

Target (NYSE:[TGT](#)) Q3 2012 Earnings Call November 15, 2012 10:30 AM ET

Executives

Gregg W. Steinhafel - Chairman, Chief Executive Officer and President

Kathryn A. Tesija - Executive Vice President of Merchandising

John J. Mulligan - Chief Financial Officer and Executive Vice President

Analysts

Deborah L. Weinswig - Citigroup Inc, Research Division

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Mark R. Miller - William Blair & Company L.L.C., Research Division

Mark Wiltamuth - Morgan Stanley, Research Division

Christopher Horvers - JP Morgan Chase & Co, Research Division

Gregory S. Melich - ISI Group Inc., Research Division

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

Charles X. Grom - Deutsche Bank AG, Research Division

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Matthew R. Nemer - Wells Fargo Securities, LLC, Research Division

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Target Corporation's Third Quarter Earnings Release Conference Call. [Operator Instructions] As a reminder, this conference is being recorded Thursday, November 15, 2012. I would now like to turn the conference over to Mr.

Gregg Steinhafel, Chairman, President and Chief Executive Officer. Please go ahead, sir.

Gregg W. Steinhafel

Thank you. Good morning, and welcome to our 2012 Third Quarter Earnings Conference Call. On the line with me today are Kathy Tesija, Executive Vice President, Merchandising and Supply Chain; and John Mulligan, Executive Vice President and Chief Financial Officer.

This morning, I'll provide an overview of our third quarter results and highlight some of our enterprise strategic priorities, and Kathy will discuss category results, guest insights and upcoming initiatives. And finally, John will provide more detail on our third quarter financial performance, along with our outlook for the remainder of 2012. Following John's remarks, we'll open the phone lines for a question-and-answer session.

As a reminder, we're joined on this conference call by investors and others who are listening to our comments today via webcast. Following this conference call, John Hulbert and John Mulligan 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.

Finally, in these remarks, we refer to adjusted earnings per share, which is a non-GAAP financial measure. A reconciliation to our GAAP results is included in this morning's press release posted on our Investor Relations website.

We're very pleased with Target's third quarter financial performance, which we announced earlier this morning. Our U.S. operations generated adjusted earnings per share of \$0.90, above the midpoint of our guidance and 4.3% above last year's very strong performance.

Our third quarter GAAP earnings per share increased 17.6% to \$0.96, as dilution related to our Canadian segment investments was more than offset

by favorable tax items and a gain on the pending sale of our receivables portfolio.

Our U.S. Retail segment generated third quarter comparable-store sales growth of 2.9%, in line with our guidance going into the quarter. And this segment generated an EBIT margin rate a bit ahead of expectations, matching our very strong profit performance in the third quarter of 2011. This profit performance reflects the continued benefit of thoughtful and disciplined expense management throughout the organization.

For the last 2 years, we have relied on this discipline to offset gross margin rate investments we've made in our 2 most visible growth strategies: 5% REDcard Rewards and our PFresh remodel program. I want to thank our team for reliably delivering on this expectation quarter after quarter, successfully controlling expense growth while continuing to provide an outstanding experience for our guests.

We also remain focused on improving our online shopping experience, which has resulted in robust growth in online sales and meaningful increases in guest satisfaction scores. In addition, as we further increase the functionality and ease-of-use of our award-winning mobile apps, we continue to generate rapid growth in the mobile channel.

We've rolled out free in-store WiFi across the chain, allowing guests to research products and use our apps while they're shopping in our stores. And we'll continue to integrate digital features into our fourth quarter marketing, incorporating QR codes in our store signing and marketing vehicles. Looking ahead, we will continue to invest meaningful resources to ensure our stores, online and mobile platforms provide a seamless experience that allow our guests to engage with us, wherever and whenever they choose.

We continue to be pleased with initial results from our newest format in the United States, CityTarget. After 2 additional third quarter openings, we now have 5 CityTarget stores operating in 4 different metropolitan areas:

Chicago, Los Angeles, San Francisco and Seattle. As expected, initial traffic to these stores have been strong, while gross margin mix has been slightly better than expected. The CityTarget team has done an outstanding job, accomplishing a virtually flawless launch of this new format. We plan to open 3 more CityTarget locations in 2013.

Our U.S. Credit Card segment delivered another outstanding quarter, with risks at historically low levels and profitability near historic highs. In addition, following extensive efforts, we were very excited about this quarter's announcement of our agreement to sell our Credit Card portfolio to TD Bank Group, accomplishing all of our goals for a sale, including moving the assets off our balance sheet, maintaining the deep integration between our Retail and Credit Card operations, continuing to earn the majority of profits generated by this high-quality portfolio and importantly, finding the right partner who will be aligned with our goals for portfolio growth and profitability. We're pleased to be working with the outstanding management team at TD Bank, and we look forward to closing this transaction in the first half of 2013.

In our Canadian segment, we're moving forward in our efforts to open our first stores by next April. We now have 45 stores under renovation, and we have 1 distribution center operating and another one scheduled to come online soon. And we are on track with implementation and testing for our Canadian segment technology platform.

Most importantly, we continue to be very pleased with the quality of talent we are hiring for our Canadian team, both at headquarters and for our stores organization who will serve as the primary ambassadors for the Target brand. While there are many significant milestones to come, we feel very good about our ability to open our first Canadian stores on time, on budget and on brand.

As we look ahead to the fourth quarter, we feel very good about our ability to deliver inspiring merchandise, most wanted gifts and unbeatable value,

while also generating expected profitability. Our stores are ramping up their preparations to deliver a Target brand experience on Thanksgiving weekend, delivering must-have items at incredible prices for an event which promises to be bigger than ever. Following that weekend, we will launch a series of merchandising and marketing plans designed to sustain excitement all the way to Christmas, with our groundbreaking partnership with Neiman Marcus at the top of the list. Kathy will provide more detail in a few minutes, but with more than 2 billion media impressions already, this event is clearly creating a lot of excitement.

While programs like Neiman Marcus event continue to elevate the Expect More side of our brand promise, we know that it's crucial for Target to continue to combine differentiation with unbeatable value. That's why we're very pleased to announce our new online price match and extended Holiday Price Match at our media event last month. These programs are yet another way we work to assure our guests that they can feel good about shopping at Target. The fact that we can offer these programs convey our confidence in Target's prices, which are consistently low every day and even lower when we run a promotion. These programs, along with our ongoing price match guarantee and 5% Rewards, allow our guests to shop at Target, a store they love, with the confidence that they're getting the very best deal.

And importantly, price matching is fully integrated into our overall profit plan for the fourth quarter. As you know, every year, we invest aggressively in price to provide value during the holiday season. Our price matching programs complement our holiday promotional plan, and we believe they are a smart way to invest in price to deliver compelling value for our guests.

While we continually look for ways to broaden our reach and appeal to a wider set of guests, we believe our first and best opportunity lies in deepening our relationship with our core guests, earning additional trips and spending from them. A prime example is 5% REDcard Rewards, which motivates our current guests to shop at Target much more often, generating

an average sales increase of more than 50% in households that begin using a REDcard.

This program turns less-engaged guests into some of our best guests, and makes our best guests even more valuable. We're on pace to add over 3 million credit and debit accounts this year, creating a powerful platform to provide additional loyalty features. For example, last month, we announced that in addition to saving 5% on every purchase in stores and at target.com and earning free shipping on all target.com purchases, REDcard holders will now receive an extra 30 days to return their purchases, if needed.

Guest response to 5% Rewards continue to exceed our expectations, as penetration of sales on our cards rose to a record 14% in the third quarter. This is nearly 3x the 5.5% penetration we experienced 2 years ago in the third quarter of 2010 when we launched the program nationwide.

Similarly, our PFresh remodel program, which launched in 2009, was a result of research with core guests who told us they would shop at Target more often if we provided them a more compelling food assortment, including perishables. The addition of a deeper food assortment gave us the opportunity to completely reinvent our general merchandise format, transforming categories throughout the store in a visually compelling environment. Today, we operate 1,130 stores that have either been remodeled or newly built with this layout. And our guests continue to tell us they love what we've done to their Target store.

Together, 5% Rewards and our remodel program are making Target more relevant to our guests than ever, creating an outstanding platform for future innovations in our merchandising and loyalty programs.

As I look across our business today, I'm very pleased with our performance throughout the enterprise. Our team is doing an outstanding job of balancing strategic innovation with day-to-day excellence in execution.

The team is aligned and motivated in support of our strategic roadmap and delivery of our long-range financial plan. And as John will cover in more detail, we're anticipating 2012 adjusted EPS that will keep us on track in the delivery of that long-range financial plan.

Before I turn the call over to Kathy, I want to personally thank the thousands of Target team members in the Northeast who have worked tirelessly to help their local communities recover from Superstorm Sandy. Our thoughts and prayers are with those whose lives were affected by this terrible storm.

Now Kathy will provide more detail on our third quarter results, recent guest insights and provide more detail on initiatives for the fourth quarter and beyond. Kathy?

Kathryn A. Tesija

Thanks, Gregg. We are pleased with both the pace and mix of our third quarter sales. As expected, comps were strongest in less discretionary categories, with particular strength in Food and Health & Beauty.

In more discretionary categories, comparable-store sales in Home led the way, most notably in seasonal categories and Housewares. Comps in Apparel were up slightly, with the strongest results in Men's Apparel and Performance Activewear.

In Hardlines, comps were down slightly overall, with the strongest performance in Sporting Goods and the softest performance in Electronics, which continued to reflect mature product cycles in several key categories.

Strengthen in Back-to-School and Back-to-College categories was a key driver of our third quarter sales results. This year's comprehensive marketing campaigns drove guest awareness, and our in-store navigation and signing streamlined and simplified shopping trips for our guests.

As Gregg mentioned, we're very excited about initial results in our new CityTarget stores. Traffic has been very strong, and guest feedback has been overwhelmingly positive. Initial research indicates that the typical guest in this new urban format is younger and more affluent than we see on average across the chain. And as expected, these stores are attracting many new guests.

We continue to make significant investments in our online and mobile platforms, both to improve the performance of our existing site and mobile applications, and to test and inform future opportunities. Throughout the year, our teams have been focused on ensuring site stability and enhancing our search and navigation capabilities.

More recently, we've improved our speed of checkout, order flow and fulfillment. As a result, our online guest survey scores are much higher than a year ago, and our mobile apps continue to receive industry accolades. And importantly, we believe we are well prepared for the upcoming launch of the Target Neiman Marcus holiday collection and the peak traffic levels of the holiday season. While we feel good about the progress we've made, continuing to improve the guest experience remains a top priority for 2013.

In addition to the specific investments we're making in online and mobile channels, we're also investing in ways to further integrate the shopping experience across channels. For instance, we recently installed new scanners at point of sale in all of our stores to make mobile coupon redemption smoother and faster than ever.

We are expanding our use of shoppable media, incorporating QR codes and text-to-buy features. And in October, we launched an online debit and credit card application on target.com and saw an immediate meaningful increase in overall REDcard applications.

Our research with guests indicates they are continuing to shop with discipline, focusing on lists and budgets and occasionally splurging on more discretionary items. Notably in the third quarter, we saw an increase in trips,

focused only on need-based items. This guest feedback corresponds to overall consumer sentiment data, showing that while consumers have increased confidence about their near-term prospects and personal finances, they have a high level of uncertainty about the longer-term health of the economy and intend to continue saving and paying down debt. For the holiday season, consumers anticipate spending slightly more than last year, but indicate they'll be focused on value, pricing and promotions.

This data informs our outlook for the fourth quarter and next year. We continue to position our inventory appropriately, maintaining the flexibility to chase sales when we experience unexpected demand, while simultaneously managing markdown risk.

Beyond this focus on order quantity for each season, we continually work to find opportunities to reduce our inventory investment by optimizing our supply chain. In fact, while you'll note that our total inventory at the end of the third quarter was lower than last year, more than 100% of that decline was due to a reduction in inventory outside our stores. Levels of inventory located within our stores, where it's available to be purchased by our guests, were up slightly from a year ago at the end of the quarter.

Looking ahead, we are confident in our holiday merchandising and marketing plans. As always, we expect the season to be highly competitive and promotional, and we have the compelling assortments and exceptional value to make Target the top shopping destination for our guests.

In Toys, we're focused on ensuring our guests know that Target has the best values, especially on must-have items. In store, we've created QR codes for each of our top 20 Toys, which allow guests to purchase items by scanning the codes on store shelves and having them shipped anywhere in the U.S. for free.

Our annual toy catalog features more than 200 toys, specially priced, to give guests the best value on the toys kids really want. Guests can browse the catalogue online and create a Target digital wish list that is instantly

shareable via email. And the [target.com/toptoy](https://www.target.com/toptoy) page is the ultimate online destination for toy lovers of all ages. This site contains links to more than 10,000 toys, including more than 300 exclusives from Barbie, Fisher-Price, LEGO and Target-owned brands such as the Circo and Play Wonder.

In Music, our exclusive partnerships ensure we've got something for everyone, with albums in-store now from P!nk, No Doubt, Rod Stewart and Taylor Swift. In fact, our exclusive Taylor Swift album, RED, became our top-selling CD release of all-time. And we're keeping the momentum in Music going with our partnership with the hot U.K. pop group, One Direction, which we announced last month. That album, which just set earlier this week, is already off to a very strong start.

We're also investing heavily in our Latin music business, allocating more in-store space in key markets and partnering with legends like Emilio Estefan to curate our collection. Our Target exclusive version of Tony Bennett's new Duets album, which set a few weeks ago, features the hottest artists in Latin music.

This year, our merchandising and product design and development teams have created a multi-layered gifting strategy in categories across the store. In Apparel, we've rolled out gifting trees, showcasing colorful product with lots of shimmer and shine. In Home, we've expanded our boxed gift program with amazing prices on unique items in beautiful boxes that are easy to wrap and give. And we've transformed our See. Spot. Save. area in the front of the store to a stocking stuffer destination.

And of course, at the top of our gifting strategy, we're thrilled about our unprecedented partnership with Neiman Marcus and 24 of the most influential and sought-after designers in the country. This unique collection of 50 great gifts, that are certain to wow our guests, will set in stores December 1. Like any limited time offer, we expect these items to sell quickly, particularly given the amazing media attention that we've already received, as Gregg mentioned earlier.

Beyond this gifting strategy, we're very pleased with results from our 2 newest brands in Home. The Nate Berkus collection, sold exclusively at Target, has already been a hit with guests since setting late last month. This signature Home collection features bedding, bath, accessories, lighting, rugs and window treatments. This will be an ongoing collection with new items added to the assortment in 2013.

And we're pleased with the launch of our new owned-brand collection, Threshold, which offers guests a fully redesigned, high-quality collection that will inspire and help update their homes. The collection debuted this quarter with a small assortment of entertaining essentials, accents and decorative accessories, and will continue to roll out through spring 2013.

We are pleased with our third quarter performance and believe we are well positioned to give our guests a superior shopping experience and drive profitable growth in what will certainly be a highly promotional fourth quarter. And as we look beyond this quarter in the holiday season, we believe our merchandising and marketing strategies will continue to engage our guests, strengthen their love of the brand and deliver strong financial results for Target.

Now John will share his insights on our third quarter performance and outlook going forward. John?

John J. Mulligan

Thanks, Kathy. Even though we were cycling over our strongest quarterly performance in 2011, this year's third quarter results reflected strong profitable growth.

Retail sales were in line with our guidance, and profitability was near the high end of our expectations, with a superb execution across each of our business segments. Specifically, we generated third quarter adjusted EPS of \$0.90, compared with an expected range of \$0.83 to \$0.93 going into the quarter. Third quarter GAAP EPS was \$0.96, reflecting \$0.13 of dilution

related to our Canadian segment, offset by a \$0.15 gain due to the pending sale of our Credit Card portfolio, along with \$0.04 of good news from a resolution of income tax matters.

In our U.S. Retail segment, comparable store sales increased 2.9%, consistent with our guidance for the quarter. This comp was slightly slower than our second quarter performance, but on a 2-year basis, our third quarter comp accelerated slightly. Similar to last quarter, comparable store sales were primarily driven by an increase in average ticket, combined with a traffic increase of 0.5%. Penetration of sales on our credit and debit cards was 14% in the third quarter, up more than 400 basis points from a year ago. As Gregg mentioned, this program shows no signs of slowing down and continues to drive meaningful incremental traffic and sales.

Profitability in the U.S. Retail segment was somewhat better than expected. Our third quarter EBIT margin rate was flat to last year, and our EBITDA margin rate was down only slightly, even as we compared against very strong prior-year performance. Recall that for the year, our plan was to generally maintain our full year EBITDA and EBIT margins flat to last year. And our results for the first 9 months show that we're right on track to meet that expectation.

Among the drivers of EBITDA margin, third quarter gross margin rate was down a couple of tenths from a year ago, as gross margin investments in 5% Rewards and higher frequency category mix from our PFresh remodel program, were partially offset by rate improvements within categories.

Our merchandising team has done a great job managing margins within their individual businesses, a key factor in delivering profitability in our U.S. Retail segment.

Third quarter SG&A rate was flat to a year ago, reflecting continued expense discipline across the organization, combined with the impact of higher expenses related to technology and multi-channel investments.

Our U.S. Credit Card segment had another great quarter, earning more than 9 percentage points above LIBOR. Profit dollars were down slightly due to a 4.7% decline in average receivables and a more modest reserve release compared with third quarter 2011. Importantly, delinquencies and write-off rates continue to decline from what are already historically low levels.

In our Canadian segment, we continue to invest in technology, supply chain, store renovations and the team as we prepare to open stores in spring of next year. These activities led to \$72 million of SG&A expense in the third quarter which, when combined with D&A expense and interest expense associated with the segment, reduced our third quarter GAAP EPS by \$0.13.

Even as we engage in significant investments to launch our Canadian segment, our operations are generating excess cash that we continue to return to our shareholders. In the third quarter, we paid dividends of \$236 million and invested just over \$100 million in share repurchase. Through the first 3 quarters of 2012, we invested about \$1.9 billion in dividends and share repurchase, an amount representing more than 90% of our net income.

Our priorities for deployment of capital remain unchanged. We invest in our core businesses on projects that fit our strategic and financial criteria. We support the dividend, and we engage in share repurchase with the goal of maintaining our strong investment-grade credit ratings.

In the third quarter, we announced our agreement to sell our Credit Card portfolio to TD Bank for the gross value of the receivables at time of closing. We plan to deploy the proceeds from this sale in a manner that's neutral to our debt ratings. Given the amount of leverage we've applied to these assets, we expect that following closing, we will invest 10% or a little more of the proceeds, in our current share repurchase program, and the remainder in debt production over time. We continue to expect to close this transaction with TD in the first half of 2013.

Now let's turn to the outlook for the fourth quarter. We're expecting fourth quarter comparable store sales to increase in the 2% to 3% range. Sales in this range would lead to a full year comp of 3% or more, consistent with our long-range plan and our expectations going into the year.

As you know, we have a 53rd accounting week this year. Because we measure our comparable-store sales over periods of equal length, our fourth quarter comp will not reflect sales in the extra week. As a result, the gap between Target's fourth quarter total and comparable-store sales will be much larger than normal. We expect fourth quarter REDcard penetration will increase 400 basis points or more above last year, consistent with our recent experience.

In Kansas City, where we launched REDcard Rewards a year earlier than the rest of the country, penetration reached 20% this month, in advance of an expected temporary decline due to normal seasonal pattern. This milestone is notable because 20% penetration represented a stretch goal when we launched REDcard Rewards. And given that so far, our nationwide experience has followed Kansas City 1 year later, we expect to mirror this performance across the chain in fourth quarter 2013.

In the U.S. Retail segment, we expect our fourth quarter EBIT margin will be essentially flat to last year, driven by a moderate decline in our gross margin rate, offset by leverage on the SG&A and D&A expense lines.

In the Credit Card segment, we expect to earn a spread to LIBOR of 8% or more, generating spread to LIBOR dollars in line with our third quarter performance. However, given that we've already cycled the large reserve releases in 2011, this performance will represent an increase in year-over-year dollar profitability for the first time this year.

Combining all these expectations, we expect fourth quarter adjusted EPS representing results from our U.S. operations, of \$1.64 to \$1.74. This performance would put us at the high end of the full year guidance we provided last quarter and would put us ahead of our long-range plan's 2012

benchmark on our journey to achieving EPS of \$7.20 or more in the U.S. by 2017.

In Canada, we anticipate that expenses will grow beyond our third quarter experience as we begin to hire a large group of team members to open our first stores in the spring. Canadian D&A will also increase as we continue to invest in technology and supply chain to serve these stores.

Our current expectation is that activities related to our Canadian market launch will reduce our fourth quarter EPS by approximately \$0.19. Combined with our expectation for adjusted EPS, this dilution would lead to fourth quarter GAAP EPS \$1.45 to \$1.55. While the economic environment this year has not been as robust as many of us would've hoped, our business has performed beyond our expectations.

Specifically, 9 months ago in our year end 2011 conference call, I laid out an expectation for full year 2012 adjusted EPS of \$4.55 to \$4.75. Given 3 quarters of actual results, combined with the fourth quarter outlook I just outlined, we now expect full year adjusted EPS of \$4.75 to \$4.85. This means the low end of our current range would put us at the high end of our expectations going into the year.

Now Gregg has a few brief closing remarks.

Gregg W. Steinhafel

As Kathy, John and I have all indicated this morning, we're very pleased with our team's performance and the financial results we delivered in the third quarter.

While we recognize that the fourth quarter and the holiday season are always intensely competitive, we are excited about the plans we have in place, confident in our team's ability to execute and optimistic about our ability to capture our fair share of our guests' hearts and wallets.

Now Kathy, John 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 Deborah Weinswig with Citi.

Deborah L. Weinswig - Citigroup Inc, Research Division

Starting on the top line, could you just talk about the impact of either inflation or deflation and what you're seeing in terms of either Food or Apparel at this point in the game?

John J. Mulligan

Deb, this is John. I don't think we're seeing really any material impact from the top line due to inflation in any of our categories -- specific categories across the store. And certainly, as we would aggregate that across the store, as has been the case for the past several years, in aggregate, inflation impact is immaterial to our results.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then as we're looking at SG&A, should we expect tech investments that are expensed to stay at the same run rate that was experienced in the third quarter?

John J. Mulligan

Yes, I think that's pretty reasonable. We continue to invest meaningfully in technology across the enterprise. And as we've said, we're also investing now in multi-channel initiatives across the enterprise and specifically around dotcom. But like I just said in the fourth quarter outlook, we expect to leverage SG&A expense in the fourth quarter despite those investments ongoing.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then as your online performance continues to improve, how do you think about the halo effect from the stores and leverage that? And then any thoughts on buying online and shipping to the store?

Kathryn A. Tesija

You know, Deb, we do think that there is a halo effect when our site is performing well. As you know, guests do a lot of research online, but then they want to come into stores and purchase. And of course, there's a lot of people who come into the store, see the product and perhaps want a different color that we offer online. So after looking at the product, decide to still order through target.com because they want something that we offer that's different online. So we see sales going back and forth between the 2 all the time, which does make those channels blur quite a bit. But I think the health of our site certainly impacts the health of our stores. And I'm sorry, what was your -- the second part of your...

Gregg W. Steinhafel

Buy online, ship to store.

Kathryn A. Tesija

Buy online, ship to store. At this point, we are not offering that service to our guests. But it is something that we've been talking about.

Operator

Your next question comes from the line of Colin McGranahan with Bernstein.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Just wanted to focus on the REDcard a little bit. It looks like the penetration, the year-on-year increase in penetration, was actually accelerating a little bit and with Kansas City at 20%, it certainly suggests there's a lot of upside potential. What do you think is driving that? I've noticed that there's

certainly a bigger push behind marketing the program. And is there any difference in the recent, let's say, 400- to 500-basis-point penetration of the newer cardholders or what you're seeing in Kansas City? Any difference in their behavior in terms of incremental spend, in terms of the FICO score, in terms of anything relative to the first, let's say, 10% to 12% penetration?

John J. Mulligan

Well, we'll try to answer all 6 of those questions in order. I think you hit it right on the head, we are seeing the performance of the REDcards continue to accelerate, and we've seen that both in Kansas City and in the U.S., and our penetration continue to increase. I think the big driver, and we've talked about this a couple of times this year, continues to be the debit card. The debit card continues to grow roughly at about 3 accounts for every one account of credit, and that has been kind of the secret sauce in the significant growth. As far as performance of the card, we continue to see both either a debit or a credit card, once they're opened, more than a 50% increase in sales on average at a household level. So the performance remains very similar to what we've seen for the past couple of years, both in Kansas City and in the broader -- in our entire store base. And I'm trying to think what else, what else you asked, Colin?

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

I think that was it. But if 20% was the stretch goal, what's the stretch stretch goal now?

John J. Mulligan

Hard to say. I think 20%, I think we said about -- if you'd have asked us a year ago, we would've said we thought 20% was the top. Obviously, with Kansas City hitting that for a period of time, and as we said, that will come back here in the fourth quarter just due to the dynamics of the quarter, we'd expect the company to be there next year, and we think there's just a very

long runway here. We think the product is an outstanding offer. Clearly, our guests are starting to understand it. The store teams are doing a great job as they communicate with our guests, helping them understand both the credit and the debit offering. So you wrap that all together, and we think there's a long runway here.

Gregg W. Steinhafel

Yes, we haven't -- we see no reason to establish an upside benchmark at this point. And I would just add from -- in addition to what John said, our guests really love this because Target is their favorite store or a favorite store of theirs to shop to begin with. And this is a very powerful, immediate and simple program. I mean, they -- we have a lot of our guests that spend thousands of dollars, and that 5% savings, along with the other bets [ph], is a meaningful savings to them. And you don't have to accumulate points or anything. And the debit card in particular has been very, very successful. So those shoppers who are coming to Target on a very regular basis can save a lot of money throughout the course of the year. So it's very understandable why they like this program so much.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay. And then second question for Kathy. Neiman Marcus, what's your expectation for cross shopping that customer who comes in for the relatively limited 50 items? And can you tell us at all what the dollar value of the inventory was in Neiman Marcus products?

Kathryn A. Tesija

We do think that there will be a lot of cross shopping, Colin, as we've seen with other limited-time partnerships that we've had, but we think particularly this time of the year, the guest is coming in to buy gifts, maybe some self gifting, but also gifts for people on their list. And Target is a great place to get gifts of all type. And so we think they'll come in for Neiman

Marcus, but we do think that they will shop the rest of the store, and there will be some impact. In terms of the inventory and the dollar amount, we don't disclose what we buy or sell on these limited partnerships. But we are very excited about it.

Gregg W. Steinhafel

And it will be our biggest event, our biggest partnership event that we've ever conducted at a great time of year as well.

Operator

Your next question comes from the line of Mark Miller with William Blair.

Mark R. Miller - William Blair & Company L.L.C., Research Division

On the new Holiday Price Match, what's your expectation for the portion of transactions that might have this price match? Is this low single digits? And then given that price transparency is here to stay, might you consider doing this as a full-time measure?

Gregg W. Steinhafel

Yes, this is Gregg. We don't see a lot of price match activity in our stores. We've been price matching for a long time. Our value proposition is so good day in and day out, and our circular price offering is so good that we don't expect this to be meaningful. So it will be in the -- we expect in the single digits. And we'll take a look and evaluate this post-holiday to determine what our plan is going forward. We haven't made any decisions as it relates to that at this point in time and really want to get through the have the period and regroup and assess the campaigns to determine how to address 2013.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Okay. And then I may have missed it, but can you give us a sense for how you're tracking in November? And what is the comp range expected for fourth quarter?

John J. Mulligan

As you might expect, the beginning of the month was a little bit choppy, certainly with Sandy on the East Coast, the election, a few things going on. But we feel really good about the guidance we gave for November of a low and more important than that, we feel really good about the quarter, the 2% to 3% comp that we just talked about for the quarter.

Gregg W. Steinhafel

So much of the -- I mean, we have 2 weeks down, 11 weeks in front of us, and we have so much of the business concentrated in that Thanksgiving weekend and in the 10 days before holidays, so that the vast majority of the holiday season is in front of us at this particular point in time. So we're excited about it. We've got a great plan. Our stores are ready, our teams are ready. We've got a great value offering and some really inspiring merchandise. So we believe we'll profitably take market share this holiday season.

Operator

Your next question comes from the line of Mark Wiltamuth with Morgan Stanley.

Mark Wiltamuth - Morgan Stanley, Research Division

On the Credit Card, you mentioned you're going to retain a majority of the profits. What are we going to see there in terms of reporting moving forward and just a little perspective there?

John J. Mulligan

Yes, we did say the majority of the profits. I think as we indicated, when we made the announcement, ultimately, we will report, as everyone else does once they no longer own the assets, we'll report the net impact, the income less the expenses that we incur for servicing those assets in SG&A within our Retail segment. So that's our plan going forward.

Mark Wiltamuth - Morgan Stanley, Research Division

Okay. And just for Canada, as we start to look forward there, when do you expect to give us an outlook on the dilution we could expect for 2013? And then what's the arc there? As you start with the sales, are you expecting kind of weak margins to start? And how do we think about the progression once it gets going?

John J. Mulligan

Yes, we'll -- we're working on detailed plans for both Canada and the U.S. business both, and we'll walk you guys through our exact plans financially when we do the fourth quarter conference call. I think importantly for Canada, probably the most important thing is that the Q4 of next year is when we have said we'll move from dilution to accretion. So our focus is on getting profitable in Q4 2013, and we feel good about that right now. I think when the stores open up, there's a lot of variables there. We said for a long time, we have a better idea of where the stores will be in year 2 or year 3 than we do in year 1. Lots of volatility, we'll certainly see a surge early, and then we'll settle in and we'll refine as we go along, both our merchandising assortment and how we operate those stores. So I think we would expect to see sales and margins we will -- we do expect to see both sales and margins improve as we go along. But by that, I don't mean you should be looking quarter-over-quarter. This will take us a couple of years to refine our operating model in Canada.

Operator

Your next question comes from the line of Chris Horvers with JPMorgan.

Christopher Horvers - JP Morgan Chase & Co, Research Division

I wanted to follow up on the Neiman question. Gregg, you mentioned that it's the biggest event ever. Am I correct that it's bigger than Missoni was last September? I thought you had about 150 products, so that sounds like you're expecting to have more inventory of a smaller assortment here?

Gregg W. Steinhafel

Well, it will be substantially larger than Missoni, but this is more tightly edited in terms of the number of items that we have. So the commitment behind each item will be substantially more than any event that we've ever done. And given the time of year that it is and the fact that these will make great holiday gifts, the inventory on a per-item basis is something that we've never supported in the past. Missoni and some of other ones have had hundreds of SKUs, as you know, and this has a much more narrowly-defined assortment base.

Christopher Horvers - JP Morgan Chase & Co, Research Division

Perfect. So you're not selling out in day 1.5 this time?

Gregg W. Steinhafel

Well, we're hopeful that this is our biggest success yet, but we're not making any predictions as it relates to the sell-through timetable. Like any event of this magnitude, there are going to be some items that sell through very, very quickly and other items that will take a little bit longer to sell through. But overall, we look at the entire assortment, we look at the portfolio of designers, and we think across the board, there's something for everyone. So we think it's going to be successful across the board. It's just a matter of how you want to gauge success, is it hours, or days, or possibly a week, which might be a stretch.

Christopher Horvers - JP Morgan Chase & Co, Research Division

Perfect. Then one follow-up. On the grocery side, grocery comps moderated in October. And so I was just wondering if you could help us with how much of that was moderation of price inflation versus cycling the hump of the PFresh opens last year? And what do you think is sort of a sustainable comp is in that category, assuming inflation doesn't really go anywhere from here?

John J. Mulligan

I think as we look at October, we think very little to do really with inflation in that category. We think the majority of what we saw in October was cycling over what was, by far, our largest PFresh remodel program in one cycle last year. As we think about grocery going forward, mid to high comps seem reasonable for us for a run rate as we look ahead here.

Operator

Your next question comes from the line of Greg Melich with ISI Group.

Gregory S. Melich - ISI Group Inc., Research Division

John, a question on leverage and then on online for Gregg or Kathy. On leverage, ex credit, it seems like you should be a little under 2x debt-to-EBITDA versus 2.5x now. Is that where -- well is my math is right; and two, is that where you want to run the business long term, or should we assume it goes up a little bit above 2x again?

John J. Mulligan

Your math is pretty correct, Greg, and I think that's about the range that you'll see us operate in. As we've said, we want to maintain the current credit ratings that we're at, and we believe as we talk to the agencies, and we'll go back and talk to them again, obviously, once all the dust settles from the receivables transactions, but we believe that's about the right range where we'll continue to operate.

Gregory S. Melich - ISI Group Inc., Research Division

And then -- that's helpful. And second on online, I mean, last year, that was an area where you were down, and I know that was a disappointment. I'm just curious in this year's fourth quarter guidance, what do you expect from online sales growth? And linked to that, how much is REDcard penetration in terms of online sales? I imagine it's quite higher than the 14%.

John J. Mulligan

Yes, first, as it relates to the impact on the comp, as we said last year, when it was not helpful, it wasn't material. And this year, while we do believe it will be helpful to the comp, it won't be a material portion of it. And I think you're exactly right, the REDcard penetration online is higher than we see in the stores. And as you might expect, in certain categories, it is significantly higher than we see in the stores, given the 5% off plus the free shipping online, you don't have to let your mind wander too far to think about categories where the penetration is probably pretty significant.

Operator

Your next question comes from the line of Peter Benedict with Robert Baird.

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

A couple of questions. John, first of all, just on the tax rate. We've consistently seen some benefits here for the last several quarters. So I'm just curious, as you think about the fourth quarter, maybe some parameters around how you think the tax rate is going to come in? And then secondly, on inventory, you mentioned that there was less outside the stores. Is that something -- is that a structural change that we should be thinking about, or something that was just a bit more unique to this period?

John J. Mulligan

Sure. On the tax rate, I'll take that, and then let Kathy talk about inventory. We have seen several, what we have characterized as onetime events over

the past several years, and they have been truly onetime as we have settled many discrete tax matters. I think for fourth quarter, we'd expect to see rates similar to what we saw last year. The caveat I'll put on that is that with Canada, with our dilution growing meaningfully year-over-year, the rate in Canada is much lower than we see in the U.S. and that, of course, puts -- when we have losses, puts pressure on our consolidated tax rates, so some impact related to that, but nothing material.

Kathryn A. Tesija

And on the inventory side, the team has done really an incredible job of managing our inventory, both to be in stock but at the same time optimizing the supply chain to make sure that we're keeping that as tight as we possibly can. A lot of the improvement that we're seeing is just indicative of what's happening right now in our business. So first of all, better management of our receipts in Toys and Home. There's some timing shifts in some gift-giving categories like Electronics. But then as we talked about in the last call as well, longer term, we continue to really succeed in moving a portion of our base inventory out of our distribution centers and our store backrooms and getting it onto the sales floor, which is a huge win for us because that's where guests can shop it. So we continue to work on those initiatives.

Operator

Your next question comes from the line of Charles Grom with Deutsche Bank.

Charles X. Grom - Deutsche Bank AG, Research Division

Not to be too near-term focused, but did I hear you, Gregg, earlier that even with the Sandy impact and the choppiness that you saw, you still feel good about November comps up low single digits?

Gregg W. Steinhafel

Well, we feel that for the quarter, we're going to be within the range that we have described and how we have characterized November. So much of November comes around the Thanksgiving weekend, and that's ahead of us yet. So we still feel good where our plans are for the month and for the quarter.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay, great. And then beginning of the year, I believe you guys stated the intention to do about \$1.5 billion in buyback -- \$1.5 billion in buyback. You didn't really do much here in the third quarter. So I was wondering as why, and I guess if you still feel good about that \$1.5 billion target for the year?

John J. Mulligan

Yes, I think we actually said \$1.5 billion or more. And I think the key is, and you see this in the third quarter in other areas, is we don't do that just on autopilot. I think as we saw, the stock price went up pretty aggressively in third quarter. We always pause to see where the market's really going to land and make sure that we're buying at a reasonable pace for the year. We still think \$1.5 billion or more is a reasonable range for us to end in.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay. And then -- and last my question, just to circle up on the Canada topic. A couple of years back, Doug talked about the dilution before you started to make money in that segment, to be about \$1. It looks like this year, with last year, will be about \$0.62 of dilution. So should we think about the first 3 quarters of next year being about \$0.38 of dilution to make up that \$1, or is there something different that's changed?

John J. Mulligan

Well, as we -- as I said a little bit earlier, we haven't provided any guidance on 2013 yet. I think if you look back, you'd find that Doug used the words "For example" when he talked about that. But I think more important than

that, as I said, we'll be back in about 3 months to give you our detailed view of what we think will happen in Canada over the next 4 months. And you kind of hit on it there subtly, but again, I go back to, I think, Q4 is the key date for next year when we move from dilution to accretion.

Operator

Your next question comes from the line of Sean Naughton with Piper Jaffray.

Sean P. Naughton - Piper Jaffray Companies, Research Division

Maybe Kathy, just a question on the merchandise. In terms of Apparel, you mentioned Men's and Performance as relatively strong in the quarter. And given the comp that you produced in that category, implies maybe a little bit weaker trends in Women's and Kids. Was it more in the fashion, basics or seasonal and anything you can help to do to reinvigorate the growth in those 2 areas for the fourth quarter?

Kathryn A. Tesija

You're correct, our strongest performance were in Men's and our Performance Activewear, which is -- Activewear has been strong really all year, both because it's a great trend in Apparel right now, but also given the quality and the value that we offer in C9, it's been really an exceptional performer. I think the weakness in Kids and ready-to-wear, or relative weakness, I think is mostly driven by seasonal. We saw some really good strength in sort of our better must-have product. But we are still waiting for weather to break in most of the country, and we have a lot of seasonal apparel, both in Kids and in ready-to-wear in particular, which is still off to a slower start. But I do feel great about the holiday season. Our sweaters are starting to sell and some of the other seasonal product that we have in ready-to-wear. So I think our assortment looks good. It's -- we'll see here in the next few weeks.

Sean P. Naughton - Piper Jaffray Companies, Research Division

Okay, fair enough. And then I guess, secondly, a question for John. You had mentioned that the SG&A was up a little bit from higher expenses in technology and multi-channel, but should leverage that in Q4. I guess, is this primarily associated with sales from that extra week that you're getting that leverage, or -- and should we expect a higher comp leverage point potentially on SG&A on the U.S. business for the foreseeable future as you make these investments in technology?

John J. Mulligan

Yes, it would start on Q3. I think the other thing I would remark upon relative to Q3, is last year in Q3, we leveraged 40 basis points of SG&A. So when we talked about the quarter at the beginning, at the end in our second quarter conference call, we actually expected to delever a bit more than we did. So we're pretty pleased with our expense discipline across the company in the third quarter. For the fourth quarter, certainly, a small element of that is related to the 53rd week. But frankly, most of the expense leverage that comes in the 53rd week is across depreciation and amortization because of the way we expense that. And that's where most of the benefit comes as you might expect. Most of our expenses happen in the 53rd week just like anyone -- any other week. Benefits, payroll, which is obviously our biggest expense across the enterprise, property taxes, that all happens just like normal. So that's the primary benefit. Going forward, we've said that we expect to maintain our EBITDA margin rates. And so we expect to overcome gross margin rate compression with SG&A leverage and to do so at a 3 comp. So nothing's really changed in our formula. We expect to accommodate the investments we're making in multi-channel and technology, both within our capital plan and our SG&A plan going forward.

Operator

Your next question comes from line of Dan Binder with Jefferies.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

On the -- just wanted to follow up on the Apparel question. If we look at what you've been doing with your different partnerships, they're very interesting, they create buzz. I'm curious, in order to get the comp maybe moving up a little bit in Apparel, is there any hope of doing something a little bit more permanent with any of these partnerships? And do you think that your price and value proposition is right?

Kathryn A. Tesija

We feel that having limited time partnerships with designers is the best place for us to be because it allows us to capitalize on current trends in the marketplace and designers who are up and coming, and we've had a great response to that. And throughout the course of the year, our Apparel business has been really solid. So I do think that our price-value relationship is very good. This is an awkward time of the year given how much seasonal product that we have in Apparel and waiting for that weather to break and guests to get really interested in seasonal product, is always sort of a timing issue. But when you look throughout the course of the whole year, our Apparel business has been very solid, and I think it will continue to be solid.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

And if I could follow up, last year, I believe on the third quarter call, you had commented about your competitor's layaway program maybe having an impact on you. I'm curious, they started it earlier this year, they actually quantified it today about how much they thought it was extra. We didn't really hear much from you on that. Do you think it had any impact on your business?

Kathryn A. Tesija

I don't think our guests, based on our research, is that interested in layaway. They are interested in great prices every day. So I think our value equation is really important to them, couple that with our Holiday Price Match, which gives them confidence to buy any time during the holiday

season and know that if it appears at a lower price from Target or anyone else later in the season, that they can get that price matched, as well as we've talked about with our debit and credit card, getting 5% off, I think that's really critical to our guests, much more so than layaway.

Operator

Our final question comes from the line of Matt Nemer with Wells Fargo Securities.

Matthew R. Nemer - Wells Fargo Securities, LLC, Research Division

Two quick questions. First, just a follow-up on price match. Although there's not a high usage rate for that, do your focus -- does your focus group research show that having it in place improves loyalty or conversion in the store? And when it is used, is there any disruption to checkout?

Gregg W. Steinhafel

We don't conduct the price match policy at the checkout. We conduct it at the service desk. And our whole strategy is about delivering a great experience and having our guests have confidence in our pricing, our value proposition, day in and day out is rock solid. On ad, we meet or beat the competition, 5% REDcard reward on top of, or in conjunction with our Price Match Guarantee, is a winning combination and unbeatable in the marketplace. So it's very strong, it's very compelling, and we're just -- we're excited about it because the value proposition is so good.

Matthew R. Nemer - Wells Fargo Securities, LLC, Research Division

And then lastly, I realize there's some runway ahead of us here. But how are you thinking about the 5.3% compare in Q1 early next year? Are there any specific plans in place to comp that in addition to the ongoing benefit of 5%, PFresh and other initiatives?

John J. Mulligan

Well, I think as we said, we haven't provided any specific guidance. But I guess, I would point to Q3 this quarter. We cycled against very strong results this quarter, a 4.3 comp, profit rates, EBITDA and EBIT margin rates were very strong for the quarter, and we just produced another very strong quarter. Obviously, last spring and first quarter, and we talked about in the conference call, it was the perfect storm of good things all happened. We had the right merchandise in our stores, weather was great and people felt great about shopping. So we have some strong business to cycle. But we'll be back to talk about what we intend to produce for results in Q1 in about 3 months.

Gregg W. Steinhafel

Okay. Well that concludes Target's Third Quarter 2012 Earnings Conference Call. Thank you all for your participation.

Operator

Thank you for participating in today's conference call. You may now disconnect.