

Fitch Affirms Target's 'A-' IDR Following Announcement of Canada
Thursday, January 15, 2015 03:53:00 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 is Stable. A full list of ratings follows at the end of this release.

KEY RATING DRIVERS

As anticipated, Target announced today that it will be discontinuing its Canadian operations. Cash costs associated with exiting the business are expected to total \$500-\$600 million.

Target will also be taking a \$5.4 billion charge during the fourth quarter. The company's investment in the Canadian business included C\$1.825 billion to acquire the store leases, around \$2.5 billion of capex and \$1.7 billion of EBITDA losses to-date, for a total investment of around \$6 billion.

The disposition of this business is a credit positive as it will result in the elimination of significant operating losses and lease obligations in Canada. Carving out negative EBITDA of \$635 million in the LTM period and capital leases of more than \$1 billion results in pro forma adjusted debt/EBITDAR of 2.2x compared with reported leverage of 2.7x as of Nov. 1, 2014.

Putting Canada behind them, management will be able to focus on the domestic business where the challenge will be to return comparable store sales growth to a sustainable 2%-3% and EBITDA margins to their historical level of 10%. Fitch expects Target's near-term results will benefit from cycling against the data breach that was announced one week before Christmas 2013 and from the impact of lower gasoline prices.

Fitch believes that under the direction of a new CEO Target will focus on improving its merchandise offerings and cost structure, among other things. Fitch will consider the sustainability of any operating improvements before becoming more constructive on the rating.

Target's U.S. segment has produced soft results over the past two years. U.S. comp store sales were down 0.4% in 2013 and up 0.3% in the first nine months of 2014, reflecting the challenging environment facing low- and middle-income consumers, exacerbated by the data breach. Comp sales trends have improved over the course of 2014, with fourth quarter 2014 comps expected to be around 3% and 2015 comps expected to track in the low single digits.

EBITDA from the U.S. segment declined to \$6.8 billion, or 9.4% of sales in the LTM period from \$7 billion, or 9.8% of sales in 2013 due to an increase in promotional activity. Fitch expects U.S. EBITDA will begin to recover in the fourth quarter of 2014 as the company cycles the data breach and improve to \$7.0 - \$7.2 billion in 2015.

Free cash flow (FCF) after dividends from the U.S. segment is projected to approach \$1.5 billion going forward, excluding Canada wind-down costs of \$500-\$600 million. While management has refrained from repurchasing shares during 2014, it is likely that the company will resume repurchasing shares over the near term.

Fitch expects the company will direct its free cash flow and some incremental borrowings toward share repurchases as it manages adjusted leverage at current levels.

RATING SENSITIVITIES

The following factors, individually or collectively, could lead to a positive rating action: improved operating momentum in the domestic business, including consistent comp sales growth of 2-3%, an improvement in EBITDA margin towards its historical level of 10%, a FCF margin excluding Canada wind-down costs of 2% (which would amount to \$1.5 billion in FCF), and adjusted financial leverage of 2.0x - 2.25x.

The following factors, individually or collectively, could lead to a negative rating action: operating shortfalls and more aggressive share repurchase activity that drove adjusted leverage above the mid-2x range for an

extended period.

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 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=970555

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