Target Corporation (TGT)

Updated December 5th, 2022, by Josh Arnold

Key Metrics

Current Price:	$163	**5 Year CAGR Estimate:**	9.9%	**Market Cap:**	$76 B
Fair Value Price:	$94	**5 Year Growth Estimate:**	20.0%	**Ex-Dividend Date:**	02/16/23[1]
% Fair Value:	174%	**5 Year Valuation Multiple Estimate:**	-10.5%	**Dividend Payment Date:**	03/10/23[2]
Dividend Yield:	2.7%	**5 Year Price Target**	$233	**Years Of Dividend Growth:**	54
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Hold

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 $76 billion and should produce about $110 billion in total revenue this year.

Target reported third quarter earnings on November 16th, 2022, and results were weaker than expected, along with somewhat weak guidance for the final quarter of the year. Adjusted earnings-per-share were $1.54 per share, which missed estimates by 64 cents. Revenue was better, rising 3.4% to $26.52 billion, which was $120 million better than estimates.

Comparable sales were 2.7% higher, which was stacked on 12.7% growth from the year-ago period. This was driven by a 1.4% gain in traffic, as well as a 1.3% increase in average ticket size. The company said Beauty, Food and Beverage, and Household Essentials were sources of strength, offset by softness in discretionary categories. Digital sales were 17.1% of total revenue.

The company guided for softening sales and profits in Q4, so guidance was quite vague for Q4. In addition, Target is looking for efficiencies across the business, with a focus on reducing complexity and lowering operating costs. The stated goal was to save $2 billion to $3 billion in the coming three years.

We now see $5.50 in earnings-per-share for this year, given inventory and margin issues. However, we see a sharp increase in earnings starting next year and beyond as this year is somewhat artificially lower.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.38	$3.21	$4.27	$4.69	$5.01	$4.65	$5.39	$6.39	$9.42	$13.56	***$5.50***	***$13.69***
DPS	$1.32	$1.58	$1.90	$2.16	$2.32	$2.44	$2.52	$2.60	$2.68	$3.16	***$4.32***	***$6.65***
Shares[3]	657	635	640	633	583	546	524	512	506	471	***450***	***400***

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 20% annualized growth from what should be a trough level for 2022 given margin issues that cropped up during the year.

We see continued comparable sales growth as driving results, along with sizable 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

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[1] Estimated date

[2] Estimated date

[3] 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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company in the coming years. The remaining buyback authorization should be good for a significant tailwind to earnings-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 the first three quarters of 2022 results come in quite weak on a gross margin basis, with enormous weakness coming from the company's inventory reduction effort. 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	***29.6***	***17.0***
Avg. Yld.	2.2%	2.4%	3.0%	2.8%	3.2%	4.0%	3.3%	2.8%	2.0%	1.4%	***2.7%***	***2.9%***

Target shares trade for 29.6 times our earnings estimate for this year, well above our estimate of fair value at 17 times earnings. We note that the 2.7% yield is the highest it's been for years. If the stock reverts to our estimate of fair value over the next five years, it will produce a huge headwind to total returns given the temporary weakness in earnings.

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%	***79%***	***49%***

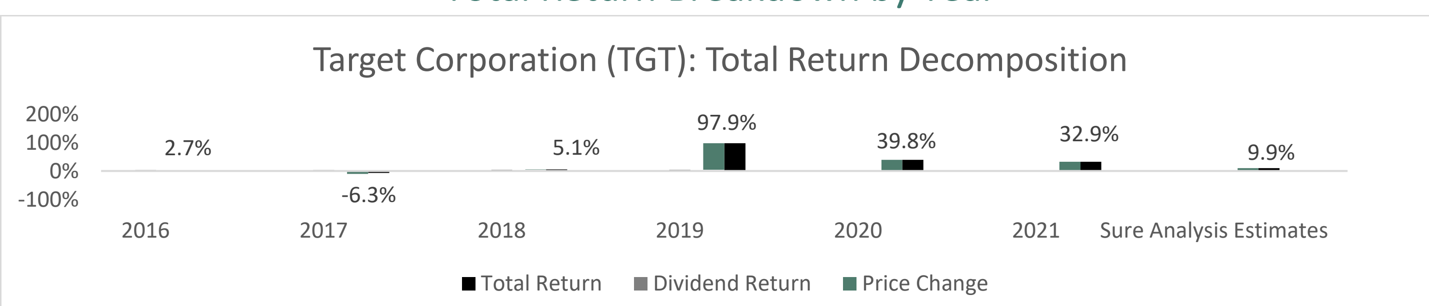
Target has grown its dividend for more than five decades, making it a Dividend King. The company is heavily investing in its business in order to navigate through the changing landscape in the retail sector. The recent 32% dividend increase was unexpected given its massive size, and the payout ratio is now 79%. We expect the payout ratio to decline significantly starting next year as earnings rise.

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 heavily overvalued despite recent weakness in the stock, and should provide a 10.5% headwind to total returns. Given weak earnings this year, we see 20% earnings growth going forward. We forecast total returns at 9.9% annually. The yield of 2.7% is high, and the dividend increase streak is impressive and should provide many more years of payout growth. We're downgrading the stock from buy to hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	73,301	71,279	72,618	73,785	70,271	72,714	75,356	78,112	93,561	106,005
Gross Profit	22,266	21,240	21,340	21,544	21,126	21,589	22,057	23,248	27,384	31,042
Gross Margin	30.4%	29.8%	29.4%	29.2%	30.1%	29.7%	29.3%	29.8%	29.3%	29.3%
SG&A Exp.	14,643	14,465	14,676	14,665	14,217	15,140	15,723	16,233	18,615	19,752
D&A Exp.	2,044	1,996	2,129	2,213	2,318	2,476	2,474	2,604	2,485	2,642
Operating Profit	5,579	4,779	4,535	4,910	4,864	4,224	4,110	4,658	6,539	8,946
Op. Margin	7.6%	6.7%	6.2%	6.7%	6.9%	5.8%	5.5%	6.0%	7.0%	8.4%
Net Profit	2,999	1,971	(1,636)	3,363	2,734	2,914	2,937	3,281	4,368	6,946
Net Margin	4.1%	2.8%	-2.3%	4.6%	3.9%	4.0%	3.9%	4.2%	4.7%	6.6%
Free Cash Flow	2,979	4,634	2,679	4,520	3,897	4,402	2,457	4,090	7,876	5,081
Income Tax	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
Total Assets	48,163	44,553	41,172	40,262	37,431	40,303	41,290	42,779	51,248	53,811
Cash & Equivalents	784	670	2,210	1,038	2,512	737	787	767	867	5,911
Acc. Receivable	---	---	---	---	---	---	---	498	631	---
Inventories	7,903	8,278	8,282	8,601	8,309	8,597	9,497	8,992	10,653	13,902
Goodwill & Int.	224	331	298	277	259	709	699	686	668	---
Total Liabilities	31,605	28,322	27,175	27,305	26,478	28,652	29,993	30,946	36,808	40,984
Accounts Payable	7,056	7,335	7,759	7,418	7,252	8,677	9,761	9,920	12,859	15,478
Long-Term Debt	17,648	12,572	12,725	12,760	12,749	11,398	11,275	11,499	12,680	13,720
Total Equity	16,558	16,231	13,997	12,957	10,953	11,651	11,297	11,833	14,440	12,827
LTD/E Ratio	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
Return on Assets	6.3%	4.3%	-3.8%	8.3%	7.0%	7.5%	7.2%	7.8%	9.3%	13.2%
Return on Equity	18.5%	12.0%	-10.8%	25.0%	22.9%	25.8%	25.6%	28.4%	33.3%	50.9%
ROIC	9.0%	6.3%	-5.9%	12.8%	11.1%	12.5%	12.9%	14.3%	17.3%	25.9%
Shares Out.	657	635	640	633	583	546	524	512	506	471
Revenue/Share	110.5	111.06	113.45	116.58	120.64	132.14	141.33	151.50	185.12	215.15
FCF/Share	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.