Fitch Affirms Target's IDR at 'A-'; Outlook Revised to Positive
Wednesday, February 10, 2016 05:29:00 PM (GMT)

Fitch Ratings has affirmed the Long-term Issuer Default Rating (IDR) on Target Corporation (Target) at 'A-' and the Short-term IDR at 'F2'. The Rating Outlook has been revised to Positive from Stable. Target had approximately $12.8 billion of debt at Oct. 31, 2015.

KEY RATING DRIVERS

The Positive Outlook reflects Target's improving comparable sales and margins along with Fitch's expectation that total adjusted debt/EBITDAR will be maintained around 2.0x. The Outlook recognizes that sales comparisons in 2015 were easier due to several quarters of weak comparable sales (comps) following the data breach in December 2013, and considers the potential for softer consumer spending if U.S. economic growth weakens. Ratings could be upgraded if comp growth continues around 2% over the next several quarters and leverage is in line with Fitch's expectation.

Strong Competitive Position: Target's credit profile benefits from its position as the second largest general merchandise discount retailer in the U.S. and its upscale discount image. Target generates over $72 billion of annualized sales, operates more than 1,800 stores, and is investing in digital, remodeling stores, and engaging in merchandising initiatives to further strengthen its brand. Fitch acknowledges Target's past challenges with its website and Expect More Pay Less brand promise but expects Target's channel-agnostic approach to growing sales and focus on signature merchandise categories to help the company maintain share.

Focus on Core Operations: Following the December 2015 divestiture of its pharmacy operations, the January 2015 exit from Canada and the March 2013 sale of its credit card business, Target is well positioned to focus on its core U.S. operations and its five key priorities. These priorities include improving the ability of consumers to shop both in store and digitally (on demand), focusing on merchandise in line with Target's core strengths, offering a more localized assortment and personalized shopping experience, expanding via urban formats, and simplifying its business while reducing cost. As a result of these efforts, Target expects outsized growth in digital sales and signature categories (style, baby, kids, and wellness), as well as realization of $2 billion of cost savings.

Solid Comp Trajectory: Target has reported five consecutive quarters of comp growth in the U.S. For the nine months ended Oct. 31, 2015, comps increased 2.2% with the number of transactions rising 1.3% and average transaction amount up 0.9%. Comparisons versus a weak 2014 have been easier but comps for signature categories are reportedly twice that of the total. Fitch views the mid-point of Target's 1.5% - 2.5% annual comp goal, which includes digital sales, as achievable but the low end of the range is more likely if the U.S. economy weakens and consumer spending slows.

Sustainable Margin Improvement: Target's EBITDA margin is improving in line with Fitch's projections but at a slightly faster pace than anticipated. For the nine-month period ended Oct. 31, 2015, Target reported an EBITDA margin of 10.0%, up from 9.2% in the prior year's period, due to higher sales, less promotional activity, favourable mix shift, and lower operating expenses. Moreover the divestiture of the pharmacy business is expected to be immediately accretive to Target's margins. Fitch forecasts EBITDA margins of approximately 10.5% in 2016 with sustainability above 10% over the intermediate term assuming comps grow at least 1.5% - 2%, gross margins remain relatively stable, and operating expenses are tightly managed.

Lower Leverage, Balanced Strategy: Target's adjusted leverage was 1.9x for the LTM period ended Oct. 31, 2015, down from 2.1x at the end of 2014. Fitch projects total adjusted debt/EBITDAR of 1.9x in 2015 and expects leverage to be sustained around 2.0x over the intermediate term if the company maintains a balanced financial strategy. FCF is forecasted to approximate $3 billion in 2015, due in part to $1.5 billion of tax benefits related to exiting Canada, and at least $1.5 billion annually thereafter. Target plans to return about $3 billion of cash to shareholders yearly, in addition to net proceeds from the pharmacy transaction, via share repurchases. Fitch believes buybacks will be partly financed with incremental debt beyond 2016.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for Target include:

--Total revenue increases approximately 1.5% in 2015, declines 2% - 3% in 2016 due the sale of the pharmacy business to CVS, and then grows by at least 2.0% thereafter;

--Comps grow 1.5% - 2.0% and new stores contribute up to 0.5% to top line growth;

--EBITDA margin approximates 10% in 2015, expands to approximately 10.5% in 2016 due to the divestiture of the pharmacy business which did not contribute to EBITDA, and is sustained above 10% thereafter. EBITDA is expected to exceed $7.2 billion in 2015 and $7.5 billion in 2016.

--FCF approximates $3 billion in 2015, due to higher earnings and a $1.5 billion tax benefit from exiting Canada, and approximates at least $1.5 billion annually thereafter.

--Total adjusted debt/EBITDAR declines below 2x in 2015 and is sustained around 2.0x thereafter.

RATING SENSITIVITIES

Positive Rating Action: Factors that could individually or collectively lead to a positive rating action include consistently strong operating momentum, represented by sustained comparable sales (comps) of approximately 2% or more with positive transaction growth and an EBITDA margin above 10%, and total adjusted debt/EBITDAR sustained around 2.0x.

Negative Rating Action: Factors that could individually or collectively lead to a negative rating action include flat to negative comps, EBITDA margins declining to or around 9% , and higher than expected share repurchases that drive total adjusted debt/EBITDAR above the mid-2.0x range.

LIQUIDITY

At Oct. 31, 2015, Target had cash of $823 million, short-term investments of $1.2 billion and a five-year $2.25 billion unsecured credit facility, which expires in October 2018. The credit facility supports the company's commercial paper (CP) program, under which there was nothing outstanding as of Oct. 31, 2015. The CP program is used seasonally to support working capital buildup. Target's liquidity is further supported by annual FCF which totaled $1.4 billion in 2014.

FULL LIST OF RATING ACTIONS

Fitch affirms Target's ratings as follows:

--Long-term IDR at 'A-';

--Senior unsecured debt at 'A-';

--Bank credit facility at 'A-';

--Short-term IDR at 'F2';

--Commercial paper at 'F2'.

The Rating Outlook has been revised to Positive from Stable

Date of Relevant Rating Committee: [February, 9, 2016]

Additional information is available on www.fitchratings.com.

Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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Contact:

Fitch Ratings
Carla Norfleet Taylor, CFA
Senior Director
+1-312-368-3195
70 W. Madison Street
Chicago, IL 60473
or
David Silverman, CFA
Senior Director
+1-212-908-0840
or
Committee Chairperson
Monica Aggarwal, CFA
Managing Director
+1-212-908-0282
or
Media Relations:
Alyssa Castelli, +1 212-908-0540
alyssa.castelli@fitchratings.com

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