Target Corporation (TGT)

Updated August 22nd, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$88	**5 Year CAGR Estimate:**	7.1%	**Volatility Percentile:**	74.5%
Fair Value Price:	$81	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	91.0%
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.8%	**Valuation Percentile:**	46.3%
Dividend Yield:	2.9%	**5 Year Price Target**	$108	**Total Return Percentile:**	46.0%

Overview & Current Events

Target was founded in 1902 and has operations only in the U.S. Its business consists of 1,839 discount stores, which offer general merchandise and food. Target has a market capitalization of $47 billion.

Target has been able to withstand 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.

Target reported its financial results for the second quarter of fiscal 2018 today. The company grew its comparable sales by 6.5%, much more than the expected 4.1% growth rate, thanks to 6.4% traffic growth. The same-store sales growth is the highest growth rate in the last 13 years while the traffic growth is the strongest since the retailer began reporting traffic, in 2008. Moreover, comparable digital sales grew 41%, on top of 32% growth last year. Target is poised to grow its digital sales by more than 25% for a fifth consecutive year. Overall, the performance of the company in Q2 was impressive and thus sent the stock to a new all-time high of $88.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.86	$3.30	$3.88	$4.28	$4.38	$3.21	$4.27	$4.69	$5.01	$4.65	***$5.40***	***$7.23***
DPS	$0.60	$0.66	$0.84	$1.10	$1.32	$1.58	$1.90	$2.16	$2.32	$2.44	***$2.54***	***$3.30***

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. Moreover, thanks to the impressive performance in Q2, management raised its earnings-per-share guidance for this year from about $5.30 to $5.40. Given its strong momentum, we expect the retailer to meet its guidance this year.

Target grew its earnings per share at an average annual rate of 5.5% from 2008 to 2017. While its earnings per share 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 growth, from $5.40 this year to $7.23 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	16.2	12.8	13.9	11.9	13.7	20.7	14.7	16.6	14.6	14.2	***16.3***	***14.9***
Avg. Yld.	1.3%	1.6%	1.6%	2.2%	2.2%	2.4%	3.0%	2.8%	3.2%	4.0%	***2.9%***	***3.1%***

Target has dramatically outperformed the market in the last 12 months, having rallied 63% while S&P has gained 17%. As a result, the stock is currently trading at a P/E ratio of 16.3, which is higher than its 10-year average of 14.9. While the strong momentum in its business performance helps explain the current rich valuation, it is reasonable to expect the stock to revert to its average valuation level in the next five years. In such a case, the stock will incur a 1.8% annualized drag due to contraction of its P/E ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	46.3%	43.5%	44.4%	47.6%	47.2%	47.2%	47.7%	51.8%	53.5%	54.4%	***53.0%***	***54.0%***
Debt/A	65.6%	68.9%	65.5%	64.6%	66.1%	65.6%	63.6%	66.0%	67.8%	70.7%	***72.0%***	***70.0%***
Int. Cov.	8.1	5.1	5.8	6.9	6.1	8.4	4.6	5.1	9.1	4.9	***9.0***	***10.0***
Payout	21.0%	20.0%	21.6%	25.7%	30.1%	49.2%	44.5%	46.1%	46.3%	52.5%	***47.0%***	***45.6%***
Std. Dev.	60.0%	39.2%	20.4%	23.4%	15.1%	16.2%	20.6%	20.7%	22.8%	30.3%	***28.0%***	***25.0%***

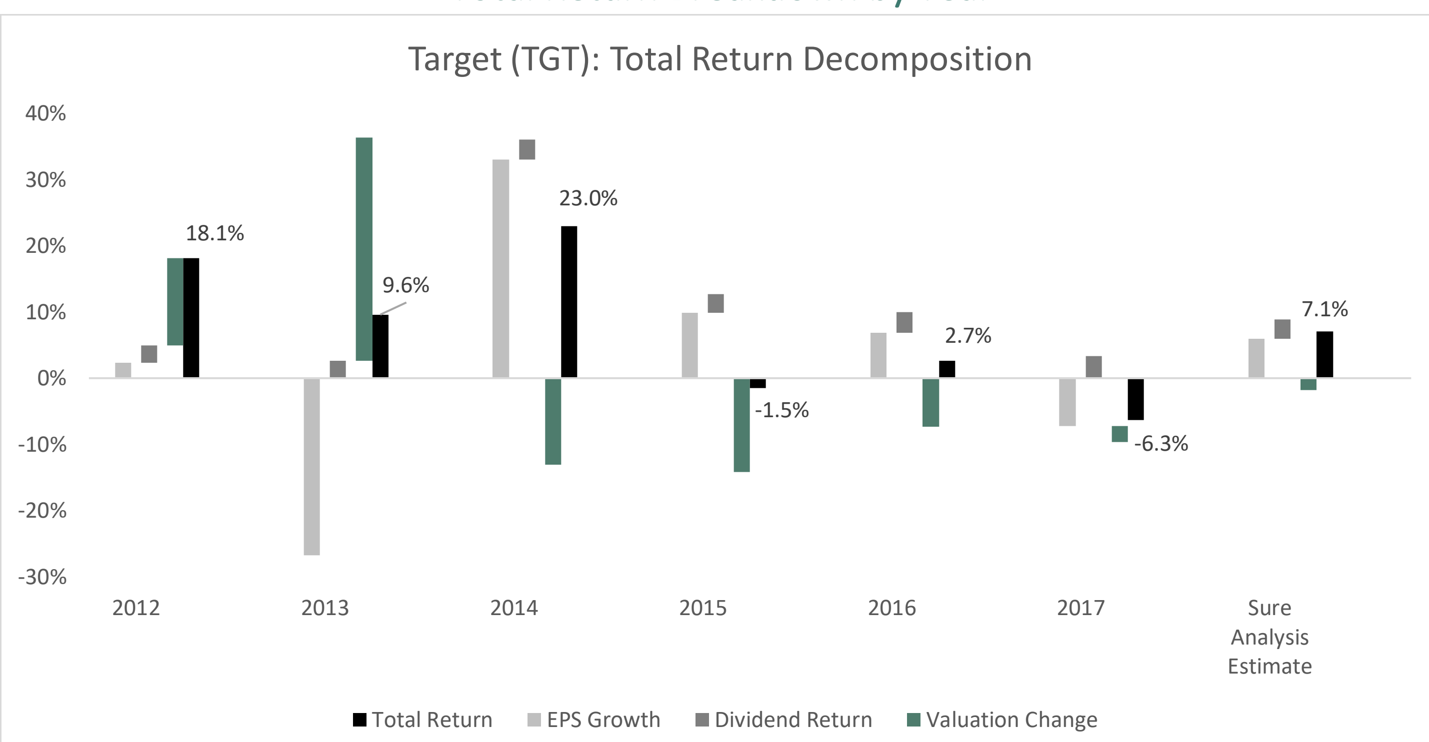
Target is a Dividend Aristocrat that has grown its dividend for 49 consecutive years. However, as it has grown its dividend much faster than its earnings, it has markedly increased its payout ratio, from 20% in 2009 to 47% this year. Moreover, the company is heavily investing in its business in order 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 earnings per share 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 earnings 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 63% during this period and is now trading at an all-time high. The stock can still offer a 7.1% average annual return over the next five years thanks to its 2.9% dividend and 6% annual EPS growth, which will be partly offset by a 1.8% annualized P/E contraction. However, due to the breathless rally of the stock, we advise investors to wait for a somewhat lower entry point, in the low 80s.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.