



Target Corporation (TGT)

Updated December 2nd, 2019 by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|---------------------------------|-------|
| Current Price: | \$125 | 5 Year CAGR Estimate: | 4.7% | Volatility Percentile: | 86.9% |
| Fair Value Price: | \$106 | 5 Year Growth Estimate: | 6.0% | Momentum Percentile: | 99.1% |
| % Fair Value: | 118% | 5 Year Valuation Multiple Estimate: | -3.3% | Growth Percentile: | 57.0% |
| Dividend Yield: | 2.1% | 5 Year Price Target | \$141 | Valuation Percentile: | 40.8% |
| Dividend Risk Score: | A | Retirement Suitability Score: | A | Total Return Percentile: | 34.5% |

Overview & Current Events

Target was founded in 1902 and after a failed bid to expand into Canada, has operations solely in the U.S. market. Its business consists of about 1,850 big box stores, which offer general merchandise and food. Target has a market capitalization of \$63 billion and should produce about \$79 billion in total revenue this year.

Target reported Q3 earnings on 11/30/19 and results were outstanding, sending the stock soaring to new all-time highs. Total revenue was \$18.7 billion, a gain of 4.7% from the year-ago period. Comparable sales growth came to 4.5% as the company's digital efforts continue to pay dividends. Digital sales rose 31% on a comparable basis, contributing 1.7% to total comparable sales growth. Target continues to reap the benefits of its years of investments in things like same-day delivery, store pickup, and drive up.

Operating income rose 22.3% in Q3 to \$1 billion as the company's operating income margin rate was 5.4%, up from 4.6% in last year's Q3. Gross margins rose 110bps to 29.8% as merchandising efforts on pricing, promotions, and assortment, combined with favorable mix contributed to better margins. SG&A costs were up fractionally as a percentage of sales, as operating cost savings were offset by higher marketing and compensation costs.

Target returned \$631 million to shareholders in Q3, roughly evenly split between dividends and share repurchases. The company has \$300 million left on its current buyback authorization, and has authorized \$5 billion in additional money for continued repurchases beginning when the old authorization is complete.

Management boosted guidance from the prior range of \$5.90 to \$6.20 to a new range of \$6.25 to \$6.45. We've boosted our estimate commensurately.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$3.30 | \$3.88 | \$4.28 | \$4.38 | \$3.21 | \$4.27 | \$4.69 | \$5.01 | \$4.65 | \$5.39 | \$6.40 | \$8.56 |
| DPS | \$0.66 | \$0.84 | \$1.10 | \$1.32 | \$1.58 | \$1.90 | \$2.16 | \$2.32 | \$2.44 | \$2.52 | \$2.64 | \$3.53 |
| Shares¹ | 755 | 729 | 679 | 657 | 635 | 640 | 633 | 583 | 546 | 524 | 515 | 420 |

Target has grown its earnings-per-share at an average annual rate of 6.5% during the last decade. 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 borne fruit and as a result, Target has significantly improved its performance in recent quarters. 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. Overall, it is reasonable to expect 6% annualized growth beyond this year. We see continued comparable sales growth as driving results, along with a small measure of margin expansion, and the constant tailwind of the buyback. Target's digital efforts are also working extremely nicely, and the company's small-format stores are performing very well, opening up a new avenue of growth for the company in the coming years. SG&A costs are continuing to rise, albeit slowly, but that is something to keep an eye on as well.

¹ Share count in millions

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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Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 12.8 | 13.9 | 11.9 | 13.7 | 20.7 | 14.7 | 16.6 | 14.6 | 14.2 | 14.2 | 19.5 | 16.5 |
| Avg. Yld. | 1.6% | 1.6% | 2.2% | 2.2% | 2.4% | 3.0% | 2.8% | 3.2% | 4.0% | 3.3% | 2.1% | 2.8% |

After yet another sizable post-earnings gain, shares are near all-time highs. Thus, the valuation has become far less attractive than it was only a few months ago. Target is trading at a price-to-earnings ratio of 19.5, which is well in excess of its 10-year average of 14.7, and our fair value estimate of 16.5 times earnings, which we are raising from the prior 15. We note this is the lowest yield the stock has traded with for several years, going back to the aftermath of the financial crisis. If the stock reverts to our estimate of fair value over the next five years, it will produce an annualized headwind of about -3% to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 20% | 22% | 26% | 30% | 49% | 45% | 46% | 46% | 53% | 47% | 41% | 41% |

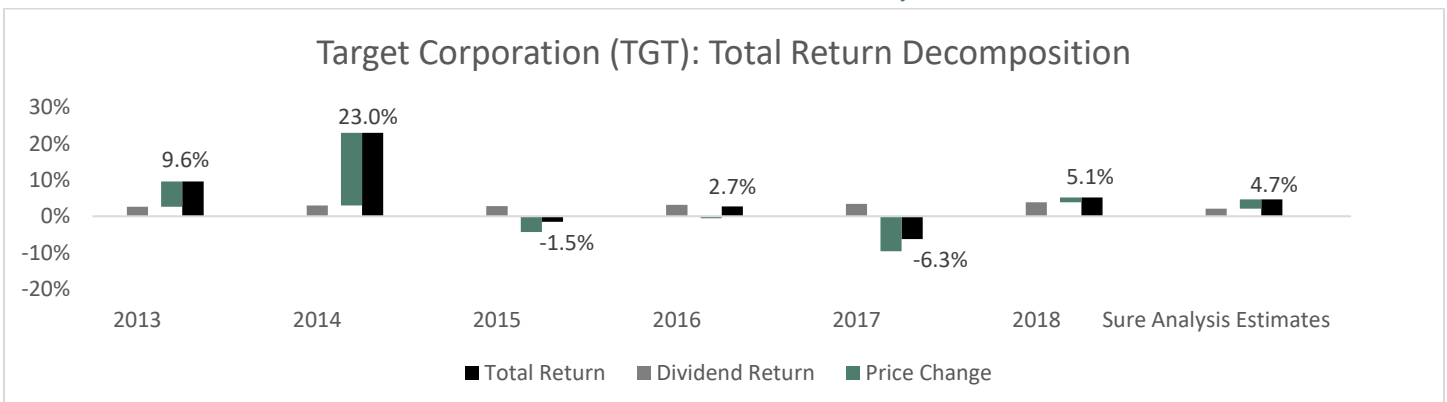
Target is a Dividend Aristocrat that has grown its dividend for 49 consecutive years. However, as it has grown its dividend much more quickly than its earnings, the company has markedly increased its payout ratio, from 20% in 2009 to 43% this year. Moreover, the company is heavily investing in its business in order to navigate through the changing landscape in the retail sector. Therefore, Target is likely to raise its dividend at a slower pace in the upcoming years.

Target's competitive advantage comes from its discounted prices on attractive merchandise in its guest-friendly stores. However, 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. In 2008, its earnings-per-share fell -14%. 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 for 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

We see Target as overvalued, but also as possessing a reasonably strong growth outlook. In addition, the company's dividend history is outstanding as it should become a Dividend King next year. We see total annual returns at just ~5% in the coming years after the recent rally, which has made the stock much more expensive. We still like Target fundamentally, but the stock is too expensive in our view, and we're reiterating our hold rating as a result.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 65357 | 67390 | 69865 | 73301 | 71279 | 72618 | 73785 | 69495 | 71879 | 75356 |
| Gross Profit | 19774 | 20805 | 21559 | 22266 | 21240 | 21340 | 21544 | 20350 | 20754 | 22057 |
| Gross Margin | 30.3% | 30.9% | 30.9% | 30.4% | 29.8% | 29.4% | 29.2% | 29.3% | 28.9% | 29.3% |
| SG&A Exp. | 13078 | 13469 | 14106 | 14643 | 14465 | 14676 | 14665 | 13356 | 14248 | 15723 |
| D&A Exp. | 2023 | 2084 | 2131 | 2044 | 1996 | 2129 | 2213 | 2298 | 2445 | 2474 |
| Operating Profit | 4673 | 5252 | 5322 | 5579 | 4779 | 4535 | 4910 | 4969 | 4312 | 4110 |
| Op. Margin | 7.1% | 7.8% | 7.6% | 7.6% | 6.7% | 6.2% | 6.7% | 7.2% | 6.0% | 5.5% |
| Net Profit | 2488 | 2920 | 2929 | 2999 | 1971 | -1636 | 3363 | 2737 | 2934 | 2937 |
| Net Margin | 3.8% | 4.3% | 4.2% | 4.1% | 2.8% | -2.3% | 4.6% | 3.9% | 4.1% | 3.9% |
| Free Cash Flow | 4152 | 3142 | 1066 | 2979 | 4634 | 2679 | 4520 | 3889 | 4390 | 2457 |
| Income Tax | 1384 | 1575 | 1527 | 1741 | 1427 | 1204 | 1602 | 1296 | 718 | 746 |

Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 44533 | 43705 | 46630 | 48163 | 44553 | 41172 | 40262 | 37431 | 38999 | 41290 |
| Cash & Equivalents | 583 | 583 | 794 | 784 | 670 | 2210 | 4046 | 2512 | 2643 | 1556 |
| Acc. Receivable | 6966 | 6153 | 5927 | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Inventories | 7179 | 7596 | 7918 | 7903 | 8278 | 8282 | 8601 | 8309 | 8657 | 9497 |
| Goodwill & Int. | N/A | N/A | 242 | 224 | 331 | 298 | 277 | 259 | 782 | N/A |
| Total Liabilities | 29186 | 28218 | 30809 | 31605 | 28322 | 27175 | 27305 | 26478 | 27290 | 29993 |
| Accounts Payable | 6511 | 6625 | 6857 | 7056 | 7335 | 7759 | 7418 | 7252 | 8677 | 9761 |
| Long-Term Debt | 16814 | 15726 | 16483 | 17648 | 12572 | 12725 | 12760 | 12749 | 11587 | 11275 |
| Total Equity | 15347 | 15487 | 15821 | 16558 | 16231 | 13997 | 12957 | 10953 | 11709 | 11297 |
| D/E Ratio | 1.10 | 1.02 | 1.04 | 1.07 | 0.77 | 0.91 | 0.98 | 1.16 | 0.99 | 1.00 |

Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| Return on Assets | 5.6% | 6.6% | 6.5% | 6.3% | 4.3% | -3.8% | 8.3% | 7.0% | 7.7% | 7.3% |
| Return on Equity | 17.1% | 18.9% | 18.7% | 18.5% | 12.0% | -10.8% | 25.0% | 22.9% | 25.9% | 25.5% |
| ROIC | 7.7% | 9.2% | 9.2% | 9.0% | 6.3% | -5.9% | 12.8% | 11.1% | 12.5% | 12.8% |
| Shares Out. | 754.8 | 729.4 | 679.1 | 656.7 | 635.1 | 640.1 | 632.9 | 582.5 | 545.9 | 524.3 |
| Revenue/Share | 86.59 | 92.39 | 102.16 | 110.51 | 111.06 | 113.45 | 116.58 | 119.30 | 130.62 | 141.33 |
| FCF/Share | 5.50 | 4.31 | 1.56 | 4.49 | 7.22 | 4.19 | 7.14 | 6.68 | 7.98 | 4.61 |

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

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