Target Corporation (NYSE:TGT) Q1 2010 Earnings Call May 19, 2010 10:30 AM ET

**Executives**

Gregg Steinhafel – President & CEO

Doug Scovanner – EVP & CFO

Kathy Tesija – EVP Merchandising

**Analysts**

Bob Drbul - Barclays Capital

Charles Grom - JPMorgan

Neil Currie – UBS

Wayne Hood - BMO Capital

Robby Ohmes - Bank of America/Merrill Lynch

Colin McGranahan - Bernstein

Dan Binder – Jefferies & Co.

Deborah Weinswig - Citigroup

Jeff Klinefelter - Piper Jaffray

Peter Benedict – Robert W. Baird

**Operator**

Welcome to Target Corporation's first quarter earnings release conference call. (Operator Instructions) I would now like to turn the conference over to Mr. Gregg Steinhafel, Chairman, President, and Chief Executive Officer.

**Gregg Steinhafel**

Good morning and welcome to Target's 2010 first quarter earnings conference call. On the line with me today are Doug Scovanner, Executive Vice President and Chief Financial Officer and Kathy Tesija, Executive Vice President of Merchandising.

This morning I will provide a high-level overview of our first quarter results. Then Kathy will discuss category results, share recent guest insights, and outline upcoming merchandising initiatives, and finally Doug will provide detail on our first quarter financial results, and our outlook for upcoming quarters. Following Doug's remarks, we'll open the phone lines for a question-and-answer session.

As a reminder we're joined on this call by investors and others who are listening to our comments today via web cast. Following this conference call John Hulbert and Doug will be available throughout the day to answer any follow-up questions you may have.

Also, as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our SEC filings.

Earlier this morning we announced that our first quarter earnings per share rose 30% from a year ago to $0.90, well above our expectations at the beginning of the quarter. As we previously indicated this performance is the highest quarterly EPS in our history, other than a fourth quarter and we are extremely pleased with the effectiveness of our strategy and proud of the superb execution by our team.

Our comparable store sales increased 2.8% in the quarter reflecting the right combination of fashion and basic merchandise at outstanding prices, compelling presentation and in stocks, and outstanding services by stores' teams.

This is the largest comparable store sales increase in 10 quarters and represents a meaningful improvement from the fourth quarter of 2009.

Comparable store transactions were up more than 2% for the quarter. When guests visited our stores stronger than expected demand for categories like apparel made their trips more profitable, as the items in their baskets represented a healthy gross margin mix.

Kathy will provide additional detail on our category performance in a few minutes. In addition to strong gross margin performance, our teams turned in another fantastic quarter on the expense line. Store productivity increased even while guest satisfaction scores continued to improve.

In our credit card segment, receivables balances continued to decline while profit flowing to Target grew to almost three times last year's first quarter performance as risk indicators turned more favorable than expected in an improving economy.

Doug will provide more detail on both our credit card segment performance and our retail segment results later in this call. Clearly the economy and consumer sentiment have improved since their weakest point in 2009, but we believe that both are still somewhat unstable and fragile and will likely continue to experience occasional set backs as the year progresses.

Persistently high unemployment rates and large deficits at both the state and federal level will continue to create uncertainty and volatility. As a result we continue to be cautious regarding our sales outlook in order to prudently manage our expenses while controlling inventory on mark down sensitive merchandise.

We take this approach to mitigate our downside risks, while at the same time we work to prepare our teams to move quickly if we see unexpected strength. This is precisely what occurred in the first quarter.

Our 2010 [P Fresh] remodel program is off to a great start. During the first quarter we completed the renovation of 96 stores in 13 markets with the greatest concentration in the Los Angeles, Chicago, and Washington, DC metro markets.

Its important to note that in this quarter alone we remodeled more stores than we typically complete in an entire year. In contrast to P Fresh remodels completed in 2009, which focused primarily on food, this year's remodels include transformations throughout the store, in home, beauty, electronics, video games and in shoes, starting in July.

We continuously refine our processes with each set of remodels, leading to reduced guest disruption, shorter construction times, and effective control of remodel expenditures. And while many of these remodels have only just been completed recently the results so far have exceeded our expectations.

Our guests tell us they love the convenience and experience of the new layout and expanded grocery selection and total store sales lifts have been higher than in last year's remodels. In addition, we've seen some early indication that the changes outside of food are leading to more cross shopping.

As a result we believe that this initiative will transform our general merchandise stores insuring we remain relevant and deliver a superb shopping experience, while meeting our exceeding a return on investment expectation for capital investments in our stores.

Looking forward we'll remodel more than 240 additional stores this year with completions spread roughly equally between the second and third quarters. By the end of the third quarter we expect to have more than 450 general merchandise locations, with the P Fresh assortment and presentation.

And in many of these locations the changes outside of food are so extensive the completed renovations resemble a brand new Target store. As we've indicated previously we are on track to open 13 new Target stores in 2010, all in the second and third quarters.

Net of closings and relocations, these openings will add about 10 locations to the chain. We're particularly excited about the planned opening of our first Manhattan location in Spanish Harlem this July.

In our marketing we launched a new campaign this month, Life's a Moving Target. Leveraging our infinitely flexible expect more pay less brand promise, this new campaign has two important facets; broadcast spots that use story-telling to strengthen the emotional connection with our guests during every stage of their lives, and shorter punctuated humorous spots that suggest items from our roster of trusted brands as solutions for their every day challenges.

All aspects of this new campaign celebrate the fact that Target is the right destination for all of our guests' wants and needs at a great value, appropriately balancing both sides of our brand promise. This is an exciting time for Target. Teams throughout the organization are focused on driving innovation, transforming our stores and our merchandise assortments, and enhancing our outstanding guest experience.

They are focused more than ever on delivering both sides of our expect more pay less brand promise, consistently delighting our guests with great prices and unique merchandise in safe, well designed stores with fast, fun, and friendly service.

I continue to be proud of this team and the results they deliver every day. Now Kathy will provide detail on our guest insights' research and additional information on our merchandising initiatives.

**Kathy Tesija**

Thanks Gregg, as we look back at the first quarter we are proud that we stayed the course during the past couple of years. While we remain flexible in our tactics, we never strayed from our expect more pay less strategy, our commitment to continuous innovation, and our goal of providing a superior shopping environment with great guest service.

The dedication and discipline of our teams helped us successfully navigate the depths of the recession and today we're more committed than ever to delivering a relevant and compelling assortment that surprises guests with its quality and value.

While the economic environment remains somewhat volatile consumers have become much more confident in their ability to manage their spending and carefully select those discretionary items that satisfy their wants at a value that doesn’t break their budgets.

To be sure there are many households that continue to feel the direct impact of job loss, and other forms of financial stress resulting from the recession. However a much larger portion of our guests did feel such a direct impact from the recession but instead, became extremely cautious in their buying behavior.

Those guests paid off debt, created and stuck with budgets, and now they’re feeling optimistic enough to begin putting well-considered discretionary items back into their baskets. Many have begun to indulge in small ways with our discretionary assortment provides the perfect opportunity for them to indulge while feeling smart about the decision.

We are seeing this trend particularly in home and apparel. Guests are starting to buy clothing and accessory items for themselves. Both men and women are freshening up their casual wardrobes, replacing basic work pieces, and picking up new shoes and accessories for spring.

In our home category stagnant real estate markets are driving homeowners to make small, affordable investments in their homes such as updating their bath and bedding with new towels and sheets, or adding excitement and color to their living spaces with new decorative accessories.

Our guests are demonstrating that their eager to purchase items when the styles and price are right. Across both apparel and home our recent collaboration with Liberty of London was an undisputed success. It launched in mid-March with an offering of more than 300 items across several areas of the store that were the perfect mix of color, print, and spring time optimism.

Sales of the collection both in store and online were well above expectations and were strong in all categories, with the most popular items in women's tops and accessories, girl's dresses, table tops, and storage.

Our own brands continue to resonate with guests generating loyalty and delivering outstanding value. In the 2009 relaunch of our household commodity brand as up and up has been highly successful and this year we plan to add another 100 items.

We're enjoying similar success with the relaunch of Circo, with sales in the infant toddler category up double-digits over last year. In home guests have responded very favorably to the relaunch of both our room essentials and home brand. We've better clarified the assortments, provided more clear design esthetic, developed new packaging that highlights the most important benefits and features, and improved the quality of both lines.

Results have been outstanding with the two brands combining for a mid single-digit comparable store sales increase in the first quarter. We continue to pursue innovation at an unprecedented pace. The recession taught us to be even more creative, aggressive, and disciplined in bringing new and profitable items to our guests.

One of the most exciting innovations is our electronics and video games reinvention, which will be in all stores by the end of June. We are turning this area of the store into a cohesive electronics and gaming destination.

The new TV wall provides a compelling focal point for the department with realistic viewing angles that showcase our quality assortment. Our TV delivery and installation service continues to be enthusiastically received by our guests, both for its convenience and value.

Positioned right next to electronics the video game category remains one of the highest productivity areas of the store. Our new more welcoming environment, easier game access, better-organized assortment, and enhanced information tools are driving positive guest feedback and enhanced conversion.

Our guests are also excited that the Amazon Kindle will roll out to all Target stores nationwide on June 6. We're currently the exclusive bricks and mortar retailer for this popular e-reader which practically flew off the shelves during our 100-store test.

Guests love this product because its fits their busy lifestyles, allowing them to get all the news and books they want most in one incredibly light, portable, easy to read product. We continue to pursue compelling cross merchandising offerings particularly when they tie into the hottest entertainment releases of the season.

In toys we've created a must see in store destination for guests interested in the latest and greatest theatrical releases like Iron Man 2 and Toy Story 3. This fresh approach to merchandising movie releases creates a store within a store environment with movie related product including toys, clothing, bedding, and video games centralized in a boutique like experience.

Our commitment to differentiation is as strong as ever. We are excited that Caldrea, the luxurious brand of household products has developed a line that's now available at Target stores nationwide. The Caldrea Essentials collection is affordably priced, from $5.99 to $19.99, and offers our guests superior cleaning products and candles in luxurious scents for their entire home.

In fashion our collaboration with red carpet design favorite Zac Posen, launched in late April, with 44 pieces ranging from $16.99 to $200.00. We worked with Zac to create a collection that is fresh and fun reflecting his esthetic, lux fabrics, and modern pop culture.

Also currently in stores are the fantastic lines from Cynthia Vincent and Eugenia Kim. Cynthia's limited edition footwear collection launched mid April and will be available until July. Eugenia Kim's collection of timeless hats is the first of its kind at Target and will be available mid April through the end of June.

And we're looking ahead to the back to college and back to school season when Target will be ready with the right assortments at the right price in a compelling and easy to shop environment. This critical season is an important opportunity for us to win the loyalty of our newly independent guests and create life long Target fans.

We experienced great success even in last year's challenging environment and anticipate more favorable results this year. We'll drive this momentum by providing must have items at affordable prices keeping our college guests coming back to Target for all their wants and needs.

We are also focused on further cross channel innovation including the development of new mobile features and intelligent shopping tools that allow our guests to easily manage their budgets and plan store trips. We are extending our lead in mobile retail with an aggressive roadmap for innovation.

In March we announced that Target is the first retailer with the scanning technology at checkout to the gift card and coupon barcodes on mobile devices in all our stores nationwide. And in April we introduced the ability for guests to create lists and manage registries using their mobile devices.

At the same time we launched a new feature to the iPhone app that lets guests scan items and search for product availability at other Target locations, access rating reviews, view extended assortments, and add items to a gift registry or list.

The changes we've made in response to the recession have positioned us to perform better in this and any economic environment. We remain focused on the most important factor driving our business, our guests, by delivering the quality and value they crave, the products they want and need, in stores that are clean, well organized and efficient to shop, we will reinforce our standing as their trusted friend in both daily essentials and pleasant surprises.

Now Doug will provide more detail on our financial performance and expectations for the second quarter.

**Doug Scovanner**

Thanks Kathy, in my remarks today I plan to review our first quarter results in both business segments, and then I'll provide my perspective on our outlook for the upcoming quarter and the remainder of the year.

As Gregg outlined our first quarter financial performance was well ahead of our expectations, as both of our business segments well exceeded their respective profit plans. Beyond a comparison to our own expectations, our consolidated performance was also remarkable in comparison to our past results as our 2010 first quarter EPS of $0.90 was $0.08 higher than our results from continuing operations in any other non-holiday quarter in our history.

In our retail segment sales increased 5.5% due to a 2.8% increase in comparable store sales and a similar contribution from our new stores. Year over year same store traffic trends were up 2.2% driving about 3/4 of our comparable store sales increase.

By any historical standard, this is a very healthy traffic trend. Our gross margin rate was 31.3% of sales, half a point above last year's strong performance and it reflected a new first quarter record. The year over year increase in gross margin was entirely the result of rate increases within categories.

In other words the impact of sales mix on our gross margin rate was essentially neutral because the pace of sales in our higher margin categories was in line with the pace in lower margin consumable and commodity categories.

We've experienced this kind of sales mix dynamic occasionally in the past, yet it has never lasted for very long because of the essence of our long-term traffic building growth strategy. Retail segment SG&A expenses were 20.6% of sales in the first quarter reflecting 30 basis points of favorable leverage.

This improvement was primarily the result of continued productivity improvements in our stores. We also recorded all time records in reported first quarter retail segment EBITDA and EBIT margin rates as gross margin and expense rates both improved and these improvements more than offset the deleveraging of depreciation and amortization expense.

In our credit card segment we enjoyed a sharp increase in all of our measures of profitability and returns on capital, as a direct result of a rapid improvement in several key risk metrics. In particular favorable trends in delinquencies give us confidence that the likely future write-off experience resulting from new credit extended in the quarter will be significantly improved from our current write-off experience.

As you know a few weeks ago we announced that we've begun to offer only the Target credit card to qualified applicants, although we will continue to service the five million active Target Visa accounts outstanding today and these accounts will likely continue to make up the vast majority of our receivables portfolio for some time to come.

We've made this decision after reviewing the results of a carefully drawn parallel test in which we learned that in the current environment new credit card guests spend considerably more in our stores when issued a Target credit card as opposed to a Target Visa card.

Separately we continue to measure the results from our Kansas City and San Antonio test markets in which we're piloting a totally different and greatly simplified credit card rewards program. Incremental sales results remain especially intriguing in Kansas City.

The Card Act which became law last year, reduced the number of tools we and other card issuers formally used to differentiate pricing to accommodate lending to different pools of borrowers with varying risk characteristics. Of course this has had the direct impact of reducing the availability of credit to American households.

Yet another layer of new restrictions from this Act take effect this August which will reduce our late fee income from that point forward. For reference, late fees contributed a little over three percentage points of annualized pre-tax yield in our portfolio in the quarter.

Turning to briefly to generation and application of cash, in the first quarter we generated nearly $1.2 billion from our operating activities, up about 16% from last year's first quarter. Together with $1.6 billion of marketable securities on hand at the beginning of the period, we applied these combined resources during the quarter to retire about $1.2 billion of debt, to invest a little more than $400 million of capital to grow our core business and to invest just under $400 million in our ongoing share repurchase program.

At the end of the quarter we continued to have about a billion dollars of immediate liquidity on hand. Now let's discuss our prospects for the second quarter and the remainder of the year. Our sales results so far in May are running somewhat behind our expectations for a low to mid single-digit increase.

Through two weeks we're essentially flat to last year yet we do not believe this two weeks sales performance will hinder our ability to generate comparable store sales in the 2% to 4% range in the second quarter and in the fall season as well.

On the gross margin line, we expect to return to some moderate rate pressures as the year progresses as we expect to experience a more typical impact of sales mix than we enjoyed in the first quarter.

We expect to offset some or all of this gross margin rate issue with continued productivity improvements in our stores, and through other means. Of course quarterly data will naturally reflect more volatility than annual data due to the relative impact of generally non-recurring items, and year over year timing differences.

Notably in the second quarter we expect a roughly neutral year over year SG&A expense rate due in part to a retiming of marketing expenses within 2010. As a reminder our second quarter results will also reflect an increment of accelerated depreciation due to our 2010 remodel program.

In our credit card segment we expect many of our first quarter trends to carry into future quarters, specifically we expect a continued decline in our receivables portfolio and we expect to sustain meaningful year over year improvement in bad debt expense throughout the remainder of 2010 followed by declining net write-off experience as well.

This late fee issue I described earlier will offset some of this good news. Final late fee regulations are well, late. I guess that's because no regulation currently governs the timing of issuance of regulations. The bottom line here is that today we can only estimate the likely impact. As a general rule we think that up to about half of our late fee income is likely to go away and that compares to the $59 million we recorded in the first quarter.

I have one final comment on financial reporting in this segment before turning to our consolidated outlook, we retired our last remaining publically traded receivables backed securities in the quarter and as a result we will no longer be filing monthly 8-K reports reflecting the performance of our receivables portfolio.

Since some of you seem to want more frequent than quarterly reporting of credit card risk metrics, we will begin posting on our website a monthly series of our credit card delinquency statistics. Generally we expect to provide this fresh data on the same day we release monthly sales statistics, beginning next month.

Now let's spend a moment on our expectations for earnings per share in the upcoming quarter and for the remainder of the year. The current first call medium estimates are $0.91 for the second quarter and $3.81 for the year. Based on our outlook in each of our two business segments these are both reasonable single point estimates for our future performance as of today.

Now Gregg has a few brief closing remarks.

**Gregg Steinhafel**

We're very pleased with our first quarter performance and believe it validates our strategy. We are confident that we have the right plans in place and the right team to implement them. While the pace of the current economic recovery will continue to effect consumer spending behavior, we're optimistic about our ability to deliver strong results and to continue to create meaningful shareholder value over time.

That concludes our prepared remarks, now Doug, Kathy, and I will be happy to respond to your questions.

**Question-and-Answer Session**

**Operator**

(Operator Instructions) Your first question comes from the line of Bob Drbul - Barclays Capital

**Bob Drbul - Barclays Capital**

The first question I have is on the May results, on the May sales trends that you talked about, can you just maybe elaborate a little bit more in terms of what you think is happening in the back half of April for you and then sort of month to date, I guess from a broader perspective.

**Gregg Steinhafel**

I would just tell you that as we've said all year its going to be volatile. There is going to be good months, bad months, and some ups and downs and I think we're seeing an environment where that kind of volatility and unpredictability is just playing out in the consumer environment.

We cited a number of consumer facing issues that I think are weighing on the minds of consumers and I think that from our perspective we're going to continue to see this throughout the balance of the year. We're going to find good weeks, bad weeks, good weeks, and bad months.

**Doug Scovanner**

Separately as you know we don't like talking about the weather, but in a period of time as short as the period you're focused on, the weather can never be ignored and the weather wasn't very good during the first two weeks of May. Now, I'll quickly observe as I have many times before that over time on average the weather is average.

So, you shouldn't hear us talking much about the weather except when questions are asked about such a short period of time.

**Bob Drbul - Barclays Capital**

On the credit card business when you look at the spread of the charge-off rate versus the bad debt expense do you think that that spread is sustainable for the next several quarters.

**Doug Scovanner**

I hope not because I expect and hope that the net write-off dollars will come down to approximate our quarterly provisioning within the next several quarters. So, in short, the provision in the quarter, the expense in the quarter give or take $200 million is well below the charge-offs in the quarter but I expect that our net write-offs per quarter will be closer to $200 million than $300 million beginning in the second quarter, beginning right now.

**Operator**

Your next question comes from the line of Charles Grom - JPMorgan

**Charles Grom - JPMorgan**

Let me ask Bob's question a little bit differently, if receivables are going to be say $7 billion at the end of the year and presumably going, potentially meaningfully lower in 2011, what do you think the appropriate balance would be for allowance for doubtful accounts at the end of the year.

**Doug Scovanner**

Well our allowance for doubtful accounts was 12.7% of receivables at year end, one quarter ago, and 12.8% of receivables right now. So essentially the allowance in the quarter moved directly in line with the reduction in receivables.

If risks unfold during the year, consistent with the significant improvement that we've seen here in Q1 then of course that percentage will fall perhaps by a couple of percentage points at the outside. I still expect even under the most rosy outlook that the allowance as a percentage of gross receivables will still be a double-digit percentage by year end.

Now having said that last year we saw pretty significant improvement in risks early and then the improvement in risks slowed down measurably so I think it's a bit premature to be thinking about much of a significant change in our allowance as a percent of gross receivables from the current 12.8% figure.

**Charles Grom - JPMorgan**

When we last spoke you noted that Wal-Mart, their roll back in [inaudible] and the price gap was in the low double-digits in a number of items on rollback had increased modestly, I was wondering if any of these figures had changed and if you could kind of speak to the competitive environment particularly given that Wal-Mart's taken another step down on their deep rollback campaign.

**Gregg Steinhafel**

Well nothing has really changed since we talked. The rollbacks at Wal-Mart announced earlier were really for a period of 90 days so we're in the early stages of that. The competitive environment continues to be aggressive but reasonable like it always is. Its generally very competitive and that continues to be so but we have not seen any meaningful change in what Wal-Mart has done over the last 30 or 60 days.

**Operator**

Your next question comes from the line of Neil Currie – UBS

**Neil Currie – UBS**

First of all a number of retailers have been talking about increasing sourcing costs coming in the second half of the year and now this may apply more to next year as I'm sure your apparel sourcing is already underway for the rest of this year, but I wondered what your outlook was on sourcing costs coming out of Asia and also what your attitude could be towards passing through price increases.

**Kathy Tesija**

So you are correct there are costing pressures coming through and its on a number of different categories from cotton to paper, copper, synthetic fabrics, even transportation. But what we have booked for the fall, or coming for this fall is we don't have cost increases coming so perhaps late fall or if we start chasing products there might be some increases to that.

But certainly in the spring I think we will start to see some of the cost increases come through. And we'll have to look at each product category independently, how large the increase is, and then whether or not we will pass it along or try to reengineer the product to keep the retail and the margin where it is.

But we will start to see some cost increases in receipts that will hit in spring, 2011.

**Neil Currie – UBS**

And about employee expenses, you did a great job last year, the last 18 months really of reducing employee expenses, I wonder as sales recover or continue to recover whether you still feel that service levels are good or whether you might have to start increasing some labor hours in the stores.

**Gregg Steinhafel**

The labor hours in the stores are going to be reflective of the performance and the sales within the stores, so we're focused on expense management, productivity management, improving efficiencies within our supply chain but as the recovery, assuming the recovery continues to proceed and sales continue to improve we'll had to add some variable labor within our stores to accommodate increases in sales.

But its our intentions to still manage our expenses tightly and make sure that we are leveraging the sales performance that we do get. We're not seeing any labor rate inflation at this particular point in time nor do we expect to see that for the foreseeable future.

**Doug Scovanner**

We're enjoying the double benefits of wonderful improvements in productivity inside our stores, and experiencing record high guest service levels and we intensively measure those service levels through the eyes of our guests.

**Operator**

Your next question comes from the line of Wayne Hood - BMO Capital

**Wayne Hood - BMO Capital**

I had a question related to the credit business, what impact if at all will be the changes in the credit card offer that you have now, exclusively the Target card, on the third party merchant fees which has been about $100 million, if at all anything.

**Doug Scovanner**

Well as you know we earn those third party merchant fees when our Target Visa cards are used anywhere else Visa is accepted, at Wal-Mart for example, and elsewhere, we profit from that merchant fee when the Target Visa card is used.

Over time that certainly will reduce that line item will reduce in line with Target Visa balances but at the moment I would not expect that the yield impact, the impact on profitability and return on capital is likely to change.

**Wayne Hood - BMO Capital**

And my second question related to credit is the late fee impact, you talked about if I think I heard you correctly, maybe 50% and I'm wondering as you roll that into 2011 and you get a full year of that, could we be looking at late fee income that might approximate $150 million or how are you thinking about as you roll that into the full year 2011 and your ability to offset some of that erosion.

**Doug Scovanner**

Well in isolation of course the late fee income impact is just in line with what you're laying out, your math is good. But of course the reaction of all card issuers, not just Target is to reduce the amount of credit available to the lower end of the file, to the lower end of the portfolio, where we can no longer recover sufficient late fee income to make sense out of lending.

So the quite direct impact of the Card Act is to significantly reduce the availability of credit to American households, so, we'll essentially offset that through underwriting and risk management by enjoying a better write-off and bad debt expense experience by no longer lending to pools of households with those kinds of risks.

**Wayne Hood - BMO Capital**

Some of the success you're seeing right now, essentially in apparel area, are you thinking about that rather than having these swing through a particular season, maybe adding them to the assortment on a more sustainable basis because demand is so strong, you've done that with some things in the past. I'm just wondering if there are things that we should be thinking about that you could bring in that's more sustainable.

**Kathy Tesija**

I think the beauty of the programs that we've brought in have been the fact that they are limited time and that we're able to fit them to the season with the right esthetic as well as the right color pallet and apply them to the right merchandise. So if we talk about Liberty it was the perfect scenario in the spring. It was very optimistic, the colors were really bright and cheerful which lended themselves well to Liberty's print and pattern.

So we like the ability to be able to move through different designers or partnerships that really help us to keep our content fresh and so certainly when there are successes we analyze what worked and what didn't and try to apply those to the future but in terms of keeping any of those on a long-term basis, we're committed to having some designers that are long-term which you're well aware of in our portfolio, but to keep that freshness going as we roll through some of the limited time offers.

**Operator**

Your next question comes from the line of Robby Ohmes - Bank of America/Merrill Lynch

**Robby Ohmes - Bank of America/Merrill Lynch**

I just wanted to clarify given what your guests are doing are you seeing within categories I think you said they're reaching more or opening up their wallets or whatever, are they up scaling their purchases, are they trading back up in price points within categories and then the second question I had is just on the remodels you have been doing even through the first quarter here, is there any negative impact on comps as the remodels are being done and also you commented on the performance being above planned, is the food lift exceeding expectations as well, the P Fresh component, or is it really home, beauty, electronics, video games, etc., that's really doing stronger post remodel than you thought.

**Kathy Tesija**

So the first question on whether or not we're seeing trade up, all along we have had higher end product that has done well and an example would be C9 which is our highest quality in apparel and it has done well throughout the recession. But in general I would say there's not a resurgence to trading up to more products like that, I would say that its more about guests feeling a little bit more comfortable putting an extra discretionary item in their basket.

So we're seeing those mixed trips where they're buying needs and wants starting to increase. Your second question about remodels, and is there any negative to sales, when we start the remodel there is a negative impact to sales as we disrupt the stores, but that's being offset by the sales that we're experiencing once they are set.

So there isn't a negative. And in total all areas are up at or expectation or above which would include food as well as the others you mentioned like home and beauty.

**Doug Scovanner**

We've previously disclosed that we expect the net impact of this remodel activity for the year to add about one full point to our reported same store sales performance during the first quarter. That net figure was between two and three tenths of a percentage point because the mix of course of stores that are under duress being remodeled is a much larger factor relative to the number of stores that have been remodeled and are producing the strong results we've described.

**Gregg Steinhafel**

The last comment I would make, this is in aggregation and really these remodels, store by store situation in some cases we see very little disruption because of the fact that the store happens to be newer and there's less reconstruction within the stores. In other cases in older stores or where we might have an older format or multiple entrances or multiple levels, the extensive nature of that reconstruction is more disruptive and we'll see a fairly significant dip in the short-term as we really transform that store.

But in aggregate we've seen in the neighborhood of about 5% disruption in 2009 and as we go into 2010 we're getting better and better at this remodel process and have already seen our ability to reduce that aggregate disruption below what we experienced last year. But you might see some varying levels, you will see varying levels of disruption depending upon what store you go in and at what point of that remodel.

**Operator**

Your next question comes from the line of Colin McGranahan - Bernstein

**Colin McGranahan - Bernstein**

First question, it looks like the units per transaction were up nicely, about 1.3%, but the AUR was off about 0.7% in the quarter and I just would have thought with the mix and some of the increase in discretionary categories that you would have been seeing maybe a little bit more positive, so can you help me understand the decline in average unit retail and what's driving that.

**Kathy Tesija**

Its really in a variety of categories and I think some of that is just lower retails where we have invested our cost savings into products. For example in kid's we have lowered our retails in kid's making it more affordable for our guests.

There's other categories like in our decorative home area or seasonal, less patio full sets and more casual seating which would lower the price point. And then there's areas like stationary where we've added say $0.99 cards to our assortment just to offer a better opening price point as well as the high end Papyrus cards and so there's I think some shifting between good, better, and best that we're seeing and it varies, the reasons vary by category.

**Gregg Steinhafel**

The other thing that I would add is that there is starting to be a little bit of a mix impact due to P Fresh now that we have 200 stores. We are going to continue to see in those particular stores a greater unit sale and a less price per item and that particular impact in the first quarter, it wasn't significant but it would have shifted the overall numbers to be more closely aligned to being up slightly in terms of the units per transaction and essentially flat in terms of dollars, the amount of dollars per unit.

**Colin McGranahan - Bernstein**

And then I know there's some advertising mix shift going on here, 1Q to 2Q but if we look at 1Q it looks like your leverage per point of comp was about eight basis points of SG&A leverage per point of comp, is that something you think is a reasonable rate to think about and I guess another way of asking that would be where's the break-even leverage given just run rate cost increases and what's leverage look like above that.

**Doug Scovanner**

Well there are a lot of factors that go into any quarter so I don't like making the generalization out of any individual quarter's results, but looking across the year give or take our point of SG&A leverage is in the range of a two comp, perhaps a little lower.

So maybe we call that a one to two comp as the point of neutrality. And generally speaking this is a shorthand, all shorthand's ultimately break down at a detailed level, but generally speaking half of our expenses vary with sales, up or down from that point and half are fixed and so you can calculate the basis points from those figures.

**Operator**

Your next question comes from the line of Dan Binder – Jefferies & Co.

**Dan Binder – Jefferies & Co.**

Just a question on your comments around P Fresh and starting to see some cross shopping, I was just curious is that only in the stores that you remodeled this year or are you seeing it in the stores that you remodeled last year as well.

**Gregg Steinhafel**

The primary increase is in the stores that we've remodeled this year. Just to refresh your memory of the 108 stores that we remodeled last year, virtually all of them, the reconstruction in those stores were focused on expanding the food side of the business. As we rolled into 2010 we are focusing more completely on the entire store.

So the first two cycles of remodels that we just completed has the destination beauty, has home, has electronics, has video games, and some new visual elements throughout the stores and its in those stores that we're seeing the improvement in cross shopping.

Ultimately we'll go back to those stores that we remodeled last year and we will be adding those elements as well and we would expect to see improvements in cross shopping in those discretionary categories once we complete those elements as well.

But we're very encouraged. Now again it's a little early, we've only got 96 stores that we've completed in our first recycle this year but we've seen a nice bump in those categories as we've really focused on improving the experience and the visual impact and presentation in those stores.

**Dan Binder – Jefferies & Co.**

And then so I assume its too early to say it might have a greater impact on sales than you're originally thinking.

**Gregg Steinhafel**

No within our modeling we've assumed all along that there was going to be a slight uptick in the discretionary spending. We laid that out for you in January, but it wasn't very modest. We were not expecting an uptick and what we have seen so far this year has been very consistent what our expectations were.

**Doug Scovanner**

This is also the context here is everything. This is a quarter in which our overall chain wide sales of higher margin merchandise moved in line with the chain wide sales of lower margin merchandise. Just as our experience over time in new stores has shown us when the chain is doing well, newer stores end up reflecting an exaggerated version of what's happening in the chain.

I think that our experience in P Fresh should be interpreted in that same context.

**Dan Binder – Jefferies & Co.**

There was some legislation I guess that got passed in the Senate last week regarding debit fee cuts, I know its early but is there any sense as to how that might help you.

**Doug Scovanner**

Well early is certainly the right word, that legislation has not passed the Senate. What you're referring to I believe is an amendment that passed that is attached to some proposed legislation that has not yet passed the Senate and the Bill that passed the House has no parallel feature in it.

Obviously we and all other retailers would benefit if that legislation were to pass given the hotly competitive nature of retailing in the United States. It is a virtual certainty in my mind that the vast majority of that benefit would be passed along to consumers, to our guests and customers of all other retailers.

But it's a long way from being a law at this point even though it's a law that makes good sense to me from a public policy standpoint.

**Operator**

Your next question comes from the line of Deborah Weinswig - Citigroup

**Deborah Weinswig - Citigroup**

Congratulations on a fantastic quarter, in terms of the Kansas City test, are you seeing a greater frequency of visit from those cardholders in addition I would assume to a greater ticket and at what time would you decide to rollout the test further.

**Doug Scovanner**

Most of the increase, substantially all of the increase is due to a higher frequency as opposed to a higher average ticket but nonetheless the increase is substantial enough to make it quite intriguing to consider relative to the fact that we are discounting sales that otherwise would have occurred in many sales that otherwise would have occurred at full price.

Its also comforting from an analytical standpoint to see that the pace of sales increase seems to be sustained. So we're not seeing any kind of drop off at all in year over year trends and now we're of course beyond six months into the test in both Kansas City and San Antonio.

Certainly we'll be carefully looking at these results here in the short-term and we will need to decide very soon whether we would want to do something on a much broader scale or alternatively other test markets because of the lead times involved to get something like that launched in time for the holiday season.

**Deborah Weinswig - Citigroup**

And would you say that you're surprised in the difference in experience between the San Antonio and Kansas City markets.

**Doug Scovanner**

Well reasonable minds can differ on that one, that's after all why we produced two very different tests but in hindsight perhaps it sounds like common sense that 5% off every item every day at point of sale seems to be quite sufficient to ultimately overcome any perceptions about purchase price as it relates to behavior of guests in our stores and 3% for whatever reason does not move the needle nearly to the extent that 5% does.

**Deborah Weinswig - Citigroup**

And then you mentioned I guess within a fairly short timeframe that all stores will have video games and TV wall, how should we think about the pace of rollout of destination beauty, home, and shoes in terms of reinvention, and why are the paces of rollout, why do they differ between the different reinventions.

**Kathy Tesija**

So you're correct the video game and TV wall will all be installed by the end of June and the simplicity with that is that's its all contained within one area of the store so as that area is transitioning we will put that all in. Home and beauty are a little bit more disruptive.

They are larger changes and more gondola movement and things like that and so that will happen with the P Fresh remodels so that the store is only disrupted once as they go through that remodel, they'll do all of the rest of it together.

And that would include the shoe reinvention which comes, starts in July in all remodels going forward.

**Deborah Weinswig - Citigroup**

And I don't know if this question is necessarily the appropriate one to throw your way but I was in a lot of stores recently and during the tours the store managers and district team leaders have talked about store segmentation opportunities which I haven't heard in the past, is that just kind of a new terminology or a new opportunity, maybe you can elaborate on that.

**Gregg Steinhafel**

I think its more a terminology change than anything. We've been micro marketing and trying to customize our assortments for many, many years and we have. I think as broadly as apparel and as narrowly as making sure that shovels are in northern climate stores and not in Florida or Texas. As we have applied new technology and become more sophisticated we have really evolved into a segmentation model where we're thinking more broadly about demographic, [cycle graphics], brands, and what is selling, urban markets, rural markets, and thing like that.

So it's a more holistic approach. This is a journey not a sprint. This is something that is going to take many, many years for us to really continue to refine and refine and refine but we're committed to it. We've seen good results from our efforts thus far.

And we believe it's the appropriate thing to do. As you know you go into, food is very localized so as you go into P Fresh remodels you'll see a food assortment that varies differently from Texas to San Antonio to Boston and that's part of that segmentation effort.

**Operator**

Your next question comes from the line of Jeff Klinefelter - Piper Jaffray

**Jeff Klinefelter - Piper Jaffray**

On new store growth, kind of just thinking ahead 2011 and beyond, any movement at all yet in the commercial development activities and/or anything else, any other visibility in terms of going into some urban markets that might change your growth trajectory and then just international, any updated thoughts on your plans and timing on that front.

**Doug Scovanner**

I'll start with the store growth expectations and let Gregg address the international aspect of the question, no, our outlook has not changed and that means that this year we expect to open 13 gross, 10 net stores and we expect that this year 2010 will be the low point in our development activity but it will be a long, long time before we approach the kinds of development pace that was firmly in place here several years ago.

So, that translates to who knows 20 or more stores next year perhaps, maybe some more in 2012 but generally speaking the large scale retail development in this country remains at very near absolute zero and so we are left to self-develop individual store sites that make economic sense.

**Gregg Steinhafel**

And regarding the question international, no new news to report there. Really we're doing the research and at some point in time we feel that we will be international but clearly in the near-term, in the zero to three, zero to five years, we're focused on really, the most important priority we have is really transforming our existing large base of general merchandise stores and making sure that P Fresh and all the related reinventions and the visual elements gets implemented through the 1300 stores that aren't super Targets, and so that is our highest priority right now and then as Doug mentioned we're going to continue to open new stores as we have in the trade areas that make sense, with the formats that we currently have.

And then three, we're looking at really trying to be more flexible with our prototype and take advantage of opportunities where there's great demographics and trade areas where our current formats simply just don't work because they're too large and we're looking at down sizing Target to fit the environment where there are guests that have lots of money and love Target and so we're focused on that as our third priority and then international would come well beyond that.

**Doug Scovanner**

We have the capital to be able to grow much, much faster. We have the capabilities, team and otherwise to be able to grow much, much faster. There are hundreds and hundreds and hundreds of trade areas in the US, maybe even more than a thousand that are suitable for Target stores that don't have one yet but this is all a matter of finding the right development opportunities that end up making economic sense to us, end up making sense on an overall basis in the communities we aspire to serve.

**Operator**

Your final question comes from the line of Peter Benedict – Robert W. Baird

**Peter Benedict – Robert W. Baird**

Thinking about the improved sales and profits you've seen lately across both retail and credit how has it looked on a regional basis across the country, specifically I'm interested in maybe places like Florida, California, have behaved on this recovery versus the rest of the country.

**Doug Scovanner**

Well as you know in both of our segments those two states in particular declined a lot more than others. Our sales in Florida for example went soft well before our sales went soft in the rest of the country. California I would put an asterisk, it is certainly a state, but it behaves in large part like three different states, where the economy and our sales and our credit card experience in the Bay area is remarkably different from the economy and our sales and our credit card experience in the inland empire and central valley, the latter geography far more challenging than any other part of the state of California and as challenging as some of the most challenging geography that we’ve operated in the country such as Las Vegas.

At the moment trends in those areas are mixed candidly. Florida certainly has shown signs of stability and the beginnings of potentially of a recovery. The best I can say about some of those other geographies is they’re not nearly as challenged as they were and aren’t deteriorating, but by no means reflecting strength at this point.

**Gregg Steinhafel**

That concludes Target’s first quarter earnings conference call. Thank you all for your participation.