about some of the progress we've made from a same-day fulfillment standpoint.

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

Paul, it's good to talk to you. As you know well, we've talked about stores as hubs now for going on 4 years. And we have always said, we like it for a couple of reasons: One, great guest service; and two, better economics. Same-day services are that on steroids. They have much better economics than shipping something to someone's home because, as we've talked about, the shipping expense is the biggest part of delivering something to someone's home. So if we take that out of the equation, then we end up with economics that are much closer to the store transaction.

The thing we love about all of the same-day services, pick up, Drive-Up and ship, all of them continue to grow faster than our overall digital growth, and we continue to find ways to improve them, as you said. Part of that is investing in technology for our teams, improving their sort paths and improving how they pick. We've done a great deal of process work to break things apart, to make it simpler for our teams to execute. We've done things to help them find items in the store so that we don't end up with what we call, INFs, or items not found.

And then we continue to invest in helping them physically. And that's a big focus for us this year and will be over the next couple of years. In the case of Drive-Up, which as we've talked about a couple of times, Brian talked about and I talked about, has been our fastest-growing same-day service since -- basically since we started it. It also has our highest NPS score, so guests love it. We let you decide when you want to come. We don't force you into a time slot. And then our team brings it out to you in 2 minutes or less. So our guests absolutely love that. And you'll see us invest in making that easier for our team, building capacity on the front end of the store.

Over the past year, we've rolled out adding temperature control products to Drive-Up. And so you'll see us have refrigeration and freezers to the front end of the store, all behind the wall so that our guests don't see that, but making it much easier for our teams to execute. And then much safer, we'll make it much easier for them to walk out to cars, protect them from the environment a little bit. So all of that experience continues to improve as well.

So every year, our team comes up with multiple ways to continue to improve the service, first and foremost, for the guest, and then on the back end, improve things for our team so they can execute it easier as we continue to grow. So we see a lot more opportunity for us. And as I said, that will be a big part of our capital investment over the next several years.

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

John, the only thing I might add is as we saw our guests turn to same-day services during the pandemic using pickup and Drive-Up and ship, we expect those services to be very sticky over time. And certainly, I think we've matured the awareness and the use of those same-day services by 2, 3, if not 4 years. And certainly, as we go into the back half of the year and during the holiday season, I think we're going to continue to see our guests turn to ship and Drive-Up and pick up. That's just an easy and convenient way to shop at Target.

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

Just a quick follow-up for Michael. Obviously, you're really showcasing a lot of confidence in the trajectory of the business, given the outlook provided for the balance of the year. Maybe just a little bit more detail on how we should think about gross margins and SG&A for what's clearly going to be a really healthy operating margin rate in 2Q and the second half.

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

Yes. Sure, Paul. Thanks for the question. And I touched on this a bit in my remarks, but if I had to summarize our profit story, it goes back to the scale benefits we see when we have growth. And our plan for the back part of the year is to see growth on top of some of the strongest quarters in Target's history last year. So we would expect that leave to -- to lead to improving profit rates on a year-over-year basis. And there's still a widsld thiee-7f

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

I'll add my congratulations to a great quarter. I wanted to just ask a little bit about share gains. And obviously, we know the categories, and you're gaining share across all categories. But I wanted to see if you could give a little bit more color on share gains by demographic, and which demographics you think you're gaining the most share from. And then I had a follow-up to that last question that was asked.

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

Karen, thanks again for joining us today. And I appreciate the question on market share. As you look at our business, and I think you know our Target guests and our Target shopper, we're appealing to all demographics. And we've had over -- now well over 30 million guests who shop us every week. Most of America shops at Target. And I think as we look at it, we're picking up share across all these various cohorts. So it's not one consumer, it's all of the guests who are shopping Target and as they return to our stores, shopping multiple categories.

And I think that's the magic behind our performance, is that great combination of in-store experience, the ease and convenience of digital, but that multi-category portfolio and that unique combination of our own brands and curated national brands, we appeal to a broad group of consumers in different cohorts. And we're picking up share across all of these different areas.

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

Okay. And then just on inventory growth. Obviously, your inventory growth was very strong this quarter, which is impressive given the freight issues, but -- and the port issues. But maybe some color on that growth in general, and how you think about the balance of actually wanting more markdowns in 2021 versus 2020, and how we should think about that in the context gross margin?

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

Michael, why don't you start? And then we can provide some additional color as Christina talks about our inventory positions.

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

Sure. Well, first off, Karen, we feel really good about our inventory position heading into the second quarter. And you can see we're up on a year-over-year basis, and we should be given the growth in sales that we've seen and continue to expect.

When it comes to markdowns through the balance of the year, we've talked about this a little bit previously, we were sold through in a lot of seasons last year, and that's not optimal for us. We don't want to look at empty shelves at the end of a seasonal set. And so with our anticipation for growth in the remainder of this year, we'll be buying appropriately to that. And hopefully, that means we've got fuller shelves at the end of a season. And with that, will come some clearance markdowns, there will be a little bit of a drag on markdown rates on a year-over-year basis if I had to guess. But I would welcome a little bit of that rate drag because it means that we're full and in stock for the guests throughout the season.

Operator

The next question is from Chris Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So a couple of questions on guidance. My first question is, in the second quarter, Michael, why couldn't you reach 10% or at least be close to that? You did a 9.8% in 1Q. Sales volumes look to be similar. Is it less rich mix performance? Or perhaps you're putting in some caution around potential promotions and clearance?

Michael J. Fiddelke

John?

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

Yes. Scott, just building on what Brian said. Basically, I think our thought has always been, the best way to staff our stores and our supply chain, frankly, is to limit turnover. And so let's invest in our team, give them a great experience. And you've seen us do that for several years now. We've invested in wages. We've invested in benefits. Just as importantly, we've invested in training to help upskill them. And then over the course of the past 1.5 years or so, we've invested in safety very overtly.

And so as Brian said, engagement is very high. Turnover is down significantly relative to 2019. So we feel really good about where our store's at. And as turnover decreases, you get so many benefits, right? We get team members that know their jobs. We get team members that know their guests that are in their stores because they're in there weekly. They can engage with them. And this kind of gets to the service model where the idea is to engage with our guests, make them feel welcomed, and importantly, solve their problem. If they have an issue, solve it in the moment for them.

And so you'll see us continue to do that. We're very encouraged by what we see. Our NPS scores across all of our services, including the in-store experience, are up over last year and up over 2019. So we're just getting started on this journey, but the early results are very encouraging. And I would just finish where Brian did. We -- you've heard us say for a long time, we have the best team in retail, and we absolutely believe that's the truth.

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

John and I had a review just yesterday with our store team leaders who look at turnover and retention rates, and we just continue to see stronger and stronger numbers. And back to the point that John had made. So the operating model changes we've made over the last few years, putting experts in place in areas like beauty and technology, those team members are really passionate about the work that they do, and they continue to learn and grow every day. And I think that focus on providing training and development opportunities, the expertise that we're providing in those key categories, that's going to continue to provide benefits to us over time.

Operator

The next question is from Kate McShane with Goldman Sachs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I wondered if I could go back to the digital fulfillment questions that were asked earlier. I think you said costs were neutral. And I wondered, is it possible for how you're fulfilling to turn into a tailwind as you continue to drive more growth towards the same-day services and away from 2-day free ship?

And then separately, you mentioned the sortation centers and the number you're opening this year. I wondered if you could talk to just the cost optimization from those sortation centers over the long term.

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

Sure. Thanks for the question, Kate. I can start, and then maybe John can provide more color on the sortation center work that we're doing. We didn't see pressure on the supply chain and digital line this quarter. That's due in part to the just incredible strength in our store business, with stores up 18% on a year-over-year basis.

I get excited by the efficiency improvements I see us continue to make in our digital experience. John talked to some of those just a minute ago. But we can do a lot with the volumes that we've built over the last 2 years in some of those same-day services. And all of that volume translates to more efficiency opportunity as we can continue to squeeze down the per unit cost to fulfill.

But I don't shy away from growth -- or from a drag on that line from a growing digital business. And the reason why is, when guests lean into digital, when we get more omnichannel guests, more guests using Drive-Up, more guests using same-day, even if that sale itself comes at a slightly lower rate, it does incredible things for the rest of our P&L because we see those guests spend more in total, about 30% more for a new Drive-Up or Shipt guest. And that's way more important than the little bit of rate drag we've seen over time from digital growth, and that's how we continue to think about it.

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

Yes. And on the sort centers, Kate, we remain pretty excited about this opportunity, but I would caution you that it's early days for us still. We're -- we always talk about crawl, walk, run. I'd say we're still firmly in crawl here in Minneapolis. And so we see a lot of opportunity in front of us. But the play here is a couple of things.

And first of all, it's about capacity in the stores. So if we can sweep packages out of the stores more routinely than once a day, that frees up space, and that frees up space for us to pack additional products in the store. And that's an important thing for us. Then as we move downstream, the more granular sort is where we start to see potentially cost reductions as we can sort to provide to our carrier partners further downstream in their operations. And like we'd announced about a month ago, using the Deliv technology, creating local routes for local packages, we can get very efficient on delivery using Shipt and Shipt drivers. And so put all that together and our guest gets a great experience, we create more capacity. And we have the opportunity to continue to improve what we believe are already advantaged economics because of our stores-as-hub model. So more to come on all that. It's early days, but we remain pretty optimistic on all 3 of those fronts.

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 ask you. You touched on it a little bit, I think, Christina, in the prepared remarks about back-to-school and being excited. And assuming we do have a more normal back-to-school and with this child tax credit coming, are you guys planning the back-to-school period in the second half any differently this year in terms of marketing or inventory levels maybe that you could share a little bit with us?

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. Joe, I'd be happy to talk about that. So we're very excited about what these life moments afford us in the back half. The opportunity for a little more "normalcy," it really creates opportunities for us to be relevant with our guests in many different ways.

And so you think about back-to-school as a huge moment where the convenience of our assortment across a multi-category portfolio is already a preferred destination. But then you think about how that leads into opportunities in Halloween and Thanksgiving and the holidays, opportunities

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

So Joe, thanks for that final question. It's a great place for us to wrap up. And hopefully, for all of you, you recognize the confidence we have in our business as we go forward, the execution that we're seeing across all of our different functions and the way we're focused on serving the guests.

So I appreciate everyone joining us today. And operator, that concludes our first quarter earnings call. So thanks again for joining us.