Target Corporation (TGT)

Updated November 24th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$67	**5 Year CAGR Estimate:**	13.5%	**Volatility Percentile:**	73.5%
Fair Value Price:	$81	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	90.0%
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.7%	**Growth Percentile:**	48.6%
Dividend Yield:	3.8%	**5 Year Price Target**	$108	**Valuation Percentile:**	71.3%
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Total Return Percentile:**	70.0%

Overview & Current Events

Target was founded in 1902 and has operations in the U.S. Its business consists of 1,850 discount stores, which offer general merchandise and food. Target has a market capitalization of $35 billion.

Target has been able to withstand the ongoing price war in the retail sector. The acquisition of Whole Foods by Amazon caused shockwaves for traditional 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 U.S. households by the end of this year.

In mid-November, Target reported (11/20/18) its financial results for the third quarter of fiscal 2018. The company grew its comparable sales by 5.1%, less than the expected 5.5% growth rate. Comparable digital sales grew 49%, contributing 1.9 percentage points to comparable sales, and adjusted earnings-per-share jumped 20% over last year. However, the report disappointed the market and led the stock plunge 11% after its earnings release. The reason is that all the growth came from non-operating factors. The tax rate of the company decreased from 22.2% in last year's quarter to 13.6%, comprising 55% of the earnings-per-share growth. In addition, the interest expense fell 54% over last year, from $251 to $115 million, thanks to early debt retirement costs in last year's quarter, and comprised the rest of growth, along with a 3% decrease in the share count. Despite high sales growth, operating income decreased 3% due to higher supply chain costs driven by higher digital fulfillment costs. This shows that Target's effort to remain competitive amid fierce competition from its peers has taken its toll on its operating margin.

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***
Shares	773.6	754.8	729.4	679.1	656.7	635.1	640.1	632.9	582.5	550.3	***525.9***	***435.0***

Due to fierce competition and the failed attempt to expand to Canada, Target's earnings-per-share remained almost flat from 2012 to 2017. However, turnaround efforts have born 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. In the latest conference call, management reiterated its guidance for earnings-per-share of $5.30 to $5.40 for 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	***12.4***	***14.9***
Avg. Yld.	1.3%	1.6%	1.6%	2.2%	2.2%	2.4%	3.0%	2.8%	3.2%	4.0%	***3.8%***	***3.1%***

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In our last research report, in August, we mentioned that Target had a rich valuation. Since then, the stock has plunged 24%, with half of the losses resulting from its latest earnings release. As a result, the stock is now trading at a price-to-earnings ratio of 12.4, which is lower than its 10-year average of 14.9. The stock has thus become attractively valued. If it reverts to its average valuation level over the next five years, it will enjoy a 3.7% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2023**
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%***

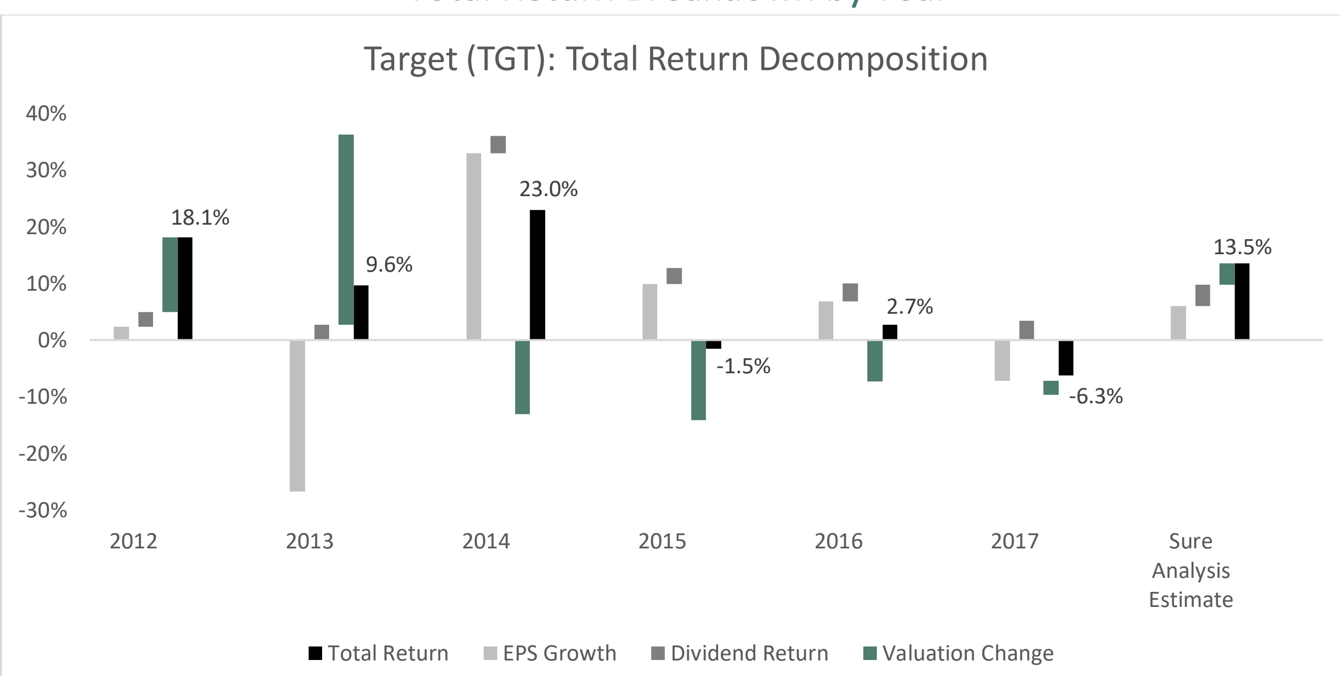
Target is a Dividend Aristocrat that has grown its dividend for 49 consecutive years. However, as it has grown its dividend much faster than its earnings, it has markedly increased its payout ratio, from 20% in 2009 to 47% this year. Moreover, the company is heavily investing in its business in order 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.

Given the price war in the retail sector, Target's moat is declining. 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

In our last report, we advised investors to avoid Target due to its valuation. Since then, Target has lost 24%, partly due to its latest earnings report, which showed that the fierce competition in the retail sector had an impact on its margins. While competition in the retail sector has heated more than ever, Target has become attractively valued. As a result, it can now offer a 13.5% average annual return over the next five years and thus earns a buy rating. The stock will be offering them a 3.8% dividend while they will be waiting for the rebound of the stock to materialize.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	64948	65357	67390	69865	73301	71279	72618	73785	69495	71879
Gross Profit	19182	19774	20805	21559	22266	21240	21340	21544	20350	20754
Gross Margin	29.5%	30.3%	30.9%	30.9%	30.4%	29.8%	29.4%	29.2%	29.3%	28.9%
SG&A Exp.	12954	13078	13469	14106	14643	14465	14676	14665	13356	14248
D&A Exp.	1826	2023	2084	2131	2044	1996	2129	2213	2298	2445
Operating Profit	4402	4673	5252	5322	5579	4779	4535	4910	4969	4312
Op. Margin	6.8%	7.1%	7.8%	7.6%	7.6%	6.7%	6.2%	6.7%	7.2%	6.0%
Net Profit	2214	2488	2920	2929	2999	1971	-1636	3363	2737	2934
Net Margin	3.4%	3.8%	4.3%	4.2%	4.1%	2.8%	-2.3%	4.6%	3.9%	4.1%
Free Cash Flow	883	4152	3142	1066	2979	4634	2679	4520	3889	4390
Income Tax	1322	1384	1575	1527	1741	1427	1204	1602	1296	718

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	44106	44533	43705	46630	48163	44553	41172	40262	37431	38999
Cash & Equivalents	562	583	583	794	784	670	2210	4046	2512	2643
Acc. Receivable	8084	6966	6153	5927	N/A	N/A	N/A	N/A	N/A	N/A
Inventories	6705	7179	7596	7918	7903	8278	8282	8601	8309	8657
Goodwill & Int.	N/A	N/A	N/A	242	224	331	298	277	259	782
Total Liabilities	30394	29186	28218	30809	31605	28322	27175	27305	26478	27290
Accounts Payable	6337	6511	6625	6857	7056	7335	7759	7418	7252	8677
Long-Term Debt	18752	16814	15726	16483	17648	12572	12725	12760	12749	11587
Total Equity	13712	15347	15487	15821	16558	16231	13997	12957	10953	11709
D/E Ratio	1.37	1.10	1.02	1.04	1.07	0.77	0.91	0.98	1.16	0.99

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	5.0%	5.6%	6.6%	6.5%	6.3%	4.3%	-3.8%	8.3%	7.0%	7.7%
Return on Equity	15.3%	17.1%	18.9%	18.7%	18.5%	12.0%	-10.8%	25.0%	22.9%	25.9%
ROIC	6.8%	7.7%	9.2%	9.2%	9.0%	6.3%	-5.9%	12.8%	11.1%	12.5%
Shares Out.	773.6	754.8	729.4	679.1	656.7	635.1	640.1	632.9	582.5	550.3
Revenue/Share	83.96	86.59	92.39	102.16	110.51	111.06	113.45	116.58	119.30	130.62
FCF/Share	1.14	5.50	4.31	1.56	4.49	7.22	4.19	7.14	6.68	7.98

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.