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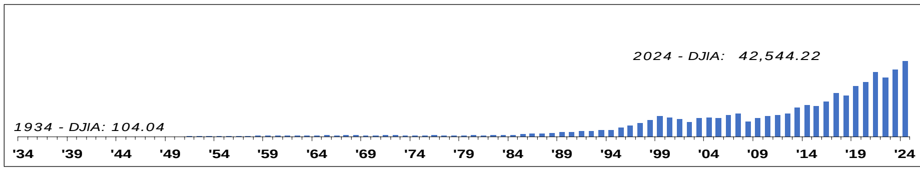
MARKET DIGEST



WEDNESDAY, JUNE 18, 2025

JUNE 17, DJIA: 42,215.80
DOWN 299.30

Good Morning. This is the Market Digest for Wednesday, June 18, 2025, with analysis of the financial markets and comments on **Rollins Inc., Jabil Inc., Norwegian Cruise Line Holdings Ltd., Meta Platforms Inc., Sonoco Products Co., and Target Corp.**

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WEBINAR ANNOUNCEMENT:

Argus Research will host its monthly Outlook & Ideas Webinar for clients at 11 a.m. ET on Wednesday, July 2, 2025. This webinar is titled Markets & U.S. Economy: What Will the Second Half of 2025 Bring? It will be hosted by Argus Director of Portfolio Strategy Jim Kelleher, CFA. Jim will be joined by Argus President John Eade and Argus Director of Economic Research Chris Graja, CFA. During the webinar, we'll share our outlooks on the economy, interest rates, the stock market, and sectors for the second half of 2025.

Please note that the CFP Board has approved Argus' Outlook & Ideas Webinar for one (1) hour of continuing education (CE) credit.

The webinar, as always, will be interactive with a question-and-answer period. We will be recording the webinar, and a rebroadcast will be available on the password-protected portion of our website. Slides related to the presentation will be posted on our website the day of the webinar and will be available via the webcast itself.

Please visit https://attendee.gotowebinar.com/register/8600113219029520981 to register. If you have any problems registering, please contact us at clientservices@argusresearch.com or by calling (212) 425-7500.

MARKET REVIEW:

Living in the "Yeah But" Economy

The consensus on the economy, the stock market, and the employment situation is that there is not much of a consensus. Each indicator remains reasonably healthy, but with question marks. Investors are watching each new data point carefully, but with little confidence that they mean what they seem to mean. And no one is quite sure what is coming next. The bond market is spooked by the deficit implications of "The One Big Beautiful Bill," yet interest rates are moving down from recent peaks. The sudden resurgence of the Israel-Iran conflict adds a new layer of uncertainty to what was already an opaque environment, yet it too showed signs of receding in importance in the U.S. stock market.

Tariff uncertainty remains the biggest complication in the outlook, but the response to tariffs is far from universal. In the face of any sign that tariffs have compromised or have not compromised economic growth, there is a "yeah but" waiting in the wings. Tariffs are bad; "yeah but" they had an immaterial impact in the first Trump administration and have not seemed to slow the economy much this time. Okay, then we can live with tariffs; "yeah but" most tariffs are paused and not yet dragging on the economy, and we have yet to really feel the impact of reciprocal tariffs from our trading partners.

With the consensus being no consensus, and with normal business planning replaced by ad hoc approaches that flex based on day-to-day realities, investors are left to do what they always do: parse the economic data (perhaps a little more carefully) and listen to Fed-speak (though perhaps a little more closely).

Economic Data Not Showing Much of a Tariff Impact

The big concern with tariffs is that they will slow employment growth and raise prices. First-quarter GDP was the one place where tariffs clearly showed up in the data. But that reflected anticipatory actions rather than actual tariff impacts. First-quarter U.S. GDP declined 0.2%, reflecting a nearly five-percentage point subtraction to GDP due to companies loading up on imported goods ahead of the April 2 “Liberation Day” tariffs. Private inventories rose over 2.5 percentage points, as all those goods had to go somewhere.

Corporate capital spending (non-residential fixed investment) also ramped up with double-digit growth, while consumer spending (personal consumption expenditures) grew moderately. Second-quarter GDP, according to the Atlanta Fed’s GDPNow predictor, is on track for nearly 4% growth given that imports (subtractive to growth) will be nearly non-existent after the first-quarter splurge.

Outside of GDP, most of the data lends itself to a “yeah but” interpretation. The first big data point of June, nonfarm payrolls for May, slightly exceeded consensus expectations. The U.S. economy created 139,000 new jobs in May, better than the 129,000 consensus estimate, though down from a revised 147,000 for April. Unemployment remained at 4.2%, in line with consensus and the prior-month level. And hourly wages grew at a healthy 3.9% annual rate, roughly in line with the 4% trend of recent years.

In the “yeah but” category, April job gains were revised lower by 30,000 and March payrolls by 65,000. That pushed three-month average monthly jobs growth down to 135,000 from 155,000 prior to the May report. Some questioned the quality of jobs, with heavy concentration of new jobs in relatively low-wage areas such as healthcare (78,000 new jobs). The manufacturing sector, which gained 5,000 jobs in April, shed 8,000 in May. Other nonservice industries, such as mining, oil and gas extraction, and construction, were little changed. Federal government employment declined by 22,000 and is down by 59,000 since January. That is much less than the 284,000 federal layoffs announced this year, according to Challenger, Gray & Christmas. Of note, former federal employees receiving ongoing severance payments are not yet counted as unemployed.

The second big data point in June was in the form of the May CPI report, which came in a little bit better than expected. All-items CPI increased 0.1% month over month while the consensus and prior-month reading were both 0.2%. Headline CPI rose 2.4% year over year, also a tick better than the 2.5% consensus. Looking at core inflation, CPI excluding food and energy rose 0.1% month over month and 2.8% year over year.

In the “yeah but” category, both all-items and core inflation remain frustratingly above the Fed’s 2% target level. In the “yeah but, but” category, two stubborn inflation series, transportation services and shelter, have declined meaningfully. These typically sticky categories have kept overall inflation elevated even as goods inflation has backed down in the past year.

The Producer Price Index (PPI) for May rose 0.1% from April. That was better than the 0.2% consensus call, but worse than the negative reading (-0.2%) for April. The annual change in core PPI was 2.6%, in line with consensus and up from 2.4% for the previous 12-month period. Core PPI (excluding food, energy, and trade services) was up 0.1% monthly and 2.7% annually.

Consumer sentiment as recorded by the University of Michigan’s Consumer Center bounced higher to 60.5 in June from a cycle low of 52.2 in the prior month. Likely driving this recovery is the recent CPI and PPI data, which are not yet showing meaningful price pressure from tariffs or from other administration policies. The “yeah but” here could come from the 50% tariffs on imported steel and aluminum that went into effect early in June, right after the UMich survey closed.

While these new duties will take time to work through the economy, economists expect hefty steel and aluminum tariffs to push up prices for vehicles, appliances, and new home construction. Prices for these goods are already very high, and new tariffs risk pushing prices out of reach for more and more consumers. Another “yeah but” is the willingness or ability of goods manufacturers to absorb tariffs rather than pass them on to buyers.

Fed Expected to Stand Pat

As of this writing, the Federal Reserve’s Open Market Committee (FOMC) had not yet concluded its June 17 and 18 meeting. Heading into that meeting, the CME’s FedWatch tool showed a very low possibility of any change in rate policy. The probability of the Fed’s target range for the fed funds rate remaining at 4.25%-4.50% was 99.9% as of 6/16/25.

Early in his second term, President Trump pressured the Fed to cut rates “immediately,” but backed off when his own administration officials suggested that threats to Fed independence were tanking the dollar and the Treasury market. The White House and GOP need the bond market to be well-behaved, given that the prospect of higher deficits from “The One Big Beautiful Bill” are putting upward pressure on interest rates.

The generally positive May CPI and PPI data did not go unnoticed in Washington. The White House responded to the good inflation data by reviving pressure on the Fed to cut rates. In making their case, administration officials also pointed to rate cuts recently announced overseas. In May and June 2025, central banks cut interest rates in China, the UK, India, and the Eurozone.

The real focus of economists after the June FOMC meeting will be on the post-meeting commentary and the so-called “dot plot,” which signals what Fed governors are currently thinking about the likely timing of future changes in Fed policy.

Over the remainder of 2025, the FOMC meets again in July, September, October, and December. Currently, the CME’s FedWatch tool shows less than a 20% probability that the Fed will cut rates at its July meeting. At the September meeting, the probability of a rate cut rises to 56%, and by the October meeting, the probability that the Fed funds target rate will still be at 4.25%-4.50%, as it has been all through this year, is less than 20%.

The “yeah buts” for rate-cut timing and rate-cut magnitude are numerous. If inflation rises again due to tariffs, the geopolitics of oil supply, or other factors, the Fed may dig in its heels and hold rates steady into year-end regardless of White House pressure. If job growth slows or swings negative and unemployment begins to climb, the Fed may be inclined to cut rates more aggressively than currently planned. That would accord with White House wishes, but it would also likely signal worrisome deceleration in the economy.

Conclusion

Late in January, the second term for President Trump began with a mix of excitement and uncertainty regarding the new administration. Five months in, there is still a lack of clarity on the final tariff schedule, government tax policy and spending, immigration policy, and international relations. Through this period, the chief “yeah but” is that the economy keeps chugging along.

Corporations have shown resilience in preserving sales and earnings growth targets, because they are not truly the monoliths they may seem to be. Instead, corporations are aggregations of their departments and sub-departments, each charged with using any and all tools to keep their unit’s P&L in the green. Those unit P&Ls pile up in a pyramid, producing consolidated profit growth that tends to surprise to the upside each and every reporting period.

This was true during the COVID-19 pandemic, the supply-chain crisis, and other past times of financial stress. And it is likely to remain true throughout the tariff transition period, notwithstanding all the “yeah buts.” (Jim Kelleher, CFA, Director of Research)

ROLLINS INC.: (NYSE: ROL, $56.41) .... BUY

Launching coverage with a BUY rating

* Rollins Inc. provides pest and wildlife control services to both commercial and residential customers.
* Rollins has boosted earnings and become a more global company through the acquisition of nearly 140 companies over the past four years.
* Management is committed to paying a dividend and has raised the company's quarterly payment every year for the past 15 years.
* ROL shares have been in a bullish pattern of higher highs and higher lows since October 2023.
* Our target price is $68.

ANALYSIS

INVESTMENT THESIS

We are launching coverage on Rollins Inc. (NYSE: ROL) with a BUY rating and a target price of $68. Rollins Inc. provides pest and wildlife control services to both commercial and residential customers. Through acquisitions and investments into technology, the company has created a platform that minimizes costs and maximizes productivity, increases brand awareness, and cross-sells to customers. The company has a long history of growth and profitability: Rollins reports 20+ consecutive years of adjusted EBITDA growth. The balance sheet is strong, and management is committed to paying a dividend, having raised the company's quarterly payment every year for the past 15 years. ROL shares have been in a bullish pattern of higher highs and higher lows since October 2023. The shares are not cheap on a fundamental valuation basis, but we believe the premium is deserved given the company's financial strength and record of growth. Our long-term rating is also BUY.

RECENT DEVELOPMENTS

ROL shares have outperformed year-to-date, gaining 22% compared to a gain of 2% for the S&P 500. Over the past year, the shares have also outperformed, gaining 21% compared to gains of 12% for the index and 6% for the Consumer Cyclical industry ETF, IYK. The shares have also outperformed their benchmarks over the past five years. The beta on ROL is 0.67.

The company recently reported 1Q25 results that topped consensus expectations. On April 23, 2025, Rollins Inc. reported adjusted operating earnings of $0.22 per share, in line with the consensus and a 16% gain year over year. Revenues of $823 million increased almost 10% year over year. The adjusted EBITDA margin narrowed year over year by 60 basis points to 20.9%.

Rollins management does not provide detailed guidance, but the company has a long history of delivering double-digit EBITDA growth, which management stresses during conference calls and presentations. Management plans to target 7%-8% organic growth and a contribution of 2%-3% from acquisitions for 2025.

The company has a growth-by-acquisition strategy and has acquired nearly 140 companies over the past four years.

EARNINGS & GROWTH ANALYSIS

Rollins has three operating segments: Residential (43% of revenue), which provides pest control services protecting residential properties from pests, including rodents, insects, and wildlife; Commercial (35% of revenue), which includes workplace pest control for customers in a variety of industries, including food service, healthcare and transportation; and Termite (21% of revenue), which offers termite protection and ancillary services for both commercial and residential customers. Almost 90% of revenue is generated in the U.S. Management estimates that 75% of revenue is recurring in nature.

The company has a long history of growth and profitability. Rollins reports 20+ consecutive years of adjusted EBITDA growth. Revenue growth is generally in the mid-to-high-single-digit range. The adjusted EBITDA margin has ranged from 19% to 23% over the past 10 years. In 2024, revenue rose 10% to approximately $3.4 billion, while adjusted EBITDA grew 12% and the adjusted EBITDA margin was 22.8%.

In 1Q25, Residential revenues were up 8% year over year. In the Commercial segment, revenues rose 10% year over year. Termite and ancillary revenues rose 13% year over year. Rollins has been seeing solid demand for all its services, with higher prices across the board. In addition, the company appears to be improving its residential and commercial businesses by increasing its pest control offerings, which promise to boost recurring revenue over time.

Management keeps a close eye on expenses. The adjusted EBITDA margin in 1Q narrowed year over year by 60 basis points to 20.9%. Margins were pressured by ongoing investments to support the company's long-term growth objectives. The current EBITDA margin is well within the company's historical range, with room on the upside.

Turning to our estimates, for 2025, based on sales and margin trends, we are setting an adjusted earnings estimate of $1.10 per share, a 10% increase year over year on a 10% increase in revenue. We look for growth to continue in 2026 and are establishing a preliminary adjusted EPS estimate of $1.23. Our long-term growth rate forecast is 11%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Rollins Inc. is Medium-High. The company receives above-average scores on our main criteria of profitability, debt levels, cash flow generation, and fixed cost coverage.

The company had cash on the balance sheet at the end of 2024 of $90 million. Debt totaled $516 million and represented 28% of total capitalization. The company's adjusted EBITDA margin is comfortably in the 20% range. The free cash flow conversion ratio over the past five years has averaged 123%.

Rollins pays a dividend. On October 22, 2024, Rollins raised its dividend 10% year over year to $0.66 on an annual basis. We think the dividend is secure and likely to continue to grow. Our 2025 and 2026 dividend estimates are $0.69 and $0.76, respectively.

The company also has a share buyback program.

MANAGEMENT & RISKS

Jerry E. Gahlhoff Jr. is CEO of Rollins; he has been with the company since 2008. Longtime company executive John F. Wilson is executive chairman of the board. Kenneth D. Krause is the CFO.

The company held an analyst presentation in May 2024 to go over strategies and goals. Key takeaways included:

— The company's goal is to compound revenue, earnings, and cash flow by acquiring and growing market-leading pest control businesses.

— Management believes the global pest control market is valued at $20 billion and is growing at 3%-4% per year.

— The global pest control industry is poised to benefit from strong secular tailwinds such as climate and environmental factors, favorable demographic shifts, social trends toward outdoor living and pet ownership, and evolving standards around sanitation.

— Rollins' competitive advantages include its brands and scale, its record of successful acquisitions, and its adoption of technology.

There are risks to owning ROL shares. They include the ability to compete in the pest control industry, labor shortages and increased labor costs, and distributor or supply chain issues.

COMPANY DESCRIPTION

Rollins Inc. provides pest and wildlife control services and protection against termite damage, rodents, and insects to both commercial and residential customers through its subsidiaries and independent franchises located in more than 70 countries. The company has approximately 20,000 employees. ROL shares are a component of the S&P 500.

INDUSTRY

Our rating on the Consumer Discretionary sector is Under-Weight. CPI inflation grew at a tame 1.5% average from 2008 through 2017, and the first round of tariffs had only a muted impact on overall spending. CPI inflation increased at an average 3.6% pace from 2017 through 2024, however. We believe the lower two-thirds of consumers, representing 45% of overall consumer spending, are straining to meet current expenses and will reduce spending on consumer durable and discretionary goods should tariffs become widely enacted.

As of the end of May, the sector accounted for 10.7% of the S&P 500. Over the past five years, the weighting has ranged from 8% to 12%. The sector was underperforming the market, with a loss of 6.2%. It outperformed in 2024, with a gain of 29.1%, compared to a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2026 EPS was 24, above the market multiple. Yields of 0.5% were below the market average. The sector's smoothed earnings growth rate of 10% was above the market average.

VALUATION

We think ROL shares are attractively valued at recent prices near $58. Over the past 52 weeks, the shares have traded between $45 and $58, and they are currently at the high end of the range. From a technical perspective, the shares have been in a bullish pattern of higher highs and higher lows since October 2023.

To value the stock on a fundamental basis, we typically use peer and historical multiple comparisons, as well as discounted cash flow analysis. ROL shares are currently selling at a multiple of 46 times forward EPS, compared to the historical range of 40-50. They are selling at a current price/sales ratio of 8, compared to the historical range of 5-9. Based on these ratios, as well as a comparison to a group of peers (CTAS, SCI, ECL, among others), the shares are selling at a premium, which we think is deserved given Rollins' clean balance sheet and history of growth. We are launching ROL shares with a BUY rating and a target price of $68.

On June 17, BUY-rated ROL closed at $56.41, down $0.31. (John Staszak and Masako Inagaki, 6/17/25)

JABIL INC. (NYSE: JBL, $196.89) BUY

JBL: Raising to BUY as positive topline comparisons resume

* We are raising our intermediate-term rating on the JBL shares to BUY from HOLD. Our long-term rating remains BUY.
* Jabil delivered fiscal 3Q25 revenue and non-GAAP EPS that sharply exceeded Street expectations and company guidance. The company returned to positive annual topline growth for the first time since fiscal 3Q23.
* Jabil meaningfully raised its fiscal 2025 revenue and non-GAAP EPS guidance. The new guidance implies annual growth in both sales and adjusted profits, versus prior guidance that assumed a decline in both categories.
* Jabil appears well positioned beyond FY25 given expanding and fast-growing opportunities in AI data center infrastructure, connected healthcare, semiconductor capital equipment, and other core businesses.

ANALYSIS

INVESTMENT THESIS

We are raising our rating on the JBL shares of Jabil Inc. (NYSE: JBL) to BUY from HOLD. The company has returned to annual top- and bottom-line growth and appears primed for continued sales and margin expansion. Our long-term rating remains BUY.

JBL shares surged almost 9% in a down market on 6/17/25 after this leading contract manufacturer and Apple supplier delivered fiscal 3Q25 revenue and non-GAAP EPS that sharply exceeded Street expectations and company guidance. Non-GAAP (core) EPS, which in fiscal 2Q25 returned to annual growth for the first time in a year, built on that momentum in fiscal 3Q25 with 30%-plus growth. Revenue grew 16% year over year, as the company returned to positive annual topline growth for the first time in two years, or since fiscal 3Q23.

Jabil once again raised its FY25 guidance, marking a third straight guidance hike following the weak initial forecast issued in September 2024. The company's earlier revenue outlook for FY25 had been impacted by the shift to an inventory consignment model in Jabil's cloud business, the absence of a contribution from mobility business, short-term inventory corrections across certain end markets, and ongoing weakness in some end markets.

Most of those issues are now behind the company, which is also experiencing stronger-than-expected demand in key end markets. Revenue headwinds in a range of end-markets, spanning both technology and non-technology, are giving way to rising demand, most notably in the AI and cloud space. Jabil now sees and $8.5 billion annual AI revenue opportunity — and the company intends to invest $500 million in new U.S. facilities. The sale of the mobility business (to BYD Electronics) has removed Jabil's highest fixed-cost business, and its absence appears to be driving margin expansion in an improving business environment. The revised forecast now assumes full-year sales growth along with strong double-digit growth in non-GAAP EPS.

In May 2024, Jabil's board replaced then-CEO Kenny Wilson with the company's CFO, Mike Dastoor. In our view, a leaner and more-profitable Jabil appears better positioned for FY25 and beyond amid expanding and fast-growing opportunities in AI data center infrastructure, connected healthcare, and other core businesses. Given improving end-market dynamics, margin improvement from the mobility asset disposition, inventory normalization across most product categories, and new energy from the executive team, we now believe an intermediate-term BUY rating is appropriate. We are setting a 12-month target price of $230 on the JBL shares.

RECENT DEVELOPMENTS

JBL is up 37% so far in 2025, while the peer group is up 24%. JBL rose 13% in 2024, versus an 84% gain for the peer group of contract manufacturers in Argus coverage. JBL advanced 87% in 2023, while the peer group rose 70%; declined 3% in 2022 in a sharply down market, while the peer group advanced 13%; rose 65% in 2021, almost doubling the 34% gain for peers; and edged up 3% in 2020, below the 9% gain for the peer group.

For fiscal 3Q25 (ended May 31, 2025), Jabil reported revenue of $7.83 billion, which was up 16% year over year and 16% sequentially. Revenue in fiscal 3Q25 was $500 million above the high end of management's $6.7-$7.3 billion guidance range and smoked the $7.09 billion consensus forecast. Non-GAAP or "core" earnings for fiscal 3Q25 totaled $2.55 per diluted share, up 35% from fiscal 3Q24 and up sequentially by $0.61. Non-GAAP EPS was above the high end of management's $2.08-$2.48 guidance range and beat the consensus forecast of $2.32.

Jabil had a challenging FY24, which included the sudden removal of the CEO, the sale of its mobility business about halfway through the year, and the shift of its cloud business to an inventory consignment model. Jabil also faced widespread weakness across its end markets, worsened by ongoing short-term inventory corrections across certain end markets.

Jabil's board in September 20204 authorized a restructuring plan. The company anticipates recognizing $150-$200 million in pretax charges across fiscal 2025. Restructuring charges totaled $144 million the first nine months of fiscal 2025. The plan is designed to focus investment in growth areas and align the support infrastructure to optimize organizational effectiveness. Disposition of the mobility business provided net proceeds of $2.2 billion, mainly used for share repurchase, and also improved diversification of Jabil's geographic footprint, removed a business requiring high levels of capital, and improved the overall operating margin profile of the company.

With Mobility now gone, Jabil announced a new operating structure focused on speed, precision, and solutions. The first segment, Regulated Industries, includes Automotive and Transportation; Healthcare and Packaging; and Renewables and Energy Infrastructure. The second segment, Intelligent Infrastructure, includes the Cloud and Data Center Infrastructure end market, Networking and Communications, and Capital Equipment (including semiconductor capital equipment). The third segment, Connected Living and Digital Commerce, focuses on multiple end markets including Connected Living, Digital Commerce, Warehouse Automation, Robotics, and Robots/Humanoids. This unit formerly contained the divested Mobility business.

Jabil's CEO noted that the Intelligent Infrastructure segment remains a key growth engine, benefiting from accelerating AI-driven demand. While other end markets are also showing recovery momentum, Jabil continues to see softness in areas including EVs, renewable energy, and 5G mobility. Management believes the diversified portfolio and operational discipline are enabling the company to track toward record core earnings per share.

Jabil's leadership remains focused on enhancing core margins, optimizing cash flow, and returning value to shareholders primarily through share repurchases. The company also will continue to target and prioritize investments in higher-margined opportunities.

For 3Q25, Regulated Industries revenue of $3.05 billion (39% of total) was unchanged annually and rose 11% sequentially, despite continued weakness in renewable energy and in EV-related markets. Core operating profit rose 10% annually, and core segment margin expanded by 50 basis points (bps) to 5.5% from 5.0% a year earlier.

Intelligent Infrastructure revenue of $3.44 billion (44% of total) grew 51% year over year and 31% sequentially, primarily driven by strong demand in AI-related cloud, data center infrastructure, and semiconductor capital equipment markets. Core operating profit rose 54% year over year, and core segment margin expanded by 10 bps to 5.3% from 5.2% a year earlier.

Connected Living and Digital Commerce revenue of $1.33 billion (17% of total) declined 7% year over year due to the Mobility divestiture; segment sales were down 1% sequentially. Excluding Mobility from prior-year comparisons, segment revenue would have increased year over year. Pro-forma revenue growth reflected strong annual demand growth across digital commerce and warehouse automation. Core operating margin was 5.3%, declining from 5.4% year over year despite the disposition of low-margined Mobility.

In the early days of the second Trump administration, Jabil addressed the topic of tariffs. Reflecting past restructuring actions, interactions with vendors and suppliers, and proactive steps ahead of the new administration, Jabil believes its supply chains remain nimble, agile, and resilient. Five months into the new administration, tariffs are unsettled and remain a major issue for customers, shareholders, and employees.

Jabil sees its large-scale and highly global manufacturing footprint as a key advantage. The company believes it is well-positioned within an evolving geopolitical situation, given its designation as a U.S.-domiciled manufacturing service and its "significant" U.S. footprint. Any changes in tariffs are a pass-through cost for Jabil.

Non-U.S. sites are meant to serve local markets whenever possible. Jabil's business in China is mainly "local for local" or "local for regional." A small portion of Jabil's Chinese production is shipped to the U.S. In Mexico, 8%-9% of the company's production is USMCA-compliant. Jabil has limited manufacturing and sales exposure in Canada. Jabil in 1Q25 opened a large-scale manufacturing site in Croatia that currently supports a European automotive OEM and will support healthcare customers beginning in FY27.

While implementation mechanics of any reciprocal tariffs are unknown, Jabil believes tariffs level the playing field for manufacturing. With 30 sites in the U.S., the company's domestic footprint has never been larger. While Jabil anticipates some challenges in further onshoring, such as finding qualified labor, management believes that the team's experience in automation and robotics will help expedite any lift-and-shift transfers. The company announced plans to invest a further $500 million in U.S. facilities, with plans to expand presence in the Southwestern United States.

In our view, a leaner and more-profitable Jabil appears better positioned for FY25 and beyond amid expanding and fast-growing opportunities in AI data center infrastructure, connected healthcare, and other core businesses. Given improving end-market dynamics, margin improvement from the Mobility disposition, inventory normalization across most product categories, and new energy from the executive team, we believe an intermediate-term BUY rating is appropriate.

EARNINGS & GROWTH

For fiscal 3Q25 (ended May 31, 2025), Jabil reported revenue of $7.83 billion, which was up 16% year over year and up 16% sequentially. Revenue in fiscal 3Q25 was $500 million above the high end of management's $6.7-$7.3 billion guidance range and smoked the $7.09 billion consensus forecast.

The GAAP gross margin was 8.7% for fiscal 3Q25 versus 8.6% for fiscal 2Q25 and 9.0% in the year-earlier quarter. The non-GAAP operating margin was 5.4% in fiscal 3Q25 versus 5.0% in fiscal 2Q25 and 5.0% a year earlier.

Non-GAAP or "core" earnings for fiscal 3Q25 totaled $2.55 per diluted share, up 35% from fiscal 3Q24 and up sequentially by $0.61. Non-GAAP EPS was above the high end of management's $2.08-$2.48 guidance range and beat the consensus forecast of $2.32.

For FY24, revenue of $28.9 billion declined 17% from FY23, while non-GAAP EPS of $8.55 per diluted share was down 1%.

For fiscal 4Q25, Jabil guided for revenue in the $7.1-$7.8 billion range, which at the $7.45 billion midpoint would be up 7% year over year. Management projected non-GAAP EPS of $2.64-$3.04. At the $2.84 guidance midpoint, core earnings would be up 23% annually.

For FY25, Jabil guided for revenue of $20.0 billion, revised upward from $27.9 billion in March 2025 and $27.3 billion issued in December 2024; initial guidance in September 2024 was $27.0 billion. The new guidance implies 1% sales growth from FY24 levels. Jabil is modeling full-year FY25 EPS of $9.33 per diluted share, revised upward from $8.95 as of March 2025 and $8.75 in December 2024; initial guidance was $8.65. Fiscal 2025 EPS of $9.33 would be up 9% year over year from $8.55 in FY24.

We are raising our non-GAAP earnings projection for FY25 to $9.36 per diluted share from $8.92. We are raising our non-GAAP EPS forecast for FY26 to $10.88 per diluted share from $10.04. We regard these estimates as fluid, and subject to revision. Our long-term EPS growth rate forecast for Jabil is 10%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Jabil is Medium-High, the second-highest rank on our five-point scale. Jabil is committed to maintaining its investment-grade credit profile. The company's debt is rated Baa3/stable by Moody's, BBB-/Stable by S&P, and BBB-/Positive by Fitch.

Cash and equivalents were $1.52 billion at the end of fiscal 3Q25; $2.20 billion at the end of fiscal 2024; $1.80 billion at the end of fiscal 2023; $1.48 billion at the end of fiscal 2022; and $1.57 billion at the end of fiscal 2021.

Debt was $2.88 billion at the close of fiscal 3Q25. Debt was $2.88 billion at the close of fiscal 2024; $2.88 billion at the close of fiscal 2023; $2.88 billion at the close of fiscal 2022; and $2.85 billion at the close of FY21.

Jabil generated cash flow from operations of $1.73 billion in FY24. Cash flow from operations was $1.73 billion in FY23; $1.65 billion in FY22; and $1.43 billion in FY21. Jabil generated free cash flow of $1.06 billion in FY24; $1.03 billion in FY23; $810 million in FY22; and $650 million in FY21. The company is modeling at least $1.2 billion in adjusted FCF for FY25.

Under its capital-allocation framework, Jabil intends to return 60% of free cash flow to shareholders via buybacks and dividends. Since fiscal 2016, Jabil has returned over $1.5 billion to shareholders, primarily via buybacks. The diluted share base has been reduced from 193 million shares in FY16 to 128 million shares as of fiscal 1Q24.

In September 2023, Jabil's board announced a $2.5 billion share-repurchase authorization. The company used accelerated repurchase programs to buy back the $2.5 billion authorized during fiscal 2024.

Jabil has not raised its dividend since October 2011, when it boosted the quarterly payout by 14% to $0.08. Our dividend estimates are $0.32 for both FY25 and FY26.

MANAGEMENT & RISKS

In May 2024, Mike Dastoor, who had served as CFO since 2018 and interim CEO since mid-April, became CEO. At that time, former CEO and board member Kenny Wilson left the company. Greg Hebard, who had served as senior vice president and treasurer since 2021, is CFO.

Fred McCoy, former executive vice president of Global Business Units, is now executive vice president of operations, replacing JJ Creadon. Steve Borges came out of retirement to resume his role as executive vice president of Global Business Units. Two other executives, Matt Crowley and Andy Priestly, were elevated from senior vice president roles to become executive vice presidents at Global Business Units.

The May 2024 leadership transition was messy and came at a time of multiple operating challenges for the company. Jabil's reputation may have been dinged, but the CEO departure did not appear to cause lasting damage. CEO Dastoor is highly regarded on Wall Street.

Jabil's long-standing business of supplying iPhone casings to Apple represents customer concentration risk, given the company's heavy revenue exposure at this one customer. We believe the relationship remains strong, and expect Apple to remain an important and profitable client. Apple has gained global market share in the smartphone market and, given higher ASPs, has increased its global revenue share in smartphones to about half the global total, even though its unit share is below 20%. High revenues and high ASPs support the view that Apple would be needlessly risking momentum by changing casing vendors. Simultaneously, Jabil needs to accelerate efforts to diversify its revenue base.

Another risk is that Jabil may be unable to improve its operating metrics to match past performance. However, because the company has experienced substantial growth due to business development and new contract wins, we are confident that management can restore margins over time.

COMPANY DESCRIPTION

St. Petersburg, Florida-based Jabil Inc. is a top-tier global player in the Electronic Manufacturing Services (EMS) industry. By segment, approximately 50% of total revenue is derived from Electronics Manufacturing Services (EMS) and 50% from Diversified Manufacturing Services (DMS). The additions of Green Point and Nypro increased the size of the DMS business and added vertical manufacturing capabilities.

INDUSTRY

Our rating on the Information Technology sector is Over-Weight. Consumer electronics demand, which was reduced by inflation, is now showing signs of recovery. IT demand in enterprise and data center markets weakened after consumer demand but now also shows signs of recovery, fueled by mounting interest in generative AI.

As of the end of May, the sector accounted for 31.6% of the S&P 500. Over the past five years, the weighting has ranged from 16% to 33%. The sector was underperforming the market, with a loss of 1.8%. The sector outperformed in 2024, with a gain of 35.7% compared to a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2026 EPS was 23, above the market multiple. Yields of 0.2% were below the market average. The sector's smoothed earnings growth rate of 15% was above the market average.

Over the long term, we expect the Tech sector to benefit from pervasive digitization across the economy, greater acceptance of transformative technologies, and the development of the Internet of Things (IoT). Generative AI is poised to become a huge industry driver, although timeline of actual AI deployments is uncertain. Healthy company and sector fundamentals are also positive. For individual companies, these include high cash levels, low debt, and broad international business exposure.

VALUATION

JBL shares trade at 19.3-times our FY25 non-GAAP EPS forecast and at 16.6-times our FY26 projection. The two-year average P/E for FY25-FY26 of 18.0 is above the trailing five-year (FY20-FY24) P/E of 10.6. The shares trade at 80% of the market multiple on a two-year forward basis, compared to an historical relative P/E of 56%. Overall, comparable historical valuation is in the upper $90s, in a rising trend, and below current prices.

JBL trades at premiums to the peer group on absolute and relative P/E, price/sales, EV/EBITDA and PEG. Peer-indicated value in the $140s is in a rising trend and below current prices. Our more forward-looking discounted free cash flow model points to a value in the low $200s.

Incorporating historical comparable valuation, peer-indicated value, and DFCF valuation, our blended model for JBL indicates fair value of around $160, in a rising trend. Given improving end-market dynamics, margin improvement from the Mobility disposition, inventory normalization across most product categories, and new energy from the executive team, we now believe an intermediate-term BUY rating is appropriate. We are setting a 12-month target price of $230 on the JBL shares. Our long-term rating is also BUY.

On June 17, BUY-rated JBL closed at $196.89, up $16.07. (Jim Kelleher, CFA, and Wallis Kelleher-Ferguson, 6/17/25)

NORWEGIAN CRUISE LINE HOLDINGS LTD. (NYSE: NCLH, $18.13)................................ HOLD

NCLH: Downgrading to HOLD

* Based on reduced fares for its Oceania brand and a slowdown in advance bookings, we are lowering our 2025 estimate to $2.06 per share from $2.20 and reducing our 2026 estimate to $2.50 per share from $2.60.
* Given the company's highly leveraged position, we think the current share price adequately reflects Norwegian Cruise Lines' vulnerability to weakening consumer spending and a slowing economy.
* Based on prospects for resilient demand for cruises over the next five years and an 8% capacity increase in 1Q24, our long-term rating is BUY.

ANALYSIS

INVESTMENT THESIS

We are downgrading Norwegian Cruise Line Holdings Ltd. (NYSE: NCLH) to HOLD from BUY. Given the company's highly leveraged position, we think the current share price adequately reflects Norwegian Cruise Lines' vulnerability to weakening consumer spending and a slowing economy.

We see fewer advance bookings given fare reductions at the Oceania brand and weakening demand for travel.

Based on prospects for resilient demand for cruises over the next five years and an 8% capacity increase in 1Q24, our long-term rating is BUY.

ANALYSIS

RECENT DEVELOPMENTS

Year-to-date, NCLH shares have fallen 30%, versus a 12% decline for the XLY, an ETF that tracks the Consumer Discretionary sector.

As discussed in a previous note, on April 30, Norwegian reported adjusted 1Q25 earnings of $0.07 per share, down from adjusted earnings of $0.15 per share in 1Q24 and below the consensus estimate calling for earnings of $0.09 per share. Management's guidance had called for earnings of $0.08 per share. First-quarter revenue was $2.13 billion, down from $2.19 billion a year earlier and below the consensus of $2.15 billion. The consensus revenue miss reflects fewer Americans taking trips to Europe. Ticket sales fell to $1.42 billion from $1.46 billion, while onboard and other revenue fell to $709 million from $731 million. Consensus estimates had called for ticket revenue of $1.43 billion and onboard and other revenue of $722 million. Total cruise operating expenses fell to $1.30 billion in 1Q25 from $1.39 billion a year earlier. Fuel expense fell to $175 million from $198 million a year earlier. The consensus estimate had called for fuel expense of $176 million.

Adjusted EBITDA was $453 million, above the consensus estimate of $441 million. The adjusted EBITDA margin was 21.3%, up from 21.2% in the prior-year period. The consensus estimate had called for an EBITDA margin of 20.6%

The operating margin fell to 9.4% from 9.9% in the same period a year earlier.

Below the line, interest expense fell to $217.9 million from $218.2 million, driven by lower debt levels and declining interest rates. The share count rose to 441 million from 431 million a year earlier.

In 2024, revenue rose to $9.5 billion from $8.5 billion in 2023. Revenue benefited from occupancy that was just under 103%, and 9.6% higher onboard and other revenue. Adjusted EBITDA totaled $2.45 billion, up from $1.86 billion in the prior-year period. Full-year adjusted earnings were $1.82, versus earnings of $0.70 per share in 2023.

EARNINGS & GROWTH ANALYSIS

In its 1Q earnings release, management forecasted 2025 net yield growth in constant currency of 2%-3% (down from a prior estimate of 3%), full-year adjusted EBITDA of $2.72 billion, and adjusted earnings of $2.05. Consensus estimates had called for earnings of $2.09 per share and adjusted EBITDA of $2.75 billion.

Based on reduced fares for its Oceania brand and a slowdown in advanced bookings, we are lowering our 2025 estimate to $2.06 per share from $2.20 and reducing our 2026 estimate to $2.50 per share from $2.60. Both our estimates are above consensus.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on NCLH is Medium, the middle rank on our five-point scale. At the end of 1Q25, cash and cash equivalents totaled nearly $184 million, down from $191 million at the end of 2024. Liquidity totaled $1.4 billion at the end of 1Q25. Long-term debt totaled $12.9 billion, up from $11.8 billion at the end of 2024. The long-term debt/capital ratio at the end of the quarter was 90.2%, up from 83.1% at the end of 2024 and well above the industry average of 59%.

The company does not pay a dividend and is unlikely to initiate one in the near term.

MANAGEMENT & RISKS

Harry J. Sommer became the company's president, CEO, and director in July 2023, following the resignation of Frank Del Rio. David J. Herrera, who had served as chief consumer sales and marketing officer of NCL since 2021, succeeded Sommer as president of NCL, effective April 1, 2023.

Norwegian Cruise Lines faces substantial risks from outbreaks of disease, as seen during the pandemic, as well as from terrorism or the threat of terrorism. The company is also vulnerable to unexpected increases in fuel costs, currency headwinds, and general economic weakness.

COMPANY DESCRIPTION

Founded in 1966 and based in Miami, Norwegian Cruise Line Holdings offers cruises to approximately 450 destinations worldwide. NCLH sells its cruises through independent travel agents, wholesalers, and tour operators. The company went public on January 17, 2013. In 2014, Norwegian Cruise Lines acquired Prestige Cruise Holdings, the parent company of Oceania Cruises and Regent Seven Seas.

INDUSTRY

Our rating on the Consumer Discretionary sector is Under-Weight. CPI inflation grew at a tame 1.5% average from 2008 through 2017, and the first round of tariffs had only a muted impact on overall spending. CPI inflation increased at an average 3.6% pace from 2017 through 2024, however. We believe the lower two-thirds of consumers, representing 45% of overall consumer spending, are straining to meet current expenses and will reduce spending on consumer durable and discretionary goods should tariffs become widely enacted.

As of the end of May, the sector accounted for 10.7% of the S&P 500. Over the past five years, the weighting has ranged from 8% to 12%. The sector was underperforming the market, with a loss of 6.2%. It outperformed in 2024, with a gain of 29.1%, compared to a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2026 EPS was 24, above the market multiple. Yields of 0.5% were below the market average. The sector's smoothed earnings growth rate of 10% was above the market average.

VALUATION

On June 13, NCLH shares fell more than 5% following the outbreak of war between Israel and Iran, However, on June 16, NCLH shares rose 4% after Iran said it wished to deescalate. Primarily reflecting elevated expenses and stubbornly high debt, the shares appear fairly valued at a projected 2026 P/E of 8.8-times our revised 2025 earnings estimate. Were the company to reduce debt significantly or net yields to grow more than we anticipate, we would consider an upgrade.

On June 17, HOLD-rated NCLH closed at $18.13, down $0.42. (John Staszak, CFA, 6/17/25)

META PLATFORMS INC. (NGS: META, $697.23) .... BUY

META: Raising target price to $790

* We see Meta's large investment in Scale AI as a strategic play to turnaround its much-criticized generative AI program.
* The company's announcement that its WhatsApp communications platform will now host advertising could become another significant revenue stream.
* Meta is looking to GenAI to underpin several opportunities from enhanced targeted advertising to its Ray-Ban AI glasses.
* We are maintaining our 2025 GAAP EPS estimate at $25.95 and our 2026 forecast at $29.41.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Focus List selection Meta Platforms Inc. (NGS: META) and raising our target price to $790 from $725. As is the case with most companies, Meta has a variety of both opportunities and risks. Its user growth at scale is certainly striking as both monetization and engagement appear to chugging along. The company's ability to capitalize on GenAI advances in advertising targeting is a particularly relevant opportunity to drive advertising spending, which is the company's lifeblood. On the risk side of the ledger, the new U.S. tariff regime, in particular the extinguishment of the de minimis import exemption is being reflected in lower advertising spend by Chinese retailers. Further, the company is in the midst of an antitrust trial brought by the U.S. Federal Trade Commission and with a highly uncertain outcome. New Chinese competitor DeepSeek adds even more uncertainty into the mix.

Meta typically builds an audience and engagement for new products before moving to monetization, and we think this is once again Mr. Zuckerberg's clearly-stated strategy around generative AI applications to Reality Labs hardware products. We also expect GenAI to pervade Meta's applications to provide another means of optimizing company performance and efficiency. We also note that Reality Labs losses continue to mount.

We caution investors that the regulatory threats against Meta in the U.S. and Europe are a material risk. Though the outcomes of myriad regulatory and legal challenges to Meta remain unclear, they have already led to large fines/settlements, and could eventually lead to more material fines and/or onerous regulatory actions including the possibility — remote, in our opinion — of breakup. Our long-term rating on META remains BUY.

RECENT DEVELOPMENTS

On June 12, Scale AI announced a "significant new investment" from Meta Platforms, valuing that company at $29 billion. Meta is reportedly investing $14.3 billion in Scale AI for a 49% minority interest in the company. As part of the deal, Scale AI co-Founder and CEO Alexandr Wang will leave Scale AI to join Meta's AI team. Scale AI is something of a "picks and shovels" company for generative AI model builders, including OpenAI, Google, and Meta, providing data labeling services that help train frontier GenAI models and other services. Meta is following a recent Tech industry pattern of "aquihiring" top talent through an investment and technology licensing model rather than outright acquisition which could give rise to a greater chance of antitrust opposition given U.S. and European regulators current hostility toward Big Tech consolidation. Of course, regulators could still investigate the deal as they have begun to investigate similar deals including Microsoft's "aquihire" of Mustafa Suleyman in its investment deal with Inflection AI.

The disappointing release of Meta's Llama 4 model and delay in the release of its "Behemoth" large language model led to industry criticism that its GenAI program has begun to lag competitors, particularly OpenAI and Google. Meta is reportedly revamping its GenAI program as it looks to hire top industry talent, including Mr. Wang, to staff a new "super intelligence" lab. "Super intelligence" is a relatively new Tech term that refers to a GenAI model that would be more intelligent than the human mind or artificial general intelligence (AGI) which seeks to mimic the human mind. Neither AGI nor super intelligence are considered close to being achieved and have many skeptics as to whether they can be achieved at all.

On June 16, Meta announced in a blog that it will begin to display advertising in the WhatsApp Status function. The company has held off on incorporating advertising into WhatsApp for the last ten years of its stewardship since the acquisition in 2014. However, it is also unsurprising that Meta would move to monetize this valuable communications application that serves 1.5 billion users a day and it certainly follows management's long-term playbook of first building audience and user engagement and then monetizing an application, typically through advertising. Meta is treading cautiously here by only putting advertising into the WhatsApp Status function rather than alongside the messaging function which might have led to the risk of user backlash and dropping the application. META shares were up about 3% intraday on June 16, as the market applauded the company bringing another perhaps significant revenue stream online.

The federal antitrust trial in a case against Meta brought by the U.S. Federal Trade Commission (FTC) concluded on May 27. The case is now with the judge though he may not issue a ruling until later in 2025 or even early 2026. The FTC's lawsuit alleges that Meta (then Facebook) engaged in anti-competitive conduct through its 2012 acquisition of Instagram and its 2014 acquisition of messaging app WhatsApp, essentially acquiring potential competitors. The FTC asks the court to break up Meta by unwinding the acquisitions.

While the market's anticipation of the trial was probably a negative for META shares, prices actually have moved higher lately. Though we give our usual caveat that litigation is notoriously unpredictable, Meta has a reasonable case in our view and could possibly win at trial. In our opinion, the FTC's argument that the social networking market only encompasses Meta, Snapchat, and a heretofore unknown application called wewe is simply wrong on its face. The current social networking market also includes the virally popular TikTok and other stalwarts including Google/YouTube, X (Twitter), Reddit, LinkedIn, and a host of smaller niche applications like Discord. Apart from the market size issue, it is bedrock antitrust law that some consumer harm should have arisen from the alleged anti-competitive behavior. The FTC may not have proved its case in this respect. We think an adverse ruling the in the case would be a negative for the META shares. While a break up would also be a clear negative, a less-draconian fine and/or consent decree outlining certain behavioral strictures would probably be acceptable for Meta. In the event of a loss by Meta, we expect the company to appeal.

On May 29, Meta and defense contractor Anduril announced a strategic partnership to develop a range of extended reality products. These will likely included augmented or virtual reality headsets/helmets/glasses or other wearable devices for soldiers with the goal of providing enhanced vision, hearing, and battlefield information processing as well as integration with smart weapons systems. The strategic Anduril partnership/Defense Department relationship is a new growth vector for the typically consumer-facing Meta though the company's advances in AR/VR device technology over the last ten years and in generative AI would seem to fit the bill for these types of advanced wearable war fighting systems exactly. Meta and Anduril are reportedly jointly bidding for a $100 million Defense Department contract to develop prototypes though the opportunity for such wearable technology could be much higher should prototypes get adopted.

Meta has reportedly been in talks with Hollywood movie studios including Disney and A24 and has already partnered with legendary director James Cameron's production company Lightstorm Entertainment for the production of virtual reality first entertainment content. According to a Wall Street Journal report, Meta's discussions have included terms that VR content would be exclusive to Meta for a first window period of time before allowing 2-D versions to be distributed through secondary exhibition windows. While Meta's Vision Quest line of VR headsets have probably been the most successful VR device, the Vision Quest along with Apple's expensive Vision Pro and other VR headsets have seen only limited sales, primarily to videogamers and have not broken through to the mass market. A significant stumbling block to VR adoption has been the lack of compelling content so that Meta's Hollywood gambit to take a shot at acquiring breakthrough popular content makes sense though may also be expensive as it continues to chase CEO Zuckerberg's VR dreams. Meta is likely developing another more powerful, perhaps sleeker and more AI-driven iterative update to the Vision Quest for probable release in 2026.

We are maintaining our 2025 GAAP EPS estimate at $25.95 and our 2026 forecast at $29.41. Our EPS estimates imply 11% growth over the next two years. Our long-term earnings growth rate forecast is 16%.

MANAGEMENT & RISKS

Meta is vulnerable to extreme regulatory backlash in the U.S. and globally, related to antitrust; the spread of misinformation, including election interference; the spread of unlawful content in private groups and encrypted communications; and the misuse of members' private information, among other risks. We say "extreme regulatory backlash" above as Meta is not only being charged with huge fines for alleged transgressions, but faces a possible forced break-up of the company, given its social media market power.

Meta is appealing a decision and a record 1.2 billion-euro ($1.3 billion) fine levied by the European Data Protection Board in May 2023. The U.S. Federal Trade Commission antitrust lawsuits, where break-up is a possible remedy, have at a minimum increased headline risk for Meta, and are an existential threat to the company. Management distraction is another risk arising from the FTC suit, and from other regulatory litigation and investigations, particularly in the European Union.

In late 2022, the EU passed the Digital Services Act (DSA) and the Digital Markets Act (DMA), both aimed at severely regulating large online businesses, i.e., Meta and other large American tech companies. The DSA and DMA are aimed at regulating practices around content moderation/disinformation and user privacy, among other issues, and Meta will be required to undergo outside audits of its practices and share algorithmic data with EU regulators. The European Commission ruled that Meta violated the DMA in April of 2025. Penalties for noncompliance to the new law are severe.

On October 24, 2023, Meta was hit with a flurry of joint lawsuits brought by 41 states in federal court. Some state Attorneys General have also filed similar suits in their own state courts. The lawsuits allege that Meta has harmed the psychological health of children and adolescents by knowingly designing psychologically manipulative "technologies to entice, engage, and ultimately ensnare youth and teens." The suits allege that Meta lied to the public by minimizing the damaging impact of these technologies and violated the Children's Online Privacy Protection Act (COPPA) by unlawfully collecting "the personal data of its youngest users" without their parents' permission. The lawsuits seek injunctions to stop the alleged actions as well as monetary damages.

Like all advertising-dependent companies, Meta could be severely hurt by a decline in advertising. This risk is heightened by the uncertainty surrounding macroeconomic growth, which closely correlates with advertising growth. Meta may be more resilient than other ad-reliant companies due to the secular trend of advertisers moving to digital from other channels and to its sophisticated ad audience targeting tools.

While Meta's user growth has migrated toward developing markets, the U.S. (Meta's home market) is still the most lucrative. As such, a meaningful defection of U.S. users from the flagship Facebook site (other than to Facebook's own sister applications Instagram, WhatsApp, Reels, and Threads) could materially impact the company's performance and business model. A significant loss of advertisers would also be a material problem.

Meta is almost entirely dependent on advertising revenue, which has grown to about 98% of total revenue. The secular trend of advertisers devoting more and more of their advertising dollars to internet-based advertising has generally softened the effect of cyclical swings in the online advertising market. The flagship Facebook platform is at saturation in the U.S., meaning that growth in that platform will likely slow over time. Meta's emerging platforms, Instagram, Messenger, WhatsApp, Reels, and Threads, have been building their respective user bases nicely, and are in various stages of monetization. Management has also warned that it is willing to sacrifice short-term margin expansion for long-term user growth and increased engagement.

Competition in the internet space is intense, and Meta is up against a number of larger companies with greater resources, including Google, Microsoft, and Apple. The company also competes with smaller virally popular and niche social media companies like TikTok, Twitter, Snapchat, Reddit, and Discord. As Meta expands internationally, it must manage its entry into new markets, where it may have limited understanding of the local culture. It also faces pressure from "national champion" competitors, especially in China, where it is currently banned. Government regulation and the possible censorship of site content could also become much more burdensome in the coming years, both in the U.S. and in international markets. The Snowden revelations involving the use of American internet company data by the National Security Agency (NSA) could make Meta's penetration of foreign markets much more difficult, and result in restrictions or outright bans by foreign governments.

Like any fast-growing tech company, Meta must successfully manage its growth trajectory. It must also ensure 24/7 system reliability in the face of increasingly toxic computer network attacks from malicious governments, organizations or individuals attempting to steal user information.

More than most internet firms, Meta is identified with its founder, chairman, and CEO Mark Zuckerberg, and his possible loss would undoubtedly be a major blow to the company.

On January 6, Meta announced that it had added three new directors to its board: Dana White, John Elkann, and Charlie Songhurst. Mr. Elkann and Mr. Songhurst are an industry leader and a tech investor, respectively, and therefore are what one would expect in this role. Mr. White, in addition to his position as CEO of sports media business UFC, is a close personal friend of President Trump. Also in early January, Meta replaced its global affairs chief Nick Clegg with Joel Kaplan. Mr. Kaplan has served as Meta's point of contact with Republican law makers since 2011. Meta also donated $1 million to the presidential inaugural committee. While some may decry these moves as genuflecting to the new administration, Meta faces serious antitrust and regulatory issues, and we objectively note that currying favor with regulators is in the company's business interest.

COMPANY DESCRIPTION

Meta Platforms operates the world's largest family of social networking websites, including the flagship Facebook site, Instagram, Facebook Messenger, WhatsApp, Reels, and Threads. The sites enable users to communicate with friends and family by posting to the site; to comment on others' posts; to share photographs, website links, and videos; to message; and to play games. The company also partners with application developers to add functionality to the sites, and allows users to pay for virtual goods and services through its Payments function. Meta derives about 55% of its revenue from outside the U.S. and Canada.

INDUSTRY

Our rating on the Communication Services sector is Market-Weight. The hyperscale companies in this "barbell" sector have been subject to profit-taking as AI enthusiasm wanes and skepticism about capital spending sets in following the arrival of DeepSeek. The telco companies at the other end of the barbell have relatively outperformed the hyperscale companies but are contending with slow subscriber growth amid a subdued 5G smartphone cycle.

As of the end of May, the sector was overperforming the market, with a gain of 3.2%. The sector accounted for 9.6% of the S&P 500. Over the past five years, the weighting has ranged from 7% to 12%. It outperformed the market in 2024, with a gain of 38.9% compared to a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2026 EPS was 17, below the market multiple. Yields of 1.1% were below the market average. The sector's smoothed earnings growth rate of 11% was above the market average.

Given the lack of historical performance data for the new sector, S&P Dow Jones Indices performed pro forma back-testing over a 10-year period to determine the general characteristics of the sector. The style mix is approximately one-third "value" and two-thirds "growth," while the predecessor Telecom sector was 100% value.

The sector, developed by MSCI and S&P Dow Jones, launched on 9/24/18. The sector delineation applies to all indices maintained by MSCI and S&P Dow Jones, including the S&P 500, S&P 400, and S&P 600, as well as various domestic and global indices maintained by MSCI. The sector includes two major subsectors: Media & Entertainment (80% of sector weight) and Telecommunications Services (20%).

Media & Entertainment includes Media (advertising, broadcasting, cable & satellite, and publishing); Entertainment (movies & entertainment, and interactive home entertainment); and Interactive Media & Services, which includes search & social media platforms. Telecom Services includes Diversified Telecom and Wireless Telecom Services.

VALUATION

META shares are up 20% year-to-date on a total-return basis, compared to a 3% gain for the S&P 500, a 4% gain for the S&P Interactive Media & Services Industry Index, a 9% gain for the NYSE Fang+ Index, and a 1% decline for the Roundhill Magnificent Seven ETF. The META shares were hit hard earlier this year by the launch of the Chinese DeepSeek GenAI model, which put into question Meta's (and others) huge planned investments in GenAI frontier models along with the beginning of a federal trial on antitrust charges then bottomed with the market in April on trade war fears. However META shares have made a powerful recovery off the bottom, outpacing the market by a wide margin, aided by continued strong results. The forward EV/EBITDA multiple of 16.5 is 6% above the peer average and above the two-year historical average discount of 17%. We are maintaining our BUY rating on Meta and raising our target price to $790 from $725.

On June 17, BUY-rated META closed at $697.23, down $4.89. (Joseph Bonner, CFA, 6/17/25)

SONOCO PRODUCTS CO. (NYSE: SON, $43.78).. HOLD

SON: Looking for a more-favorable entry point

* SON shares have underperformed year-to-date, declining 10% compared to a 2% advance for the S&P 500.
* The company missed Street EPS expectations for the second quarter in a row; core demand is uneven.
* We like the dividend yield of 4.8%, which signals value.
* We will look to return SON to the BUY list as we begin to see an improved demand environment.

ANALYSIS

INVESTMENT THESIS

Our rating on Sonoco Products Co. (NYSE: SON) is HOLD. Sonoco is a global provider of consumer packaging, industrial products, protective packaging, displays, and packaging supply-chain services. We view Sonoco as a well-run company with a long track record in its industry. Though an acquisition is driving near-term sales and earnings growth, core business conditions are challenging given high costs and weakened demand. The tariff impact has been greater than expected and the near-term macro environment presents challenges, as we expect rising raw materials costs. The balance sheet is solid, the dividend yield of 4.8% is attractive and we expect the company's earnings to benefit from the Eviosys acquisition in the next year. However, to move the shares back to the BUY list, we will look for signs of better core revenue and earnings growth.

RECENT DEVELOPMENTS

SON shares have underperformed year to date, declining 6% compared to a 6% advance for the S&P 500. Shares have also underperformed over the past year, falling 23% compared to a 9% increase for the index. They have underperformed the Materials industry ETF (IYM) over the past one- and five-year periods. The beta on SON is 0.74.

The company recently reported 1Q25 adjusted EPS that rose 23% year over year but fell short of consensus forecasts for the second consecutive quarter. The company reported 1Q25 net sales of $1.7 billion, which grew 31% from the prior year, due entirely to the impact of an acquisition. Adjusted earnings came to $1.38 per diluted share, up 23% year over year, but short of the $1.41 forecast by the Street. Adjusted EBITDA reached $338 million, up 38% from 1Q24, driven mainly by the recent acquisition and productivity gains. The adjusted EBITDA margin expanded 170 basis points year over year to 16.6%.

Along with 1Q25 results, management reaffirmed their FY25 guidance. Management continues to expect earnings of $6.00-$6.20 per share on an adjusted basis, implying growth of 25% at the midpoint from FY24. Management's projection for FY25 full-year adjusted EBITDA remains in the range of $1.3-$1.4 billion

The company's results are linked in part to trends in paper production and pricing. Corrugated paperboard and solid fiber box prices generally are near the top of the historical range. According to the U.S. Bureau of Labor Statistics, the current producer price index for Pulp, Paper & Allied Prices (which we use as a proxy for the industry) is approximately $344, with a five-year range of $260-$344. Though prices are at the top of the range, the trend has been relatively flat for the past year.

EARNINGS & GROWTH ANALYSIS

Sonoco has an uneven record of growth and profitability. Over the past four years, revenue declined a total of 2%. While adjusted EBITDA grew 13% over that time period, last year it was down 3% year over year. The adjusted EBITDA margin ranged from 13.8% to 19.6% during the period. The dividend grew 3% per year on average.

The company has two main segments: Consumer Packaging (62% of 1Q sales) and Industrial Paper Packaging (33%). Its remaining businesses (5%) form the "all other" segment. Recent segment results are summarized below.

In the latest quarter, Consumer Packaging reported 1Q sales that were up 83% year over year on a reported basis, reflecting added sales attributable to the Eviosys acquisition. On a pro forma basis, sales rose 3% year over year. The segment-adjusted EBITDA margin was 17.8%, up 350 basis points from a year earlier.

In Industrial Paper Packaging, 1Q25 net sales fell 6%, reflecting volume declines across the segment and unfavorable currency impact. The segment-adjusted EBITDA margin expanded to 18.1% from 16.0% the prior year, driven by strong productivity and price/cost gains, partially offset by currency translation.

In "all other," 1Q net sales fell 37%, primarily due to the divestiture of the Protexic business in 2024 and lower volumes in industrial plastics.

Turning to our estimates, based on recent revenue and margin trends as well as management's guidance, we are maintaining our 2025 adjusted EPS estimate of $6.00. Our estimate is at the low end of management's guidance range and implies an EPS gain of 23% year over year. We look for moderate growth 2026 and are raising our preliminary estimate to $6.50 from $6.30, reflecting our expectations for moderate demand recovery and continued realization of gains from the Eviosys acquisition.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Sonoco is Medium. The company generally receives average marks on our main financial strength criteria of debt levels, fixed-cost coverage, cash flow generation, and profitability.

Total debt at the end of 2024 was $7.0 billion. Cash and cash equivalents were $431 million. The net debt/total cap ratio was 74%. The EBITDA margins are typically in the mid-teens.

Sonoco has a share repurchase plan.

The company also pays a dividend. In May 2025, it announced a 2% increase in its quarterly dividend to $0.53 per share or $2.12 annually, for a yield of about 4.8%. Our dividend estimates are $2.11 for 2025 and $2.15 for 2026.

MANAGEMENT & RISKS

Howard Coker is the company's CEO. He previously served as senior vice president, Global Paper/Industrial Converted Products. Roger Fuller is the COO. Jerry Cheatham was appointed interim CFO in January 2025, replacing Rob Dillard. John R. Haley is the chairman.

The company continues to refine its portfolio of assets. Sonoco recently completed their acquisition of Eviosys, a leading metal food can and aerosol packaging platform for $3.9 billion. Eviosys has 44 manufacturing facilities across 17 countries and will raise its total addressable market by an estimated $25 billion. They have since rebranded this business as Sonoco Metal Packaging EMEA.

Investors in SON shares face risks. Sonoco faces the risk of rising raw material costs, in addition to higher energy, freight, and labor costs. The company also faces foreign exchange risk and costs related to M&A and restructuring activities. Sonoco has raised prices to offset these higher costs, though these increases may hurt volume. Other risks include the potential for lower packaging product demand in both consumer- and industrial-related businesses.

COMPANY DESCRIPTION

Founded in 1899, Sonoco Products is a global provider of consumer, industrial, healthcare, and protective packaging, with operations in 40 countries. The company is based in Hartsville, South Carolina. Sonoco has approximately 23,000 employees. The shares are a component of the S&P 400 Midcap Index.

INDUSTRY

The combined global paper, pulp and packaging industry had an estimated market size of approximately $410 billion in 2024, up from $395 billion in 2023 and from $385 billion in 2022. Argus Research estimates the industry will remain strong and experience modest growth with a compound annual growth rate of 3%-4% through 2028. We favor companies with pulp, paperboard packaging, and corrugated product lines and expect this segment to show continued long-term growth through 2030. (Industry sources valued the containerboard market at approximately $125 billion in 2021 and $130 billion in 2022.) The containerboard segment is expected to continue to increase through 2025 in line with e-commerce growth. Our forecast is less favorable for companies focusing heavily on graphic papers. We project graphic demand for writing papers and newsprint will experience a continuation of the decade-long downward trend due to displacement by electronic communication devices and what appears to be the approaching obsolescence of physically printed newspapers, periodicals, magazines, and retail catalogs.

VALUATION

We believe that SON shares are fairly valued at current prices near $44, below the mid-point of their 52-week range of $39-$58. From a technical standpoint, the shares have been in a bearish pattern of lower highs and lower lows that dates to May 2021.

On the fundamentals, SON shares are trading at 7-times our 2026 EPS estimate, with a historical range of 7-17. The price/sales multiple is 0.77, with a historical range of 0.7-1.2. The price/book multiple is 1.79, with a range of 1.8-3.2. The dividend yield of 4.8% is well above the market yield and signals value. However, given the outlook for the core business, we think the current discount valuations are appropriate and rate the shares HOLD.

On June 17, HOLD-rated SON closed at $43.78, down $0.73. (Alexandra Yates and Samuel Strikowsky, 6/17/25)

TARGET CORP. (NYSE: TGT, $95.02) .... BUY

TGT: Reducing target price to $135 from $150

* With a 4.68% dividend yield and significant upside to our new price objective of $135, we believe that the current risks facing the company are reflected in the share price.
* Our reduced EPS estimate of $7.05 is at the bottom of the company's wide non-GAAP guidance range of $7.00 to $9.00 for the current FY26. We would take a very hard look at our recommendation if we had to lower our earnings estimate again.
* Comparable sales were down 3.8% in fiscal 1Q, which was worse than the consensus call for a 1.9% decrease. The number of comparable transactions was down 2.4%, and the average transaction amount was down 1.4%. Comps originated in stores fell 5.7%. Digital comps increased 4.7%.
* Target announced a multiyear Enterprise Acceleration Office, which will be led by chief operating officer Michel Fiddelke. Christina Hennington, the company's chief strategy and growth officer, will "depart" Target and become a strategic advisor through September 7. Amy Tu, the company's chief legal and compliance officer, is also leaving the company.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Target Corp. (NYSE: TGT). With a 4.68% dividend yield and significant upside to our new (reduced) price objective of $135, we believe that the current risks facing the company are reflected in the share price. Target is on track for 54 consecutive years of increases in the annual dividend.

In recent notes, we have expressed our belief that Target remains very relevant to its customers as a place where they can get food and staples at good prices as well as stylish, budget-friendly clothing and home goods. We have also said that TGT is a very easy place to shop (and make returns) with in-store shopping, delivery, and curbside options.

The 2.4% decline in 1Q transactions (traffic) on top of a 1.9% decline in the prior-year period is a warning. We regard traffic as a measure of relevance. Our reduced EPS estimate of $7.05 is at the bottom of the company's wide non-GAAP guidance range of $7.00 to $9.00 for the current FY26. We would take a very hard look at our recommendation if we had to lower our earnings estimate again.

Although it is only June and some students are still in school, we are entering the critical period for retailers. Back-to-school/college is the most important season after the holidays. A Target we visited before Father's Day already had back-to-college merchandise at the front of the Home department. We usually don't see back-to-school collections until after July 4 weekend. There are two things we will be focusing on that should be important for Target. The first is that we want to see a very compelling value proposition for back-to-school merchandise. Walmart always has price rollbacks, supplies for under $1, and collections of supplies at a low price. We would like to see a compelling and clearly identified combination of style and price at Target. The second is that we want to see a strong combination of values and differentiated merchandise as the company enters 3Q. We have felt that Walmart has often done a better job of showcasing reduced prices or compelling Everyday Low Prices.

We are reducing our 12-month price target to $135.

RECENT DEVELOPMENTS

On May 21, Target reported fiscal 1Q26 sales and adjusted earnings that missed consensus and our estimate. The company lowered guidance on an adjusted EPS basis. These non-GAAP earnings exclude gains from a legal settlement.

"Target's strategy, scale, and long-term perspective enable us to stay resilient in difficult times and keep investing in the future. We are not satisfied with recent performance, and we're focused on accelerating our strategy to drive long-term profitable growth and deliver the assortment, experience, and value consumers expect from Target," the company's CEO Brian C. Cornell said.

First-quarter EPS fell 36% year over year to $1.30 on an adjusted basis, which excludes a $0.97 legal benefit in the just-completed quarter. Our estimate was $1.66, and the StreetAccount consensus was $1.61. Target earned $0.97 on a GAAP basis.

Sales declined 2.8% to $23.8 billion, compared to our estimate of $24.5 billion and consensus of $24.2 billion.

Comparable sales were down 3.8% in fiscal 1Q, which was worse than the consensus call for a 1.9% decrease, driven by soft demand in discretionary categories like home furnishings, which was down 8.5%. The number of comparable transactions was down 2.4%, and the average transaction amount was down 1.4%. Comps originated in stores fell 5.7%. Digital comps increased 4.7%.

TGT expects fiscal 2026 sales to decline in the low single digits. The full-year GAAP EPS guidance is $8.00-$10.00, which benefits from $0.97 of gains from litigation settlements. Adjusted EPS, which excludes these gains, is expected to be approximately $7.00-$9.00 versus previous guidance of $8.80-$9.80, which didn't include the settlement. Our prerelease estimate was $9.00. The Capital IQ consensus was $8.53.

The company expected to see meaningful pressure in 1Q relative to the rest of the year. The pressure came from team member investments, health care, general liability, and start-up costs from capital investments. Additionally, lower-than-expected sales, higher markdowns, tariff and consumer spending uncertainty, store remodeling projects, and costs associated with inventory and receipt adjustments caused this guidance reduction.

Sales originating in stores represented 80.2% of 1Q total sales. Orders placed online represented 19.8% of sales, compared with 18.3% in the prior-year quarter. The company's stores fulfilled 97.6% of total sales, 0.1% less year over year.

The company held or gained market share in 15 of 35 categories, with strong gains in women's swimwear, performance apparel, and the toddler category.

The gross margin declined by 60 basis points year over year to 28.2%, matching our estimate. The consensus was 28.3%. Gross margin was hurt by a higher percentage of digital fulfillment, supply chain costs, and higher promotions and clearance activity. There was a benefit from lower inventory shrink.

The 1Q expense rate increased by 70 basis points, without the litigation settlement gains, because of cost increases in wages and benefits. With the litigation gains, which were an offset to expenses, the expense rate decreased by 170 basis points. The operating margin increased by 90 basis points from the prior year to 6.2%, including the benefit. Excluding the settlement, the operating margin was 3.7%, down from 5.3%. Our estimate was 4.4%. Consensus was 4.3%.

The company generated $275 million in cash flow from operations in 1Q26, compared with $1.1 billion a year earlier. Net earnings increased by 10% year over year. Inventories were a use of cash rather than a source, and accounts payable were a bigger use.

Also on May 21, Target announced a multiyear Enterprise Acceleration Office, which will be led by chief operating officer Michael Fiddelke. Christina Hennington, the company's chief strategy and growth officer, will "depart" Target and become a strategic advisor through September 7. Amy Tu, the company's chief legal and compliance officer, is also leaving the company. Melisa Kremer, the company's head of human resources, will hold the position while the company conducts a comprehensive search.

EARNINGS & GROWTH ANALYSIS

We are reducing our FY26 estimate to $7.05 from $9.00 on an adjusted basis. This may be a little conservative relative to adjusted consensus, which is now $7.36 according to Capital IQ. We wanted to set a low bar to make sure our valuation analysis was still compelling. We are reducing our 2Q estimate to $1.92 from $2.54. We expect a decline in operating margin from approximately 5.2% in FY25 to 4.4% for the full year.

We are reducing our FY27 EPS estimate to $8.00 from $9.77. We are modeling 2.0% sales growth and about a 40-basis-point increase in operating margin. Consensus is also approximately $8.00.

At a meeting with the investment community on March 4, Mr. Cornell said, "Our expectation is to drive more than $15 billion in revenue growth over the next five years. To get there, we must hold or grow share across most of our categories."

Key initiatives include: new partnerships with Champion and Warby Parker; faster product development, production, and delivery; expanding the offering of beauty products; increasing third-party marketplace sales on the company's website; and doubling the size of the in-house media company. For the summer season specifically, TGT will be offering more than 10,000 new items, starting at $1, to expand its business for low-income consumers.

We are maintaining our five-year EPS growth rate forecast at 7%. We use this number in our valuation models. We are using our actual estimates in the first two years of our modeling and assuming that EPS grows 7% in the following three years. We then assume that the growth rate declines to 3% from 7% over the next five years. It is still the company's objective to have a dividend payout of 40%.

The company's goal is to grow sales in the low-to-mid single digits. TGT also plans to raise operating margin, raising annual EPS growth in the mid-to-high single-digit range.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating is Medium-High. Debt was approximately 2.85-times EBITDA in FY23 and 2.25-times EBITDA in FY24. FY25 EBITDA of approximately $8.7 billion and debt of $19.6 billion put the ratio at 2.25-times EBITDA for FY25. This reduction puts the company more comfortably into Medium-High territory. We believe this ratio will have to come down slightly to maintain a single-A rating from S&P and an A-1 short-term rating, but the level is still solid. At the end of 1Q26, debt was approximately 2.4-times our GAAP EBITDA estimate for FY26.

TGT ended 1Q26 with $2.9 billion of cash. Debt of $19 billion was 57% of capital.

The company owns approximately 80% of its stores and has another 8% of locations in which it owns a building on leased ground. This total of 88% is high relative to our retail coverage universe. The Target balance sheet lists the value of property and equipment at $33 billion.

The company has top-tier ratings on its commercial paper, which we see as an advantage over the course of the credit cycle. There was no commercial paper outstanding at the end of 1Q26.

We believe the management team is committed to maintaining investment-grade, single-A credit ratings.

FY24 dividends totaled $4.36 a share. FY25 dividends totaled $4.44. On June 12, 2025, TGT announced a 1.8% increase in the quarterly dividend to $1.14 per share, which was in line with our expectation. We are maintaining our FY26 dividend estimate at $4.52 per share, which is now 64% of our EPS estimate. This isn't unstainable, but it is higher than we would like. The ratio should decline as earnings improve. Over the last five years, Target has raised the dividend at a compound annual rate of 11%. Our FY27 dividend estimate is $4.60 per share. The dividend yield is a respectable 4.7%.

The company repurchased $7 billion of shares in FY22 and had $12.3 billion remaining under the share repurchase plan. Repurchases were just $10 million in 1Q23. Target repurchased $2.6 billion of its stock in 2Q23. The company did not repurchase any shares in 3Q23 or 4Q23 in an effort to maintain mid-single-A credit ratings. There were no repurchases in FY24 or in 1Q25. The company repurchased a modest $155 million of shares in 2Q25, $354 million in 3Q25, and $506 million in 4Q. Target repurchased $251 million of shares in 1Q26. The company refrained from share repurchases in April amid uncertainty about the timing of tariffs. Target had $8.4 billion remaining on its repurchase plan at the end of 1Q26.

The company's capital priorities are to invest in growing the business, pay a competitive dividend and increase it annually, and maintain credit ratings in the middle of the single-A range. If the company has excess cash after meeting these goals, it intends to buy back shares.

MANAGEMENT & RISKS

Target, like other retailers, was stung by unprecedented economic volatility in FY23. The company went from chasing inventories to meet strong demand during supply-chain disruptions to clearing inventories as higher fuel and grocery prices cut into discretionary spending on higher-margin apparel and home furnishings. The company has struggled to one degree or another since then.

Target gained market share as a convenient shopping destination during the pandemic. While we remain optimistic about the company's prospects, shoppers could start going to a wider range of stores. Some appear to be going to Walmart to save money.

Target has faced boycotts from consumers on both sides of the political spectrum. This is likely to be an ongoing risk for retailers.

Target is also vulnerable to tariffs; 30% of Target's merchandise is produced in China, high when compared to competitors like Walmart, but lower than the 60% reliance in 2017. Half of Target's sales come from items that are sourced internationally. Target has employed many strategies to mitigate the impact of tariffs in recent month, including expanding into new countries (in Asia and the Western Hemisphere) for production capacity and ensuring that half (and growing) of production occurs in the United States. They have also been evolving their assortment through lower-price options at the "Bullseye's Playground" locations at the front of the store, where "fun, seasonal, low-priced items" are on display for $1-$5. These goods have lower cost for Target than their usual imports.

Target is investing in inventory-management analytics and more efficient distribution. Its goal is to reduce labor costs, eliminate inaccessible inventories in storage rooms, and get more of its inventory on store shelves.

Target is also working successfully to integrate its e-commerce capabilities with brick-and-mortar stores by offering in-store pickup for online shoppers and same-day delivery for in-store shoppers. This added convenience has been a source of growth. It has also added e-commerce applications that help furniture shoppers to visualize what selected pieces of furniture might look like in a room.

Customers don't always give Target credit for having low prices (mostly because many stores are, in our opinion, very nice). In our experience, the company often has prices that are competitive with Walmart's and in many instances will match the prices of major competitors, including Amazon; however, there are some limitations and exclusions that we regard as reasonable. We often find that checkout is much faster at Target than at many big-box stores and that product returns are easy because of the company's technology investments. Target may need to do a better job articulating the values it offers.

Target has done what many other retailers have failed to do. It continues to differentiate itself from Walmart while remaining a broad-line discounter. We do not think there is a secret formula. The stores are clean, bright, and logically arranged; there is always reasonably priced, stylish merchandise; and there are often plenty of checkout lines open.

The FY22 gross margin of 28.3% was down from more than 33.5% in FY06. Gross margin declined in FY23. It made a partial rebound to 27.2% in FY25 and could take a couple of years to fully rebound depending on when the mix of discretionary sales improves.

We believe that Target's sales of healthcare products, cosmetics, food, and cleaning supplies provide some insulation from a weak economy; however, sales of hardlines and home furnishings could be (and have been) seriously hurt by a downturn and more recently because inflation has crimped discretionary spending. Target has placed an emphasis on fresh foods over the last few years. We think this adds some stability to sales and increases inventory turnover, although a deflationary environment could reduce sales. An important question is whether the addition of more fresh food gets shoppers to visit Target more often. In the COVID crisis, food gave the company a reason to be open, which was tremendously important.

While we have traditionally thought of Walmart as the biggest risk to Target, Amazon could be more difficult to counter. Target has historically offered a lower mix of food but is working to expand this segment. However, though the food and beverage industry adds a favorable consumer element of convenience, it offers minimal differentiation from both a product quality and cost perspective. The size of this category for Target pales in comparison to big players like Walmart and Kroger.

The chief risk that management can control is merchandising execution, which has generally been very good, though not perfect, in the U.S., though the business plan failed in Canada. Management is trying to reignite the former excitement with new brands in apparel, home, and workout apparel. The company will have to gain lost ground against Walmart and improve its own financial metrics in order to maintain favor with investors.

Target, like other retailers, could also face a margin squeeze from higher labor, healthcare, utility, and accident costs. We believe that the regulatory environment could prove to be tougher for big-box retailers because of some politicians' belief that national chains should pay their workers more and because local governments are looking for taxes that can help them close their budget gaps.

The credit card business is also a risk factor, although the risk has diminished with the sale of the receivables portfolio, which is owned by TD Bank. Target earned $576 million in profit-sharing income in FY25, $667 million in FY24, and $734 million in FY23.

We believe that in the long term, the company could be hurt if stronger Asian currencies or tariffs made it more expensive for Target to import goods. High gasoline prices are another issue that can affect store traffic and sales. Expensive gas could trim many shoppers' spending power and reduce the number of shopping trips they are willing to make. Low gas prices can aid discretionary spending, but it is far from certain that consumers will spend all of the savings or that a retailer like Target will get its fair share.

TGT shares could suffer a "double whammy" from both lower earnings and a lower P/E multiple if its results are lower than expected. Shares of Target have traditionally been slightly less volatile than the S&P 500.

The cost and disruption from the theft of credit card data didn't have a significant long-term impact on other retailers whose systems have been breached, but Target's sales softened following the announcement that its customer data was hacked in 2013. The company said that while the breach was significant, it did not materially hurt results. Another breach could hurt sales and have significant additional costs.

Brian Cornell became the company's chairman and CEO on August 12, 2014. His top priorities are to improve the company's performance and advance its omnichannel strategies. Mr. Cornell was previously the CEO of Pepsi's food division and president of Walmart's Sam's Club. On September 7, 2022, the company announced that Mr. Cornell would remain as CEO for approximately three more years.

On October 9, 2019, Target announced that Michael Fiddelke would become CFO, replacing the very able Cathy Smith who announced, in January, her plan to retire. Ms. Smith was 55 when the prior annual report was published. She remained as an advisor until May 1 of 2020. Mr. Fiddelke has spent more than 15 years at Target, most recently as SVP of operations. Before Target, he worked at Deloitte. Mr. Fiddelke recently switched roles to become chief operating officer.

Jim Lee joined the company in 2024 to become CFO. He previously spent more than 25 years at PepsiCo.

Ernst & Young has been the company's auditor since 1931.

COMPANY DESCRIPTION

Target Corp. is the second-biggest U.S. discount retailer. It differentiates itself by selling stylish products at reasonable prices. The company has partnerships with an evolving group of designers. Based in Minneapolis, Target ended FY25 with 1,978 stores in the U.S., with a total of 248 million square feet. Target sold its in-store pharmacies to CVS in December 2015. For the fiscal year ended February 1, 2025, the company had total revenues of $106.6 billion, including $31 billion from Target's own brands. Sales on Target.com represented about 19.6% of the total in FY25, up from 18.3% a year earlier and 8.8% in pre-pandemic FY20. The company's fiscal year ends on the Saturday closest to January 31.

Approximately 31% of merchandise sales came from beauty and household essentials, 13% from hardlines, 16% from apparel and accessories, 14% from home products, and 25% from food. Target was moved to the Consumer Staples sector from Consumer Discretionary in 2023.

VALUATION

Target shares are down 32% over the last 12 months. They are currently trading at 13.8-times our FY26 EPS estimate and at 12-times our FY27 forecast.

Target is clearly underperforming Walmart and Costco based on sales and earnings growth, but at least some of the differential is reflected in valuation multiples. Target trades at 12.7-times consensus for the next four quarters while Walmart trades at 35-times and Costco trades at 51-times.

We believe that Target shares are worth about 20-times earnings based on a two-stage dividend discount model (DDM). The company's 10-year average P/E is 20-times, actually 19.9. The five-year average is 22.7-times. Walmart has been performing better than TGT and gets a lower cost of equity based on our assessment of risk and cash flow stability. The assumptions in our two-stage DDM are that Target will grow EPS at an average rate of 7% over the next five years, with a 50% dividend payout. We are using a cost of equity of 7.75% (compared with 6.4% for WMT). As a reminder, discounting expected future cash flows at a lower rate raises the value of a stock just like accepting a lower yield raises the price of a bond. In the steady-growth phase, we are assuming 3% growth, an 85% payout (reflecting both dividends and share repurchases), and a 7.6% cost of equity.

The shares are trading at an enterprise value of approximately 10-times trailing EBIT. That is a compelling multiple unless we have to lower our earnings estimates.

We believe that TGT is worth about $150 per share based on analysis with our new (reduced) EPS estimates and our DDM. We are using our actual EPS estimates of $7.05 and $8.00 for FY26 and FY27, respectively. We are using our five-year growth rate of 7% to calculate earnings estimates for FY28, FY29, and FY30. We are still modeling a five-year decline (transition) in the growth rate from 7% to steady-state growth of 3%. Our estimate of the steady-state dividend payout is 85%. Our cost of equity estimate is 7.75% for the next five years and 7.6% in the steady-growth phase.

Amid the consumer uncertainty and disappointing traffic, realizing a target price of $150 may take a while. We are reducing our 12-month target to $135. This represents upside of more than 35%. The dividend yield is $4.68%.

On June 17, BUY-rated TGT closed at $95.02, down $2.35. (Christopher Graja, CFA, and William Neumann, 6/17/25)