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TGT.N - Q1 2023 Target Corp Earnings Call

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OVERVIEW:

Co. reported 1Q23 YoverY total revenue growth of 0.6%. Expects full-year 2023 GAAP and adjusted EPS to be \$7.75-8.75 and 2Q23 GAAP and adjusted EPS to be \$1.30-1.70.

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John Hulbert *Target Corporation - VP of IR*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation First Quarter Earnings Release Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, May 17, 2023.

I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

John Hulbert - *Target Corporation - VP of IR*

Good morning, everyone, and thank you for joining us on our first quarter 2023 earnings conference call. On the line with me today are Brian Cornell, Chair and Chief Executive Officer; Christina Hennington, Chief Growth Officer; John Mulligan, Chief Operating Officer; and Michael Fiddelke, Chief Financial Officer. In a few minutes, Brian, Christina, John and Michael will provide their perspective on our first quarter performance, along with our outlook and priorities for the second quarter and beyond. Following their remarks, we'll open the phone lines for a question-and-answer session. This morning, we're joined on this conference call by investors and others who are listening to our comments via webcast. Following the call, Michael and I will be available to answer your follow-up questions.

And finally, as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, including those described in this morning's press release and our most recently filed 10-K. Also in these remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on the first quarter and his priorities for the second quarter and remainder of the year. Brian?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Thanks, John, and good morning, everyone. In the first quarter, our team's discipline and dedication to staying in step with our guests, drove results that met or exceeded the expectations we set at our financial community meeting back in February. Q1 total sales increased 0.5%, reflecting flat comparable sales at the midpoint of our guidance range, combined with the benefit of sales in new locations.

Profitability for the quarter was ahead of expectations. We came into the year clear-eyed about what consumers are facing with persistent inflation and rising interest rates. And we were determined to build on the trust our guests have had in target by unifying as a team to deliver affordable joy each and every day as consumers and businesses navigate, a third straight year of dynamic challenges. We knew this year would demand agility and teamwork and the ability to flex across our multi-category portfolio as we emphasize the categories our guests need most now. Well, our team did all of that in Q1, taking other step forward on our long-term growth trajectory. I might point to 3 unbroken years of traffic growth as a proof point.

In the first quarter, comparable traffic grew 0.9%, even as consumers were becoming more cautious in their overall shopping behavior. That's a healthy indication of the trust, loyalty and strategic relevance we've created, especially given how much and how frequently consumers and the world circumstances have changed over those 12 straight quarters of traffic growth. Very few others can point to anything like that. This growth in guest engagement is the product of deliberate investments we've been making for many years. In all we do, we put the guests at the center, listening carefully to them and finding innovative ways to make their lives easier, more convenient and more joyful.

And here again, both the balance of our multi-category portfolio and the flexibility of our stores as hub model are helping us stay in step with our guests. The mix of in-store shopping has been growing for well over a year now as consumers have become increasingly comfortable in public places. This has led them to choose more in-store visits causing in-store sales growth to outpace digital in the first quarter, both this year and a year ago.

Notably, even within the digital channel, our same-day services, which rely entirely on our stores expanded more than 5% during the quarter. As usual, this increase was led by our Drive-Up service. We saw growth in the high single digits as more and more of our guests embrace the speed, convenience and reliability it provides. In total for the quarter, more than 97% of our sales were fulfilled by our stores.

As it did throughout last year, pressure from inflation and rising interest rates affected the mix of retail spending in Q1, with a further softening in discretionary categories in the March and April time frame. This coincided with the deterioration in consumer confidence, reflecting recent events such as the banking crisis that emerged in March. These continued signs of caution among consumers have reinforced why we entered this year with a conservative inventory position.

And as Michael will cover in more detail, we maintain that cautious stance throughout the first quarter and feel good about our current positioning in light of the trends we've been seeing. But as Christina will highlight in a few minutes, our cautious posture has not reduced our commitment to offering fresh, on-trend merchandise throughout the year. We know that newness is a critical element of what our guests expect when they shop with us. And even if they manage their household budgets and make disciplined buying choices, our guests continue to respond when we offer the right combination of newness, trend right fashion and affordability. That's what we mean when we talk about affordable joy. It's something that's core to our brand and a key differentiator in the marketplace.

Beyond macroeconomic challenges, we continue to contend with significant headwinds caused by inventory shrink, building on a worsening trend that emerged last year. While shrink can be driven by multiple factors, theft and organized retail crime are increasingly urgent issues, impacting the team and our guests and other retailers. The problem affects all of us, limiting product availability, creating a less convenient shopping experience and putting our team and guests in harm's way. The unfortunate fact is violent incidents are increasing at our stores and across the entire retail industry. And when products are stolen, simply put, they're no longer available for our guests who depend on them and left unchecked, theft and organized retail crime degrade the communities we call home.

As we work to address the problem, the safety of our guests and our team members will always be our primary concern. As a result, we are engaged in a variety of mitigation efforts, which began with significant resource investments to protect our team and our guests. In addition, we're installing pictures to protect merchandise and adjusting our assortment in affected stores.

Beyond safety concerns, worsening shrink rates are putting significant pressure on our financial results. More specifically, based on the results we've seen so far this year, we expect that shrink will reduce our profitability by more than \$0.5 billion compared with last year. And while we're doing all we can to address the problem, it's an industry and community issue that can't be solved by a single retailer. That's why we're actively collaborating with legislators, law enforcement and retail industry partners to advocate for public policy solutions to combat organized retail crime. As we communicate with those partners, we emphasize that we're focused on keeping our stores open in the markets where problems are occurring.

Our stores create jobs, serve local shoppers and act as critical hubs in communities across the country and we'll continue to do everything in our power to keep our doors open. At the same time, we'll be closely monitoring the safety of our team and guests as well as the financial impact to our business as we determine the right path forward at Target.

Even as we navigate through multiple short-term challenges, we remain focused on making Target stronger and better for all our stakeholders over the long term. Right now, our team is rallying around a focus on retail fundamentals to ensure we're staying reliable and affordable for our guests and that we're translating key points of difference like our physical proximity to the vast majority of U.S. shoppers and our emphasis on a joyful guest experience into unmatched ease and inspiration for our guests as we continue to grow and scale.

We're also intently focused on creating easier and more efficient ways for our team to deliver on our strategy and fuel our ongoing growth ambitions.

Underpinning all of this is our continued commitment to disciplined, return-based investments that will benefit stakeholders both today and well into the future.

This goes well beyond our physical capital. As John will outline, we'll continue to make important investments in our team. This begins, of course, by building on the robust investments in wages and benefits we've made in recent years. Because of those past investments, today, we offer starting a wage range of \$15 to \$24 across the country. We significantly enhanced the health and wellness benefits we provide and tens of thousands of our team members are enrolled in our industry-leading debt-free college educational program. But our efforts extend well beyond the wages we pay and the benefits we offer. We are committed to building a culture of growth, providing our team with strong foundational learning, enhancing their skills and providing them to excel not just at their current role, but their next role on the Target team, as they continue to build a rewarding career with us.

I want to close my remarks by thanking our team. Nothing is more energizing than the time I spend with them, from visits to our stores and distribution centers across the country to the time I recently spent with our headquarter team in Bangalore, India. Our team is proud to work at Target, and they show that pride through their actions every day, all in support of our guests. I'm proud to work alongside them, and it's a privilege to represent their efforts in venues like these.

With that, I'll turn the call over to Christina.

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

Thanks, Brian, and good morning, everyone. In many ways, the themes of the first quarter operating environment were very similar to what we've outlined in recent quarters. So it likely comes as no surprise that we continue to face elevated volatility and see a reprioritization of spending away from discretionary categories in the face of persistent inflation in groceries and essentials. Despite the near-term challenges facing the retail industry and our business, we remain confident in our ability to generate long-term results, largely driven by the unwavering commitment displayed by the Target team, to our guests, each other and the communities where we operate. Guests continue to place their trust in Target, choosing to shop with us more and more often, at a time when consumers are hyper-focused on managing their budget.

As Brian mentioned, American consumers continue to face difficult trade-off decisions as they juggle the wants and needs of their families. Consumer saving rates are down, and while inflation rates are finally declining, so is consumer confidence. The fear of a looming recession weighs heavily on many American families and though discretionary spending remains soft, our guests are still looking to sprinkle some affordable joy into their regular shopping at Target.

In the first quarter, comparable sales were flat to last year, which was squarely at the center of our expectations. As you heard from Brian, we continue to benefit from traffic and sales growth in our frequency categories; Food & Beverage, Household Essentials and Beauty, which helped to offset softer year-on-year sales in our more discretionary home, apparel and hardlines categories. Within the quarter, total sales were strongest in February, began decelerating in March and softened further near the end of April.

Q1 performance was led by Beauty, which delivered comp growth in the mid-teens in light of continued strength in both Core Beauty and Ulta Beauty at Target assortment. Food & Beverage grew in the high single digits, reflecting broad-based strength across the category. Household Essentials delivered low single-digit growth, reflecting notable strength in both health and pet care categories. Apparel, home and hardlines all experienced sales declines from the mid-single digits to low double digits as guests continue to pull back on discretionary purchases. Notably, guests are shifting to shop more just in time in these categories as they wait until the last moment before key events to invest in new decor or wardrobe refreshes.

As we've been noting for some time, despite overall softness in discretionary categories, seasonal moments and newness in apparel, home and hardlines continue to be bright spots, prompting great responses from our guests. Within the first quarter, we had a strong Valentine season and Easter holiday across multiple assortments, ranging from food and hosting solutions to decor and giftables. New offerings in apparel, including the latest wave of our designer dress collection and new sets in women's athleisure have seen incredible responses from guests. And this year's major theatrical releases such as Super Mario Brothers and the upcoming Disney film, The Little Mermaid, are driving outsized share gains and sales momentum. These examples demonstrate that when our assortments are fresh, seasonally relevant and affordable, that's a winning formula to engage and delight our guests.

Given that consumers are cautious when buying discretionary items, we are being more declarative than ever about affordable joy and leaning into value messaging across all our media channels, in-store signing, merchandise displays and through our digital platforms. With a balance of strong opening price points, timely and relevant promotions, as well as a mix of competitively priced national brands and high-quality and affordable owned brand offerings, we have an opportunity to boldly demonstrate the power of Target's value proposition to our guests.

As I've shared in prior calls, this is where the power of Roundel and Target Circle really shine through, creating collective value for our guests and for Target.

With consumers more price conscious and focused on promotions right now, we know they're willing to search for a deal, but appreciate when we make the hunt easy for them. By utilizing our rich guest insights, we are best able to match the right product to the right guests with the right promotion. This is why we take such a differentiated approach with Roundel, thoughtfully and selectively connecting vendors and their products to our guests. Roundel's interconnection with the broader Target digital ecosystem means we are uniquely positioned to inspire the millions of users of our website, the Target app and other diverse media platforms. This helps vendors find consumers that are most likely to be interested in our products, creates awareness and conversion to new products for our guests through compelling deals and ads and drives top line and bottom line benefit to Target, all with an eye to enhancing the guest experience.

Similarly, we know this personalized touch is why active Target Circle users make 2.5x the trips in Q1 compared to non-Circle guests and spent 3x more. Whether through everyday offers or member exclusive events like Target Circle week in March, we see incredible guest response to Target Circle promotions. Roundel and Target Circle provide opportunities for us to connect with guests in both the short and long term, offering instantly gratifying promotions in the now and a tailored and elevated experience that builds lasting affinity tomorrow and beyond. And beyond promotions and product placements, we know that when guests try our own brand offerings, they love the value and quality they receive, and this leads to repeat purchases.

We also know that simplified, easy to understand, pricing and promotions removes friction from the shopping experience, both in stores and online. This explains why our guests are responding to affordable home decor selections where we are expanding our assortment of items priced under \$10. It's why we recently launched new swim assortments starting at just \$12 and to help our guests get ready for summer celebrations of all kinds our only at Target Sun Squad brand, offers everything needed to be outside this summer with more than 60% of the entire assortment priced under \$10 and nearly 90% of the assortment priced under \$20.

But our comprehensive view of affordability extends beyond compelling price points. In particular, our own brand portfolio offers an unmatched combination of quality and price. For an example, look no further than our \$3 billion owned brand, Cat & Jack, featuring on-trend durable and affordable kids clothing. With everyday essentials like \$4 T-shirts, \$5 leggings, and \$8 dresses and jeans, Cat & Jack offers both affordability and style. And because we stand behind not just the price but the quality of these items as well, we guarantee all Cat & Jack apparel for 1 full year with free returns should anything not meet our guest expectations. This is just another example of how we offer comprehensive value for our guests giving them affordable options without skimping on quality.

As we look to the second quarter and beyond, we will continue the steady drumbeat of newness and value all while maintaining a cautious inventory ownership position in our discretionary categories.

In terms of seasonal moments and holidays, Target teams are focused on helping our guests celebrate all summer long. Starting last weekend, we kicked things off by celebrating Mother's Day with affordable and inspiring ways to thank the moms in our lives, and we have plans to continue celebrating key summer moments all summer long wrapping up with everything needed to host the perfect Fourth of July Barbecue.

With new summer Food & Beverage offerings, including more than 100 new Good & Gather items to target exclusive pickleball sets for amateurs and pros alike, we are listening closely to our guests and providing the hottest trends across our entire assortment.

In apparel, guests will find vibrant color palettes across our offerings, helping all families celebrate summer in style. Best of all, these apparel items provide amazing value with clear, compelling opening price points.

For kids and kids at heart, the summer's roster of exciting movie blockbusters will find their way into multiple assortments ranging from apparel to toys to collectibles, featuring familiar characters from Disney, Marvel, Teenage Mutant Ninja Turtles and more. And because you can never have too much of a good thing, the latest assortment drop from Tabitha Brown just launched a few days ago. Already off to a fabulous start. This collection celebrates the joy that comes from gathering alongside friends and family, recharging in the summer sun and pausing for fun and games. The assortment includes over 60 items ranging from backyard entertaining essentials, games, tableware, outdoor furniture as well as guest favorite food items back by popular demand.

As we navigate this challenging environment, we will continue to lean into flexibility and focus on retail fundamentals while remaining vigilant in monitoring changing trends with the consumer and the economy. It's only because of our incredible team that we are able to stay nimble, listening for and quickly applying guest feedback into our operations. To our teams in stores, supply chain and headquarters locations around the world. Thank you for sharing your talent and passion and support of our guests. You are truly the best team in retail, and you bring Target's values to life each and every day.

With that, I'll turn the call over to John.

John J. Mulligan - Target Corporation - Executive VP & COO

Thanks, Christina. Through all of the rapid and unexpected changes we've experienced over the last 3 years, teams throughout our operations have done an amazing job, maintaining their energy, staying agile and doing everything in their power to serve our guests' ever-changing needs. And today, with 2 years of unusually rapid growth behind us and last year's excess inventory in the rearview mirror, we are focusing this year on training and development for our team with an emphasis firmly centered on retail fundamentals. Our goal is to reinforce the reliability and consistency of our shopping experience as we help our team members to succeed in their current job and build the right skills to prepare for the next one.

More specifically, every store this year is engaging in assessments to reinforce consistently strong execution throughout the country and every day of the year. These assessments are centered on the factors most essential to operating great stores and delivering a consistent experience, ranging from staffing and scheduling to inventory management, in-store signing, digital fulfillment, guest and team member safety and the checkout experience.

In support of these efforts, we're investing in training and development across every level of our team from entry-level team members to the store leaders. Beyond the reinforcement of everyday best practices, we're preparing our team to support new services including the upcoming rollout of Drive-Up returns and the opening of additional Ulta Beauty at Target locations. In addition, to develop our store supervisors and leaders, we're investing in a cohort-based peer learning model, in which participants engage in classroom experiences, one-on-one coaching and on the job practice. All of this training is designed to help our teams succeed today and build our pipeline of future leaders.

Of course, a foundational element of our team development effort is our education assistance program called Dream to Be, which enables our U.S.-based part-time and full-time team members to pursue tuition-free undergraduate and associate degrees, certificates and boot camps. This industry-leading program features tuition-free options in more than 250 business aligned programs across more than 40 schools, colleges and universities. Since the rollout of Dream to Be in 2021, tens of thousands of our team members have successfully participated in this program.

As you saw in today's release, we ended the first quarter with 16% less inventory than a year ago. This decrease reflects our current cautious position in discretionary categories, combined with the impact of excess inventory on last year's balance sheet. Those factors are being partially offset by some purposeful inventory investments. These include investments in support of our frequency categories, in light of the rapid growth we've been seeing and to ensure we're in stock. And I'm happy to say that these investments have been paying off.

In the first quarter, out of stocks of our most important Food & Beverage and Essentials items, we're running at 3-year lows and trending in a favorable direction. In addition to support of our frequency businesses, we're also making strategic inventory investments where we believe we have a long-term market share opportunity, most notably in the upcoming Back-to-School and Back-to-College seasons. As you know, in our supply chain, we're engaged in a multiyear journey to modernize how we replenish inventory in our stores.

When I moved into this position 8 years ago, store inventory replenishment was a standardized inflexible process. That placed a heavy burden on our store team members. With this modernization effort, our primary goal is to reduce those labor demands on our stores. We achieved that result by moving work upstream to a distribution center, where we can apply the appropriate processes, technology, tools and automation to accomplish the work at scale. This results in higher labor efficiency for the company overall while allowing our store team members to spend more time in the front of our stores with our guests.

In the upstream distribution centers we've opened over the last 2 years, we've implemented technology and capabilities that improve how product is sorted and loaded on to trailers headed for our stores. These improvements reduce the necessary time for the store team to unload the trailer and for them to move the inventory to where it's needed in the store. In these new buildings, we've also invested to automate the sortation and packing of break pack items, facilitating the shipment of quantities smaller than a full case pack. This automated process makes the shipment easier to unload, reduces sorting time for the store team and lowers the amount of inventory in our store backrooms.

Outside of our new facilities, we're working to roll out similar capabilities to our legacy distribution centers. In addition, throughout our legacy network, we continue to focus on reducing the overall cost of store replenishment by implementing automation, along with other improvements. For example, we've been testing ways to improve the lead time and accuracy of our deliveries from several of our existing buildings and have seen an increase in speed and lower out-of-stocks in stores service from these facilities.

But I want to stress, automation is only 1 way to deliver value to our business. Consider our sortation centers, which are positioned downstream from our stores to provide speed and efficiency in support of last mile delivery. Our sort centers are not highly automated. Instead, they use technology and sophisticated process logic to sort packages and provide a faster and better guest experience at a significantly lower cost. In fact, it's because of the relative simplicity in the design of these buildings and the efforts of an incredibly innovative and energetic team that we've been able to scale the number of these buildings so quickly from 3 a year ago to 9 today. And an expected total of 15 or more in 2026.

Beyond rapidly scaling the number of sort centers, our team continues to innovate around the existing processes in those buildings, finding ways to deliver additional value to the business. One example is a new facility that we opened earlier this month in Smyrna, Georgia. This new facility, which costs very little to open, serves as an extension of the existing sortation center in the Atlanta market extending the reach of our next-day delivery capability.

With this new facility, online orders that have been packed by Atlanta area stores continue to flow to the sortation center, where they're sorted and delivered via our national carrier partners or a ship driver. However, a portion of local orders falling outside the sortation centers last mile delivery area can now be transferred to Smyrna extension, where ship drivers can pick them up and serve additional neighborhoods.

With the opening of this extension facility, our next-day delivery capability is now reaching more than 3 million guests in the Atlanta market. As we mentioned at our recent financial community meeting in our Dallas and Minneapolis sortation centers, Target and Shipt have been testing the development of high-capacity van routes that enable us to bring last-mile delivery to a larger number of guests. In addition, over the past year, across all of our markets served by our sortation centers, we have shifted more routes to larger passenger vehicles and early results have been positive.

Compared with routes previously served by sedans, SUVs and minivans can deliver more than double the number of packages per route while high-capacity vans can service nearly 5x as many packages. And beyond capacity, the use of larger vehicles enables further route optimization, increasing the number of packages that can be delivered per hour.

With these changes, in the first quarter, approximately 65% of our last mile deliveries serviced by Shipt were made with larger vehicles compared with 0 a year ago. This resulted in meaningful cost savings for our last mile delivery program overall. Based on the success of these efforts, we're developing plans to begin testing high-capacity vans at a larger scale. In addition, we're developing a standardized faster way to load those vans, enabling package containerization and easy identification of the correct packages at delivery.

In addition to simplifying the load process for the drivers, this new process will enable us to safely move a larger number of Shipt drivers in and out of our sort centers in a given amount of time, expanding our last mile delivery capacity in these markets. While there are many different ways our team is working to gain efficiencies and deliver value to the business, all of our projects have some things in common. First and foremost, they're all designed and implemented with a focus on our guests and continuing to build their engagement with Target.

In keeping with that guest focus, we design processes and deploy technology and automation as a way to highlight the human element in our business rather than minimizing it. It's an essential element of our purpose to help all families discover the joy of everyday life. As I get ready to close, I want to pause and thank our team for bringing that purpose to life every day for both our guests and for your fellow team members. You're the reason that guests trust and love our brand and why they choose to shop at Target.

With that, I'll turn it over to Michael.

Michael J. Fiddelke - Target Corporation - Executive VP & CFO

Thanks, John. In many ways, the environment today feels completely different than 3 years ago when the pandemic was just beginning and no one knew what to expect, but today even as the pandemic feels further and further behind us, we continue to face elevated macro uncertainty and volatility as the world continues to transition toward a new normal. From a macro perspective, inflation remains high and stubbornly persistent, having recently peaked at decades high levels. To control this inflation, the Federal Reserve has been raising interest rates at an unprecedented pace. But for now, despite the building economic pressure from both inflation and higher interest rates, the U.S. unemployment rate is lower today than it's been in 50 years. And as Christina mentioned, consumer spending patterns continue to evolve, putting significant pressure on our discretionary categories.

While I'm guessing we're all looking forward to the day when economic conditions begin to stabilize and normalize, I'm pleased that today, even in the face of all these challenges, we're continuing to see deeper engagement from our guests. That's most visible on our traffic, which grew just under 1% in Q1 and has now grown for 12 consecutive quarters. In fact, since 2019, prior to the pandemic, first quarter total sales have increased more than 43%. The vast majority of that growth is the result of an increase in sales per square foot over that time of which a significant portion has been driven by traffic.

Total sales grew 0.5% in the first quarter, reflecting flat comparable sales, combined with the contribution from new locations. Total revenue growth of 0.6% reflected sales growth, combined with double-digit growth on the other revenue line, led by our Roundel ad business. As Brian mentioned,

sales trends softened over the course of the first quarter. More specifically, we began the quarter with positive comp growth in the month of February and then saw the trends soften into low single-digit declines by the end of April and so far into May.

Our first quarter gross margin rate of 26.3% was about 60 basis points higher than a year ago. Among the drivers, we saw more than a percentage point of favorability in merchandising, driven primarily by a reduction in freight and transportation costs, along with the benefit of retail pricing and a lower clearance markdown rate as we compared over last year's inventory actions. We also saw a small gross margin rate benefit from lower digital volume and a more favorable mix of lower cost same-day fulfillment.

Offsetting those 2 sources of benefit, shrink reduced our gross margin rate by a full percentage point compared with a year ago. As Brian highlighted, pressure from shrink has continued to increase, and we now expect that if current trends continue, shrink will reduce our full year profitability by more than \$500 million compared with last year. One note, the impact of merchandise mix on our first quarter gross margin rate was approximately neutral as the rate impact of sales declines in our highest-margin categories was offset by sales declines in lower-margin rate categories.

Consistent with the guidance we provided for the quarter, our first quarter SG&A expense rate was 19.8%, up about 90 basis points from a year ago. This increase reflects our continued purposeful investments and paying benefits for our team, combined with inflationary cost pressures throughout our business against a backdrop of flat comparable sales, partially offset by the benefit of productivity increases and strong expense discipline across the company. Our first quarter D&A expense rate was down about 10 basis points, reflecting lower accelerated depreciation related to our remodel program compared with last year. Altogether, our first quarter operating income rate to 5.2% was higher than expected, due primarily to upside in our gross margin rate as the benefits from lower freight and transportation costs and our efficiency efforts offset a higher-than-expected impact from shrink.

As John mentioned, Q1 ending inventory was about 16% lower than a year ago. Within that inventory number was a decline of more than 25% in discretionary categories, reflecting the excess inventory we were carrying last year and the cautious approach we are taking this year. Partially offsetting the decline in discretionary inventory are the purposeful inventory investments we're making in our frequency categories, along with some strategic bets in support of long-term share opportunities. We believe our cautious inventory approach has served us well so far this year and will continue to be the right approach going forward.

As I turn now to capital deployment, I'll start where I always do, by reiterating our long-standing priorities. First, we fully invest in our business in projects that meet our strategic and financial criteria. Second, we support the dividend and look to build on our record of annual increases, which we've maintained since 1971. And third, only after we've supported those first 2 priorities, we deploy any excess cash to repurchase shares over time within the limits of our middle A credit ratings. Regarding the first priority, we made capital investments of \$1.6 billion in the first quarter as we continue to remodel stores, open up new locations, build upstream inventory replenishment capacity and ramp up our sortation center strategy.

With 1 quarter of the year behind us, we continue to expect our full year CapEx will be in the \$4 billion to \$5 billion range. Regarding the second priority, we paid dividends of \$497 million in the first quarter, up from \$424 million last year, driven by a 20% increase in the per share dividend, partially offset by a decline in average share count.

And finally, given the impact of the current environment on our financial performance, we didn't repurchase any shares in the first quarter. In the near term, we'll maintain that approach and don't intend to resume repurchase activity until it's compatible with our long-term credit rating goals.

On that note, I'm pleased with our progress in strengthening our balance sheet. Even as profitability remains well below our long-term potential, we've already seen an encouraging improvement in our operating cash flows. More specifically, our operations generated \$1.3 billion of cash in Q1 in stark comparison to a year ago when our operations absorbed \$1.4 billion. This dramatic year-over-year improvement was driven almost entirely by changes in our inventory investment compared with last year.

And finally, I want to end my review of the quarter with our after-tax returned on invested capital. For the trailing 12 months through the first quarter of this year, our after-tax ROIC was 11.4% compared with 25.3% a year ago, reflecting both the change in profitability and the increase in working capital we began to see a year ago. As we move further into the year, we expect to see higher profitability than a year ago and continue

to benefit from the inventory efficiency reflected in this quarter's cash flow. Based on these expectations, we anticipate a recovery in the ROIC metric this year and expect to continue building back toward our longer-term potential in 2024 and beyond.

So now let me turn to our expectations for Q2 and the full year. As I mentioned, on the sales line, we experienced notably softer comp trends as we exited the first quarter and moved into May. As a result, we're anticipating second quarter sales in a wide range centered around a low single-digit decline, consistent with those recent trends. In terms of profitability, we're expecting a range of possibilities as well.

On the gross margin line, we believe that many of the same trends that emerged in Q1 will continue in the second quarter, including a meaningful tailwind from freight and transportation costs, and a significant headwind resulting from inventory shrink. Similarly, on the SG&A expense line, we'll continue to face broad-based inflationary pressures and expect to benefit from efficiency efforts and cost discipline across our team. However, if our second quarter comp sales end up declining in the low single digits, which is where they are trending currently, we'll see greater SG&A rate pressure related to cost deleverage than we experienced in Q1.

In light of all of these expectations, we believe our Q2 operating margin rate will be much higher than the very low rate we earned a year ago, but lower than the 5.2% we saw in Q1. Altogether, our expectations translate to a second quarter GAAP and adjusted EPS range of \$1.30 to \$1.70. As we look beyond Q2, we continue to believe that we entered this year with the appropriate level of caution planning conservatively in light of a tough macro environment and rapidly changing consumer trends. While we're facing some clear headwinds in the short term, we also have multiple actions underway to mitigate them, including ongoing efficiency work and cost saving efforts that we expect to flow into the P&L in the second half of the year.

While we feel good about these efforts, we also remain cautious on the overall environment in light of the macro industry pressures we've outlined today. Taking this all into account, we are maintaining the full year guidance we provided at our Financial Community Meeting in February. Namely, we're planning for full year comparable sales in a wide range centered around flat. We expect to grow our full year operating income by \$1 billion or more, and we expect our business to generate full year GAAP and adjusted EPS of \$7.75 to \$8.75.

As I get ready to turn the call back over to Brian, I want to reiterate my confidence in our longer-term prospects for profitable growth. Even today against a very challenging backdrop, we're starting to assemble the building blocks for a recovery in our operating margin rate back towards its longer-term potential. And while spending pressures in discretionary categories are currently outweighing the continued strong growth we've seen in our frequency categories, we're confident that the economy and the consumer will stabilize over time and will once again benefit from growth in the more discretionary portion of our assortment.

In the meantime, we have the capacity to navigate this environment with a strong balance sheet and a resilient business model. We have the right long-term strategy, and we're privileged to work with the best team in retail. I want to express my sincere thanks to our entire team. You are, by far, our most valuable long-term asset.

With that, I'll turn it over to Brian.

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

As Michael just mentioned, we don't build our strategy based on a single moment, but focus on the best way to serve our guests over time. We take that approach when we invest in our stores, in our supply chain, in digital fulfillment and our team. And as we've said many times, we also build our assortment to serve the long-term needs of our guests and the benefit of this flexible assortment strategy has been clearly evident over the last few years. Following the onset of the pandemic, we saw unprecedented traffic and sales growth in our discretionary categories.

And now this year, even as guests are pulling back on discretionary purchases, we still grew traffic just under 1% in the first quarter as guests increase their spending in Beauty, Food & Beverage and Household Essentials. But a short-term pullback in discretionary purchases doesn't mean we'll turn away from our apparel, home and hardline categories. Instead, we'll continue to invest in them and deliver fresh new items throughout the year. That's because our guests continue to love these categories, and we're focused on building our guest engagement with them.

Think about it this way. When I arrived at Target just under 9 years ago, our Food & Beverage category was underperforming and losing market share. But rather than turning away from that part of our business, we decided to lean in. We committed to the long term and engage in the hard work that we needed to improve our performance, ranging from our relationship with vendors to our French food supply chain, store labor model, assortment strategy and our own brands. Much of that work happened behind the scenes, and it took time before business trends in Food & Beverage started to change, but the work paid off over time. We entered 2023 following 3 straight years of unprecedented growth and market share gains in Food & Beverage, having grown that category by more than 61% between Q1 2019 and this year's first quarter.

Beauty is another category where past investments are paying off. It's been performing well for years because we continually invested in the store experience, in passionate, talented and well-trained team members, in our digital experience and our assortment. Our growing partnership with Ulta Beauty is the latest example of how we're finding innovative ways to further enhance our beauty assortment and experience. And our business results clearly demonstrate that our investments are paying off.

We've experienced double-digit growth in Beauty sales for the last 3 years in a row and just saw mid-tear growth in the first quarter. These examples demonstrate why we're investing and maintaining our long-term focus across the board on every 1 of our merchandising categories, fulfillment options, stores, services and our team, all in service to bringing affordable joy to our guests.

If we do that right, we'll always be ready to serve our guests as their needs change, further deepening our long-term relationship with them.

With that, we'll move to Q&A. Christina, John, Michael and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ed Kelly with Wells Fargo.

Edward Joseph Kelly - Wells Fargo Securities, LLC, Research Division - Senior Analyst

I wanted to start with the guidance. I mean, clearly, you're beginning to see increased consumer pressure now in Q2. And I think those signs of weakening are broad out there. But the midpoint of your guidance implies a pretty good back half improvement. I'm just kind of curious how you thought about Q2 with the reaffirmation of the full year? And is it realistic for us to think that the back half would be in the low \$2 range, given what Q2 guidance is?

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

I'll let Michael start by talking about Q2, and then I'll talk about our focus on the balance of the year.

Michael J. Fiddeleke - Target Corporation - Executive VP & CFO

Yes, thanks for the question. You said part of the answer right in your question. We continue to take a cautious approach to the top line. We think that served us really well in the first quarter. 1 of the reasons we got the profit outcome we did in the first quarter is that with inventory position conservatively, that gives us flexibility and agility. And so you'll continue to see us take that posture for the balance of the year. And that comes with an impact on the top line and the bottom line. Our leverage looks different at a slightly negative comp than it does when we're running a positive comp.

A couple of other things that I dimensionalize kind of in how they'll paginate over the year, though. When the shrink with the current trends continuing, that year-over-year pressure from shrink is certainly front half loaded in the year. And so you see that impact in Q2 as well. And then

we're excited about the continued work on our efficiency initiatives, and you'll see some of that come to bear in the back half of the year, too. So taking that all together, we feel good about the full year positioning, and we're appropriately cautious for the second quarter.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

You heard Christina talk about the changes we've taken from an inventory standpoint, the benefits that it's going to provide over the balance of the year, that gives us optimism as we think about the full year guidance. The combination of reduced inventory allows us to bring newness into our assortment, make sure we're on trend with the items we know our guests are shopping for, continue to leverage the traffic gains we've seen now for 12 consecutive quarters and balance the strength we're seeing in Food & Beverage, Household Essentials and Beauty with the seasonal moments where Target shines. So as we sit here today, we're excited about Back-to-School and Back-to-College. We've got great plans for the holiday season. And Christina and her team have done a fabulous job of making sure we've got new on-trend items that are going to delight our guests and provide that affordable joy we're looking for each and every day.

Edward Joseph Kelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Just a follow-up. At the Investor Day, you mentioned that 6% is, I guess, potential for '24. And the backdrop is shifting though. Can you just sort of update us on your thoughts around that building blocks considering the macro?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes, nothing new to share on that front today. I mean, as we sit here 1 quarter into the year with a comp that played out kind of exactly as we expected and a full year guidance that we think is still appropriate. I think we're -- the underlying work in front of us to build back profitability, a meaningful piece of which is part of our plan here in 2023. It will be the first step along that path.

Operator

Our next question is from Chris Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So a follow-up to the first question there. So on the comp side, is it your expectation that despite disinflation in consumables that clean inventory, some new newness and easier compares, you're expecting general merchandise performance to, I guess, maybe get less worse as we get into the back half of the year?

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Chris, maybe I can start this one. We acknowledge that there's a lot of volatility and that we cannot predict the future, but our expectation is that some of the strengths of Target really amplified during the back half of the year. And it starts with what Brian said, Back-to-School, Back-to-College, where the full value proposition of Target is really put on display. You can leverage all 5 categories in our multi-category portfolio to achieve what you need for your families, buying backpacks and lunches and new outfits for school. And that really then sets up into a cadence of the fall with -- we start new fashion trends in September. We go into October with Halloween, followed by Thanksgiving and Christmas, and those are big moments for Target.

On top of that, we do believe that there's some market share upside in key categories, especially in home, where we believe Back-to-College will benefit strongly from market disruptions in categories like domestic and kitchen appliances. So we're betting on some of those things as well as

the newness and the agility that both Michael and Brian have spoken to that having the right fresh assortment and continuing to lead into the affordable side of that will give us momentum in the back half.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Chris, the only thing that I might add to that is, that's all underpinned by a clean inventory position. I mean 1 of the benefits of planning inventory cautiously as we've got the flexibility to lean in to all the good stuff Christina just talked about. And so the end of the quarter, down 16% on a year-over-year basis, that's over 25% in the discretionary categories gives us a lot of room to maneuver as we get into the back part of the year.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Got it. Then as a follow-up, just thinking about the puts and takes as you move through in the back half of the year on the margin, particularly on the gross margin front. So it sounds like the shrink kind of wait and it sort of dissipates as you hopefully catch up on an accrual here. Does freight also improve? And then as you think about the benefit of freight rise into the back half? And then as you think about the efficiency efforts, can you talk about how they're proceeding and where you expect those efficiency efforts to play out in the P&L?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. You're hitting on some of the 3 key big factors as we get into the back part of the year. We're pleased to see headwind on a year-over-year basis. From freight, we're in a better place now than we were a year ago certainly on that front, and that will continue as we get into the back part of the year based on how we currently have things projected.

On the efficiency side of things, I mean, there's a lot within that. Some of that will come to bear this year. As we've shared before, importantly, some of that will come to bear over the next few years. But as an example of something that we'll see more benefit from in the back half of this year, sortation centers are a perfect example. We've got many more facilities open this year. They'll do a lot of business in the back half of the year. And so that's -- it's more sort centers helping deliver goods faster in a sort center market and save us some last mile shipping costs with our Shipt and drivers delivering those brown boxes. And so that's 1 of many initiatives that will start to bear fruit as we get into the back part of this year and the years to come.

Operator

The next question is from Michael Lasser with UBS.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

One of the key debates right now on Target is what's the sustainable gross margin rate moving forward? And the first quarter performance is going to help inform the various perspectives on that. So with that being said, can you help bridge the gap in your first quarter 2023 gross margin performance versus 2020 -- excuse me, 2019? I know you said that 100 basis points of the gross margin decline versus last year was shrink. I think you previously said that heading back to last year, there was a 150 basis point drag. So is it right to think that the -- more than 2/3 of the decline from this quarter to 2019 was just shrink related?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

So I'll take a swing at that, Michael. The -- as I said in my remarks, the big drivers, speaking on a year-over-year basis of margin in the first quarter, we had a tailwind from freight. We already talked a little bit about the benefit we're seeing there on a year-over-year basis versus 2019, freight is still a headwind, to be clear. But on a year-over-year basis, we're seeing some benefit. We also saw some benefit on a year-over-year basis on the

markdown and think salvage front as we recover from some of the inventory actions that we started to take last year. And then we saw the headwind from shrink, a full percentage point in the first quarter on a year-over-year basis. Like I said, if the current trends were to continue, we'd see that drag from shrink to be front half of the year loaded and kind of how it shows up throughout the year. But you're hitting on the key -- 3 key drivers on a year-over-year basis.

Michael Lasser - UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines

Okay. And my follow-up question is, the other area of discussion is going to be how do you get this flattish comp for the full year in light of what proceeds to be deteriorating macro situation. So perhaps you're going to make some purposeful choices trading off some margin in order to drive traffic? And if that's the case, how much are you willing to sacrifice the profitability in order to maintain the top line performance as we move into the second half of the year and beyond?

Michael J. Fiddelke - Target Corporation - Executive VP & CFO

I'm happy to start. Christina, feel free to chime in. We think about it a little differently than that, Michael, in that as we think about the last back half of the year, I mean, we're going to drive traffic in a lot of ways, but it's not a simple trade margin for traffic play. It's about being relevant for our guests in the moments that matter. And is evidenced by the strength in traffic we saw in Q1. With the balance we have across categories, we can appeal to whatever is at the top of the guest shopping list. And first and foremost, that's how we think about staying relevant and driving traffic. So our guide for the year unchanged at the end of Q1 versus what we said 90 days ago, incorporates our best view of how we see all of those puts and takes playing out. And it's a wide range on the top line and the bottom line, but we believe is appropriate from the variables as we digest them sitting 1 quarter into the year. Christina, feel free to -- is there anything you'd add?

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

Yes. I agree with Michael, 100% that we aren't looking to make those 2 trade-offs. What we do instead is we look at where is there potential for us to take share because our unique proposition in the market might play really well under these circumstances. But in the discretionary categories, we're going in with a very conservative posture. And so it's the strength of our multi-category portfolio and the guests choosing Food, Beverage, Household Essentials and Beauty that's creating the majority of the traffic gains that we're seeing right now.

And I'm very confident about what that means in terms of what the guests are saying in the categories where there's the most price inflation and the most price sensitivity. They're choosing us disproportionately often, which I think is a very good sign of the relevance that we created. Now we will lean into newness, we will lean into affordable joy. We will lean into areas where the guests also are telling us that they're finding our value proposition to be relevant. That showed up in the first quarter in key seasonal moments and is why I'm excited about the back half because we have more of them and there's more disruption in key categories like home.

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

Michael, the only other thing I would add is as we think about leveraging our multi-category portfolio in this environment, we have the advantage of a nice balance between national brands and the continued strength we see in own brands, particularly at a time when our guests are looking for that affordable joy from Target. So we do think we're uniquely positioned to continue to maneuver through a challenging 2023 through the strength of our multi-category portfolio, the great national brand partnerships we have, complemented by our own brands and the flexibility we built into our system by reducing inventory and giving us the ability to flow fresh new items that are trend right for our guests.

Operator

Our next question is from Karen Short with Credit Suisse.

Karen Short

I just wanted to ask a little bit about your -- you had a lot of discussion in terms of price points that are going to be lower in discretionary. So I guess my question is, how much of there -- how much of your weakness in discretionary is just a misperception on your actual price point and your value proposition? That's my first question.

And then my second question is when you obviously have more of an extreme issue on shrink than some other retailers, how much are you losing sales based on some of the measures that you're taking?

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

Karen, why don't I start and address the last point because as we sit here today, we think about what's happening from a theft and organized retail crime standpoint. It's an urgent issue, not just for Target, but across the entire retail industry. It is a problem that impacts availability of product, the shopping conditions are less convenient. And unfortunately, what I'm most concerned with is it puts our team and our guests in harm's way. So we are working right now with NRF, our partners at (inaudible), other retailers across the country to make sure that we can talk to legislators that we can work with law enforcement to make some industry-wide changes and we're advocating for public policy changes to address the growing issues that surround all of us in retail today with theft and organized retail crime.

Christina, if we talk about our approach to discretionary categories, I think we've been very clear about the fact that we've been trying to bring fresh new items and at a great price point and value that our guests are looking for. And Karen, I think that's been really consistent throughout the last couple of years as we've seen an overall decline in apparel sales in the industry, in home and hardline-related categories. But Christina can talk to the fact, in many cases, we're holding or growing share in categories that have been soft. But where we've continued to see strength in our ability to hold share and bring newness that's relevant to the guest.

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

Yes, that's absolutely right. We have been talking about unit share for many, many, many quarters in a row because in many cases, we didn't actually raise our prices as much as the market. And we maintained that affordability. And so that has continued to help contribute the traffic gains that we've seen and the performance that we've seen in aggregate. Our value proposition is always a balance between expect more and pay less, and we're always going to play up that. And so the opportunity for us is to make sure that we are cutting through in our -- with the clarity of our promotions that we continue to put those great items in front of the guests and our merchandise displays and that our website reflects the incredible value that we do offer.

I would tell you though that something that we're leaning into that has the potential to continue to create relevance for our guests is Target Circle. Target Circle is our loyalty program. It's free, and it offers personalized promotions and it is -- we've seen that, that is generating better returns than mass promotions. And so our ability to not only create relevance for our guests, but deliver better returns for the business is a big priority for us. And that is part of the ecosystem the way we deliver value. The last part that I'd offer up, though, is because of the way we deliver value and our value proposition is about balance, it comes through a lot in the assortment and own brands play a particular role here. Not only are they great quality products that have been designed with specific guest needs in mind, they're also incredibly accessible from a price point perspective. And that's why you hear us talking a lot about that, particularly in this environment.

Operator

Our next question is from Rupesh Parikh with Oppenheimer.

Rupesh Dhinoj Parikh - Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst

I just want to get your perspective in terms of what you're seeing right now in the promotional backdrop. And then for Q2, just curious if you guys have assumed a more promotional backdrop in Q2?

A. Christina Hennington - Target Corporation - Executive VP & Chief Growth Officer

Right now, there's no question that guests are seeking deals. The opportunity to balance their budget by finding deals is very visible. As I just talked about, the way that we're continuing to evolve our proposition is make sure that the deals that we do offer are certainly competitive with the market, but that they're increasingly more personalized. And as has been said a couple of times now, the inventory position that we're in right now gives us the ability to compete with the market but not chase the market down. And so that's what we're really excited about. We have an agile playbook that will allow us to continue to go after creating relevance for our guests and offering value but keep it rational.

Rupesh Dhinoj Parikh - Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst

Great. And then my follow-up question, just on the shrink, I think per estimates, I think shrink is now \$1 billion-plus headwind over a 2-year basis. Does your team feel that you can fully recover that headwind over time? And then with some of the efforts that you already have in place, are you starting to see traction with any of those efforts, even if they're maybe in the early stages?

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

John, why don't you talk about some of the mitigation efforts we put in place?

John J. Mulligan - Target Corporation - Executive VP & COO

Yes, I think -- as we think about mitigation efforts, I would go back to, first, what Brian said, it starts, first and foremost, with creating a safe environment for our team and for our guests. And there are multiple approaches to that, that also have a financial impact. So clearly, there is what we do with merchandise and how we display it and how we make that available to a guest. There is assortment changes that we can make to improve that performance as well.

And then finally, there's security changes in the store that we can make. You put all 3 of those together and as you said, we introduced some of those last year. And over time, we do see the impact of that. We see improvement in the safeness of the store. We see improvement in sales and we see a reduction in out-of-stocks, all of which to us are positive indicators that we can make progress. And we'll continue to implement those. Now some of those create additional friction for our guests. It's on us to create the right environment with our team so that we reduce that friction as much as possible. But we do see, overall, again, through time, we see those things improve.

Operator

Our next question is from Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman - Morgan Stanley, Research Division - Executive Director

Brian, and it's been said a few times, the consumer is becoming more cautious. Can you talk about the competitive backdrop? I think it's natural that it's gotten more competitive. It sounded like that in Christina's remarks. Can you maybe give perspective on how it compares maybe to last year or even pre-COVID?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

I think we've seen pretty consistent trends year-on-year. One of the things, as we think about discretionary categories, Simeon, and we talked about this in February at our financial community meeting. While we have seen some softness, last year, we generated almost \$55 billion of revenue in those discretionary categories. And if we go back to pre-pandemic, we've seen sizable gains across all 3 of our major discretionary categories; apparel, home and hard lines. So there's still a consumer who's shopping those categories.

There's certainly a competitive activity that we're watching carefully. But to Christina's point, we're trying to make sure that we're not leading the market down. We're using the benefits of Target Circle that personalized offers to those guests that we know are looking for those items at Target and blending the balance of our national brands with our own brands to provide great value each and every day. So those categories are still relevant to the consumer. As Christina mentioned, we see certainly dislocation in the retail market that's going to open up market share opportunities for us. I think we're going to start realizing some of that during the Back-to-College season. But we'll also see opportunities over the balance of the year and as we go into the holiday season, they continue to make sure guests are turning to Target for those discretionary purchases they're looking to make.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

And then a quick follow-up maybe for Michael. The negative flow-through in Q2 looks like it's higher than that of Q1. And there is some movement in math given the comparisons here. Curious, why shouldn't there be more margin recovery in Q2 even on the negative comp or potentially negative comp?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. I think I've hit most of the key themes there already. Just to repeat a couple, we're positioned in the top line conservatively and that means what leverage looks like in an inflationary cost environment throughout the P&L looks different planning for a slightly negative comp in our guide for Q2. So you see some deleverage there. And then we've talked a few times, the headwind of shrink will be present again in Q2, and that's more of a front half of the year thing than a back half of the year thing. But those would be some of the key things that we'll watch as the quarter plays out.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Operator, we have time for 1 final question today.

Operator

Our final question is from Dean Rosenblum with Bernstein.

Dean Rosenblum - *Sanford C. Bernstein & Co., LLC, Research Division - Research Analyst*

I want to just follow up on the gross margin questions first. So you mentioned that relative to 2019, rate is a headwind, shrink is a headwind, et cetera. When we talked back in the fourth quarter event, we've asked about the notion of permanent sort of impairment to gross margins. We're looking at gross margin historically. In the second quarter with gross margin above 30%, can you give us some idea of where you might expect gross margins to come in for the second quarter? What might you consider middle slice and may be ambitious for gross margins for the second quarter?

MAY 17, 2023 / 12:00PM, TGT.N - Q1 2023 Target Corp Earnings Call

Michael J. Fiddelke - Target Corporation - Executive VP & CFO

Yes. Our expectations for both margin and SG&A and the rest of those are all baked into that EPS guide. And so as you guys know, we don't break out the specific components in our guidance. And the other thing I'd note, you probably heard me say this before, quarterly margins have more noise in them than I think sometimes the group here might appreciate. And so stepping back and seeing the margin trajectory over a longer period of time, I think, is going to be important. And we've got some work to do on that front. It's baked into our guide for the year to recover some of the margin pressure that we saw last year.

Brian C. Cornell - Target Corporation - Chairman of the Board & CEO

All right. So that concludes our first quarter call. And we appreciate all of you joining us and look forward to talking to you later this year. So thank you.

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