

Capital Expenditure Analysis: Target Corporation

Prepared for:

Target Capital Expenditure Committee

Prepared by:

Justin Lisoway

May 4, 2021

Table of Contents

Executive Summary	iii
Introduction	1
Mode of Analysis	1
Data and Analysis.....	1
Hurdle Rates	1
1: The Barn - Accept.....	2
2: Stadium Remodel - Accept	2
3: Gopher Place - Accept	2
4: Whalen Ct - Accept	3
5: Goldie Square - Reject	3
Cost of Capital.....	3
Conclusions	4
Recommendations	4
Appendix	5
Appendix 1: Quantitative Analysis.....	5
Appendix 2: Qualitative Analysis	6
Appendix 3: Score Methodology	7

Executive Summary

To show shareholders our commitment to the aggressive growth strategy of opening 100 new stores each year, ten new Capital Project Requests (CPRs) will be discussed at the next CEC meeting. Half of the projects must be evaluated in greater detail using a comprehensive quantitative score that considers the NPV, IRR, R&P forecasts, prototype benchmark risk, surrounding demographics, and competition, as well as a qualitative analysis that considers the other strengths and weaknesses of each project.

Base on this analysis, The Barn, Stadium Remodel, Gopher Place, and Whalen Ct projects should all be accepted due to their strong financials, demographic growth opportunity, and/or strategic competitive opportunity. Only one of the five borderline projects should be rejected—Goldie Square—because its store IRR is less than the store hurdle rate, it has high internal competition, and is expected to greatly underperform its prototype benchmark. If funding all approved projects exceed the CPR budget, bonds should be used as an external funds source.

Introduction

We are committed to opening 100 new stores each year. Given the company's stagnant 2006 year, stockholders, who were pleased with the strategy, are looking closely for us to follow through with it.

We have been given ten CPRs, and five will require more intensive review. In pursuit of opening 100 new stores, we must ensure the Target brand stays strong from the perspective of consumers and shareholders. This report analyzes each of the 5 CPRs that require further review from both a quantitative and qualitative perspective and makes recommendations on which to accept and reject.

Mode of Analysis

To determine which projects to accept and reject, a comprehensive quantitative analysis and qualitative analysis were conducted. The results of each analysis were taken into consideration when making final recommendations.

Quantitatively, 5 separate factors were considered: the financial core (NPV, IRR, and net investment), R&P sensitivity forecasts, relative financial risk, surrounding demographic prospects, and internal/external competition. Each category has relevant indicators that are given a score. These scores are calculated relative to the specific CPR and the prototype store, and are thus considered fairly across all projects—see Appendix 3 for further detail. The scores are then given weight based on which category they represent. 60% of total weight was given to the financial core, sensitivity forecasts, and financial risk. The remaining 40% of weight was split between demographics and competition. After compiling each category's scores for each CPR, they were added together to produce final scores. The CPRs were then ranked from 1 to 5, based on this quantitative analysis.

Qualitatively, specific details from each CPR were compiled in a table. These details included the number of nearby Target locations, anchors, open/close dates, own/lease option, size, prototype, developer, and key advantages/disadvantages of each proposal. Key advantages and disadvantages may also include exceptionally weak or strong line items from the quantitative analysis. This qualitative analysis is designed to be used in conjunction with the quantitative scores to gain a better understanding of the overall value each CPR may provide. Using both analyses, a fully informed decision is made for each proposal.

Data and Analysis

The most important quantitative and qualitative factors for each CPR are discussed here in order of their quantitative ranking from 1 to 5. Further details of the quantitative and qualitative analysis are provided in Appendix 1 and 2, respectively. A brief hurdle rate analysis and cost of capital analysis are also provided to aid in determining which projects to accept.

Hurdle Rates

There are two different hurdle rates for stores (9%) and REDcards (4%), because there are different risks associated with operating a store versus funding credit-card receivables. Store operation is a far more complex task that has more costs and risk associated and thus has a higher hurdle rate. Credit-card debt is a relatively low risk investment and can be insured against, thus a much lower rate. For the purposes of evaluating CPRs, each proposal's IRR based on store operations is compared to its hurdle rate of 9%, and IRR from REDcard operations is compared to its hurdle rate of 4%. A CPR will not be accepted if either of its IRRs do not exceed their hurdle rates.

1: The Barn - Accept

From a quantitative perspective, the rural Barn CPR has the highest ranking. The relatively small net investment of \$13 million allows the Barn to have a high overall IRR (16.4%). Furthermore, its store IRR of 17.5% greatly exceeds the store hurdle rate of 9%, and the credit IRR of 8.1% exceeds the REDcard hurdle rate of 4%. Sales could drop 18.1% and the NPV of the location would still at least meet its P04 prototype benchmark. The Barn also closely resembles the P04 prototype which Target will own, which is good for consistency in the company.

This location is over 80 miles away from the nearest Target and has no major external competition in the area. The project's approval is also known to be the deciding factor in a new shopping center, which may allow for more leverage in dealing with contractors and municipal planners.

This location's most relevant weaknesses are the demographics (which do not strongly represent the target market, and are not predicted to grow well), and the relatively volatile risk of NPV should sales or gross margin decline or construction costs increase.

The incredibly strong quantitative financial value of this location outweighs the weak demographic and NPV volatility. Based on the strong IRR, strong R&P sensitivity forecasts, and low internal competition, this project is the most promising of the 5 borderline CPRs and should be accepted.

2: Stadium Remodel - Accept

The Stadium location has already been remodeled twice and has become outdated for a third time. Qualitatively, this location has a long history of success and is placed in a prime affluent demographic. Remodeling gives a fresh look to the Superstore prototype, which would refurbish brand image in this location and is expected to rebound overall IRR back to a healthy 10.8%. Furthermore, its store IRR of 12.5% exceeds the store hurdle rate of 9%, and the credit IRR of 4.6% exceeds its hurdle rate of 4%. This location does have relatively high NPV risk should sales be less than expected, and there is some uncertainty in how the 8 nearby Target stores' sales would be affected if this CPR is approved.

The qualitative opportunities of this location are enough to justify some financial risk and uncertainty. Based on the long-standing successful history of this location, its prime demographic placement, and its relatively healthy financials if the remodel takes place, this CPR should be accepted.

3: Gopher Place - Accept

The Gopher Place CPR has decent quantitative support. Sales could decline 5.3% and still meet its NPV P04 prototype benchmark. The store and credit IRRs are also strong at 12.7% and 8.1%, both of which exceed their hurdle rates.

The real strength of this location is found in the optimistic demographic future and in competing with Walmart's expansion. Gopher Place has the highest population growth rate of all 5 borderline proposals and ranks highly in house-hold medium income. Furthermore, Walmart is planning to build a supercenter in 2007 and another in 2008. Thus, establishing a stronger presence in this area before full expansion takes place would be to our benefit.

The Walmart expansion could be seen as a potential weakness due to higher competition, but if acted on now, we could consume more market share in the area. This CPR should be accepted based on its value

in competing against Walmart, expanding Target in a high population growth area, and its steady financials.

4: Whalen Ct - Accept

Whalen Ct's weaker store IRR of 9.9% is mostly a product of its high net investment of \$119 million; however, it is still greater than the store discount rate of 9%. Its credit IRR of 8.2% also exceeds the REDcard hurdle rate. This location requires a much higher investment due to its lease agreement in this intensely rich demographic area.

There are 45 other Targets near this location, but transfer sales are expected to be a relatively low 5%. Furthermore, with population estimates as high as 18.8 million in the MSA, this high density of Target stores is justified. This area also experiences 100% market share. Qualitatively, this Whalen Ct addition provides a high foot trafficked area that is important for brand awareness and serves as free advertising for the company.

The relative financial weakness of this CPR is justified by its incredible qualitative value. This opportunity is also time sensitive due to the lease agreement terms and should therefore be accepted at this meeting based on its strong demographics, great brand visibility opportunity, and minimal internal and external competition. Final approval will need to come from the board of directors, because the net investment exceeds \$50 million.

5: Goldie Square - Reject

Goldie Square was the lowest quantitatively ranked CPR. This is largely due to its weak IRR of 8.1%, which does not exceed the store hurdle rate of 9%, and its incredibly low NPV of just \$317,000. Furthermore, transfer sales are expected to exceed 50% and expected sales would have to increase more than 45% to meet its P04 prototype benchmarks for NPV and IRR. This CPR's only strength is in its projected affluent demographic growth which would provide decent brand awareness.

The projected demographic growth of Goldie Square is not enough to overlook the fact that its expected IRR is below the store hurdle rate. Due to this, its weak R&P sensitivity, and its high internal competition, Goldie Square should be rejected at this time.

Each CPR has its own qualitative strength or weakness, which does influence whether each should be approved; however, Goldie Square is the only CPR that must be rejected regardless of qualitative factors because it is the only CPR that has a store IRR below the store hurdle rate. The Barn, Stadium Remodel, Gopher Place, and Whalen Ct all have store IRRs at least above the store hurdle rate, thus other factors may be considered further. Of the 4 accepts proposals—in order of their ranking: The Barn, Stadium Remodel, Gopher Place, and Whalen Ct—each has its own qualitative strength and strong enough financials to support its approval, each of which is outlined above.

Cost of Capital

If the total investment cost of all approved CPRs exceeds the CPR budget, external capital may be used. Due to the current state of shareholders, it would be wiser to consider issuing new corporate bonds to raise external capital instead of diluting share value by issuing new common equity. Considering Target's A+ debt rating, this may also be a wise financial decision. However, each project's IRR and NPV should be re-evaluated based on the new cost of the debt used to fund the projects. If issuing new corporate bonds

to fund these additional CPRs does not significantly impact their IRR or NPV, then the projects should be approved.

Conclusions

All four accepted CPRs—The Barn, Stadium Remodel, Gopher Place, and Whalen Ct—will provide great value either financially, in other important qualitative factors, or both. Goldie Square—the only rejection—was rejected principally because its store IRR does not meet the hurdle rate. Accepting four of the five borderline projects will add to our goal of adding 100 new stores by the end of the year and help show shareholders that we are committed to company growth. If we must use external capital to fund any of these projects, it should be debt in the form of Target's A+ corporate bonds.

Recommendations

Based on this report's quantitative and qualitative analyses of five borderline CPRs, the following projects should be accepted due to their respective reasoning:

1. **The Barn**; strong IRR, low internal competition, and expected to greatly outperform its prototype benchmark.
2. **Stadium Remodel**; strengthen brand image and boost sales in a historically successful location.
3. **Gopher Place**; fast growing demographic, impede Walmart's expansion, and sound financials.
4. **Whalen Ct**; increase brand awareness, strong demographics, and minimal competition.

If required, new corporate bonds should be used as the external funds source to raise the CPR budget.

Based on the same analysis, the following project should be rejected at this time due to its respective reasoning:

1. **Goldie Square**; IRR below the hurdle rate, low NPV, high transfer sales, and expected to significantly underperform its prototype benchmark.

Appendix

Appendix 1: Quantitative Analysis

Inputs	Gopher Place	Whalen Ct	The Barn	Goldie Square	Stadium Remodel
Financial Core:					
Base Case NPV (\$000)	\$16,755	\$25,875	\$20,527	\$317	\$15,739
IRR	12.3%	9.8%	16.4%	8.1%	10.8%
Net Investment (\$000)	\$23,016	\$119,263	\$13,017	\$23,939	\$16,855
R&P Sensitivity Forecasts:					
NPV - Sales	-5.3%	1.9%	-18.1%	45.1%	0.0%
IRR - Sales	2.2%	31.1%	-23.2%	47.2%	0.0%
NPV Risk:					
10% Sales Decline	(\$4,722)	(\$16,611)	(\$4,066)	(\$4,073)	(\$7,854)
1pp Gm Decline	-3481	-11494	-3111	-3929	-6457
10% Const. cost Increase	-1494	-2178	-988	-1470	-910
Surrounding Demographics:					
MSA:					
2005 Population (000s)	650	18,768	135	1,415	806
2000-2005 Pop. Growth	15%	2%	3%	13%	5%
Median HH Income	46700	57200	36600	56100	50774
% Adults 4+ Yrs. College, 2005	15%	30%	16%	36%	28%
Trade Area:					
2005 Population (000s)	70	632	151	222	113
2000-2005 Pop. Growth	27%	3%	3%	16%	16%
Median HH Income	\$ 56,400	48500	38200	56000	65931
% Adults 4+ Yrs. College, 2005	12%	45%	17%	24%	42%
3-Mile Radius:					
2005 Population (000s)	16	1,248	19	67	84
2000-2005 Pop. Growth	20%	2%	7%	4%	15%
Median HH Income	\$ 59,400	\$ 43,800.00	\$ 47,300.00	\$ 50,000.00	\$ 64,597.00
% Adults 4+ Yrs. College, 2005	11%	37%	34%	26%	44%
Competition (External and Internal):					
Expected Market Share	24%	100%	13%	17%	0%
Expected Tranfer Sales	-19%	-5%	0%	-54%	0%

Condensed Weighted Scores	Weight	Gopher Place	Whalen Ct	The Barn	Goldie Square	Stadium Remodel
Financial Core:	40%	0.165	0.055	0.339	0.017	0.202
R&P Sensitivity Forecasts:	10%	0.002	-0.016	0.021	-0.046	0.000
NPV Risk:	10%	-0.017	-0.011	-0.025	-0.015	-0.037
Surrounding Demographics:	20%	0.030	0.064	0.024	0.037	0.042
Competition (External and Internal):	20%	-0.026	0.003	0.001	-0.079	0.000
Final Scores		0.154	0.095	0.359	-0.086	0.208

	Gopher Place	Whalen Ct	The Barn	Goldie Square	Stadium Remodel
Final Quantitative Rankings :	3	4	1	5	2

Appendix 2: Qualitative Analysis

Qualitative Analysis	Gopher Place	Whalen Ct	The Barn	Goldie Square	Stadium Remodel
Key Advantages	Good prospective demographics (high median income and growth rate)	Major Metropolitan area important for Brand awareness, essentially free advertising for all passerbys.	Leverage in deal because shopping center depend's on Target's participation. Low Capital investment and high ROI.	Hotly contested area with affluent and fast-growing population. Provides good brand awareness if expected growth occurs.	A successful store at a strong long-term location serving an affluent family-oriented trade. Remodel would rehabilitate brand image in the area.
Key Disadvantages	Walmart Supercenter expansion plan: Supercenter relocation in 2007, and additional Supercenter in 2008.	Time sensitive (now or never) due to lease agreement. High capital investment.	Weak demographics for target. Low population, not expected to grow. NPV very sensitive to sales decline.	Very sensitive and risky financials. High competition.	Uncertain NPV sensitivity and competition.
Nearby Target Locations	5 in this market	45 in this market	None, closest 2 are 80+ miles away	12 in this market, with expansion planned to go to 24	8 in this market
Prototype	P04	Unique Single Level	P04	Super P04	Interior Remodel to Super P04
Developer	Gopherville	Sawicky and Co.	Hulbert Ventures	Barsky Enterprises	N/A
Anchors	Freestanding	Home Depot, Best Buy	Lowe's	JC Penny, Circuit City, Borders, Bed Bath & Beyond, Ross	N/A
Open Date	October, 2007	October, 2008	March, 2007	October, 2007	March, 2007
Size	127,000	173,585	126,842	173,770	~ 175,000
Own/Lease	Own	Lease	Own	Own	Own
Land/Lease Close Date	November, 2006	October, 2006	April, 2006	August, 2006	N/A

Appendix 3: Score Methodology

Scores	Gopher Place	Whalen Ct	The Bam	Goldie Square	Stadium Remodel	
Financial Core:						
Base Case NPV (\$000)	0.728	0.217	1.577	0.013	0.93	<< NPV as % of Net Investment
IRR	0.123	0.098	0.164	0.081	0.10	<< IRR
Net Investment (\$000)	-0.117	-0.608	-0.066	-0.122	-0.08	<< Net investment as negative % of total net investment if all projects are approved
R&P Sensitivity Forecasts:						
NPV - Sales	0.053	-0.019	0.181	-0.451	0.00	<< Negative NPV - Sales
IRR - Sales	-0.022	-0.311	0.232	-0.472	0.00	<< Negative IRR - Sales
NPV Risk:						
10% Sales Decline	-0.205	-0.139	-0.312	-0.170	-0.46	<< As % of net investment
1pp Gm Decline	-0.151	-0.096	-0.239	-0.164	-0.38	<< As % of net investment
10% Const. cost Increase	-0.065	-0.018	-0.076	-0.061	-0.05	<< As % of net investment
Surrounding Demographics:						
MSA:						
2005 Population (000s)	0.030	0.862	0.006	0.065	0.03	<< As % of total population of all projects
2000-2005 Pop. Growth	0.150	0.020	0.030	0.130	0.05	<< Population Growth
Median HH Income	0.189	0.231	0.148	0.227	0.20	<< As % of total Median HH Income of all projects
% Adults 4+ Yrs. College, 2005	0.150	0.300	0.160	0.360	0.28	<< % Adults 4+ Yrs. College, 2005
Trade Area:						
2005 Population (000s)	0.059	0.532	0.127	0.187	0.09	<< same as MSA
2000-2005 Pop. Growth	0.270	0.030	0.030	0.160	0.16	<< same as MSA
Median HH Income	0.213	0.183	0.144	0.211	0.24	<< same as MSA
% Adults 4+ Yrs. College, 2005	0.120	0.450	0.170	0.240	0.42	<< same as MSA
3-Mile Radius:						
2005 Population (000s)	0.011	0.870	0.013	0.047	0.05	<< same as MSA
2000-2005 Pop. Growth	0.200	0.020	0.070	0.040	0.15	<< same as MSA
Median HH Income	0.224	0.165	0.178	0.189	0.24	<< same as MSA
% Adults 4+ Yrs. College, 2005	0.110	0.370	0.340	0.260	0.44	<< same as MSA
Competition (External and Internal):						
Expected Market Share	0.048	0.200	0.026	0.034	0.00	<< 20% of market share percentage
Expected Transfer Sales	-0.190	-0.050	0.000	-0.540	0.00	<< Expected Transfer Sales

Weighted Scores	Weight	Gopher Place	Whalen Ct	The Bam	Goldie Square	Stadium Remodel
Financial Core:	40%	0.165	0.055	0.339	0.017	0.202
Base Case NPV (\$000)	19.5%	0.142	0.042	0.308	0.003	0.182
IRR	19.5%	0.024	0.019	0.032	0.016	0.021
Net Investment (\$000)	1%	-0.001	-0.006	-0.001	-0.001	-0.001
R&P Sensitivity Forecasts:	10%	0.002	-0.016	0.021	-0.046	0.000
NPV - Sales	5%	0.003	-0.001	0.009	-0.023	0.000
IRR - Sales	5%	-0.001	-0.016	0.012	-0.024	0.000
NPV Risk:	10%	-0.017	-0.011	-0.025	-0.015	-0.037
10% Sales Decline	6%	-0.012	-0.008	-0.019	-0.010	-0.028
1pp Gm Decline	2%	-0.003	-0.002	-0.005	-0.003	-0.008
10% Const. cost Increase	2%	-0.001	0.000	-0.002	-0.001	-0.001
Surrounding Demographics:	20%	0.030	0.064	0.024	0.037	0.042
MSA:	4%	0.005	0.014	0.003	0.008	0.006
2005 Population (000s)	1%	0.000	0.009	0.000	0.001	0.000
2000-2005 Pop. Growth	1%	0.002	0.000	0.000	0.001	0.001
Median HH Income	1%	0.002	0.002	0.001	0.002	0.002
% Adults 4+ Yrs. College, 2005	1%	0.002	0.003	0.002	0.004	0.003
Trade Area:	12%	0.020	0.036	0.014	0.024	0.028
2005 Population (000s)	3%	0.002	0.016	0.004	0.006	0.003
2000-2005 Pop. Growth	3%	0.008	0.001	0.001	0.005	0.005
Median HH Income	3%	0.006	0.005	0.004	0.006	0.007
% Adults 4+ Yrs. College, 2005	3%	0.004	0.014	0.005	0.007	0.013
3-Mile Radius:	4%	0.005	0.014	0.006	0.005	0.009
2005 Population (000s)	1%	0.000	0.009	0.000	0.000	0.001
2000-2005 Pop. Growth	1%	0.002	0.000	0.001	0.000	0.002
Median HH Income	1%	0.002	0.002	0.002	0.002	0.002
% Adults 4+ Yrs. College, 2005	1%	0.001	0.004	0.003	0.003	0.004
Competition (External and Internal):	20%	-0.026	0.003	0.001	-0.079	0.000
Expected Market Share	5%	0.002	0.010	0.001	0.002	0.000
Expected Transfer Sales	15%	-0.029	-0.008	0.000	-0.081	0.000