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# EDITED TRANSCRIPT

TGT - Q4 2017 Target Corp Earnings Call and 2018 Financial Community Meeting

EVENT DATE/TIME: MARCH 06, 2018 / 4:30PM GMT

## OVERVIEW:

TGT reported 4Q17 adjusted EPS of \$1.37. Co. expects 2018 adjusted EPS to be \$5.15-5.45 and 1Q18 adjusted EPS to be \$1.25-1.45.



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## PRESENTATION

**John Hulbert** - *Target Corporation - Senior Director of IR*

Well, good morning, everyone. Thank you for joining us. For those of you here with us in the room, we're really excited that you joined us here in our hometown. And hopefully, you found the experience last night, the store tour, the exhibits this morning helped you get a deeper understanding of what we're working on.

Couple of housekeeping items. First, there's a couple, I'm going to just literally read the slides. First of all, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our SEC filings.

Second, in today's remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP measures to the most directly comparable GAAP measure are included in our financial press releases and SEC filings, which are posted on our Investor Relations website.

So finally, something new this year for those of you on the webcast. You can submit questions. I'm happy to say we are already getting questions, so please submit those. The team will get those questions to us, and we will take some of those during the Q&A session after the speeches.

So with that, we can get started with Brian.

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

Well, thanks, John, and good morning, and thank you for joining us today in Minneapolis. John, Cathy and I really enjoyed spending time with you during last night's tours and the reception. And I hope all of you had a chance to explore even more this morning. While we can make slides or show videos, there's simply no substitute for being here live and in person, walking the sales floor, talking to our teams, touching, feeling and experiencing new products and services, seeing for the first hand the future of Target.



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What's so exciting for me is that, last year at this time, all we could do was talk about the future. Most of what we could show were still renderings. Today, those things are real. The work is well under way. We've made a ton of progress against our priorities. And as you saw today, our teams are more focused than ever. And our guests are responding in kind. What a difference a year makes.

Think back to this meeting 2017. The world could not have looked more different. Coming out of soft holiday sales, the headlines were all about store closures, a catastrophic border tax and a looming retail apocalypse. That morning, we had a tough message of our own. But one by one, many of you pulled me aside that day and said, "Brian, I'm glad you're investing. We believe in your strategy. I'd make the same moves if I was standing in your shoes." It was a long flight home, but let me tell you what happened as soon as we landed in Minneapolis. The very next morning, we gathered our senior leadership team from every part of the country, and we grounded them in our company purpose, making sure every decision we made from that moment forward was in service to our purpose, to help all families discover the joy of everyday life. We talked about where we were and what it would take to continue to build the love our guests have for our brand. We talked about the things that makes Target unique, playing our own game, what it means for Target to really win. We talked a lot about urgency, getting things to market, testing, learning, doing it faster than ever before and rallying the organization around our multiyear plan, committing more than \$7 billion to modernize every dimension on our business and lean into the things that truly sets Target apart, blending the best of our digital and physical shopping experience, reimagining our network of more than 1,800 stores as inspiring showrooms and neighborhood fulfillment centers, moving in a new smaller markets, creating digital capabilities that bring incredible ease and convenience to our guests' lives and doing what Target does better than anyone else in the marketplace, creating great brands at scale and with style.

And we talked about what it was going to take to make all of that happen, the power of our Target team, nearly 350,000 people all around the world, the connection they have to their community, the passion they have for our brand.

I've been in this business now for more than 30 years, and I've never seen anything like it. Never. The people who work at Target, they love the brand. They take great pride in taking care of our guest, and our guest sees it every day. They know the people who work in their neighborhood store. They seek their expertise. They appreciate their hospitality and their friendly service. When you ask our guests why they shop at Target, more often than not, they say it's because of the people. So it should come as no surprise that given our team's drive and competitive spirit, they never consider a forecast a foregone conclusion. It's just another challenge to raise the bar even higher.

So last March, we told our store teams if you post positive comps in 2017, well, we told them they could wear jeans every weekend in 2018. Sure enough, if you were in a Target store on Sunday, you saw a lot of denim because here's what happened next.

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

I've seen that video a half dozen times now, but it still makes me smile. I couldn't be more proud of what this team has accomplished. 2017 was quite a year. We introduced 3 new billion-dollar brands; 10 new brands in all; 110 remodels; nearly 30 small formats, Herald Square, Houston, Hearth & Hand; new payment systems; new partnerships; new promotional strategies; a new mobile app; and new fulfillment capabilities, next day, same day, pickup, Drive Up and, of course, tens of thousands of new personal shoppers delivering Target products from Shipt.

Early this morning, we reported our fourth quarter and 2017 year-end results. And you don't have to get too far to the numbers to see that our strategy is working. Guests like what we're doing. The investments we're making are taking root, and they're driving results. Here are just some of the highlights. Strong Q4 traffic, not just in digital but, importantly, in our stores, which led to a 3.6% comp increase. We saw that growth come across our business as we gained market share in all 5 core merchandising categories. This was the fourth year in a row that digital grew by more than 25%. But it was our coast-to-coast network of neighborhood stores that enabled that growth, as our stores fulfilled more than half of our total digital volume.

Given the strong sales performance and the benefits from the recent change in the tax code, we finished the fourth quarter with adjusted EPS of \$1.37 and \$4.71 for the full year. But what's most encouraging to me is that we can't hang these results on any one single aspect of our strategy.



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Rather, it's a sum of the parts, everything working together and everything working that carried the day. While we're obviously pleased with the results, there's no time for a victory lap because you know, and I know, we still have a lot of work left to do.

So while 2017 was all about putting down a plan, getting the wheels turning in the right direction, 2018 is about acceleration, leveraging our greatest assets and leaning in to our competitive strength, all in service of making Target America's easiest place to shop.

So as many of you experienced this morning, newness and innovation are essential elements of our strategy. Our teams are exploring retail applications for just about every buzzword you can imagine, AI, CGI, machine learning. And while we're looking for future opportunities to build adjacent businesses and disruptive technology, the vast majority of our teams' time and talent is aimed at our core and advancing our investments around several key strategic categories: creating a more inspiring and connected shopping experience; reimagining our supply chain and fulfillment capabilities by positioning our stores at the heart of our network; continuing to reinvent our own brand portfolio; and investing in what is by far our most valuable asset, our team.

These are the choices we're making to ensure Target continues to stand out from the pack and further distinguish our brand in the minds of the guests. And today, I'm happy to report we're either on pace or ahead of schedule in delivering what we laid out 1 year ago. And it's all because of our people. They are, in every sense, our greatest point of difference, and that's true across every corner of our organization.

Consider for a moment what it takes to bring a shirt to market. The buyers, textile designers, sourcing managers, fabric engineers, all the planners, the pricing analysts, the marketers, the packaging experts, the global trade managers and those visual merchandisers, every one of those jobs is held by a Target team member. The talent and expertise you see at every single node in that global value chain gives us an unrivaled competitive advantage. That's what's equally important is the fact that for that shirt when it reaches the store, well, our team members who greet our guests and help them find what they're looking for, that's why we're investing in training and teaching not only to sell the shirt, but to sell the whole outfit. We're also providing new tools to manage tasks more efficiently, so we have more time for personalized service. And we're creating new pathways for advancement, developing new skills and leaning in how to manage, motivate and lead others.

During the past year, we've made great strides in changing our service model and added payroll in areas where our guest expects a more human touch. And of course, I'm really proud of the leadership position we took in October, raising our starting wage to \$11 and committing to \$15 an hour by 2020. I will tell you that within days of that announcement, applications for seasonal positions spiked by more than 30%, and we had a much stronger pool of talent to hire from. But the benefits of that investment go much further than just the short-term seasonal boost. Our leadership position on wage establishes Target as an employer of choice and will drive preference for years to come. And now you're seeing a number of employers inside and outside of retail follow our lead. And today, I'm happy to announce, we will raise our starting wage again to \$12 starting with current team members this spring.

So when we talk about elevating the shopping experience, the work is all about connecting physical and digital and empowering our people to bring in all the life. Despite all the changes across the consumer landscape, one thing remains absolutely true. Our guests love to shop. Our team is laser focused on creating the kinds of experiences that are worth the trip or an extra click, and you saw that first hand last night. The before and after images of our downtime store, well, they tell the whole story. It's not just about better and more modern design. It's about creating experiences based on how we want our guests to feel when they shop. It's about being welcoming. So in Beauty, this means making sure our guests see themselves in the product and the marketing, asking for what we can do to encourage them to explore even more. We want them to feel inspired. So in Apparel, it's not just presentation. It's about helpful service. Across the entire experience, we also want to make sure we continue to make it really, really easy. And by no means, we'll then experience, look the same from store to store.

Each day today, 42,000 people walk past our Herald Square store during that evening commute. Not one of them wants to walk out with a 50-inch flat screen TV on one hand and try to hail a cab in the other. Every design decision, every merchandising choice has to be made with the guest experience being top of mind.

Now if you haven't been to our next-generation store in Houston, I can assure you it is worth the trip. You've often heard me talk about the power of and. Our new store in Houston is really the physical manifestation of that phrase. It was designed for ease and inspiration, style and essentials,



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mass and specialty. And it's a glimpse into our future, not because we plan to open dozens of new stores just like it, but because we're picking and choosing elements from that prototype to create customized concepts for every store we remodel.

Last year, we committed to remodeling 600 stores over 3 years, and now we're going to raise the bar. In 2017, we delivered 110. This year, we'll triple that pace and do 325 more. We'll keep going at that rate, completing over 1,000 remodels by 2020. We'll also open up more small-format stores in prime urban markets, including 3 more tomorrow. And when we put it together, the aggregate investment we're making in key markets, like Chicago, L.A. and right here in Minneapolis, will exceed several hundred million dollars across each one of those communities.

We're also investing to bring the best of digital into our physical experience. Consider the stat during the holidays. Our stores fulfilled more than 2/3 of our digital orders. So now if I'm sitting at my desk and I order something from Target.com, but I pick it up on my way home, does it make sense to call it a digital transaction? If I buy a patio set with my phone, while I'm sitting on the store display model, is that a digital sale? Our finance folks would say yes. I can tell you, our guests could care less. And our technology teams, they're working hard to create new tools to completely erase that line altogether. For example, we folded our popular Cartwheel app into our flagship app to simplify the experience. And we introduced Wallet, so our guests can find deals and pay more easily and faster than ever before.

On Target.com, we added a 360-degree digital shopping experience. We're investing in augmented reality. We're elevating our storytelling around key brands and key life moments. And we're finding new ways to extend our assortment and better leverage our platform. So not only are we creating better showrooms out of our stores, we're also using these buildings in a profoundly different way. They should be hubs for commerce and community. And given the fact that we're nearly 10 miles from every doorstep in America, we see a huge advantage in leveraging that proximity. We just needed to realign our network.

So a few years ago, we started shipping digital orders from our back rooms. We started small, and we worked out the kinks. We focused on getting orders to our guests with greater efficiency, reducing inventory across our network and dramatically accelerating delivery times. But that was just the start.

In August, we acquired Grand Junction, a technology platform that enables us to connect to third-party carriers and provide same-day delivery service. In October, here in Minneapolis, we piloted Drive Up, pull up, pop your trunk, we are out with your order in less than 2 minutes, rain or shine.

Then in December, we announced the acquisition of Shipt, a technology platform, which is allowing us to provide tens of thousands of personal shoppers and closes that last mile delivery gap from days to minutes. I can tell you I've spent time with the Shipt team, talking to their network of shoppers. What really stands out for me is the people, the personal relationships they build with their customers. Think about people who love Target shopping who are out there shopping for Target lovers. It's a great combination, and John is going to share a lot more details about where we're headed, but I wanted to give you a sense for how we're moving even faster to take them to scale.

Today, we're announcing how we're going to expand our same-day delivery service from Manhattan to all 5 boroughs and several other big-city markets. With Drive Up, we're taking our 50-store test nationwide to nearly 1,000 locations coast to coast. And finally, I am really excited about this, we're going to offer free 2-day delivery on hundreds of thousands of items on Target.com. No membership, no extra fees.

When you think about all the bold moves we've made, none was more ambitious than our plan to reinvent our own brand portfolio. We promised 12 new brands in 18 months. Standing here today, I can tell you we're well ahead of schedule. In 2017, we brought 10 new brands to market and introduced 2 more, each one focused on replacing long existing brands or filling a whitespace in our current portfolio. Think about A New Day in ready to wear, JoyLab in active wear, Goodfellow for men, in Home Project 62 and Hearth & Hand with Magnolia, a partner with America's favorite family, Chip and Joanna Gaines. Each one of those brands delivered exceptional quality and unbeatable value. In a world where everything is increasingly commoditized, each one helps differentiate Target and build preference for our overall brand. Across the board, the results have been phenomenal.

(presentation)



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

While each brand has delivered incremental sales, they're working hard across our assortment, driving traffic to other categories and inspiring cross-shopping.

For example, we were highly intentional about launching Hearth & Hand early in the holiday season. It was an invitation for our guests to explore and an opportunity for inspiration, driving results across Home, but also helping categories, like Food as well. And while our design and marketing teams would tell you we set an incredible pace in 2017, we're only going to move faster and faster in the months to come. Last month, we launched Opalhouse in Home. And last week, we debuted a limited-time-only collection with Hunter, a long admired English heritage brand.

So before I turn it over to John and Cathy, I want to finish up where I started. 2017 was a big year for Target. We laid out an ambitious agenda, blending digital and physical, creating new experiences, reimagining our network of stores as hubs for commerce and community, expanding into new markets and reinventing our brands. We made bold investments, more than 100 remodels, dozens of new formats, key acquisitions, blockbuster brands, industry-leading investments in our team, and our team delivered.

We're headed into 2018 with a road that couldn't be more clear. Our strategy is working. Our guests are responding. And we're accelerating the pace, pushing even harder, moving faster than ever before, 3x as many remodels, dozens of new stores, new services, new solutions, moving from concepts like Drive Up to scale and taking Shipt nationwide. And you'll see us continue to invest in our team and roll out one new brand after another all year long. Putting it all together, this is a strategy that's going to make Target America's easiest place to shop.

So now let me welcome John Mulligan, our Chief Operating Officer, to the stage. Thank you.

### **John J. Mulligan** - Target Corporation - COO and EVP

Good morning, everyone. You just heard from Brian that the Target team delivered on the commitments we made last year and then some, from standing up new stores to remodeling existing ones, rolling out new fulfillment options and expanding capabilities to get products to our guests even faster. We're changing our operations to use our stores in new ways, while we continue to offer an exceptional in-store experience, and it's all made possible by the teams that bring those buildings to life.

We have more than 300,000 team members in our stores, face-to-face with millions of guests and tens of thousands more behind the scenes, creating, ordering, moving product and developing the technology, automation and tools that allow us to serve the guests in ways we hadn't even dreamed of just a few years ago. They're the experts, the inventors and the personalities behind every guest experience and the reason we've made meaningful progress toward putting our strategies in motion.

Just about everything our team has done, and continues to do, is in service of supporting our stores as hubs, hubs that offer a great shopping experience, support our communities and fulfill digital orders. They're at the center of how we're welcoming and inspiring guests and how we're making it really easy for them to shop at Target.

So here's a question I get all the time, in today's digital world, why invest in stores? And for us, the business case is simple. When a digital order comes in, we basically have 2 choices, fulfill it from one of a few fulfillment centers across the country or ship it out the back of a local store. We're fortunate to have more than 1,800 stores in really great locations, prime real estate just down the street from our guests, so we can deliver it faster, nearly 2 days faster than if we'd sent it from a regional fulfillment center, plus the inventory is already there because our stores feature a curated assortment we know our guests want. Naturally, it's the same merchandise they buy most often online. And when one store is out of an item, we have other stores nearby that could help fill the order.

Even more, our stores' flexibility to ramp up when things get busy is incredibly powerful. This past Cyber Monday, our stores shipped millions of orders out their back doors. Without that capacity, we would have needed twice as many fulfillment centers as we have today. And when peak



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was over, the stores ramped right back down. So we avoid spending all that capital on new facilities we'd really only need a few weeks out of the year.

Now that's all great, but here's the real kicker and probably the thing you all care about most. Shipping from a store is the best way to lower the total cost of digital fulfillment. We hear a lot about optimizing, picking and packing, which can help make fulfilling an online order more efficient. But step back and look at the total cost of fulfillment. There are fixed and variable costs required to run and staff the fulfillment center. But no question, shipping is, by far, the largest chunk. Going after the variable cost, while really important, only gets you so far. To lower the total cost, you can't ignore the big dog. Shipping from a local store optimizes the most dominant standalone cost by dollars per order. And because we haven't sunk capital into a massive fulfillment center, our overhead and other fixed costs essentially go away. You've all seen our strong digital growth, and we expect that to continue.

So at some point, we'll need to build more upstream facilities just to manage volume, but we're not there yet. Using our stores to fulfill millions of orders lets us delay those investments or avoid some of them altogether. And because our stores are the fastest and most efficient fulfillment method, they'll continue to be our preferred shipping point in the long run. Bottom line, shipping from our stores moves product faster, and we do it at a significantly lower cost. I'm confident, none of you need a spreadsheet to see that, that's a really good thing. For a company like us with well-located assets already in place across the country, this strategy makes complete sense. But the entire supply chain operation has to support it. With everything we're asking a store to do, they need more product than ever before. We're replenishing the shelves and fulfilling digital orders, all in one building from the same pool of inventory, so product has to come fast and often. But there's already so much happening in a store, so the trick is to send them only the right amount of product at the right time and quickly.

You all know our team has been building an entirely new operating model for our supply chain. Last year, I told you about our plans to become more flexible on how we move product. The goal is to be able to move inventory in any quantity, whether that's cases, pallets or individual units, so we can replenish only what we sold. That might mean sending a truck with bottles of shampoo next to cases of ketchup and pallets of water. We send the store precisely what it needs to restock the shelf. It keeps product from clogging up the back room and makes it easier for our teams to manage the inventory. It's a model we've been testing with a distribution center in the Northeast, and it's working. The store supported by that DC have reduced their backroom inventory by more than 1/3 and cut out-of-stocks to half of what we see across the rest of the chain.

Of course, we did all that with an entirely new facility, and we're expanding that operation to support more stores in Northeast. But we're also testing how to work to retrofit our existing network. And by the fourth quarter, multiple DCs will begin the journey to evolve to this model. To do it, we're scaling some of the most promising robotic solutions we've tested in the past year. That automation makes it possible for us to sort and move huge volumes of single units without putting an unsustainable burden on our DC teams or the stores. With less inventory in the back of the store, we can dedicate more room to digital fulfillment.

This past holiday season, we tested a new design in the backroom, complete with more pack stations and dedicated space to sort orders for delivery, and capacity shot up. It was incredible. As orders came pouring in on Cyber Monday, the teams were picking, packing and sorting boxes, just like a fulfillment center. And with an enhanced layout and process, they did up to 6x the volume of the year before. Best of all, guests got their packages faster. Nearly every order that came into those stores that day was picked, packed and ready to ship in 24 hours. This year, to keep up with digital demand that continues to far outpace the industry, we're introducing this new backroom design to more than 150 stores, and we're reengineering the operation in more than 1,000 others. With this additional capacity, our stores plan to shift nearly double the number of packages for Cyber Monday 2018 compared to last year. That's good news because, as I said earlier, shipping more orders from our stores reduces our costs, while allowing us to move faster. And speed is the part our guests will notice. With the changes we've been making across our operation these past few years, the average delivery time for an order was nearing 2 days. But we weren't doing it consistently enough to make that promise to our guests, until now. We're announcing today that we're offering free 2-day shipping on hundreds of thousands of items, no membership required. With more mature fulfillment capabilities, we're updating our promise and resetting our guest expectations of what's possible. It's an offer that's compelling and competitive, and it's just the start.

Speaking of being competitive, one of the biggest leaps we made this past year was our swift move into same-day delivery. With our acquisition of Shipt, Target gained the ability to deliver product to our guests in hours or even minutes. We knew Shipt was a fit for Target right from the start. Here's a startup delivery company that's gone from one market in Alabama to more than 70 markets in just 3 years, so the operation is strong and



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proven to scale. It's a company built on speed, but focused on service, which means working with Shipt, we could jump years ahead in our fulfillment plans without sacrificing the guest experience, staying true to how we've grown for more than 50 years. Take a look.

(presentation)

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### **John J. Mulligan** - Target Corporation - COO and EVP

Just 8 weeks after our announcement, we began offering millions of guests the ability to shop online for more than 50,000 items across Grocery, Essentials, Electronics, Baby and more, and have those products delivered that same day. Already, we brought Target same-day delivery to Shipt members across the Southeast and in the Twin Cities, and we're rolling into new markets almost every week. By holiday, we'll be the first retailer to offer same-day delivery in nearly every major market.

As you just heard, the beauty of Shipt is that it's not just a transaction. Our guests will get a personalized service and care that these shoppers offer, unlike anyone else, while also accessing a wide assortment of products, priced right daily and delivered in hours. The whole package is something no one else is offering today.

At the same time, guests still like to come into our stores and shop, but for guests in urban areas, like Manhattan, they can only buy what they can carry home. Last year, our team saw a need and knew we could help. Just weeks later, they'd rolled out a service at our TriBeCa location in New York City, where guests shop the store and then play (sic) [pay] a flat fee, about the cost of a short cab ride, very cheap, very inexpensive, to have that order delivered that same day. Today, we're offering delivery from 4 stores in New York, and guests love it. It's quick and efficient, and it's all possible because of the technology we acquired from Grand Junction last year. The platform assigns every order to the most logical local carrier, which is what allows us to efficiently scale the service beyond a single store or a market.

Starting this spring, we'll go even bigger in the city, offering the service in 25 more New York locations and reaching all 5 boroughs by Q4. And at the same time, we'll roll it out in other markets, like Boston, Chicago, San Francisco and D.C.

Delivery goes a long way in making our guests lives easier, but just as meaningful as when a team member can put formula and diapers right in the back of a minivan, saving the guest from unloading the car seats to run inside. Last summer, we started testing Drive Up in the Twin Cities. It took order pickup to the parking lot, where our store teams would walk the order out to a guest car. We saw the demand for it right away, and guest feedback was overwhelmingly positive. In fact, Drive Up's Net Promoter Score is consistently over 80. And those of you who are familiar with that metric know that's incredibly high. This spring, at the same time we take Shipt across the country, we'll roll out Drive Up, putting the service in nearly 1,000 stores by the end of the year. In every fulfillment option, shipping, delivering or walking orders to the car, the store is at the center. It also continues to be a destination for millions of guests every week, while fielding much of our digital growth at the same time, so we have to be sure they are equipped to do both.

Brian and I spent a lot of time visiting stores across the country. A little over a year ago, we toured a few markets together and it was clear, the stores that we lean on so heavily needed some love. Not only did the design need a refresh, and by that I mean losing the neon and the vintage signs, but many of the layouts weren't set up to handle digital fulfillment. We walked stores where the team was holding order pickup packages in the backroom meeting areas because they didn't have space upfront or boxing orders in whatever backroom cranny that could fit a pack station. So our store design team developed a new prototype that would do it all. They reimagined the entrances, sales flooring, fixtures to make shopping our stores easier and more inspiring. At the same time, they expanded the order pickup calendar, built a Drive Up lane and rearranged the backroom to handle a growing number of digital orders. In November, we opened a new store in Houston with this latest generation of design. Check it out.

(presentation)



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### **John J. Mulligan** - Target Corporation - COO and EVP

We're incorporating elements of this latest design, as we remodel more than 1,000 stores across the country over the next 3 years, including the 325 we'll do in 2018. But it won't be the same in every store. We'll adjust and evolve, applying what we learn and leaning into what works. And we'll continue to design an experience that feels relevant for each location, from cinema lights on a former theater in Brooklyn to big skylights at the store near sunny UC Irvine.

The fulfillment capabilities our stores gain are critical for our strategy, but so is the improved guest experience that comes from updating a store that hasn't been touched in years, and the difference is real. After a store has remodeled, traffic grows. And we see the 2% to 4% sales lift, on average, that we'd expected.

In addition to the individual stores we're remodeling, we've made investments in key markets. Pick the Dallas-Fort Worth area. Last year, we remodeled 28 stores across the metro, and guests noticed. The refresh design is inviting guests to come back in and to shop, and the reviews have been overwhelmingly positive. We saw with Dallas and with LA25 a few years ago that we can learn a lot from putting our latest thinking into one market. So this year, we'll go big in our hometown and remodel nearly 30 stores in the Twin Cities, on our way to putting the latest design into all area stores over the next few years.

Even as we reimagine our existing stores, we're continuing to find opportunities to bring an elevated experience to new guests, and we're doing that with our small format stores. The flexible design allows us to open in areas where our traditional big-box footprint simply wouldn't fit, city centers, dense neighborhoods, even college campuses. They bring us into new markets, like Vermont, which will officially put us in all 50 states and closer to new guests, like students at the University of Cincinnati and Penn State. Part of joining a new community is being a good neighbor, so our teams go deep into those neighborhoods to really know those guests and tailor the experience to what they need. It's a capability we'd built and refined over time. You can see that most easily with our assortment. And of course, we've got portable electronics and Mac & Cheese in our campus stores.

But we also get specific to a neighborhood, even within the same city. Chicago is a great example. The assortment in our Lakeview Ashland store is focused on Baby and Kids products because that's what those guests buy most. While just 7 blocks away, Lakeview Belmont overindexes on top-selling categories, like home decor and liquor. Last year, we opened nearly 30 small format stores, doubling the number we'd opened up to that point. This year, we'll add another 30. In fact, we're opening a few of them tomorrow in D.C., Boston and Chicago. And we'll do another 30 in 2019, putting us on pace to operate more than 130 small formats by the end of next year, so we can meet the needs of even more guests across the country.

Now all that said, it's the team inside those buildings that make us Target. And our teams work hard to deliver for our guests and serve our communities every single day. So we're continuing to invest in them. You heard our announcement of increasing our minimum wage to \$12 an hour this year on our way to \$15 an hour by 2020. And while pay is important, our investment goes deeper than that. We're also giving our team opportunities to develop and use new skills -- skills that offer outstanding guest service, while also building the basket. Gone are the days when a team member shows up on Monday to work on Apparel and Wednesday to work in Electronics. Instead, we're placing people based on their interest and their background and providing data and paid training to help them truly be specialists in their areas. In fact, we've committed hundreds of thousands of payroll hours for training that helps them succeed in their jobs, but also in their careers.

At the same time, we're giving them tools to better serve the in-store guests. Last year, we launched an application on the team member device that allow them to order something for a guest if the item they want wasn't in their store. This holiday season, it's saved the sale and extended the aisle for thousands of guests. And soon, our teams will use the same technology to save guests from standing in line. When the check lanes are full, our team can use the devices to give us more capacity at point-of-sale. They're able to ring up a guest's full order on the spot, busting lines and saving time. It's just another way they are quick to make a guest experience easier and more convenient.

We've always said that the guest is at the center of everything we do, so it only makes sense that our 1,800 stores in neighborhoods across the country are at the center of how we do it. It's why you'll see our progress continue to support our stores, whether it's modernizing the supply chain, standing up new small formats, building on digital capabilities or, most importantly, investing on our team. All of it is in service of delivering a retail experience guests can't find anywhere but Target. Thank you.



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### **Catherine R. Smith** - *Target Corporation - CFO and EVP*

Wow! Like Brian said, what a difference a year makes. Coming out of this meeting a year ago, we were really confident that we were on the right path. Even so, we knew we'd be a show-me story for a while. We need to begin putting some points on the board to show that our strategy was working. And now that started to happen. But let me be clear, I know for some of you, we still remain a show-me story. And we remain confident in our path, but I'd all -- I thought -- I think we'd all agree we're in a much different place today.

Last year was the beginning of a multiyear effort to position our business for long-term profitable growth. It was an investment year, as we ramped up our capital spending and devoted a portion of our operating income to reposition Target in this new era of retail. Looking back, I'm happy to say that we made all of those investments and more. And with those investments, our business performed far ahead of our expectations, both on the top lines and the bottom lines. In particular, multiple data points either met or exceeded our expectations, including a 2% to 4% sales lift on average from our store remodels; compelling financial performance from our new small formats, including sales productivity, margins and ROIC; a strong guest response to our new brands; digital sales growth of more than 25% for the fourth year in a row; disciplined execution and a positive guest response to our new -- our tests of our new fulfillment centers -- fulfillment options; and following our investments in being priced right daily, our guests noticed, with our sales at Everyday Low Prices were up more than \$4 billion compared to 2016. And finally, the most important metric, guest traffic. It accelerated as the year progressed. Last year, we said that 2018 would be a transition year, and that view is still appropriate today. Our priorities remain the same, but you'll see a rapid acceleration in our pace. To support that acceleration, we'll grow our capital investment to well over \$3 billion this year. To provide a differentiated shopping experience, we'll triple the size of our remodel program. We'll open more than 30 small-format stores in new neighborhoods. We'll expand fulfillment options into new markets across the country, including Drive Up and the same-day delivery enabled by Shipt acquisition. We'll build capacity to ship more orders from our stores, increasing speed and reducing cost. We'll continue investing in our supply chain to enhance the store replenishment and digital fulfillment. We'll differentiate with more exclusive brands, combined with our curated assortment of national brands. And we'll continue to monitor and maintain the right balance of everyday prices and promotions by category. These are important investments to create the Target of tomorrow, which will position this company for growth in 2019 and beyond.

In 2018, we expect that our EPS from our core business will stabilize. This reflects several profit headwinds, including accelerated depreciation resulting from our remodel program, continued cost pressure from the rapid rollout of our new fulfillment options, ongoing wage investments in the face of a tight labor market across the country and the impact of last year's price and value investments, which we'll annualize throughout 2018.

However, unlike last year, we'll expect these pressures will be mostly offset by multiple tailwinds in our business, including the mix benefit of continued strength in our high-margin categories, lower unit costs for digital fulfillment driven by our supply chain, modest expense leverage from a low single-digit increase in comparable sales and of course, continued cost control across every aspect of our business.

And finally, beyond operating income, we expect to benefit from the continued focus on disciplined capital deployment through lower interest expense and modest EPS leverage from share repurchase.

This highlights one of the most important aspects of our business: its ability to generate cash year after year. Look at 2017. Even with an operating margin decline driven by our investments, we generated almost \$7 billion of cash from operations. That is \$1.5 billion more than 2016, nearly a 30% increase, despite the massive changes happening in our industry. So even without tax reform, we would have entered 2018 in a really strong position.

Now let me pause for a moment and talk about tax reform. As a domestic retailer, we have long had one of the highest effective tax rates around, well over 30% in recent years, so we are certainly encouraged. The tax reform has put our company, our industry on a more level playing field and made the United States more competitive globally. But the question we've heard a lot since tax reform was passed, what are you going to do with the benefits? And when you think about that question, it's important to realize we didn't wait for tax reform to make big investments in our business and our team, because we were confident they were the right long-term choices. Think back to our second quarter conference call in August, when



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we first announced we plan to invest more than \$3 billion in our business in 2018, and then a month later, when we took decisive action in support of our single most important differentiator, our team. We announced higher investments and hours training to better equip our team to provide an outstanding guest experience. And to support our team members, we announced we would raise Target's national minimum wage to \$11 an hour as part of a plan to reach \$15 by the end of 2020. And again today, we made another step forward with the announcement of our national starting wage is moving to \$12.

Beyond investments in our team, we're accelerating our capital investments as well. Today, we're raising our CapEx guidance to a range around \$3.5 billion in 2018, reflecting the incremental investments in both our stores and our supply chain in support of the priorities I outlined earlier. So for us, the question -- the answer to the question what are you going to do in light of tax reform is simple. We're investing in our business and our team to support Target's long-term sustainable growth using the same approach we always have. Now you've heard us say it so many times. We first look to invest in projects that promise to generate long-term value, then we want to support our dividend to extend the record -- our record of annual increases. And finally, we look to return any excess cash beyond those first 2 priorities within the limits of our middle A credit rating.

So with that, let's cover a few details underlying our financial expectations for 2018, and then we'll talk about the first quarter. Back in January, we outlined our expectations for a low single-digit increase in comparable sales this year and a full year adjusted EPS of \$5.15 to \$5.45. And today, those expectations remain the same. Among the drivers, we expect our operating margin rate will be down about 20 basis points this year, reflecting the net impact of the headwinds and the tailwinds I outlined earlier. Across the lines of the P&L, we're expecting relatively small changes in gross margin and SG&A in 2018, which together should net to approximately 0. So in essence, this year's expected decline in our operating margin rate will be driven entirely by \$175 million increase in depreciation and amortization. One note, this is -- this expected increase is smaller than I outlined in our last conference call. Since then we have continued to refine our outlook and expect less year-over-year D&A pressure in the year as it goes on, specifically in the third and fourth quarters.

Beyond operating metrics, we expect our interest expense to decrease about \$60 million this year, reflecting last year's debt retirement and refinancing activities conducted by our treasury team. And finally, we expect our consolidated tax rate to be in the low to mid-20% range, lower than in recent history in light of tax reform.

Now I'll turn briefly to our expectations for the first quarter. On the top line, we're planning for a low single-digit increase in our first quarter comparable sales. We're expecting a moderate increase in our first quarter gross margin rate, which will be more than offset by an increase in our SG&A expense rate. And we're expecting an increase in our first quarter D&A expense of about \$80 million, consistent with the outlook I provided on our last conference call.

Altogether, this adds up to a decline in operating margin rate of 60 to 80 basis points in the first quarter. Combined with a reduction in our interest expense of about \$20 million and the benefit of the lower tax rate, we're expecting first quarter adjusted EPS to be \$1.25 to \$1.45.

One final note on our guidance. As you began seeing in our results last year, our new stores are starting to have a meaningful impact on our total sales growth. As a result, in 2018, for both the first quarter and the full year, we expect that our new stores will add approximately 50 basis points to our total sales growth. So now I want to step back and talk a minute about how our financial model is changing. While we're not going to provide long-term guidance today, we can offer a strategic view. With the changes we're making to our business model, we expect our financial model to evolve as well. Like the past, we'll continue to focus on growing traffic sales and profits, enabled by our strategic investments we've highlighted today. And our stores will be right at the center of that growth, providing an outstanding shopping experience along with fast and efficient digital fulfillment in support of a rapidly growing suite of convenient options. By placing our stores at the center, we expect our business will generate somewhat higher asset turns and somewhat lower operating margins than we've seen historically. This evolution will support continued outstanding after-tax returns on invested capital, something that's been a strength of this company for a very long time. In fact, if you think back in our history, this isn't the first time our business model and financial model have changed in service of an evolving consumer. Remember, our company began over 100 years ago as a traditional department store. It had a business model that generated higher margin rates and lower asset turns compared with Target stores. Yet, even as we completely transformed our business model from department stores to Target stores, our company has generated strong returns on capital for decades. Even in 2018, an investment year, we earned a very healthy 14% after-tax ROIC, and that's after we exclude the onetime benefits from tax reform. This is performance that many in our industry would love. And in 2018, we expect ROIC to move beyond 14% even in the face of increase in capital spending.



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As we look past 2018, we don't believe that margin rates are going to unsustainably low levels. And we can clearly see a path to evolve our financial model and reward investors by delivering growth and attractive returns, consistent with the long-term record of this great company. We know we serve as stewards of a company that will have a very long history, and I can assure you that this leadership team is all in, in sustaining that great legacy we've inherited.

So now I want to end my remarks where Brian began, with a shout-out to our team. As soon as I came to Target, I quickly realized how special this team really is. I see it every day that I'm out in our stores, walking the sales floor or when I'm visiting our distribution centers or every day in our headquarters. No matter where they are or what they do, when you spend time with our team, you feel firsthand the pride they have in our company, our brand and the role Target serves in every community we are in. They share a common purpose to bring joy to our guests' lives, and they project an infectious sense of optimism. They see clearly that Target will succeed if we focus on the long term and make the right choices for our business, for our team, for our guests and our shareholders. So while there is no question that times were tough a year ago, our team's passion and energy never faded. Our team embraced the challenge to move faster and think bigger and begin moving Target from a show-me story to a long-term success story again.

So I want to say thank you to the entire Target team for everything you do. It's a privilege to work with you as we write this new chapter in our history.

So now I'm going to turn it back over to Brian for a brief wrap-up, and then we'll move to questions. Thank you.

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

So I love the way Cathy just brought it all together. We have an incredibly talented team at Target, and they truly delivered in 2017. I couldn't be more proud of their ambition, their passion for the brand and the way they always do the right thing for our guest. When you think about 2017, you heard it from Cathy and John, it was in every sense an investment year. We made big bets on new brands, new experiences and capabilities. We leaned into new partnerships and empowered our people. 2017 was a year of progress. As we looked to the year ahead, 2018 is all about scale and acceleration, so we're tripling the remodel program. We'll add another 30 small formats. We'll introduce many new brands. We're rolling out new service models and game-changing fulfillment capabilities and making even deeper investments in our team. And I'm really confident about what's next.

I'll be the first to say we still have a lot of work to do. The competition is fierce, the pace of change is unrelenting, and our guest deserves the very best. But I couldn't be more bullish about Target's prospects. The strategy we're pursuing is working. Our guests are responding. And now our team is more than ready to pick up the pace and move faster than we ever have before, with one goal in mind: to make Target America's easiest place to shop.

(presentation)

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## QUESTIONS AND ANSWERS

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

All right. So I'm going to ask John and Cathy to join us on stage, so we can answer some of your questions. In addition to questions in the room here today, we also have questions coming from our webcast. We're going to try to make sure we incorporate those into the approximate 30 minutes we have for Q&A today. So we've got mic runners. They'll have bull's-eyes in their hand. I would ask, as you ask your questions, if you could just pause to identify yourselves. We can see many of you, but not very well. So why don't we start with Simeon, right up front. I can see up to about the second row, so it was an advantage.



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**Simeon Ari Gutman** - *Morgan Stanley, Research Division - Executive Director*

I want to focus on 2 items that have been pressuring margins. First, investments and capabilities, investments being a catchall, including wage. I mean -- and then the second pressure point is the shift to a lower-margin channel. And can I ask you to comment on each, where you are in terms of your spend? The SG&A guide sort of implies that we've reached some peak level, and we're going to taper off. And then second with regard to the mix shift to online, where are you in that journey? You said the customer is agnostic. Are you financially agnostic?

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

Yes. So let me start, and then I'll turn it over to Cathy and John. But I think as we outlined today, we've made significant investments in the last year in our team, in new capabilities, in new brands. You're going to see that stabilize as we go into 2018. And as Cathy mentioned in our outlook, we expect to see gross margin rates stabilize, if not slightly improve, in 2018, offset by some of the investments we'll make in SG&A. So I think we've reached a point of general stability in our model. We're going to continue to invest. It's a period of, now, acceleration. But we've spent a lot of time over the last 3 years testing and validating our investments, making sure they are the right thing for our guests, the right thing for our shareholders, that we're going to be sustainable and then we're also going to provide the right return on invested capital. And I think you saw that today in our outlook. So again, we've got a lot of work to do in 2018. It is a year of acceleration. But we're accelerating based on the validation that we saw in '18 and the confidence that we're going to continue to drive great returns.

**Catherine R. Smith** - *Target Corporation - CFO and EVP*

The only thing I'd add, Simeon, is kind of longer term, that perspective of as our business model is evolving using the stores at the center of that strategy, we do expect that you'll see continued, really terrific ROIC or after-tax ROIC and so kind of probably lower operating margins than we've seen historically, not inconsistent with where we are today, but really strong continued asset efficiency, which will drive that ROIC, so growth in our ROIC.

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

And your question about digital and the mix between the 2 channels. As I said several times today, we really want to make Target America's easiest place to shop; allow our guest to interface with great stores and even better store experiences as we remodel; give them a number of options for fulfillment, whether it's order online and pick up in our store, now drive up to our lot and pop that trunk, and we'll put it right in there; use Shipt to provide same-day delivering in hours, if not minutes; and convenient service right to their home. So we have to be agnostic, let the guest decide. But one of the great highlights from our fourth quarter was the fact that we saw really strong traffic and growth, both in our stores and our digital channel. And we expect as we go into 2018 to continue to drive positive growth into our stores, to drive positive comps in stores, that's critically important, and to continue to be a leader in digital growth. And I think the investments we're making in Shipt, in Drive Up, in other services positions Target uniquely, as we move into this next era of retailing.

**Wayne Hood** - *BMO Capital Markets Equity Research - MD & Research Analyst*

Just to follow-up on his question, looking at the spend rate in remodels may be peaking by 2020, the wage investment is actually peaking then as well. Why wouldn't you expect operating margins to lift in 2020, given the runoff in D&A and the spend is actually over? And then I had a question about John, if you talk a little bit about the execution on -- a lot of I heard -- what have we seen so far today is absent on improve processes, but it that didn't really address maybe the headwind in the store. And that's the modular issue that the systems will allow you to get right quantities, but the challenge is the modulars are not really set in a way that allows it to flow very -- as nice as you would like to see. So how do you address that the modular side, as the store format begins to change over time?



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

So why don't I start with the first part of the question. And Wayne, you're absolutely right. As we get into the out-years, we are going to see our remodel schedule begin to normalize. Right now, we're in a catch-up state. And as we accelerate over the next 3 years, obviously, we'll touch the vast majority of our stores. So in the out-years, we do expect that to normalize. But we have a lot of work to do in these next few years. It's all about making sure we execute our plan and touch and enhance the experience in as many stores as possible before we return to a normal remodel schedule.

**John J. Mulligan** - Target Corporation - COO and EVP

I'm sorry, Wayne. I didn't fully understand the second part of your question.

**Wayne Hood** - BMO Capital Markets Equity Research - MD & Research Analyst

I probably didn't ask it right, but I'll ask it again. So the challenge to me has always been on store replenishment side was the modulars really are not of the size that allows you to get a full case pack onto the modular. And you can do all the backroom maneuvering that you want to do that gets you so far. But those modulars over time seems to me have to change to allow for bigger quantities, what you want to do. And then you take into account how the store is changing and what modulars may or may not present there in 5 to 10 years now, you may be looking at another remodel around based on where the modulars are.

**John J. Mulligan** - Target Corporation - COO and EVP

Yes, I think this goes back to why we talk about flexibility in the supply chain to address that. I think when you look where we're at today, and you're right, it will evolve over the next 10 years. Who knows what we'll have in store then? Maybe Mark does, but that will come later. 70% of that stuff doesn't sell more than 1 per store per week. So I don't need to flow case packs into that store for those items. If you think about bike helmets, the likelihood of us selling more than 1 bike helmet in a week this time of year in Minneapolis is very low. We may sell 1, and probabilistically, we will sell 1 sometime this month, but we won't sell more than that. And so that's why we go back to flexibility. There's things that are going to have to go in there in a very high-speed, high-capacity. To your point, we need to make sure a case pack fits on the floor or a case pack and half or 3 case packs in the case of Tide or 8 case packs or 20 case packs, because we move that in pallet loads. But for the majority of what we sell, much lower volumes, that needs to come in, in single units. And so it's really about having that flexibility upstream to meet the demands of whatever it is we're doing in store. And that's why we're headed down the path we are.

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

Why don't we go to this side of the room? Oliver?

**Matthew Jeremy Fassler** - Goldman Sachs Group Inc., Research Division - MD

It's actually -- it's Matt Fassler from Goldman Sachs. I've got a question about the level and cadence of expense growth as you move through the year. The guidance that you gave for Q1 and then for the year as a whole would imply that the expense profile improves as you move through the year. As the wage growth piece seems like it will be persistent, are there expenses that fade as you go through the year? Are there cost-out opportunities that build? Or is there a top line acceleration implied in the guidance?



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**Catherine R. Smith** - *Target Corporation - CFO and EVP*

Yes, it's a little bit of -- I talked about all of the tailwinds, and it is a little bit of all of those things. So we'll see some leverage because of the continued comp sales increase. We'll see some continued cost control, as we move throughout the year, that we have planned. So it's kind of the combination of the 4 different tailwinds and 1 of the headwinds.

**Matthew Jeremy Fassler** - *Goldman Sachs Group Inc., Research Division - MD*

And if I could just ask a quick follow-up. You also shared lots of top line drivers. You talked about remodels, the new brands, Shipt, free 2-day shipping for a larger array of goods. Can you talk about how those layer into the revenue forecast over the course of the year?

**Catherine R. Smith** - *Target Corporation - CFO and EVP*

Well, we gave first quarter guidance -- I can start John, I guess. We gave first quarter guidance, obviously, low single digit, and we gave full year guidance low single digit. And those all contemplate, obviously, our continued brand rollouts as well as all of our fulfillment expansion. So those are all included in that low single. Just so happens, it's Q1 and full year.

**John J. Mulligan** - *Target Corporation - COO and EVP*

Yes. And much of that digital, absent the 2-day, which is effective today, the Shipt and Drive Up, those are the 2 big ones that we'll expand nationally. Our goal -- you'll see a pretty linear ramp-up through the end of Q3. And our goal is to have all of that done ready for Q4 to be done, and that'll all ramp up as we go along throughout the year.

**John Hulbert** - *Target Corporation - Senior Director of IR*

Brian, we got one from the webcast participants. We got somebody that said they applaud us for the CapEx that we have, projects that are high-returning, wondered after this wave of remodels is over, the 1,000 over the next 3 years, what a more normalized level of CapEx might look like in the longer term?

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

I think most of you know, we're not going to provide long-term guidance, and we're not going to provide long-term CapEx guidance. But we're going to continue to look at different projects that add value and provide great returns for our shareholders. And we'll be looking in the future to think about how we continue to provide a great physical and digital experience for our guests and make the right investments that continue to add value for our shareholders. So we don't have a long-term guidance that we're going to provide today for CapEx, John, but we're going to continue to take the same disciplined and surgical approach to CapEx that you've seen over the last few years.

Why don't we go upfront. I'll give Oliver a chance, since I jumped over him before.

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

The digitization of the supply chain is likely key to unlocking the asset turns. What do you think about that with respect to algorithms as well as your relationships with vendors and as you think about robots and making sure that's on track?



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### **John J. Mulligan** - Target Corporation - COO and EVP

Yes. So all things we're working on, Oliver, you heard me talk about we spent the last 12 months testing automation in, I think, 5 different facilities, various different forms of automation, bringing them together in different combinations in the Perth Amboy facility out in the Northeast. We're starting implementation of 1 view of that. We're implementing something different here in a DC located in Fridley. So that's a piece of it. We have a large team working on supply chain analytics, primarily located, but not exclusively located, out in the Bay Area, working with Mike's team to provide the technology and the analytics in combination. And again, if you look at Perth Amboy, Mike's team built an entirely new warehouse management system. And then there is the analytics attached to it to move how much inventory. So were moving down the path on all of those together. It is going to take all of those to deliver what we want from a supply chain perspective.

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

And Oliver, we try to showcase, obviously, a lot of the initiatives today, give you a chance to interact with the team, see the work that we're doing today. What underpins so much of that is the work we're doing from a data and analytical standpoint. So our team in Sunnyvale is supporting Mark and his team to make better assortment choices, better pricing and promotional choices. Mike's team of engineers that's driving so much of the work we're doing, as we reinvent how we run our stores, how we fuel our supply chain. So the commitments and the investment we're making in our team go well beyond what you've seen today, and a lot of it is to make sure we have cutting-edge data analytics. We've got great engineer and computer scientists that are helping Mike and Mark and Rick make better decisions from a merchandising standpoint, a digital standpoint and a marketing standpoint. And that is certainly going to fuel our business as we go forward for years to come.

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

Last question is about value. What are your thoughts about value in terms of making sure you communicate a clear value? And as we model comp store sales, should we continue to see your check size versus traffic? How do you think that will evolve in stocking versus fill-up?

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

Yes. I think one of the great highlights this year that we really didn't cover is the work that was done between Mark's merchandising team and Rick Gomez's marketing team to make sure that as we made these investments to be priced right daily, we communicated that to our guest, both in-store from a personalized standpoint and throughout the year in our marketing and advertising campaign. And I think it was the combination of all that work that yielded the benefits that Cathy talked about today, that significant mix of \$4 billion of sales from promo to Everyday. So as we go forward, we'll continue to remind our guests that we offer great value, that we're priced right daily on thousands of items across the store. And I think one of the great turning points for our business this year was the balance that we brought back to advertising Target style, but also letting our guests know every single week that we were priced right daily and there was great value within the store. And I think that's driving traffic. I think that played a significant part in the traffic increases we saw in the fourth quarter that's driving basket. And beyond some of the numbers that we've shared, it's driving an acceleration in units in those important personal and essential categories. So that commitment to value and being priced right daily, we think, is critically important to driving traffic, to leveraging our multi-category portfolio and making sure people are shopping us not only for the great style brands that our teams are bringing to market, but those household essentials that bring cars into our parking lot and clicks to our site every single week. So that commitment to value is something that you'll see throughout '18 and for years to come.

Why don't we go to the back of the room, and I'll let you pick a hand, because unfortunately, from here, we can't see. So if you can identify yourself, we'd really appreciate it,

### **Robert Scott Drbul** - Guggenheim Securities, LLC, Research Division - Senior MD

It's Bob Drbul from Guggenheim Securities. Brian, 2 questions I have. I guess the first one is, as you look at the full year expectation for gross margin coming off of this holiday season, can you just reiterate what you see from a gross margin and competitive perspective that gives you the confidence

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in a flattish or up-slightly gross margin? And the second question is on the free 2-day shipping program, will that be fulfilled out of the stores? Or is that going to be a fulfillment-center type, can you just maybe elaborate on that expectation going forward?

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

Why don't I start from a margin standpoint? And as we've talked about throughout the last few quarters, our team has made significant progress, as we have shifted our business from promo to Everyday, the by-product of that commitment to being priced right daily. That's going to continue as we go forward. As you've seen over the last couple of days, we'll continue to introduce great new own brands in those signature categories that, as we all know, are higher-margin and provide a great return, both in-store, but also to our digital business. So we'll continue to see the benefits of the analytics, the science that we're placing behind our pricing and promo strategy, the shift from promotional sales to more regular-priced business, the benefits as we bring new excitement into our stores with great innovation. That's going to continue to stabilize and improve our margins over time, and it's a great point of differentiation. So whether it's Opalhouse or Umbro or some of the things you saw this morning, many new things that we'll talk about over the balance of the year, those higher-margin Home and Apparel items, those great own brands that you can only find at Target, benefit not only our store margins but also our digital margins. And we'll continue to drive efficiency over time. John, you want to talk about fulfillment?

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**John J. Mulligan** - Target Corporation - COO and EVP

Yes. I think you'll see -- next year at this meeting, you will see that our penetration of units delivered from stores will grow relative to 2017 and relative to 2-day, absolutely. We would expect the majority of that to be delivered from store. We know that's the fastest place it can be delivered from.

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

John, should we go to the webcast?

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**John Hulbert** - Target Corporation - Senior Director of IR

Yes. Thanks, Brian. We've got a variety of questions about Shipt, so I'll just give you all of them. One being, are we getting new guests coming in because of Shipt yet? One, the decision to maintain the marketplace in order -- in other words, share that marketplace with other retailers on the Shipt platform. And then finally, the decision of why to acquire them versus to just become a partner on their platform.

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

John, you want to lead this one off?

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**John J. Mulligan** - Target Corporation - COO and EVP

Sure. I think maybe I'll start with just what are we trying to do with Shipt and then hopefully, address some of those questions. We have 3 priorities for Shipt that we have been focused on since we closed the acquisition. One is scale Target nationally under Shipt app and shipt.com. And we are well down that path, we're in 455 stores. We're adding markets every single week. The second was -- is bring Shipt to target.com. Mike and his team are working hard on that to provide that option for guests who come to us directly through target.com will provide same-day delivery service for our entire assortment. And then third was expand the marketplace. And I guess, to get at a little bit of this, we think the value here is about bringing all those retailers together. That's the value of the membership. We know consumers have different reasons they go to different retailers. Often they come to Target, we really like that. Sometimes they go other places. But bringing all those retailers together on 1 marketplace is incredibly



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powerful to bring consumers into the Shipt app. And so we've had great conversations with other retailers. We already have great partners in H-E-B, in Publix, in Meijer, Costco, all on the app, and we'll continue to grow that. So we're very interested in continuing to grow that marketplace.

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

And to the other question, Cathy, John and I, all spent quite a bit of time looking at other same-day delivery options, and we invested a lot of time getting to know the Shipt organization. We were attracted to Shipt and decided to take an ownership position because of that personal connection we saw with their member. And as we spent time and went to Birmingham, worked with some of their shoppers, saw the caliber of people that were shopping for Shipt, these moms who were shopping for moms, the approach they took to really building a relationship, we felt it was so important to own that last mile touch and that human interaction that we think really differentiates Target from anyone else in that space. So we certainly had options to partner with other last mile delivery companies, but we thought Shipt had a very different approach. It wasn't just the transaction, it was building a relationship. And we thought, owning that human touch was very consistent with what we think is our greatest asset, and that's our people that make such a difference, as we talk to guests and they describe why do they shop at Target. As said earlier today, most of the time the answer is pretty simple, it's because of our team.

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### **Peter Sloan Benedict** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Peter Benedict of Baird. Two questions. First, the cost to upgrade these fulfillment centers, the modernization, John, that you talked about. Can you give us a sense of maybe how much that is going to contribute to capital spend over the next few years? And what's the cadence? How many do you need to do? And when do we get to the endpoint there? And the second point -- question would be on inventory growth. How should we think about that as you kind of clean up the back rooms, you improve the flow of product over the supply chain? How should we think about inventory growth maybe versus sales?

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### **John J. Mulligan** - *Target Corporation - COO and EVP*

Yes. I think, first on the capital. Cathy has provided the capital guidance. It's all within our capital guidance, everything we've talked about, we have planned for. If that changes, I am sure Cathy will come back and let you know that changes. I think pace, we will know more about that actually near the end of this year than I do right now. We're very focused on getting the Perth Amboy facility up and operating and -- because that's kind of the end state. This is what great will look like. Simultaneous with that, like I said, we're testing how we can start to evolve the broader network into that step-by-step-by-step, and what we're doing this year will be the first step. And we hope to have a decision about perhaps getting to 8 of those, realistically, probably very early next year and then expand from there. Meanwhile, while we're doing that, go back into the local distribution center and say okay, what's the next step we would bring to that in order to move it down the path? So that's kind of the sequence we're thinking about year-over-year. This won't happen over the next 18 months, because it can't. This is a conversation we have internally a lot. If we could like shut down for 9 months and not deliver any product to stores, we could get this done very quickly, but we don't have that ability. We need to keep producing product for the store, or shipping product to the store. So it will be a gradual evolution over time. I mean, the investments will follow that gradual evolution.

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### **Catherine R. Smith** - *Target Corporation - CFO and EVP*

Can I answer the inventory question real quick for you? Longer term, as we've talked many times, Peter, we do see the inventory loads, as we move product exactly where we need it, when we need it, will continue to come down. Obviously, we want to make sure we have a great guest experience and we're in stock. And so we're going to balance that as we're evolving supply chain, so -- through this transition period and then obviously, to support all of the wonderful new brands and products we're bringing in.



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

So just to build on that, it is going to take time. And as you've seen over the last couple of years, with the approach we've taken to a number of initiatives, we're going to test, learn, iterate and then move forward. And it's a same model we took to own brands, starting with Cat & Jack, learning from that success, and now we're building out the portfolio. It's the same approach we took to remodels. We started with 25 stores in L.A. We continue to learn and listen and iterate. And once we saw the right response from the guest and the right return on invested capital, we moved more quickly. We're doing the same thing from a DC standpoint. We're constantly learning and updating our approach. And we think we've got a model that you can expand, but we're going to do that very, very carefully and make sure that we have a system that can be scaled. And when we get there, to Wayne's question, we will see better units of measure flowing into the stores, which will naturally improve inventory levels and working capital. But this is one that's going to take time. To John's point, we are not shutting down our system for 9 months. It's going to be a multiyear journey, but we're going to make sure that we do it right and we get the right returns and continue to provide the right experience for our guests.

We got a question upfront here.

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### **Gregory Scott Melich** - MoffettNathanson LLC - Partner

It's Greg Melich with MoffettNathanson. So I had a follow-up for Cathy. And then Brian, I had another question. Cathy, the \$3.5 billion CapEx that is, I think, about \$500 million more than what you were thinking before. Should we think about that -- I know you're not giving long-term guidance, but is that more of a pull-forward of things that you had or more of -- given what you see, there's more stuff you want to lean into this year? And then Brian, I had a follow-up.

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### **Catherine R. Smith** - Target Corporation - CFO and EVP

Yes. So consistent with our strategy Brian had laid out, we intend to remodel. We're seeing the great returns, 2% to 4% lift. We make sure we have great returns on invested capital with those. And as we've seen the remodels perform, we're going to continue to get towards that 1,000 stores that Brian talked about. But -- and by the time we get there, much of our fleet will be much younger in age. Obviously, some of the heavier needs are earlier on, which is why the capital is a little higher. But I would expect we've done -- did \$2.5 billion last year, \$3.5 billion this year. Obviously, we're not slowing down. We're seeing great return, and we're seeing a great response from our guests. So we're not giving long-term guidance, but you can expect that we'll continue down those stores.

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### **Gregory Scott Melich** - MoffettNathanson LLC - Partner

And then Brian, you talked a lot about acceleration, right, what happened last year and it's now time to really accelerate it. Could you talk a little bit more about the brand acceleration? It seems like with 12 brands in 12 months and -- is that a new run rate? I mean, can the organization really be expected to come up with that many new great brands and ideas every year? Or is there a certain amount that you -- or could that become 18 in a year? Or is there a certain amount of product that you're sort of limited on that, ultimately, we only want to change over 1/4 of the SKUs or something like that?

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

So Greg, I wouldn't expect that to be the long-term run rate. But certainly, as Mark and his team have looked at the portfolio, we've seen opportunities to replace some of the existing brands that have been in our portfolio, fill new white spaces. And over the balance of 2018, we'll continue to bring newness and innovation to own brands. And then we'll continue to listen to the guests, understand category trends and bring great newness and innovation, whether it's with a new own brand or some of the great partnerships we'll continue to bring forward on a limited-time basis like we announced earlier today. So I wouldn't expect that to be the run rate, right, for Mark and his team, but we see significant opportunities to continue to strengthen our own brand portfolio in 2018, and we'll look for further opportunities in the years to come.

All right, let's go to -- all the way to the back of the room.



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**William Arthur Dreher** - *Susquehanna Financial Group, LLLP, Research Division - Analyst*

Bill Dreher here from Susquehanna Financial Group. I have a question regarding the renovations and remodels. How do you prioritize the renovations or remodels? So are you working with the stores with the greatest opportunity, the oldest stores, or how do you work on that? And then how do you -- how much of the new store remodel program can be brought in? Not 100% of all the new modules can be brought in. Should we be expecting a similar 70%, 80% of the modules brought in? And how does that roll out?

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

John, do you want to tell about the remodel strategy?

**John J. Mulligan** - *Target Corporation - COO and EVP*

Yes. So it's a little bit of everything you said, actually. When we're choosing the stores, we have a model that helps us generate age, condition, when's the last time. Part of it that comes into it is how hard is this store shopped, how high-volume is it, what is the average basket, so do they get shopped really hard day in and day out. And then to your point, where can we have the biggest impact, where can we go in and say, look, these 10 stores or dozen stores, we know that they are in need of it and we will have a big impact. So we go through a process. The team recommends those. They have conversations with the senior store leaders as well to get their local viewpoint about what's going on in that marketplace, has somebody opened up 6 grocery stores around us or whatever it is and say, hey, this is one where we could really use the help competitively. So there's multiple pieces we come together with. The team distills that down, and then we come to a consensus about this is the list we're going to go after for this year. As you can imagine, when you're doing 100, that's a lot more difficult when you're doing -- than when you're doing 325. The list gets a lot more easy and a lot less contentious. So it's a great process. The team is already working on 2019 and actually thinking about 2020. So that all happens much further in advance. To your question about what gets put into the remodel, our goal is always to put in as many elements as we can in any individual store. The calibration though is we want to make sure that store can afford to have that much investment, and so lower volume stores get less. And the great thing is, and I've seen this happen multiple times, when we say here's where we're going to draw the line on lower volume stores, Brian challenges the team, go figure out a way to get these 2 more elements into that store. They go back, they value engineer, they find ways to do it more efficiently. Certainly, as we do more scale, that brings efficiency to it. And so we found ways to move some of the elements we really like even into those low-volume remodels.

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

So I've gotten the note to say it's time wrap up this session. But before we close out, I do want to thank you for joining us in Minneapolis this week. We spent a lot of time debating where to hold this meeting. And really thought, based on the stage of our journey, it was the right time to have you here, so you could see our new renovated downtown store, spend quality time with our leadership team. This morning, we wanted to give you a sense for all of these initiatives we're working on and how they're going to help us create the Target of the future, give you a glimpse into some of the things we're doing from a technology standpoint that's going to make it easier for our guest to shop at Target and easy for our team to support that guest. And I hope, today, we were able to give you a sense for our excitement for 2018. 2017 was a year of significant progress for this team. 2018 is all about acceleration, taking all the learning that we've gathered over the last couple of years and really stepping on the accelerator. And I think we're on our way to creating long-term value for our shareholders, but most importantly, continuing to differentiate our brand and ensuring Target is one of the long-term retail winners as we move forward. So thanks again for joining us. Travel safely. And we look forward to seeing you again later in the year. So thank you.



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