Fitch Rates Target's Issuance of 5 & 10 Yr Notes 'A-'
Tuesday, June 17, 2014 08:40:00 PM (GMT)

Fitch Ratings has assigned a rating 'A-' to Target Corporation's (Target) issuance of $1 billion of 5-year notes and $1 billion of 10-year notes. The proceeds from the notes will be used to pay for a $1 billion tender for higher coupon notes maturing in 2028 - 2038, and for general corporate purposes. Fitch rates Target's Long-term Issuer Default Rating (IDR) 'A-', and its Short-term IDR 'F2'. The Rating Outlook is Stable. A full list of ratings follows at the end of this release.

KEY RATING DRIVERS

The rating reflects Target's strong competitive position in the discount retail sector and steady but recently softer performance from its U.S. business. These factors are balanced against a difficult market entry into Canada leading to sizable operating losses, with challenges ahead in turning the business around. The rating further reflects Fitch's expectation that financial leverage will moderate over the next year to around 2.3x times from 2.55x currently.

Sales were soft in Target's U.S. segment in 2013, reflecting the challenging environment facing low- and middle-income consumers, exacerbated by the data breach that was announced one week before Christmas. Target's U.S. comp store sales were down 0.4% in 2013 and down 0.3% in the first quarter of 2014 (1Q'14). The EBIT margin narrowed from 7.8% to 7.0% during 2013 due primarily to lower credit card income following the sale of the receivables portfolio to TD Bank in March 2013, as well as investments made to support multichannel initiatives. Fitch expects the challenging environment will likely continue to constrain sales growth in the near term, with U.S. comp sales growing by 1%-2% for full-year 2014, leading to modest domestic EBIT growth.

The significant shortfall in the performance of the Canadian business could constrain Target's results over the medium term, as sales volumes are much lower than initially expected. The costs associated with clearing excess inventory in Canada were a major drag on Canada's earnings in 4Q'13 and into 1Q'14. The Canadian business had EBITDA of negative $714 million in 2013, and Fitch expects EBITDA losses will narrow by $250 million - $300 million in 2014.

However, generating positive EBITDA in Canada will be a significant challenge. Assuming Canadian SG&A (net of depreciation and amortization of $300 million) of $1 billion to $1.1 billion and a 30% gross margin rate, sales in Canada would have to reach $3.3 billion to $3.7 billion, essentially double the LTM sales level of $1.62 billion, to reach a breakeven EBITDA level.

Fitch views the data breach, which was announced on Dec. 19, 2013, as a manageable issue. The negative sales impact from the data breach continued into fiscal 2014, but is starting to abate. Fitch expects other costs such as fraud reimbursement, card reissuance costs and litigation will be manageable in the context of the company's healthy ongoing cash flow.

Free cash flow (FCF) post-dividends is projected at around $1 billion beginning in 2014, supported by a reduction in capex to around $2.4 billion in 2014 from $3.5 billion in 2013 due to the completion of the Canadian store build-out. Target has guided to share repurchases of $1 billion - $2 billion in 2014, but has not given any guidance as to the cash costs of resolving the data breach liabilities. It is expected that the company will size its share repurchases based on its operating performance and the level of the data breach costs, and that debt levels will be flat for the year.

Adjusted leverage was 2.55x at May 2014 compared with 2.4x at end-2013 (Feb. 1, 2014). Leverage is expected to improve to 2.3x at end-2014 on flat debt levels and improved EBITDA to $6.6 billion versus $6.2 billion in 2013, and to drift down to the 2.1x - 2.2x range over the next few years, which is consistent with the company's long-term target.

RATING SENSITIVITIES

A positive rating action could be triggered by improved operating momentum in the domestic business, a successful turnaround in Canada, and a policy to maintain leverage at or below 2.0x.

A negative rating action could be triggered by operating shortfalls and/or more aggressive share repurchase activity that drove leverage to over 2.5x for an extended period.

Fitch rates Target as follows:

--Long-term IDR 'A-';

--Senior unsecured debt 'A-';

--Bank credit facility 'A-';

--Short-term IDR 'F2';

--Commercial paper 'F2'.

The Rating Outlook is Stable.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Corporate Rating Methodology' (May 28, 2014)

Applicable Criteria and Related Research:

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=835069

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Industries: Department Stores, Discount/Variety, Professional Services, Finance, Retail
Languages: English
Primary Identifiers: TGT-US
Related Identifiers: TGT-US
Source: Fitch Ratings
Subjects: Bond/Stock Rating