



# Target Corporation (TGT)

Updated May 28<sup>th</sup>, 2022, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$167	<b>5 Year CAGR Estimate:</b>	11.4%	<b>Market Cap:</b>	\$73 B
<b>Fair Value Price:</b>	\$180	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	08/18/22 <sup>1</sup>
<b>% Fair Value:</b>	93%	<b>5 Year Valuation Multiple Estimate:</b>	1.5%	<b>Dividend Payment Date:</b>	08/10/22
<b>Dividend Yield:</b>	2.2%	<b>5 Year Price Target</b>	\$265	<b>Years Of Dividend Growth:</b>	54
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## 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, as well as serving as distribution points for the company's burgeoning e-commerce business. Target has a market capitalization of \$73 billion and should produce about \$110 billion in total revenue this year.

Target reported first quarter earnings on May 18<sup>th</sup>, 2022, and results were much worse than expected from a margin perspective. Adjusted earnings-per-share missed estimates by 87 cents at \$2.19. Revenue was up 4% year-over-year to \$25.2 billion, which was \$690 million ahead of estimates.

Comparable sales grew 3.3%, which was due to traffic growth of 3.9% and a slightly lower average ticket size. Store comparable sales were up 3.4%, while digital comparable sales grew 3.2%.

Operating income was \$1.3 billion, down from \$2.4 billion, driven primarily by a lower gross margin rate. Gross margins plunged from 30.0% to 25.7% of sales due to higher markdowns and costs related to freight, supply chain disruptions, and increased wages.

The company noted operating margin rate should be roughly where it was in Q1 for Q2, and the company expects to see low- to mid-single digit revenue growth and operating income margin around 6% for the year.

We've slashed earnings-per-share estimates for this year to \$10.60 following a shocking Q1 report from a margin perspective.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$4.38	\$3.21	\$4.27	\$4.69	\$5.01	\$4.65	\$5.39	\$6.39	\$9.42	\$13.56	<b>\$10.60</b>	<b>\$15.57</b>
<b>DPS</b>	\$1.32	\$1.58	\$1.90	\$2.16	\$2.32	\$2.44	\$2.52	\$2.60	\$2.68	\$3.16	<b>\$3.60</b>	<b>\$4.82</b>
<b>Shares<sup>2</sup></b>	657	635	640	633	583	546	524	512	506	471	<b>450</b>	<b>400</b>

Target has grown its earnings-per-share at an average annual rate of nearly 13% 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 -4.8% per year in the last six years, although the pace of buybacks has slowed as the share price has risen. Overall, we expect 8% annualized growth from what should be a trough level in 2022.

We see continued comparable sales growth as driving results, along with a measure of margin expansion from low levels in 2022, and a tailwind from the buyback. Target's digital efforts are also working extremely nicely, as we saw again in 2021 results, and the company's small-format stores are performing very well, opening a new avenue of growth for the company in the coming years. The remaining buyback authorization should be good for a significant tailwind to earnings-

<sup>1</sup> Estimated date

<sup>2</sup> Share count in millions

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per-share in the coming years. However, we note that Target remains committed to investing in its digital capabilities, as well as its 50+ year streak of dividend increases. The only caution is on margins now that we've seen second half 2021 results come in quite weak on a gross margin basis, and margins in Q1 2022 were awful. That's something that could remain a wildcard for earnings in the near future.

## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.7	20.7	14.7	16.6	14.6	14.2	14.2	14.4	14.0	16.6	<b>15.8</b>	<b>17.0</b>
Avg. Yld.	2.2%	2.4%	3.0%	2.8%	3.2%	4.0%	3.3%	2.8%	2.0%	1.4%	<b>2.2%</b>	<b>1.8%</b>

Target shares trade for just 15.8 times our earnings estimate for this year, well below our estimate of fair value at 17 times earnings. We note that the 2.2% yield is still near the lowest yield the stock has traded with for several years. If the stock reverts to our estimate of fair value over the next five years, it will produce a tailwind to total returns.

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

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	30%	49%	45%	46%	46%	53%	47%	41%	28%	23%	<b>34%</b>	<b>31%</b>

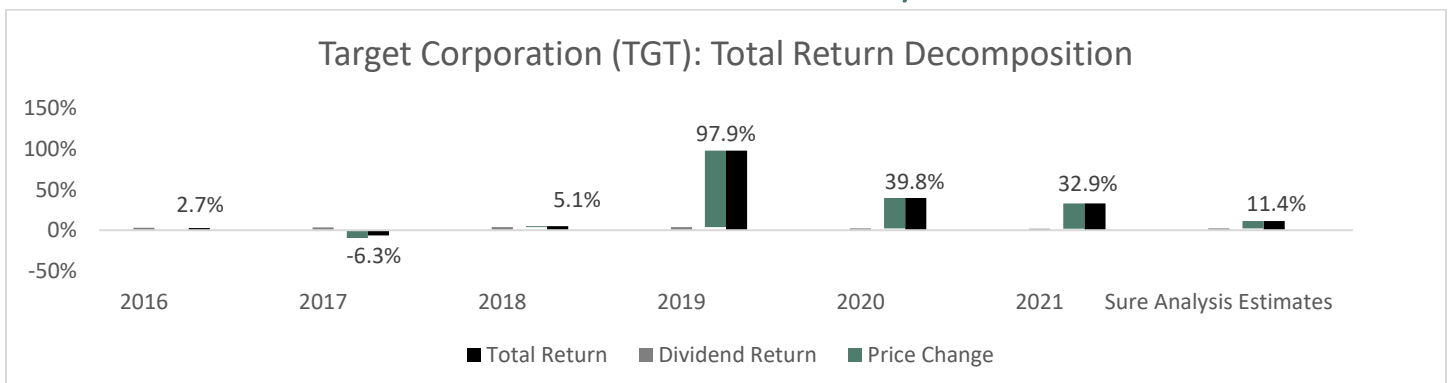
Target has grown its dividend for more than five decades. The company is heavily investing in its business in order to navigate through the changing landscape in the retail sector. The recent 32% dividend increase was unexpected given its massive size, but the payout ratio is still just 34%.

Target's competitive advantage comes from its everyday low prices on attractive merchandise in its guest-friendly stores. However, given the price war in the retail sector, Target's moat faces decline. 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. Target is combatting this in part with its massive push towards digital sales channels, which is working.

## Final Thoughts & Recommendation

We see Target as undervalued following recent weakness in the stock. Given explosive earnings growth in 2020, and more of the same in 2021, we see diminished growth potential moving forward. We forecast total returns at 11.4% annually. The yield is now higher given the decline in the share price, but the dividend increase streak is impressive and should provide many more years of payout growth. We're reiterating the stock at a buy rating following Q1 results.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	73,301	71,279	72,618	73,785	70,271	72,714	75,356	78,112	93,561	106,005
<b>Gross Profit</b>	22,266	21,240	21,340	21,544	21,126	21,589	22,057	23,248	27,384	31,042
<b>Gross Margin</b>	30.4%	29.8%	29.4%	29.2%	30.1%	29.7%	29.3%	29.8%	29.3%	29.3%
<b>SG&amp;A Exp.</b>	14,643	14,465	14,676	14,665	14,217	15,140	15,723	16,233	18,615	19,752
<b>D&amp;A Exp.</b>	2,044	1,996	2,129	2,213	2,318	2,476	2,474	2,604	2,485	2,642
<b>Operating Profit</b>	5,579	4,779	4,535	4,910	4,864	4,224	4,110	4,658	6,539	8,946
<b>Op. Margin</b>	7.6%	6.7%	6.2%	6.7%	6.9%	5.8%	5.5%	6.0%	7.0%	8.4%
<b>Net Profit</b>	2,999	1,971	(1,636)	3,363	2,734	2,914	2,937	3,281	4,368	6,946
<b>Net Margin</b>	4.1%	2.8%	-2.3%	4.6%	3.9%	4.0%	3.9%	4.2%	4.7%	6.6%
<b>Free Cash Flow</b>	2,979	4,634	2,679	4,520	3,897	4,402	2,457	4,090	7,876	5,081
<b>Income Tax</b>	1,741	1,427	1,204	1,602	1,295	722	746	921	1,178	1,961

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	48,163	44,553	41,172	40,262	37,431	40,303	41,290	42,779	51,248	53,811
<b>Cash &amp; Equivalents</b>	784	670	2,210	1,038	2,512	737	787	767	867	5,911
<b>Acc. Receivable</b>	---	---	---	---	---	---	---	498	631	---
<b>Inventories</b>	7,903	8,278	8,282	8,601	8,309	8,597	9,497	8,992	10,653	13,902
<b>Goodwill &amp; Int.</b>	224	331	298	277	259	709	699	686	668	---
<b>Total Liabilities</b>	31,605	28,322	27,175	27,305	26,478	28,652	29,993	30,946	36,808	40,984
<b>Accounts Payable</b>	7,056	7,335	7,759	7,418	7,252	8,677	9,761	9,920	12,859	15,478
<b>Long-Term Debt</b>	17,648	12,572	12,725	12,760	12,749	11,398	11,275	11,499	12,680	13,720
<b>Total Equity</b>	16,558	16,231	13,997	12,957	10,953	11,651	11,297	11,833	14,440	12,827
<b>LTD/E Ratio</b>	1.07	0.77	0.91	0.98	1.16	0.98	1.00	0.97	0.88	1.07

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	6.3%	4.3%	-3.8%	8.3%	7.0%	7.5%	7.2%	7.8%	9.3%	13.2%
<b>Return on Equity</b>	18.5%	12.0%	-10.8%	25.0%	22.9%	25.8%	25.6%	28.4%	33.3%	50.9%
<b>ROIC</b>	9.0%	6.3%	-5.9%	12.8%	11.1%	12.5%	12.9%	14.3%	17.3%	25.9%
<b>Shares Out.</b>	657	635	640	633	583	546	524	512	506	471
<b>Revenue/Share</b>	110.5	111.06	113.45	116.58	120.64	132.14	141.33	151.50	185.12	215.15
<b>FCF/Share</b>	4.49	7.22	4.19	7.14	6.69	8.00	4.61	7.93	15.58	10.31

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

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