



# Target Corporation (TGT)

Updated July 12<sup>th</sup>, 2018 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b> \$78	<b>5 Year CAGR Estimate:</b> 9.4%	<b>Volatility Percentile:</b> 74.5%
<b>Fair Value Price:</b> \$79	<b>5 Year Growth Estimate:</b> 6.0%	<b>Momentum Percentile:</b> 94.8%
<b>% Fair Value:</b> 99%	<b>5 Year Valuation Multiple Estimate:</b> 0.1%	<b>Valuation Percentile:</b> 63.7%
<b>Dividend Yield:</b> 3.3%	<b>5 Year Price Target</b> \$105	<b>Total Return Percentile:</b> 63.1%

## Overview & Current Events

Target was founded in 1902 and has operations only in the U.S. Its business consists of 1,829 discount stores, which offer general merchandise and food. Target has a market capitalization of \$41 billion.

Target has been affected by the ongoing price war in the retail sector, which has heated more than ever. The acquisition of Whole Foods by Amazon caused shockwaves in the market over its potential repercussions to conventional retailers but the dire forecasts on pricing and market share have not materialized. Moreover, Target has moved in the right direction to address its challenges. It has invested heavily in the remodeling of its stores and expects the same-day delivery option to be available to 65% of the U.S. households by the end of this year. Furthermore, it will expand this initiative to include all the major product categories next year.

In Q1, Target reported 3.0% same-store sales growth (vs. expected 2.8%) and 3.7% traffic growth, which was the highest quarterly rate in more than a decade. Its digital sales rose 28% and are thus on track to grow more than 25% for a fifth consecutive year. However, due to the above initiatives of the company in response to the fierce competition, its operating margin fell from 7.1% to 6.2% and thus led the company to miss the analysts' EPS estimates (\$1.32 vs. expected \$1.38). Consequently, the stock plunged 6% on the day of its earnings release. Nevertheless, the market seems to have realized that the company is moving in the right direction and hence the stock has retrieved all its losses.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.86	\$3.30	\$3.88	\$4.28	\$4.38	\$3.21	\$4.27	\$4.69	\$5.01	\$4.65	<b>\$5.27</b>	<b>\$7.05</b>
<b>DPS</b>	\$0.60	\$0.66	\$0.84	\$1.10	\$1.32	\$1.58	\$1.90	\$2.16	\$2.32	\$2.44	<b>\$2.54</b>	<b>\$3.30</b>

Due to the fierce competition and the failed attempt to expand to Canada, the earnings per share of Target remained almost flat from 2012 to 2017. However, the turnaround efforts have eventually begun to bear fruit. In addition, the company will greatly benefit from the recent tax reform, as its tax rate will drop from about 30% to the low 20s. As a result, the analysts and the management expect the EPS to climb 13% this year, to approximately \$5.27.

Target grew its EPS at an average annual rate of 5.5% from 2008 to 2017. While its EPS have remained almost flat in the last five years, Target has significantly improved its performance in the last 12 months. The company has reduced its share count by about 4% per year in the last five years and is likely to maintain a similar buyback rate ahead. It is reasonable to expect 6% annualized EPS growth, from \$5.27 this year to \$7.05 in 2023.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	16.2	12.8	13.9	11.9	13.7	20.7	14.7	16.6	14.6	14.2	<b>14.8</b>	<b>14.9</b>
<b>Avg. Yld.</b>	1.3%	1.6%	1.6%	2.2%	2.2%	2.4%	3.0%	2.8%	3.2%	4.0%	<b>3.3%</b>	<b>3.1%</b>

Target has dramatically outperformed the market in the last 12 months, having rallied 52% while S&P has gained 14%. Moreover, in our previous update, three months ago, we had stated that we were expecting the P/E ratio of the stock to rise from 13.9 towards its 10-year average of 14.9. Indeed, since then, the P/E ratio of the stock has climbed to 14.8. Consequently, most of the stock appreciation potential from a valuation point of view has disappeared.

If we assume that the stock will be trading around its average valuation level in 2023, the stock will enjoy just a minor 0.1% annualized gain thanks to the expansion of its valuation level.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	46.3%	43.5%	44.4%	47.6%	47.2%	47.2%	47.7%	51.8%	53.5%	54.4%	<b>53.7%</b>	<b>54.0%</b>
<b>Debt/A</b>	65.6%	68.9%	65.5%	64.6%	66.1%	65.6%	63.6%	66.0%	67.8%	70.7%	<b>71.3%</b>	<b>70.0%</b>
<b>Int. Cov.</b>	8.1	5.1	5.8	6.9	6.1	8.4	4.6	5.1	9.1	4.9	<b>6.5</b>	<b>6.5</b>
<b>Payout</b>	21.0%	20.0%	21.6%	25.7%	30.1%	49.2%	44.5%	46.1%	46.3%	52.5%	<b>48.2%</b>	<b>46.8%</b>
<b>Std. Dev.</b>	60.0%	39.2%	20.4%	23.4%	15.1%	16.2%	20.6%	20.7%	22.8%	30.3%	<b>28.0%</b>	<b>25.0%</b>

Target is a Dividend Aristocrat that has grown its dividend for 49 consecutive years. However, as it has grown its dividend much faster than its earnings, it has markedly increased its payout ratio, from 20% in 2009 to 48.2% this year. Moreover, the company is heavily investing in its business in order to navigate through the changing landscape in the retail sector. Therefore, the company is likely to raise its dividend at a slow pace in the upcoming years. In each of the last two years, it has raised its dividend by only 3%.

Given the price war in the retail sector, Target does not have a moat. In addition, as consumers tend to curtail their consumption during recessions, the company is vulnerable in such periods. To be sure, its EPS fell 14% in 2008. Nevertheless, that performance was much better than that of most companies, which saw their earnings collapse during the Great Recession. Moreover, it took only one year to the EPS of Target to return to their pre-crisis level. Therefore, while Target is vulnerable to economic downturns, it is much more resilient than most stocks in such periods.

## Final Thoughts & Recommendation

After a rough year, Target has markedly improved its performance in the last 12 months. As a result, the stock has rallied 52% during this period and hence most of the capital appreciation potential of the stock from expansion of its P/E ratio has disappeared. Nevertheless, the stock can still offer a 9.4% average annual return over the next five years thanks to its 3.3% dividend, a 0.1% annual expansion of its P/E ratio and 6% annual EPS growth. This return is certainly attractive and is much higher than the upside potential of most stocks at the current phase of the ongoing 9-year bull market.

## Total Return Breakdown by Year

