

Thanks, John. And good morning to all of you. We are pleased with Target's third quarter financial performance which we announced earlier this morning.

Our adjusted earnings per share of \$0.54 was better than our guidance of \$0.40 to \$0.50. Driven by US segment comp sales growth of 1.2% which is also better than our expectations.

Importantly the US segments saw positive comps in all three months of the quarter. And we are encouraged that the pace of US traffic continues to recover for a very challenging trend earlier in the year. While US traffic still declined slightly in the third quarter, performance was more than a full percentage point stronger than traffic trends through the first half of the year.

As we mentioned in our second quarter earning call, we saw a strong start to back-to-school and to the back-to-college season and that strength continued in September. Like many others, our sales slowed as we entered October, but recovered nicely towards the end of the month as we approached Halloween.

While our Canadian segment continues to see robust year-over-year growth, third quarter sales in Canada fell short of our expectations. As Kathee outlined in our last earnings call, the team in Canada has been working diligently to make improvements to operations, assortment, and pricing, in preparation for the fourth quarter.

With these changes we believe we are better positioned to serve our guests at a time of the year when traffic will naturally be higher. The guest response to these changes both in their shopping behavior and overall sentiment towards Target will inform our perspective as we continue to assess our longer-term potential in Canada.

As I visited stores across the US and Canada, and worked with the Target team, I have been continually impressed with the level of their talent and passion to perform.

As the leadership team has begun, our work to develop Target's longer term goals, we have aligned around five key operating principles. First, we will provide strategic clarity to the team. Second, we will articulate what Target stands for in today's retail marketplace. Third, we will thoughtfully prioritize what we do applying discipline to ensure we are focused on work that adds the most long-term value. Fourth, we will invest resources, and build capabilities to support our priorities so the team is equipped to deliver on these goals. And finally we will foster a culture of accountability at all levels of the organization.

While our work to define Target's longer-term vision is not yet complete, we've made significant progress in defining the short and longer term priorities for our business. First, omni-channel and flexible fulfillment capabilities are key to our long-term success.

Target's digital sales are growing much faster than the industry and they have been accelerating all year and we are planning for even faster growth in the fourth quarter. But our omni-channel journey is just beginning. As we plan for the future, we will take a channel-agnostic view of our growth allowing our guests to interact with us where and when they want, online, in stores and on their mobile device. And because an increasing number of Target visits begin on a digital platform, we will continue to push ourselves to innovate and build capabilities and features into our digital experience that will inspire guests while removing friction from their daily lives.

Second, we are defining how we will strategically segment our categories and increase our focus on signature categories we can and should be known for. Categories like baby, kids, wellness and style.

Over time we will work to grow these areas more quickly by investing a higher share of our resources including capital, marketing and product development. Importantly this view of segmentation doesn't mean we are abandoning our other categories. Let me restate this. It does not mean we are abandoning our other categories. But we will have different expectation for those categories compared to the ones in which we are investing to outperform.

For example, we believe we should continue to present a meaningful food offering in our stores and online. But we need to ensure that our food offering is uniquely Target and clearly differentiated from our competitors.

Looking ahead, we know our identity and food will continue to involve a combination of national brands and our own and exclusive brands with increased emphasis on natural and better-for-you products.

Third, we know that localization and personalization will be a key focus going forward. Fifteen years ago, all Target stores were virtually identical, and were focused on providing consistent assortment, and experience across the country. In today's world we need to continue to maintain our brand standards across every store. But our guests expect each of our stores to reflect the local communities in which they operate.

In the past we have taken some initial steps to localize our store environment and assortment. But we have only scratched the surface to this opportunity. Similarly, Target's digital experience will become increasingly personalized for every guest.

This year we have developed and rolled out a new personalization engine which is currently generating product recommendations for guests on our digital platforms. Even though this new engine is in the beta rollout stage, conversion rate from its recommendations are already exceeding what we were previously seeing with the third party product.

As we continue to make changes based on initial learning, we expect conversion rates will expand further overtime. Looking ahead we expect to leverage this engine's capability to provide customized experiences across our digital platforms.

As we contemplate potential store growth, we believe that smaller formats present an exiting opportunity for Target, because urban consumers have such a high affinity for our brand. If we can reach more of these guests with small flexible formats like City Target and Target Express we can offer urban consumers greater convenience, unique merchandise and an outstanding value with extended assortment available at [target.com](https://www.target.com).

And finally as we plan for the future, we must focus on ways to responsibly control cost to help fuel investments in our growth. The team has made solid progress in expense optimization effort over the last few years, but we believe we must continue to find cost saving opportunities in the years to come.

In the coming months, the leadership team will continue our work to fully math out longer-term aspiration for Target and we will communicate those plans to you early next year. In the near-term we are focused on strong execution our fourth quarter plans both the US and Canada. These plans are designed to embrace the core of our expect more, pay less brand promise inspiring our guest with unique products and experiences while providing unbeatable value to our low prices. Kathee will provide more detail in a few minutes.

In Canada we are expecting much better fourth quarter performance than we experienced last year. But we know that to succeed in Canada we will need a major step change in performance. The fact is, given where we are performing today, we need to see improved financial performance from every Target store in Canada overtime. The team has worked hard to prepare for the Canadian operations for the fourth quarter. And we will be watching to see how those improvements connect with our guests during the holiday season.

While there is much more work to be done, I am very pleased with the momentum we are seeing in the US business, and the changes we have implemented to better position our Canadian segment.

My confidence in the potential of this company and this brand have only been reinforced in the last three months as I gain deeper knowledge of Target to my work with the team. I am committed to realize in the potential of this great American brand to the benefit of our guests, team, shareholders, and communities. And I believe we are taking the right first steps in that journey.

Now I will turn the call over to Kathee for a recap of the third quarter performance and our plans for the holiday season. Kathee?

Kathee Tesija

Thanks, Brian. On our last conference call, we outlined that we had already seen a strong start to the third quarter driven by initial results in the back-to-school and back-to-college season. A key question at the time was whether this early strength would prove to be temporary resulting in a pullback later in the quarter. With the quarter now behind us, I am happy to report that we continue to outperform our US forecast throughout the quarter and saw positive US comps all three months.

As Brian mentioned earlier, third quarter US traffic was down slightly from a year ago but we are encouraged that our traffic trend has improved meaningfully every quarter this year. Consistent with year-to-date trends, average ticket increased 1.6% in the third quarter driven by growth in average retail per item, particularly partially offset by a decline in items per basket.

At a category level in the US, third quarter comparable sales performance was strongest in healthcare and beauty led by beauty which continues to benefit from this year's store fixture innovations, and the introduction of new brands. Third quarter comps in home were up in the low single digits with particular strength in seasonal categories, benefiting from back-to-school, back-to-college sales early in the quarter and late quarter strength in Halloween.

Third quarter comp sales in grocery were up in the low single digits, and hard lines was up slightly led by toys which saw a high single digit increase on strength in licenses like Frozen and Teenage Mutant Ninja Turtles.

Comp sales in apparel were down slightly as strength in baby and kids was offset by softness in jewelry accessories and intimates. From a mixed perspective it's worth noting that our combined home or combined comp in home and apparel was the strongest we have seen in two years.

In October and early November, we completed the rollout of our new apparel fixtures and layout to an additional 600 stores bringing the total to about 650 locations featuring this enhanced presentation.

Consistent with our expectations, the US third quarter gross margin rate was about 50 basis points lower than last year, about half the decline we saw in the second quarter. This reflects continued moderation of our promotional intensity which we intentionally moved higher in the wake of last December's data breach.

Digital sales were up more than 30% in the third quarter and contributed about 60 basis points our US comparable sales growth. Consistent with the rest of the industry, all of our digital traffic growth is on our mobile platforms where third quarter traffic grew more than 50%. Conversion this quarter was up strongly on both the conventional site and on mobile compounding the benefit from the traffic growth.

Following the success of our second quarter decision to offer free shipping on all target.com orders over \$50, in October we announced that we are offering our guests free shipping on all orders this holiday season.

Since this announcement, our guests have responded enthusiastically. We've seen a meaningful increase in both orders and conversion compared with trends prior to the announcement. Of course I would be remised if I didn't point out that REDcard holders continue to receive free shipping on all orders year round.

In Canada, third quarter sales were up 44% from a year ago moderately below our expectations. Our third quarter gross margin rate of 19.5% was consistent with our expectations as we continue to clear excess inventory from earlier in the year.

As Brian mentioned the team in Canada has been working diligently to improve operations, assortment and pricing and our internal measures show that we are making progress.

However we are also measuring the impact these changes are having on Canadian consumer sentiment and that data is more mixed. We will continue to measure guest sentiment in the fourth quarter when all of our recent improvements will be fully in place and traffic will be naturally higher.

As we look ahead to the fourth quarter and the holiday shopping season, we are excited about our plans to inspire our guests with unique products, outstanding deals and increased convenience provided by our flexible fulfillment efforts. On our digital platforms, we are coming into this holiday season with many more capabilities than we had a year ago. In fact it was

about a year ago that we rolled out in-store pickup across all of our US stores. So far this year store pickup orders have averaged about 15% of digital traffic with more than 80% of orders ready within an hour.

Based on last year's results, we expect in-store pickup orders will become a much higher share of digital traffic in the days leading up to Christmas as consumers increasingly value the certainty this service provides compared with the potential risk posed by weather related shipping delays. And we continue to explore potential enhancements to flexible fulfillment like our curbside test, pickup test in 10 San Francisco Bay Area stores and our same-day delivery test in Minneapolis, Boston and Miami.

The Target app and Cartwheel are both top 10 retail apps, and we continue to innovate to maintain our leadership position in this space.

In the third quarter we re-launched our mobile and tablet apps making it easier for guests to locate and purchase what they are looking for with interactive store maps and shopping lists, streamline checkout and the addition of Apple Pay for the iPhone app.

Our new list function automatically notifies guests when an item is on sale or eligible for an offer on Cartwheel, and our new interactive store maps show item locations throughout each store. For our in-store Black Friday guests this year, special interactive maps will show door buster locations throughout each store.

We completed a successful national-wide rollout of ship-from-store capability in October. With the rollout we are now shipping about 60,000 eligible products from 136 stores in 38 markets covering more than 90% of the US population. The ability to access stores inventory to fulfill online orders improves our digital in-stocks and drives incremental sales in situations where we are out of stock in our fulfillment centers. And while shipping from stores significantly lower shipping costs, most importantly it allows us to get items into guests' hands more quickly. This change is already being noticed.

In the third quarter Internet Retailer reported a survey showing that we were leading our competitors with the fastest delivery having been near the back of the pack earlier in the year.

We recently rolled out and improved omni-channel experience for our registries with new web-enabled smart scanners and a matching target.com user experience. The new smart scanners allow guests to add items more quickly to a registry and new features like collections and check lists provide inspiration and help guests build registries more quickly.

Guests can add online-only items like specific colors or models right from the device in the store without having to edit online at home later. And companion and related products are suggested immediately when a guest adds an item to their registry. And when gift givers access a registry on our new in-store iPad kiosks, they can send gift list to their smart phones via SMS with saving time, reducing costs and eliminating waste from paper printouts.

As we enter the holiday shopping season, we are featuring a dazzling array of unique and exclusive products and of course outstanding deals. In September we announced that Target would be partnering with TOMS on a limited edition holiday collection of home goods, apparel, accessories and shoes for women, men and children.

Similar to TOMS' one-for-one giving model, for each item purchased, a donation will be made with the potential to provide more than 11 million meals, blankets and shoes to those in need. The collection rolled out at all Target stores in the US and Canada and on target.com on November 16th.

We also recently announced our holiday collaboration with Faribault Woolen Mill. Founded in 1865 and located on the banks of the Cannon River in Faribault, Minnesota. This mill is part of American history having provided woolen blankets for pioneers headed west and for American troops in two world wars.

On November 2nd, we rolled out a variety of American made giftable items from this iconic company featuring 100% wool scarves, throws, tote bags and tech accessories in four patterns available exclusively on target.com. If there's one thing we have learnt from our partnerships with Taylor Swift is that our guests can't get enough of Taylor and her music. Even though gifting season is yet to come, our Target exclusive deluxe edition of Taylor CD titled 1989 featuring three exclusive songs and voice memos that gives fans unique insight into her song writing process has already become our best-selling album of all time.

Disney's Frozen has been huge for us all year, and is positioned to be one of the most popular licensed brands at Target this holiday season with 600 frozen products, 60 exclusive to Target across 20 categories.

For the holidays we are partnering with Renée Ehrlich Kalfus, costume designer for the contemporized Annie film to offer guests a limited edition collection of kids' apparel and accessories inspired by the film. Annie for Target will be available through December 26th or while supplies last at all US Target stores and on target.com. The film debuts in theaters nationwide on December 19th.

In beauty we continue to experience strong growth in natural products and we are constantly on the lookout for new lines that we appeal to our guests. We have already launched 7 premium skincare brands this year and we are thrilled to announce that two more super-luxe lines are on the way available now on target.com and in select stores. In March 2015 Target is adding S.W. Basics of Brooklyn and Nuxe to its lineup of premium skincare products.

All new in beauty, Skinfix, experts in steroid-free skin healing solutions for the whole family debuted its incredibly effective product exclusively at all US Target stores and online at target.com. Skinfix products are based on an original formula created over 150 years ago by pharmacist Thomas Dickson in Yorkshire, England.

And in hair care we are seeing continued momentum in natural with our Made to Matter products and we are excited about recently added salon products like Proganix from Vogue and exclusives like Procter and Gamble's hair food and L'Oreal's Dessange.

In healthcare, we announced earlier this week that Target and Kaiser Permanente are teaming up to launch four Target clinics in Southern California. For the first time at Target, guests will have access to expanded services not typically available in retail clinics, including pediatric and adolescent care, well woman care, family planning and management of chronic conditions like diabetes, and high blood pressure.

And coming in 2015, our new pharmacy app, Target Healthful, will allow guest to organize and transfer prescriptions, check prescription status, and order refills.

And finally of course, we are designing our marketing plans to bring the entire holiday season together from amazing products to outstanding deals. Our holiday marketing campaign is designed to encourage people of all ages to let loose, get into the spirit and feel the unmistakable joy of the holiday season.

The advertising will boldly embrace the iconic elements that make Target, Target. Lots of red, white and our lovable mascot Bullseye. The campaign will include broadcast, radio, out of home and catalogues and we are increasing digital media support by 50% over last year.

Target stores will be transformed with fun and whimsical in-store decor created in partnership with David Stark, one of the top event planners. This year we are partnering with innovative New York retailer STORY which brings an editorial lens to retail and reinvents itself every four to eight weeks from merchandise and store design to floor plans and fixtures, bringing to life a new theme or trend. From Target's design partnerships to its everyday

collections, STORY has curated its favorite holiday treasures from Target alongside its other must-have items for the season.

We just launched our kids Wish List app on October 31st, a modern and digital take on the classic tradition of creating holiday wish lists for parents and kids. Kids can add must-have items to their list, while parents can share the list with friends and family, plus guests can save 10% on their wish lists on one day of their choosing before November 26th.

Through the holiday shopping season, Cartwheel, Target's industry leading savings app will offer daily deals for its more than 11 million users. And from November 2nd to December 24th, it will feature 50% off, a different joy everyday. The app will have new features for the holidays including special deals for top users, personalized recommendations, and a select number of popular offers that don't expire. As always REDcard holders get 5% off nearly all purchases, free shipping at target.com and an extra 30 days for returns. Since 5% REDcard rewards rolled out in 2010, Target has saved guests more than \$2 billion and we will thank guests for their loyalty with perks throughout the holiday season.

We know our guests are pulled in a million different directions as the holidays get underway, so we are helping them save time and money by offering more access to Black Friday deals. Whether shopping online, on their phone or in our stores, Target guests will find Black Friday deals on top guests throughout November. We already offered early access to Black Friday deals for one-day only on November 10th. We've announced a presale on Wednesday, November 26th, and Cartwheel will feature access to additional Black Friday deals between November 23rd and November 29th.

On Thanksgiving Day, Black Friday deals will be available first in the morning on target.com, then at 6 pm, Target stores will open for Black Friday shoppers and the first several 100 guests will receive a Christmas cracker, gift synonymous with the holidays in many parts of the world which will include a Target gift card or coupon.

On Black Friday, from 6 am to noon, guest can purchase up to \$300 in Target gift cards at a 10% off at Target stores and target.com, the first time Target has ever offered a discount on Target gift card purchases. The following day additional Saturday only deals will be available in Target stores and at target.com.

And finally beginning Monday December 1st, guests will find new deals everyday at target.com as part of Target's largest ever cyber week sale with more than 100,000 items on sales throughout the week. The offers will include category-wide sales in key gifting areas and steep discount on

apparel, toys and housewares. More information and deals will be available at the end of November.

As we look back at an eventful year, we are pleased with the steps we have taken to improve our performance in both the US and Canada, and our financial results show that we are making meaningful progress. While there is much more work to be done, we are confident in our plans for the upcoming holiday shopping season, and pleased with our progress in -- charting a longer-term course for the Target of the future.

Now I will turn it over to John, who will share his insights on our third quarter financial performance and our fourth quarter outlook. John?

John Mulligan

Thanks Kathee. Our third quarter financial performance was better than expected driven by stronger than expected sales and operating margin performance in our US segment. Adjusted EPS of \$0.54 was \$0.02 or 2.9% below last year reflecting a decline in US segment profit partially offset by the benefit of reduced losses in our Canadian segment.

GAAP EPS of \$0.55 was \$0.01 or 2.7% higher than last year benefiting from the resolution of tax matters in the quarter. Our third quarter US comparable sales increase of 1.2% matches our best performance in the last two years.

Digital sales in the US including flexible fulfillment grew more than 30% contributing about 60 basis points to our US comparable sales. With ship-from-store capabilities now fully in place, we expect digital sales growth to accelerate to nearly 40% in the fourth quarter.

Our third quarter US segment EBITDA margin rate of 8.5% was ahead of our expectations driven by a better than expected SG&A expense rate of 21% which is about 20 basis points lower than last year. This performance was the result of our expense optimization efforts, better leverage on stronger than expected sales, and retiming of some expenses into the fourth quarter.

US REDcard penetration was 21% in the third quarter, up about 110 basis points from last year driven by growth in both credit and debit penetration. As we described last quarter, applications for new REDcard debit cards are running below last year causing penetration growth to decelerate from last year's pace. We believe this trend will continue in the fourth quarter when we expect US REDcard penetration will be flat or up slightly compared with last year.

With the success of recent initiatives designed to increase REDcard applications, we expect the fourth quarter will mark the low point in year-over-year penetration growth after which we should see a reacceleration in 2015.

In our Canadian segment, third quarter sales were below our expectations growing 44% above last year reflecting sales from new stores and a comparable sales increase of 1.6%. As I mentioned last quarter, the comparable sales metric in Canada will be noisy until we fully annualize the rapid pace of last year's store rollout. Given the sustained grand opening surges we experienced in those stores and the densification around early cycle stores that occurred later in 2013.

REDcard penetration continues to grow in the Canadian segment reaching 4.2% in the third quarter compared with 2.9% last year. As expected third quarter Canadian segment EBITDA and EBIT margin rates improved somewhat from last year, and EBIT dollar losses were about 18% lower than a year ago. While this improvement is encouraging, financial results in this segment remain unacceptable. And as Brian mentioned earlier we need to see a significant step change in Canadian segment financial performance.

Outside of operating results in the US and Canada, our third quarter GAAP EPS of \$0.55 reflects a few items not included in adjusted EPS. Specifically, \$0.05 of accretion related to the resolution of income tax matters and \$0.04 of offsetting dilution from data breach related costs, reduction in beneficial interest asset and impairment losses.

Moving to consolidated metrics, third quarter interest expense was flat to last year, and we paid \$330 million in dividends in the quarter, and increase of 21% over last year. As expected we didn't repurchase any shares in the third quarter. And given current performance and our goal to maintain our single 'A' debt ratings, we don't anticipate any share repurchase in the fourth quarter as well. Of course the timing and magnitude of any future share repurchase activity will depend on the pace of improved financial performance in both the US and Canada.

Before I move to our outlook, I want to first address our inventory, which at quarter end was about 7% above last year. This increase was entirely driven by our US segment and was the result of two factors. While a third of this increase relates to our recent efforts to reduce out-of-stocks on commodity products, while the remainder reflects receipt timing including the impact of our efforts to manage around slowdown at West Coast ports. Bottomline, we feel very good about our current US inventory level.

Now let's move to our outlook for the fourth quarter. As we consider the broader environment, we see some encouraging signs including lower gas prices than we've seen in some time. However consumer spending patterns remain quite volatile, and we expect the competitive environment will remain highly promotional this holiday season.

Based on this backdrop and the Q3 to Q4 expense retirement I covered earlier we are continuing to plan cautiously and maintaining our prior full-year guidance despite stronger than expected third quarter performance.

In the US we are expecting a fourth quarter comparable sales increase of about 2%. So far in November, we are running ahead of our forecast but I will quickly remind everyone that the bulk of the season remains ahead of us.

We expect our fourth quarter US gross margin rate will improve somewhat from a year ago. Last year in the US, we faced unexpected gross margin headwinds because of the data breach including the pre-Christmas weekend in which we gave our guests 10% off every transaction along with incremental clearance markdowns resulting from softer sales.

So while we expect the typical year-over-year gross margin pressure from an intensely promotional and highly competitive fourth quarter, we believe that pressure will be more than offset by the benefit from annualizing last year's breach related markdowns.

We expect our US segment SG&A expense rate to be flat to down slightly from last year as the benefit from expense optimization and better leverage on a 2% comp is expected to be offset by the timing of expenses which moved from the third to the fourth quarter. Altogether, our outlook is for the US segment EBITDA margin rate to improve 50 to 60 basis points compared with last year.

In Canada, we expect a high single digit increase in total sales driven by a mid-to-high single digit increase in comparable sales. We expect the gross margin rate of around 20% much better than last year's 4% rate which resulted from extreme clearance activity and reserves taken on excess inventory.

With an expected SG&A expense rate of between 35% and 40%, we anticipate fourth quarter Canadian segment EBITDA losses of about \$100 million, an improvement of about \$160 million compared with last year.

Turning to consolidated metrics, we expect a small increase in fourth quarter interest expense compared with last year. And for the first time this year, we

expect our tax expense to be higher than last year in light of the expected improvement in profitability.

Altogether these expectations will lead to fourth quarter adjusted EPS of \$1.13 to \$1.23 well above the \$0.90 we earned last year. Fourth quarter GAAP EPS is expected to include \$0.02 of dilution from the reduction in the beneficial interest asset and any future data breach expenses which are not expected to be material.

For the full year, the center of our adjusted EPS expectation remains at \$3.20. GAAP EPS is expected to be \$0.45 lower than adjusted EPS reflecting a variety of adjustments including debt retirement and breach related expenses.

Fourth quarter will mark a notable inflexion point as we annualize the data breach and expect to see the first year-over-year increase in operating profit this year. This would provide clear financial evidence of the healing process we've been engaged in throughout the year, and we look forward to entering next year with an energized team and positive momentum in our financial performance.

With that we will conclude today's prepared remarks. Now Brian, Kathee and I will be happy to respond to your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Sean Naughton from Piper Jaffray. Please go ahead.

Sean Naughton

Good morning, and thank for taking the question. So John, you mentioned there has been a lot of talk about gas prices and the potential positive benefit on the consumer. But just curious if you could speak to the potential benefit you may receive on the P&L from a distribution standpoint? And if those are savings that are there, how would you guys look to use those additional distribution savings between flowing through to earnings and potentially reinvesting to drive traffic?

John Mulligan

Yeah, I think a couple of things. Certainly there would likely be some benefits if we continue to see fuel prices come down, but we haven't reached the threshold where fuel surcharges begin to come out of our contracts and I

think importantly given the great work the team has done to manage some of the port issues out west, we are working around that and moving some freight further, expediting some freight, flying some freight, and I think net-net, that will probably be more of a drag than any fuel savings we will see.

Sean Naughton

So – and then I just guess just the second question on the overall basket, the UPT continues to be -- to decline and actually looks like it'll decelerate a little bit on a two-year basis. Just wondering if you could give us a little bit more color around that particular dynamic either at the store level perspective given the higher food concentration I would be expecting that to improve but maybe this is being offset by online? And I guess the follow-up would be is how do you improve that dynamic moving forward? Thanks.

Kathee Tesija

Yeah, Sean, this is Kathee. It's predominantly a mix story for us. So we have higher ticket items like all the Apple products including the launch of the iPhone 6 in the quarter. We've got video game consoles that are higher, we have a lot of trade-up strategies both in inessentials like you talked about like in grocery with organics, but also in areas like skin care which I described a little bit earlier. So this is really a mix story.

Sean Naughton

So it's less about the shift between online and store at this [point in time] [ph].

Kathee Tesija

Correct. Yeah.

Sean Naughton

Thank you, and best of luck for the holiday.

John Mulligan

Thank you, Sean.

Operator

You next question comes from Matt Nemer from Wells Fargo.

Matt Nemer

Good morning and congrats on improved US results. My first question is on expenses in the US. They've basically been running flat on a dollar basis this year, down a little bit per foot. I am wondering if you can get into a little more detail on what's driving the cost savings, and then in terms of the outlook, is this a line that you think you can run flat to up in dollars, up slightly in dollars over the next year or so or should we expect it to grow a little faster than that.

John Mulligan

Hi Matt. Yeah, I think the expense savings I would tell you, we've talked about the expense optimization efforts all year, been very focused on that and has been across the entire enterprise and we've seen good news in SG&A and also in the cost of goods. There are a couple of areas I would point out the stores performance has been outstanding driving productivity increases while still continuing to remain very strong guest service scores, frankly our guest service scores historically, so we have seen great performance there. And then it's just really many other areas. There's been great work done in marketing around the circular. There's been great work done in our transportation and how we optimize our network of transportation. So really across the enterprise. I think importantly to your question about [Indiscernible], we believe there continues to be significant opportunity for us to continue to take expense out and so for the foreseeable future we would expect to continue to see expenses very well controlled and to lever expenses at really -- relatively modest increases in sales.

Brian Cornell

And it's Brian. And to build on John's point, and as I discussed in my prepared comments, as we move forward, we recognize that we are going to continue to need to focus on expense management to fuel the investments we are going to make to drive continued growth across our store base and our digital platform.

So as we come back to you in the spring and we talk more specifically about our strategy, you should expect us to continue to talk about cost optimization efforts and how we will use those efforts to reinvest in the fuel that's going to drive our growth.

Matt Nemer

Okay, that's great. And then secondly on target.com, I wanted to ask a question about the free shipping program. Does the incremental volume offset the incremental shipping expense? Is it profit accretive? And do you think that the customers that are utilizing this offer are high life time value customers?

Kathee Tesija

Yeah, it's not accretive. I will tell you we do ship even prior to the holiday free shipping. We do free ship a lot more than perhaps you would think and certainly more than some of our competitors given REDcard and the fact that that ships free all year round.

So we have seen -- we know it's the number one frustration with our guests and the number one reason for abandoned cards. And so it was important for us this holiday season to be able to take that friction away and we have seen meaningful move in orders and conversion because of it. So we are very pleased with the result so far.

John Mulligan

Yeah, Matt, the only thing I'd add while not accretive -- the only thing I would add is it's not material either to our results in the fourth quarter.

Matt Nemer

Okay, very helpful. Best of luck this holiday.

Brian Cornell

Thanks Matt.

Operator

Your next question comes from Oliver Chen from Cowen and Company.

Oliver Chen

Thank you, and congrats. Regarding the -- the great idea regarding signature categories and where you are focusing there, how would you help us just prioritize which categories have the most opportunities in terms of lead time and revenue mix and timing of impact? And is the extrapolation there that traffic will be the biggest kind of comp upside driver as you do focus on these categories? Thanks.

Brian Cornell

Yeah, Oliver I think as we go forward, and as Kathee and the team really elevate our focus around those signature categories, categories like baby and kids, wellness and style, you should expect to see additional focus in store. You should see additional innovation, partnerships. But really ensuring that we are leading with trend, we are anticipating what our guest is looking for in those categories, and those are categories that Target becomes

famous for. And we are certainly going to double down our efforts in those categories because our guest has asked us to. There are categories that are very important to our guest. They are synonymous with the Target experience the guest is expecting. And you will see signs of that as we move into 2015 and beyond. Certainly some of the work that Kathee and her team have done in preparation for the fourth quarter are already bringing our efforts to life in apparel. Some of the things that we have done in home, the partnerships that Kathee talked about in her prepared comments, our continued focus on baby and kids and we know how important toys are during the holiday season. So we are already making progress in those spaces.

But I also want to make sure it's really clear that does not mean we are walking away from other categories in our stores. They just play a different role in our future strategy and there'll continue to be areas where we are going to look to improve our execution and performance. But from a prioritization standpoint we think those signature categories that we've talked about are key to the guests. The guest has told us those are critically important to them and Kathee and her team are working rapidly to ensure that we continue to build our position, enhance our assortment, and bring great newness and innovation to those key categories.

Kathee Tesija

So a couple of things I would add to that you will already see in stores right now. Brian talked about those four areas, baby, kids, wellness and style. So in baby, about 200 stores have a new presentation where we have invested in labor in the stores to help guests create registry and gift givers find the perfect gift.

We have added mannequins and things that help the presentation. I also chaired today the registry that we have redone completely - the whole experience from the in-store hardware to the software that we use and how that helps guests create registries much easier. We are already seeing the benefit of that.

Wellness, we have talked a lot about Made to Matter, and better for you products. So you see that already this year. And then in style just to touch on that for a minute, we now have about 650 stores that have our new presentation in apparel including mannequins. So already some progress and we will continue to push forward in those areas and you will see more and more as the months and year goes on.

Brian Cornell

Oliver, the final point I'd add, as we think about style. Certainly apparel and home are critically important in that space but so is beauty. And as John and Kathee have referenced, we use one of our standout categories in the third quarter and we expect continued strong performance as we exit the year.

Oliver Chen

Thank you. And just as a follow-up that's related. There seems to be a lot of energized agility Brian regarding -- thinking about what Target stands for from a bigger picture perspective. What are some of the initial thoughts on where you see that opportunity as you work to further differentiate and innovate yourself?

Brian Cornell

Oliver, I think, we are making progress across a number of different areas. Certainly we talked about omni-channel, and really making sure that we are a significant player in this space. We are seeing very strong performance up over 30% in the third quarter. John talked about that that we expect that performance to accelerate in Q4. We clearly took away the pain point of shipping by announcing free ship in the fourth quarter and we think that's another way for the [indiscernible] to declare we are significantly committed to this space.

We are seeing a great response to Cartwheel and have 11 million users today, and we are going to use that to make sure that we use digital as the front door to connect to the target brand going forward.

We talked about some of the progress that's being made in merchandising and we've got 35,000 new items in stores for the holiday. And we are going to continue to test and partner as we continue to make sure we are bringing the right solutions to our guests.

If you haven't seen some of the holiday creative, I think it's some of the best Target's delivered in years and I am getting emails and comments from guests and friends and people I know everyday talking about their reaction to the holiday creative and how the curative campaign it's uniquely Target. And we are certainly upping our game both in-store. But we are also going to spend significantly more in digital this year to touch our guests no matter how they are connecting with the brand.

In-store we have made significant progress in a very short period of time going from testing, ship-from-store, to now we are in 38 markets, 136 stores where our stores are acting like flexible fulfillment centers. You can shop there, you can pick up there, but they are also shipping to -- directly to

our guests. And allows us to cover 90% of our marketplace in a very short period of time. Takes the pain away from that last mile.

So I think you are going to continue to see us make these points and that's a sneak peak of Target in the future. And I think that is creating positive energy in the organization.

Kathee and I are hearing really positive things from our vendors. Our organization knows we got to be more -- we got to show more agility, we got to be responsive, we got to make sure we are externally focused in following the guest. I think you are seeing some of those things take shape today.

Oliver Chen

Thank you. Thank you very much. Best regards for the holidays.

Brian Cornell

Thank you.

Operator

Your next question comes from Wayne Hood from BMO Capital.

Wayne Hood

Yeah Kathee, I have questions, maybe a little bit longer terms in places of the context of how you evolve a company and that is related to where you see AUR trending because you are talking about more of this is in kids and baby which typically is lower ticket and maybe pulling back on promotions and electronics because that's not cooler. I am just wondering where you think you are AUR might land over the next few years in light of kind of 2% to 3% growth you've been experiencing under the existing strategy. And then if you could talk about -- John, if you could talk about the growth in inventory next year and its impact on working capital as you think about being better in stock on the ad merchandise and the like? Thank you.

Kathee Tesija

We haven't modeled exactly what that will be yet. But I would tell you I think it will be moving up for a couple of reasons. So you heard Brian talk about those areas that we are going to focus on and really being famous for them in delighting our guests. And when we are at our best we offer both expect more pay less together in all of these categories and that means a really thoughtful balance of good better best having clear features and benefits as we move up that ladder allowing guests to be able to buy

whatever is important to them but importantly offering really good trade-up opportunities. So you are seeing some of that right now in some categories. But I think as we move forward, and we become famous again for some of these categories, there will be a lot of trade up opportunities.

So I would say overall, seeing it moving up.

Brian Cornell

And Wayne, your second question, inventory, I think, the one thing I would say if you look at our number this quarter, 6% to 7%, all the US, really only about a third of that do we view as temporary. The vast majority of that was receipt timing. But that curve we expect to stay around; we started that in second quarter this year. We will cycle it again next year in second quarter somewhere around 2% to 3% increase for the first half and next year. But offsetting that ultimately as we start to get back to positive comp sales, we should see faster turn and that should ultimately lead to better payables leverage.

So not a meaningful impact overall once we get past fourth quarter here on our working capital.

Wayne Hood

Right. Thank you.

Operator

Your next question is from Greg Melich from Evercore ISI.

Greg Melich

Thanks. I have two questions that are maybe a little bit linked. John if we start on dotcom which if my [indiscernible] writes around 2.5% of sales in the quarter. What does that do to the margin going forward? I know you mentioned it sort of immaterial for the fourth quarter but tell us what it did in the third quarter and how we should think about it? I mean it's probably dilutive of some effect and whether it's more in gross margin or SG&A? And then I had a follow-up.

John Mulligan

On margin, it's definitely dilutive, Greg, if for no other reason in the shipping expense. And I think as it continues to grow, that will put margin pressure on the P&L and we've talked a little bit about this. There are lots of puts and takes in gross margin as we think about it going forward that we're working through today. As that business grows, it will be margin dilutive. But as we

increase penetration of ship-from-store and pickup in-store that significantly not only improves our guest experience, but significantly improves the P&L.

We're also balancing how we look at pricing right now and balancing inventories across the network as we ship from store. So some of those are up, some of those are down. And we're working through right now where ultimately gross margin will land.

Greg Melich

And then the follow-up, and maybe Brian, you -- in your comments, you talked about making sure in the five-key operating principles, that invest to build capabilities. I love your perspective on -- this year CapEx is down a lot and we're running I guess a little over \$2 billion as the run rate. What do you think is the CapEx need sort of going forward to invest in what Target really needs to do to be the best it can be?

Brian Cornell

Greg, we're assessing that right now as we think about 2015 and beyond. But you should expect us to be investing in the capability to continue to build out our digital experience, to continue to enhance our in-store experience, to make sure we have the analytical tools to properly manage expenses and margin even more surgically going forward. And I talked about -- while certainly in the early stages, we're going to continue to look at smaller formats and how we use smaller formats to penetrate urban markets, allow our guest a chance to interact with the Target brand both in-store, but also continue to build out the opportunity for them to purchase online.

So we're in the early stages of assessing our long-term capital needs, but you should expect us to be investing in the right capabilities and tool to provide long-term shareholder value and allow us to continue to fuel our growth and enhance both margins and continue to manage operating expenses effectively.

Greg Melich

Would that mean CapEx would be above D&A at some point in the future or do you think you can stay below that?

John Mulligan

Greg, we think -- at least Brian said I think with the caveat that we're working through this right now, we think we're probably in about the right range right now. The spend may move around a little bit. I think the one

wild card is the point Brian made about small formats. But I would note that obviously the investment there is significantly below what a prototypical Target would look like. So it would take a lot of those to meaningfully move our CapEx number. So like we've talked about something in for the US in that \$2 billion -- \$2.5 billion range still makes sense, but we're doing the work right now.

Greg Melich

That's great. Thanks a lot. Good luck for holiday.

Brian Cornell

Thank you.

Operator

Your next question comes from Matthew Fassler from Goldman Sachs.

Matthew Fassler

Thanks a lot and good morning. I know there's a lot of big picture questions to discuss, but actually I have two quantitative ones related to the quarter. First of all, John, can you talk about the expense, the magnitude of the expense dollars that shifted from the third quarter to the fourth and talk about perhaps functionally speaking what they're related to?

John Mulligan

Yeah, most of it is marketing moved around. And the magnitude, if you think about us beating by somewhere in the neighborhood of \$0.09, is a little bit less than half the beat. So somewhere in that \$30 million to \$40 million moved between the quarters.

Matthew Fassler

Got it. Thanks for that. And then secondly, you talked about running ahead of the fourth quarter plan. Just as we think about the cadence of that plan, obviously you had a tough January as did many retailers particularly given the breach. So when you say running ahead, is that running ahead of the 2% number as we speak or running ahead of a plan that's maybe a bit more nuanced than that as we think about where we are in the progression of the quarter and your compares a year ago?

John Mulligan

Well, I wouldn't want to get into that level of detail. Clearly, last year pre-breach was stronger than post-breach, and we took that into account as we thought about the calendarization of the plan, and right now we're running ahead of that and we feel good about where we're at, not only relative to the plan, but on an absolute basis is what I'd say. But there is a lot of business left to be done before we get to the end of January.

Matthew Fassler

Got it. Thank you for both of those, appreciate it.

Brian Cornell

Thanks Matt.

Operator

Your final question comes from Michael Lasser from UBS.

Michael Lasser

Good morning. Thanks a lot for taking my question. It's on the food category. And recognizing you're not going to deemphasize it, you're just going to streamline it, how are you thinking about the return profile of that space within the store? And then could there be any differences in amongst how space is allocated, could that area get less over time?

Brian Cornell

Yeah, and let's drop back and make sure we clarify our point on the food category. We have no intentions today to streamline those categories. But Kathee and the team are certainly stepping back, listening to the guests, really understanding what the Target guest is looking for in food. From an assortment standpoint, from a newness standpoint, we talked about the fact that as we go forward, you should expect to see more natural and organic offerings. We've seen a terrific response from the guests, it's something that we call Made to Matter, a collection of items that are on trend for our Target guest, feature a number of exclusive items that Target from manufacturers that are in the organic and natural space, that can bring great innovation, gluten-free, on-trend products to our guests. And we certainly recognize that we have an opportunity to connect with the guests in a different way when it comes to food. But you shouldn't expect us to deemphasize those categories. That's not the point. We're not streamlining our food offering, but we are stepping back and really listening to the guest, making sure we curate on their behalf the right items that are uniquely Target that meet the needs of our guests in the food categories.

So a lot more to come as we talk about this in the first quarter, but to make sure we're really clear, we're not streamlining food. We're not de-emphasizing food, we're not walking away from food. But we certainly want to make sure we put our mark on the food category with items that are uniquely Target, that are right for our guests, that are on trend, and you should certainly expect to see more natural, organic offerings in that space because the Target guest has asked for them.

Michael Lasser

Okay, that's very helpful. And you think you can manage the return profile on that space to certainly meet the hurdle lights that you expect from it?

Brian Cornell

We would certainly expect to see that, and Kathee talked about some of the changes we're seeing in mix. And certainly when we talk about natural organic, when we talk about some of these unique items, they tend to have a higher average unit rank.

So you should expect to see some mix changes, but importantly, food is an important part of our future. We're not going to deemphasize the category, we're not looking to take away space. We want it to be more impactful, more on trend, and we want to fill it with items that the Target guest is looking for.