

Target Corporation (TGT)

Rating	OUTPERFORM
Price (20-Mar-18, US\$)	71.56
Target price (US\$)	86.00
52-week price range (US\$)	78.58 - 50.18
Market cap(US\$ m)	38,556

Target price is for 12 months.

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COMMENT

Another Look at the Toys Opportunity, Using Updated Filings, and Store Overlap Analysis

- **We refresh our analysis on the potential benefit to Target from Toys R Us closings, based on new SEC filings**, which continues to show an annual *comps lift in the 90 bps range*, with incremental gains materializing in 2H18 once liquidations are complete. There is still plenty of inventory left to liquidate at Toys R Us, which may limit the upside in 1H18, but share gains should continue. Given TGT's mix and store overlap, we see it benefiting disproportionately. Obviously if AMZN were to take these locations, it would be a problem (for TGT and others), but it's not clear that will happen.
- **Current state of Toys R Us domestic.** Based on the SEC filings, the company generated sales of \$6.5 bn in the US in 2017, comprised of \$4.2 bn in Toys R Us sales (\$3.7 bn in brick and mortar, rest online), and \$2.3 bn in Baby R Us sales (\$1.7 bn in brick and mortar, rest online). Inventory at year end was \$1.36 bn that will need to be liquidated. Using a 40% gross margin estimate, implies \$2.3 bn in retail sales, with liquidation sales expected to run through June. That would be down from \$2.65 bn in 1H17, though the \$2.3 bn doesn't account for additional purchases during the liquidation process.
- **Most of TRU sales should be addressable to TGT.** 90% of Toys R Us stores, and 96% of the Baby stores have a Target within five miles. There is plenty of competition as we discuss later, but TGT's overlap is higher than in recent case studies, and should be positioned to take a fair share. Our math: TGT captures 15% of addressable Toy R Us store sales, 5% of Baby R Us sales, and 5% of online sales, adding >\$600mn, or 90 bps to comps.
- **A look at recent case studies.** For Best Buy, we believe that the closing of hhgregg added 30-50 bps comps, on an annual basis, or 70-120 bps to the most relevant categories (consumer electronics and appliances). That represents a 6-11% capture of hhgregg's sales, in year one. For Dick's, we believe that the closing of Sports Authority and other chains added over 200 bps to comps (calculated on a net basis, after considering the decline in DKS' base business), a ~10% capture of these chains annual sales.

Share price performance



On 20-Mar-2018 the S&P 500 INDEX closed at 2716.94
Daily Mar20, 2017 - Mar20, 2018, 03/20/17 = US\$54.37

Quarterly EPS	Q1	Q2	Q3	Q4
2018A	1.21	1.22	0.91	1.37
2019E	1.35	1.47	1.05	1.37
2020E	1.34	1.44	1.12	1.51

Financial and valuation metrics

Year	1/18A	1/19E	1/20E
EPS (CS adj.) (US\$)	4.70	5.25	5.41
Prev. EPS (US\$)	-	-	-
P/E (x)	15.2	13.6	13.2
P/E rel. (%)	72.0	77.0	82.5
Revenue (US\$ m)	71,879.0	72,315.3	73,372.0
EBITDA (US\$ m)	6,758.0	6,802.7	6,916.5
OCFPS (US\$)	12.58	10.36	10.64
P/OCF (x)	6.0	6.9	6.7
EV/EBITDA (current)	7.0	7.0	6.8
Net debt (US\$ m)	8,944	9,101	8,813
ROIC (%)	14.33	14.77	14.70
Number of shares (m)	538.80	IC (current, US\$ m)	20,653.00
BV/share (Next Qtr., US\$)	-	EV/IC (x)	-
Net debt (Next Qtr., US\$ m)	-	Dividend (current, US\$)	-
Net debt/tot eq (Next Qtr., %)	-		

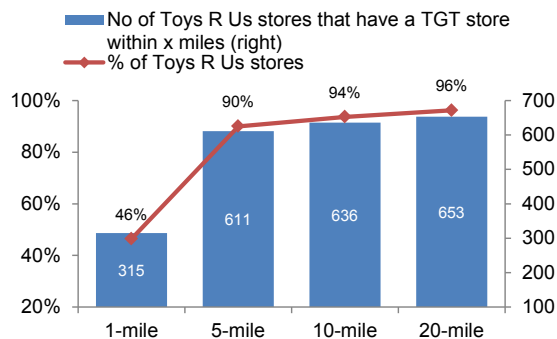
Source: Company data, Thomson Reuters, Credit Suisse estimates

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- Weighing differences vs. past examples.** First, as we think about the impact to TGT, the *store overlap is much higher* than these other recent case studies; 52% of TGT stores have a Toys R Us within 5 miles. That compares to 22% of BBY stores with an HGG store, and 28% of DKS stores with a Sports Authority store. But, we also consider that the *toy category is more competitive*. For example, 82% of the Toys R Us stores have both a TGT and WMT within five miles. Further, Toys R Us even noted in their bankruptcy filings that low pricing including at WMT, AMZN (and TGT) were among the challenges. We consider all of that in our sales capture assumptions, shown below.
- See initiation report ([Positioned for Improving Trends](#)) for details.

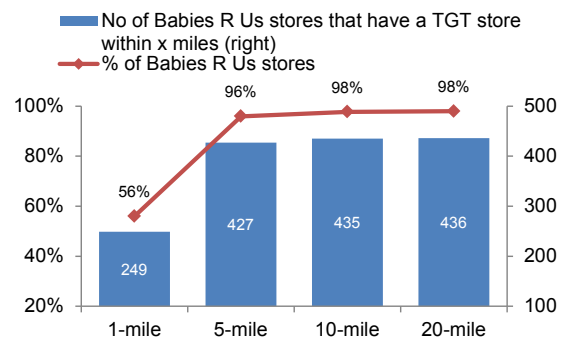
Store Overlap Analysis

Figure 1: 90% of Toys R Us stores have a TGT store within five miles



Source: Company data, Credit Suisse estimates

Figure 2: 96% of Babies R Us stores have a TGT store within five miles



Source: Company data, Credit Suisse estimates

Market Share Capture Math

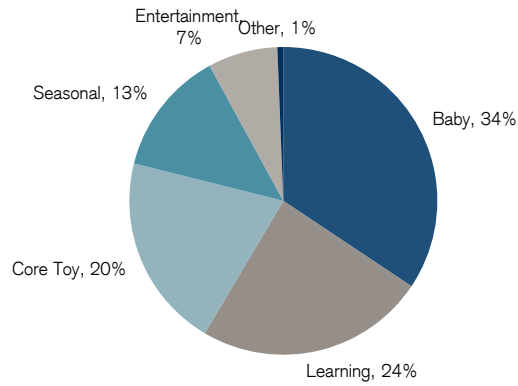
Figure 3: Potential 90bps comps uplift for TGT with TOYS closings

	2016	2017E
Toys R Us Brick & Mortar Sales, ex Baby R Us	3,976	3682
% Store Overlap		90%
Addressable Sales		3314
x Target estimated share capture		15%
Incremental sales		497
Online Sales, ex Baby R Us	598	555
x Target estimated share capture		5%
Incremental sales		28
Lift to Comps		0.74%
Baby R Us Brick and Mortar Sales	1,990	1,743
% Store Overlap		96%
Addressable Sales		1674
x Target estimated share capture		5%
Incremental sales		84
Baby R Us Online	576	572
x Target estimated share capture		5%
Incremental sales		29
Lift to Comps		0.16%
Total Comps Lift for TGT		0.90%

Source: Company data, Credit Suisse estimates

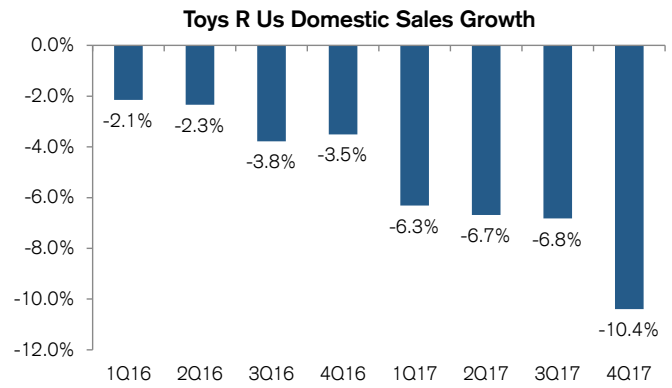
Toys R Us Relevant Data Points

Figure 4: Toys R Us Domestic Sales Mix (Trailing 12 Months, through 3Q17)



Source: Company data, Credit Suisse estimates

Figure 5: Toys R Us Sales Trends Appeared to Deteriorate in 2017



Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 19-Mar-2018)

Target Corporation (TGT.N, \$70.34, OUTPERFORM, TP \$86.0)
Walmart Inc. (WMT.N, \$87.45)

Disclosure Appendix

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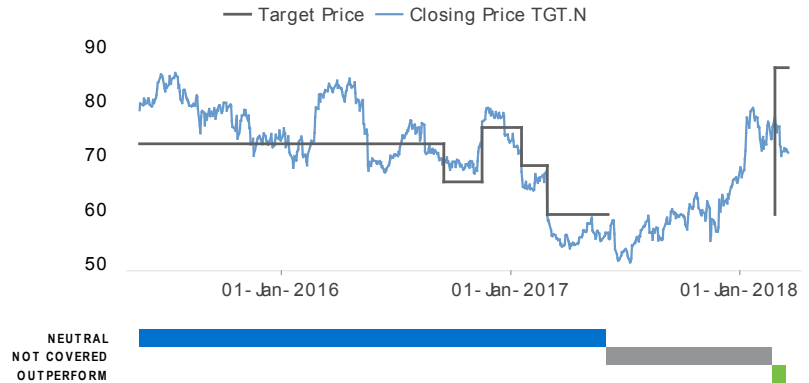
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3-Year Price and Rating History for Target Corporation (TGT.N)

TGT.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
20-May-15	78.18	72.00	N
16-Sep-16	69.23	65.00	*
16-Nov-16	76.03	75.00	
18-Jan-17	66.85	68.00	
28-Feb-17	58.77	59.00	
05-Jun-17	55.63		NC
26-Feb-18	76.90	86.00	O *

* Asterisk signifies initiation or assumption of coverage.

Effective July 3, 2016, NC denotes termination of coverage.



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Neutral/Hold*	37%	(55% banking clients)
Underperform/Sell*	13%	(55% banking clients)
Restricted	2%	

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Target Corporation (TGT.N)

Method: Our \$86 target price and Outperform rating for TGT is based on 16.5x our 2018 EPS. Our target price is based on an equal weighted average using HOLT, our peer multiple analysis (weighted based on TGT's sales mix), and fundamental stock drivers (specifically, comps as a driver of valuation and relative valuation).

Risk: Risks to our \$86 target price and Outperform rating for TGT include 1) Reliance on sales to drive EBITDA improvement. Expectations are also now higher post-holiday sales. Other costs could be an offset, including transportation – which has worsened since guidance was provided; 2) Competitive landscape: risk of incremental price/other reinvestments. Guidance assumes full tax benefit flowing to the bottom line; and 3) Structural business mix challenges.

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This research report is authored by:

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