Good morning, and welcome to our 2011 First Quarter Earnings Conference Call. On the line with me today are Doug Scovanner, Executive Vice President and Chief Financial Officer; and Kathy Tesija, Executive Vice President, Merchandising.

This morning, I'll provide a high-level summary of our first quarter results and priorities going forward, and Kathy will discuss category results, guest insights and upcoming initiatives. And finally, Doug will provide detail on our first quarter financial results and outlook for the rest of the year. Following Doug'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 Doug will be available throughout the day to answer any follow-up questions you may have. Also as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our SEC filings.

This morning, we announced first quarter earnings per share of $0.99, up 9.8% on top of last year's 30% increase. This performance was the result of unusually strong profitability in our Credit Card segment, which offset the impact in the Retail segment of softer-than-expected sales.

In the Retail segment, driving sales continues to be our biggest challenge and #1 priority. Comparable store sales grew 2% in the first quarter due to the contribution from our remodel program and 5% REDcard Rewards. Outside of sales and traffic driven by these initiatives, guests were cautious in their behavior as they faced continued economic headwinds, including near record high prices at the gas pump. As a result, food and commodity categories performed well while we experienced less consistent patterns, including some sales declines in the rest of the store.

In our Credit Card segment, we continued to benefit from strong execution and disciplined underwriting by our team, combined with an improving credit environment. As a result, portfolio risk levels continued to decline, leading to a strong improvement in expenses and profitability compared to last year. While the U.S. economy is showing some signs of improvement, we expect the recovery will continue to be slow and uneven, particularly for more moderate-income households. We believe these households need to see further improvements in housing and income growth before they'll have the capacity to meaningfully increase their discretionary spending. In addition, unemployment remains stubbornly high, hampering overall consumer sentiment and spending.

Our PFresh remodel program is on track in driving meaningful increases in traffic and sales. We now have 550 general merchandise locations incorporating our expanded food layout, and we expect to remodel approximately 300 more locations by the end of October. These remodels completely transform the look and feel of the store, creating a more relevant assortment in a more compelling and exciting shopping environment. Guests continue to tell us how much they love what we've done to their Target in these remodels, and they show us by increasing their trips to remodeled stores, causing traffic to increase an average of about 6% in the first year after the remodel is completed.

Our other major sales driving initiative, 5% REDcard Rewards, is also performing as expected, enhancing loyalty and driving incremental traffic and sales among our better and best guests. Even though this program only launched nationwide last October, REDcard sales penetration increased 2.7 percentage points above last year to 7.6%, a level we haven't experienced since 2003. And household level data continues to confirm that just under 1/2 of this additional sales penetration is the result of purchases that are incremental for Target.

Beyond these broad initiatives, our merchandising teams are working diligently to drive units, consistent reliability and value on high-quality well-designed merchandise in every assortment. We are fostering an environment that rewards appropriate risk taking, ensuring our teams are constantly seeking new ways to surprise and delight our guests on every visit to our stores and target.com. We want our guests to be confident that they can find reliably low prices on the items they need while creating excitement with the latest fashions and trends throughout the store.

In our stores, we are vigilant in our efforts to provide a superior shopping experience with clean, safe, well-organized stores and fast, friendly service on both the sales floor and at checkout. We opened 10 new Target stores in March, getting 5 locations net of one relocation. We expect to open another 15 stores in the next 2 quarters, and we continue to look for opportunities to open additional locations of our current formats in markets throughout the U.S.

We're very excited about the upcoming launch of our new online platform, which we expect to greatly improve the shopping experience for online and mobile guests. This ambitious project is on time and on budget, and our team is now focused on executing a flawless launch in terms of stability and the overall experience. We've designed this experience to be best-in-class, providing greater personalization, advice, community, navigation, product detail and visual appeal.

Looking beyond 2011, we will continue to open additional locations of our current formats in the United States when we find projects that meet our strategic and financial criteria. In 2012, we expect to open 15 to 20 new stores in our current formats and expect to slowly ramp up that pace in future years.

In addition, we continue to develop our plans for a new small urban format called City Target and expect to open about 5 locations of this concept in 4 markets in 2012. We're planning each of these locations with a very customized and local approach, designed to fit the particular trade area in which each store will operate. While this approach is a key to success for the City Target strategy, we expect to gain insights from these stores that we can apply to our larger format stores in the U.S. and Canada.

Our Canadian market entry continues to generate a great deal of excitement. We're still in the process of evaluating sites, working with landlords for the current Zellers stores to determine which sites we will begin to lease and subsequently how many of those sites will become Canadian Target stores.

Separately, we're building and developing a Target Canada team, which is responsible for developing and executing our marketing entry strategy. This team is deeply engaged in studying Canada broadly, along with each of the separate markets throughout the country. This will allow the team to develop a detailed merchandising and marketing strategy that will meet the unique needs of the Canadian guests in each province.

In addition, this team is developing technology and supply chain solutions that will allow us to open our first Canadian Target stores in early 2013. In each of these efforts, our goal is to stay true to the Target brand while ensuring that our strategy is appropriate for the Canadian market.

At Target, we say "Speed is life" and we're living it every day. Today's challenging environment requires that we carefully listen to our guests to understand their wants and needs. We need to constantly monitor the economic and competitive environment and understand how they impact our business. We're seeking new ways, both large and small, to drive traffic and sales in existing stores, while thoughtfully growing our store base in the U.S. and beyond. We won't take anything for granted. We're proud of our brand and long history of strong performance and committed to enhancing both.

Our team, more than 355,000-strong, is aligned, energetic and moving our business forward. I want to recognize them for their tireless effort. They define our competitive advantage and make me proud to be at Target every day.

Now, Kathy will provide more detail on our first quarter results, share recent guest insights and outline initiatives for the second quarter and beyond. Kathy?

Kathryn Tesija

Thanks, Gregg. In the first quarter, we experienced consistent strength in our less-discretionary assortments like healthcare, beauty and food, while we saw volatility in the sales of many other categories. At times, the volatility correlated with weather patterns across the country, and clearly, Easter timing had a dramatic impact on the pattern of March and April sales.

As we've outlined in prior conference calls, guests are shopping closer to the moment of need, waiting until the last minute to come out and cautiously spend. We saw this pattern in April as holiday-sensitive categories like candy, toys, entertainment and kids' apparel experienced a notable surge in the 2 weeks before Easter.

Recent guest research indicates that confidence in the future is once again increasing, particularly for upper-income households. Consumers continue to place a priority on reducing debt and are now more likely to save up before spending on events like a vacation. Guests continue to indicate that household budgets are tight, particularly in the face of higher gas prices but they acknowledge that their spending discipline creates fatigue over time, leading to an occasional indulgence when presented with the right opportunity.

As Gregg mentioned, we're working diligently to provide our guests compelling reasons to visit our stores and to fill their baskets on those visits. While we can help our guests by providing great prices on high-quality items, we can also help them to find opportunities to splurge, in small ways, that feel smart and responsible.

In electronics, committed to providing more knowledgeable service, helping guests make more informed decisions and find exactly what they want. Our guest surveys show that we've made meaningful progress with higher ratings for an engaging experience and having knowledgeable team members who are available when they're needed. We've also added a trade-in program at our Target Mobile locations, providing guests a convenient way to responsibly return outdated devices while earning Target store credit that can be used for purchases in any category across the store. Target Mobile is in about 1,300 stores today, and we'll have this concept in about 1,490 stores by the end of June.

We're also pleased with the results since we launched My Target Tech last year. Guest satisfaction with this free support service has been very high, and we've seen a decline in electronics items returned since the launch of the program.

In healthcare, we're pleased with increases in awareness resulting from our Ask Us campaign, which highlights our approachable and friendly pharmacists. This year, we're continuing to focus on assuring our guests that Target can make healthcare easy and affordable, offering convenient services like flu shots at an amazing price.

In both Healthcare and Beauty, we've identified an opportunity to enhance segmentation across stores and markets, providing deeper multicultural assortments and addressing demographic groups like empty-nesters.

In Home, we've identified opportunities to better serve key guest segments in assortments like kids party, where we're seeing great results with our new owned brand Spritz. We're also strengthening our assortment and presentation in key areas like kitchenware because we know that many of our guests are increasingly focused on cooking and eating at home. We're focused on an opportunity to help guests furnish small living spaces, providing thoughtful and affordable solutions that make these spaces feel more comfortable and functional.

And with our current dominance in seasonal holiday programs, we're focusing on an even stronger presence in key seasons: Valentine's Day, Easter, summer, Back-to-School, Back-to-College, Halloween and the fourth quarter holiday season.

Target's theme for summer this year is Make Summer Funner, highlighting Target's role in helping guests make the most of the season. We'll offer nautical-themed graphics on water bottles, beach towels, lanterns and paper goods and incorporate bright colors and sunny patterns in tabletop items, backyard essentials, picnic and beach supplies.

In apparel, we continue to see incredible growth in C9 by Champion active wear and we believe we have the potential to continue to grow this billion-dollar brand. This assortment is a perfect fit with the Target brand and core guest, providing men, women and kids with outstanding value on the latest technology on products that support their family's health and well-being.

We continue to evolve our designer partnership strategy, focusing on fewer but bigger programs. We're currently enjoying strong sales across multiple categories with our limited-time assortment from Calypso St. Barth. And we're very excited about our recently announced partnership with Missoni that will launch this September for a limited time. Target will be partnering with this high-end designer brought brand to introduce a limited-time collection spanning multiple product categories, including home, baby, beauty and apparel for women, men and kids.

Beyond limited-time programs, we're focusing on bringing value, differentiation and newness to every part of our store. For example, in denim, we continue to build on successful strategies from last year like adding additional fit options for women and deepening the category throughout apparel. In addition, strong back wall presentations look great and allow us to be more reliably in stock every day. We're particularly excited about our partnership with Levi Strauss and the launch of their Dennison brand exclusively at Target in July. This will provide a great opportunity to expand our branded offering and will serve as a perfect complement to our existing denim assortment.

In home, we're pleased with early results from the recently expanded Smith & Hawken collection available on target.com, which includes expertly crafted teak patio furniture, solid-forged garden tools and decor items.

In food, we just launched 2 exclusive new Ben & Jerry's Ice Cream flavors in April, Volun-tiramisu and Peanut Butter World. These whimsical flavors support Target's partnership with Ben & Jerry's in support of volunteerism by encouraging guests to visit VolunteerMatch.org after they've enjoyed one of these summer treats.

In entertainment, we continue to enjoy partnerships with world-class artists across the musical spectrum, offering deluxe edition CDs with additional content available only at Target. In the first quarter, we announced partnerships with Grammy award-winning singer and actress Jennifer Hudson, and country artist Alison Krauss. With the theatrical release of the movie Cars 2 in June, we're planning a broad assortment of themed items across multiple categories, including bedding, sleepwear, food and toys.

In toys, we will make a dominant statement with 65 items, including 21 that are available only at Target. In our stores, we'll capture every child's attention with an interactive end cap showcasing an exclusive line of powered racing sets.

And in beauty, we continue to make specialty beauty accessible and affordable through designer cosmetic and hair care collections. This spring, we're launching new products from Sonia Kashuk, Jemma Kidd, Napoleon Curtis and Pixi by Petra Strand.

In the last conference call, I outlined our plans to preserve gross margins in the face of input cost inflation in fabrics and other raw materials. During the first quarter, these pressures accelerated as rising oil prices lead to increases in shipping costs. As I indicated last quarter, we're attempting to drive down costs through product design, fabric standardization and optimization of pricing, promotions and sizing. However, in some cases, we've had to increase retail prices to offset higher costs, and we've seen others in the marketplace do the same.

For the spring, we've increased prices in the low- to mid-single-digit range for some categories in apparel, and increases have been in the double digits for some items in soft home. For the fall, we now believe increases will move into the double digits in both apparel and home and will affect a greater portion of these assortments than in the spring. We'll continue to be thoughtful and strategic in our approach to pricing, and we'll continue to monitor the market to ensure our prices remain competitive. Importantly, when we anticipate retail price increases, we are diligent in adjusting unit buys to ensure that our inventory position remains appropriate.

While we noted the environment presents numerous headwinds, we embrace the challenge of driving profitable sales and providing our guests ever-increasing value on the items they want and need. We know our guests expect Target to deliver on both halves of our "Expect More. Pay Less." brand promise, and we are confident we can continue to earn deeper guest loyalty by anticipating their ever-changing needs and surprising them with newness on every visit.

Now, Doug will cover first quarter financial performance and provide details on our outlook for the remainder of the year. Doug?

Douglas Scovanner

Thanks, Kathy. This morning, I'll provide additional detail on our first quarter results then summarize our progress on the 2 major transactions we have underway, our acquisition of Canadian leasehold interests from Zellers and our intended sale of guest accounts receivable, and a related agreement to service these accounts going forward. At the end of my remarks, I'll wrap up with some clarified guidance on our expectations for the rest of the year.

As you know earlier today, we released our results for the first quarter which included earnings per share of $0.99, representing a 9.8% increase from the record $0.90 we earned in the first quarter of last year. As is usually the case, these results contain certain elements that should be celebrated and another set of elements that clarify our near-term challenges.

In our U.S. Retail segment, our sales growth was weaker than we expected at the beginning of the quarter, while our EBITDA and EBIT margin rates were in line with our expectations. Although these margin rates were lower than last year's levels, as we discussed in our prior conference call, this had more to do with the exceptional strength of last year's pace than with any aspect of this year's performance. Our EBITDA margin rate of 10.1% of sales, for example, is the second best performance on this metric in any first quarter in modern history, second only to last year's achievement of a 10.7% of sales.

We expected our gross margin rate to decline in the first quarter due to the strength of last year's base and the impact of our 2 sales driving strategies, if the magnitude of this decline was slightly worse than we expected. Offsetting this impact, our expense performance was a little better than we had expected. Net-net, the key to our future prosperity lies in the continuing challenge to reinvigorate our sales growth while generally preserving our very healthy EBITDA and EBIT margin rates in this segment.

In our U.S. Credit Card segment, our core performance measures segment profit grew from $111 million last year to $194 million this year, principally as a result of an acceleration of favorable trends in nearly all measures of risk related to these Credit Card loans. As a result, bad debt expense recorded in the quarter fell to only $12 million compared with $197 million last year. While the magnitude of this improvement is not likely to be sustainable, our risk trends continue to be very impressive in this segment.

Also as previously discussed, our results today included a Canadian segment for the first time. In the quarter, we recorded $11 million of startup expenses in this segment, diluting our aggregate EPS results by about $0.01.

We aggressively executed against our share repurchase authority in the quarter, as we wanted to get a strong jump on our annual plan early in the year. In total, we invested just over $800 million buying back our shares, reducing our outstanding shares to 689 million at quarter end. This is the first time in decades that our shares have fallen below 700 million on a split adjusted basis. For reference we peaked at just over 913 million shares in the first quarter of 2004.

We continue to believe that this activity will create a lot of value over time for our remaining shareholders, as we believe that our shares are significantly undervalued, even in light of our challenges in the current environment. The value created from this activity will be especially strong if we come even close to producing the $8 of EPS we believe is achievable by 2016 or 2017.

Turning to the 2 transactions which are in flight at the moment, let's first review our Canadian market entry. As you know, we agreed in January to pay Zellers a fixed price of CAD $1.825 billion for an option to acquire up to 220 of their existing store leases. At that time, we outlined our plan to convert somewhere between 100 to 150 of these sites to open as Target stores in 2013 and 2014, as the first step to what will likely add up to more than 200 Target stores in Canada over the next 10 years.

Our first payment of 1/2 of the amount owed to Zellers is due at the end of next week, enabling our acquisition of up to 110 of these leases. We're delighted with the progress we've made so far with landlords who collectively comprise the significant majority of the stores we want to convert and nearly all of the best stores we hope to convert.

Within the next few weeks, we expect to be in a position to clarify how many leases will be named in this first tranche, and more particularly, of that total, how many we expect will become Target stores after a significant investment in leasehold improvements.

Between now and September, we'll continue our discussions with the remaining landlords and also with third-party retailers to determine from the remaining Zellers stores which leases we might choose to assume for our use and which leases we might elect to assign to other retailers or assign back to the landlords, in either case, in exchange for some form of consideration. Of course, any leases that are not ultimately part of our transaction will remain with Zellers.

Turning next to our intended sale of credit card receivables and to the related servicing agreement we intend to execute with a bank partner, the initial interest in partnering with us was as strong as we would have hoped and expected. And at this point, we're proceeding to a phase of more detailed 2-way due diligence with a smaller set of carefully selected, high-quality, large financial institutions. Importantly, we continue to believe that such a transaction could potentially close later this year, allowing us to sell the existing portfolio and enter into a strategic and financial arrangement with our new partner, all on terms that each of us would view as in our best interest.

During the quarter, we successfully completed discussions with the Chase Card Services business segment of JPMorgan Chase to allow, at our option, an early exit of our 2008 transaction with them in exchange for paying a make-all premium at the time of such an early exit. This enables us to market our Credit Card portfolio to others without the complexity of needing the workaround or otherwise accommodate this existing 2008 arrangement.

Now let's turn to our outlook for the second quarter and for the rest of the year. The dynamics I've just described regarding Canada envision closing on a large number of highly valuable Canadian lease transactions sooner than we originally anticipated. Strategically, this is terrific news. Although in the short run, it will create more of an expense burden as we recognize additional depreciation and amortization expense. 90 days ago, we said that the direct expenses of our planned Canadian market entry would burden our 2011 EPS by roughly $0.10. And that together with indirect effects, our overall results would be $0.15 to $0.20 lower in 2011.

We also tried to be clear that these figures were likely to change as we gained more clarity throughout the year. As of today, we believe that the estimate for direct expenses should be raised from roughly $0.10 to a new range of $0.16 to $0.20 for the year, reflecting an expected $0.05 to $0.06 EPS impact in each of the next 3 quarters. This provision is driven in part by these strategically important real estate dynamics and in part to a more refined analysis than was possible until we were further along in the process.

In summary, both the expected profits once we open in Canada and the expected burdens prior to opening, are larger than we thought was likely 90 days ago.

Today, the median First Call estimates for Target for the second quarter and full year are $1 and $4.23, respectively. Our ability to deliver results in line with these projections depends in large part on 3 key measures of our performance. First, we clearly need to pick up the pace of same-store sales increases to drive the top line growth required to deliver this kind of EPS performance. We continue to expect same-store sales growth to meaningfully accelerate as the year progresses, even in light of our softer-than-expected sales performance in the first quarter. So far through the first half of May, we've enjoyed a stronger sales trend, and were on pace to achieve growth in same-store sales, consistent with the low- to mid-single-digit outlook we shared at the beginning of the month.

Second, we would need to produce U.S. Retail segment EBITDA margins in the range of a fully healthy 10% for the year. In the first quarter, as expected, we experienced a margin rate decline, which put this rate at just over this 10% benchmark. And in the second quarter, we again expect to deliver EBITDA margins in line with our first quarter experience. For the fall, we would need to at least stabilize year-over-year trends to achieve a rate close to 10% for the year.

Finally, we would need to continue to experience the very strong trends we've enjoyed over the past several quarters in our U.S. Credit Card segment. We believe we're likely to enjoy average pretax returns on the capital Target has invested in this segment in the range of 20% or better on an annualized basis for the rest of the year. Please bear in mind that beginning in the second quarter, the kind of year-over-year growth in segment profit we've enjoyed for some time will be behind us, as the amount of capital Target has invested in this segment is quite a bit less than we had invested last year and as we cycle prior-year periods that produced similarly strong ROIC performance, driven in part by reserve reductions

So what does this all mean? To us, it means we recognize there are clear risks to our ability to achieve the magnitude of EPS growth implicit in current external estimates, and some of these risks were underscored in the first quarter. In the second quarter, an EPS outlook of $1, which represents the current median First Call estimate, seems potentially achievable. Although as of today, it is above the midpoint of a reasonable range of likely outcomes.

Similarly for the year, $4.23 seems as if it is above the midpoint of a reasonable range, requiring us to achieve some combination of all the 3 key performance benchmarks I outlined a moment ago to get there.

Now Gregg has a few brief closing remarks.

Gregg Steinhafel

We're pleased with our first quarter EPS performance but we're not satisfied with our Retail segment results. We are focused on driving sales through major initiatives like our PFresh remodel program and the 5% REDcard Rewards, while driving value and innovation in every category in our stores and online.

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

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of David Strasser with Janney Montgomery Scott.

David Strasser - Janney Montgomery Scott LLC

I'm just trying to look a little bit at the demographics. I mean, I think one of the things that you've talked about a bit, Wal-Mart has talked about it particularly low [ph], and on work we've done at the lower end, in particular, continues to be a lot tougher than mid or higher end. Can you just kind of give a little bit of a view about what percent of your business is $50,000 and below? Or however you feel comfortable giving some of that graphics and just kind of frame sort of where some of that difficulty is coming from?

Douglas Scovanner

Well, the way we would characterize our answer to that question is that we take a look back at the profile of household income demos of our guests and the guests of several competitors through some purchased research. The last time we looked at this carefully, our median is just over $60,000, that is well above that of Wal-Mart and well below that of say Kohl's, Costco, Macy's, Bed Bath and others.

David Strasser - Janney Montgomery Scott LLC

I guess if I ask you a little bit differently, what -- as you kind of look at your analysis of your customers, how different is sort of the, I guess, if you want to use the median, how different is the spending that you're seeing below your median income versus above or how impactful do you think that is to the business?

Douglas Scovanner

I think it's highly impactful, and I personally don't need to look any farther than what's happening with the success of our 5% Rewards program to see that the response by guests driving the incremental sales is very heavily skewed to guests who are already our best, better and best guests measured in annual sales. And by and large, that set of guests is above the median 60-plus thousand dollar income figure that I referenced earlier. So our sales growth is coming from the top 1/2, not the bottom 1/2 of the income profile of guest households.

Gregg Steinhafel

I would also add that the affinity for Target and whether they like us and enjoy shopping in our stores is very robust, and it's the same in all demographic strata. So even those that are more economically challenged at below the $60,000 or below the $50,000 a year household income still love shopping at Target but they just have less discretionary income to spend on those want kind of trips that as when times are better, they would look to Target to come to.

David Strasser - Janney Montgomery Scott LLC

And just one last final question, I apologize, but as you kind of look at the REDcard, I know you kind of look at sort of the trend so far relative to what's happened in Kansas City. Has that continued? Has it gotten better or worse? Or is it still very much in line with that?

Douglas Scovanner

Our aggregate experience nationally is very much in line with precisely where we were in Kansas City a year ago, which gives me even greater confidence that what we said 3 months ago remains true today. And that is that we expect the contribution to our same-store sales performance from the 5% Rewards program to grow more rapidly in its importance, possibly adding close to 2 percentage points to same-store sales growth later in the year.

Operator

Your next question comes from the line of Adrianne Shapira with Goldman Sachs.

Adrianne Shapira - Goldman Sachs Group Inc.

Just, Doug, following up on that, if you could update us in the quarter in terms of the 5%, PFresh, what that contributed to the quarter comp and maybe help us think then what that implies for the core?

Douglas Scovanner

Each of 5% Rewards and PFresh contributed more than a full percentage point, by our estimates, to our total same-store sales growth of 2.0% implying that the core, as you term it, was slightly negative in the quarter. Using that same definition, I think it's important to observe that we're cycling against a core figure that was the strongest quarter last year by some measure. We do not expect the core, by that definition, to remain in negative territory for the balance of the year.

Adrianne Shapira - Goldman Sachs Group Inc.

So just following that line of thinking, as you updated or gave us your thoughts on guidance, what does that imply for comps for the remainder of the year? I mean, last call, it sounded as if 4% to 5% was the commitment for the year. And how should we be thinking about that today?

Douglas Scovanner

I don't believe that I used the word commitment. I certainly used the words prediction or estimate or best guess or something of that kind in making that forward-looking statement. I believe that we remain quite likely to achieve 4% to 5% same-store sales performance in the fall. I believe that we're quite likely to experience better same-store sales growth in Q2 than we did in Q1. And likewise in sequence, better same-store sales growth in the fall than in the spring. Whether the math actually adds up and weights out properly for the full year to be better than 4%, hangs in the balance of how much better than 4% the aggregate of the next 3 quarters might be compared to the 2.0% that we just posted. Obviously, 2.0% was less than what we expected going into the quarter and therefore, it certainly adjusted the prospects of achieving 4% to 5% for the full year.

Adrianne Shapira - Goldman Sachs Group Inc.

Okay, helpful. And then, Kathy, maybe your comments on inflation in terms of what have you seen so far? You talked about low- to mid-singles in the spring, with soft home up double digits. Maybe give us a sense of elasticity and as you're expecting prices to be up double digits in the fall, you talked about being sensitive to units, how are you planning inventories in light of what you're seeing today in terms of elasticity of demand?

Kathryn Tesija

So in general, Adrianne, I would say that we are encouraged by our experience so far this spring. So you're correct that our apparel increases were up in the low- to mid-single-digit and we hit double-digit in some categories in home. And in general, we're seeing that our competitors are also taking their retails up so the market is moving along with the cost increases. And the response from our guest has been neutral to slightly positive on the sales line. So obviously, as we enter the fall season and the increases continue to grow in number of categories as well as the size, we need to continue to be very thoughtful and strategic in where we take those retail increases. But so far, based on our spring results, I'm encouraged.

Adrianne Shapira - Goldman Sachs Group Inc.

Okay. Then just lastly, Doug, the fact that Canada, we should be expecting a bit higher and faster on the expense side, should that also imply that we should expect these stores to open sooner than originally expected?

Douglas Scovanner

No. Our timetable for opening stores remains the same as we previously outlined. We expect to open in several waves beginning in the spring of 2013 and we expect from among the Zellers leasehold interests to open 100 to 150 total stores between 2013 and '14, with the majority in 2013.

Operator

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

Greg Melich - ISI Group Inc.

Two questions. One is on the traffic in the quarter. Clearly, sales was a disappointment. And while PFresh and REDcard are building, we did see traffic decelerate really from at any quarter last year but right into this year to 0.4% from 1.6%. Could you describe what that is, if it is the REDcard is building, is it bringing that higher-end consumer into the store more? What was really driving that deceleration in traffic?

Douglas Scovanner

I think this circles right back to the discussion we were having a moment ago regarding, I think the word was the core. In other words, excluding PFresh and 5% Rewards, we were slightly negative for the quarter. And the traffic trend that you're putting your finger on is right in line with that core figure. In other words, the fact that our units are accelerating and our average unit selling price is decelerating has a whole lot to do with PFresh, for example. And the traffic trend, excluding these initiatives, was negative in the quarter, and meaning that it drives -- it's a direct correlation with that implied negative core same-store sales result.

Gregg Steinhafel

Again, I would also add that first quarter traffic deceleration trends could also be due to the fact that seasonal merchandise did not perform as expected throughout the store. You've heard from other retailers that it’s been cooler and damper, so far compared to last year. And seasonal business is a big part of our business this time of year, and we too, were affected by that same trend. So portion of that was probably due to that as well.

Greg Melich - ISI Group Inc.

Duly noted, Gregg, you mentioned the weather, not Doug.

Gregg Steinhafel

We note it.

Greg Melich - ISI Group Inc.

And then -- and as a follow-up to that, if you're getting the traffic from that the higher-end consumer that has the REDcard, how are you thinking about really more aggressively changing the merchandising so that customer that is in your store more frequently actually cross-shops not just apparel, but home in particular where the comps have stayed soft?

Gregg Steinhafel

Well, we don't think the REDcard Rewards program changes the merchandising philosophy at all. I mean, we focus on newness and freshness and making sure that each and every experience is relevant. And so REDcard Rewards will complement that but there isn't any significant change in merchandising strategy as we think about that.

Kathryn Tesija

I would just add that because REDcard is our better and best guests and typically they are more affluent, that I think that's where we seeing some of the increases in our better and best price points, particularly the best. So some of our higher-end brands, this guest is shopping around the store, and we do see strength in that best category as well as good.

Operator

Your next question comes from the line of Deborah Weinswig with Citi.

Deborah Weinswig - Citigroup Inc

Gregg, you've comment -- or excuse me, Doug, you commented that expense performance is better than expected. Was that in Retail or just in Credit?

Douglas Scovanner

That comment was specific to our U.S. Retail segment.

Deborah Weinswig - Citigroup Inc

Can you expand on that, please?

Douglas Scovanner

Certainly. So we're talking about favorable leverage in round terms of 20 basis points of sales on a relatively soft 2% same-store sales performance. 2% in same-store sales performance usually, all else being equal, would create more of a neutral than a favorable expense leverage environment. On the positive side of the ledger, and thinking through the things that are likely to influence future quarters as well, first of all, our stores' teams did a magnificent job, favorably leveraging hourly payroll and benefits in light of that sales performance. Separately, in the notes to our financial statements, you can see that effective with the launch of 5% Rewards, we re-characterized the intersegment intra-company accounting, essentially our Credit Card segment, has a profit-sharing arrangement with our Retail segment just as we would expect to have a similarly structured arrangement with a new bank partner moving forward. Those 2 items alone represented net 100% or more of the favorable expense leverage. Separately, in the category of things that happened in the quarter that don't really have forward-looking value or benefits from my standpoint, oh, there's a host of offsetting issues from timing issues to accrual adjustments to generally unfavorable leveraging of things that are inflating faster than our 2% sales. But in the aggregate, that whole bundle of issues, generally nonrecurring issues, if you will, was relatively neutral in the quarter.

Deborah Weinswig - Citigroup Inc

And then Gregg, you said that you're not satisfied with the results so far. How much of that is macro versus how much of that is within your control?

Gregg Steinhafel

Well, it's hard to say. There's probably -- both factors are impacting our business. We clearly expected to drive stronger top line sales in the first quarter and we are disappointed that we didn't deliver on that. So we're working extra hard to try and gain share in both the discretionary and nondiscretionary side of the business. As we've said, our Beauty business, Healthcare, Food and need-based businesses were very, very solid and we struggled in the quarter in areas like electronics, music and movies, seasonal categories and some categories in home. All-in-all, we have to do better broadly across the store.

Deborah Weinswig - Citigroup Inc

All right. And then, Kathy, you talked about enhancing the segmentation in Healthcare and Beauty. Are you doing this in other areas of the store as well? And then maybe can you talk about is that technology-based or what's driving that?

Kathryn Tesija

We're segmenting across the whole store. My comment was, I think we, based on the success that we've seen, can go deeper in Beauty and in Healthcare. And this is fairly advanced at Target. We've been doing this for a number of years from volume strategies, climate strategies, lots of different segmentation. So this is just a continuation for us deeper into some categories where we still see opportunity. And particular, in both Health and Beauty, there's a lot going on there demographically. Our Hispanic and African-American guests are really responding for -- to our Beauty offering. And then I think with Healthcare, the aging of the population, that gives us opportunities to segment our assortment and improve upon our results.

Deborah Weinswig - Citigroup Inc

So this is really done at a centralized level as opposed to at the store level?

Kathryn Tesija

Correct.

Operator

Your next question comes from the line of John Zolidis with Buckingham Research.

John Zolidis - Buckingham Research Group, Inc.

Was wondering if you could talk -- there seems to be a perception that 5% Rewards and also PFresh, to a lesser extent, are being met with some cherry-picking by customers. So in that regard, they're coming in, they're using the discount or they're buying the lower margin consumable items, and therefore the margin impact of these 2 programs is more severe to the downside than what was anticipated in the original guidance. So I know you've commented on this in the past, but could you just address that? What are you seeing in terms of cross-shopping in different areas of the store?

Douglas Scovanner

You need to segregate the analysis between the 2, but in either case, the assertion that you've heard is just not true. In the case of 5% Rewards, the mix of sales driven at the margin, in other words, the incremental sales mix, is only slightly different from the sales mix of our base business before 5% Rewards. In the quarter, that mix issue regarding 5% Rewards had a trivial impact on our aggregate gross margin rate. In the aggregate, gross margin rate was down between 80 and 90 basis points. And the mix issue related to 5% Rewards was a low-single-digit number of basis points of that 80 to 90 basis point change. So with respect to 5% Rewards, totally off-the-mark. With respect to PFresh, we have acknowledged many, many times that the sales mix on the incremental sales at the moment is very heavily skewed toward lower-margin merchandise in the store, but that is right in line with our expectations, not different from our expectations. There, there certainly is a sales mix issue. It is exactly the one that we expected. Net-net, taking everything into account, the gross margin rate on the incremental sales, the incremental expenses and so forth, PFresh continues to deliver aggregate profitability right in line with our original expectations. So the 2 programs do behave very differently. In total, if you look at the gross margin rate change for the quarter, the significant majority of the rate change is attributable to these 2 programs. Let's call it 50 to 60 basis points of the aggregate 80 to 90 total. The 50 to 60 is the impact that we would expect these 2 programs to have going forward. The residual amount, unexplained by these 2 programs in the quarter, having a lot to do with last year's base, by the way, is a little bit of residual mix, adverse mix unrelated to these 2 programs and net, a small amount of gross margin rate change, adverse gross margin rate change, gross margin rate decline due to things other than 5% Rewards and other than PFresh.

John Zolidis - Buckingham Research Group, Inc.

And then on the Canada, just one follow-up. Do you still expect Canada to be accretive in 2013?

Douglas Scovanner

Expect the Canada, year-over-year, to be hugely accretive in 2014. Whether or not Canada is accretive in 2013 hangs in the balance of how dilutive it is in 2012, and that's something we have not commented on yet.

Operator

Your next question comes from the line of Robbie Ohmes with Bank of America Merrill Lynch.

Robert Ohmes - BofA Merrill Lynch

Two quick follow-up questions. I was hoping maybe, Doug, you can answer this. Could you remind us historically, I am sure you guys have analyzed this up and down over the last 10 years, what gas pump price impact, generally, is on your customers' spending habits and traffic? And if where gas is now, if that pattern is playing out the way it has historically or is there something different this time? And then the second is just a follow-up on the line of questioning you've been getting from Gregg and John and everybody else. I just want to understand with the commentary you gave on the Rewards program. So I think you're saying that it's skewed to your best guests, and the incremental sales mix is generally in line with what you were looking for. So then if I look at that, is the non-REDcard part of your customer base comping even more negatively than we all realized in the non-consumables portion of your mix? And if you could just sort of give us sort of more of a picture of where the shortfall is then, in the sort of home and sort of non-food consumable space?

Douglas Scovanner

Let me address the second set of questions first, and we'll come back to the gas price question. Nothing's changed in our 5% Rewards experience from our initial read of the Kansas City data long ago. It's driving -- it drove in the quarter a little better than a full point of same-store sales performance. The combined impact of the low-single-digit basis point change in gross margin rate and the, call it 30-ish basis point, change in gross margin due to the markdown component of the program is right in line with our expectations, right in line with Kansas City. Nothing's changed yet the program itself is still small enough that it's not masking any kind of underlying changes that are different from what's aggregate and reported. This is 7% or 8% of our sales with a fairly small change in the aggregate, and so it's not changing or masking any underlying trends. What we're talking about is the underlying trends are the same trends with and without 5% Rewards. A 7% of sales component of our business can't have that kind of impact to change the underlying dynamics. Separately, on the gas price question. You have to see the smile in my face. We've employed MBA summer interns a couple of times to do a pretty careful and rigorous statistical analysis and has come up short of having something that is reliable in a statistically significant sense that I could describe as a correlation. So I would say that the relationship is logical but is very hard to show on a time series in any kind of proper statistical analysis.

Operator

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

Peter Benedict - Robert W. Baird & Co. Incorporated

Just first on the CapEx, I don't know Doug, maybe you can talk about your most updated thoughts on what the CapEx could look like this year? Sounds like you've got some better visibility into what the new store plan will be for next year, so that's the first question. And then the second question related to the inventory levels. I know at the end of April, on your sales call, you had said that they're a little bit higher. It looks like that was the case with the numbers today. Can you talk about kind of the complexity of that inventory? Your thoughts on markdown risk given it sounds like May is trending a little better?

Douglas Scovanner

Sure. First of all, on the CapEx front. 3 months ago, we said we expected CapEx in our U.S. Retail segment in 2011 would be about $2.5 billion, plus or minus $200 million. And today, that outlook remains intact, $2.5 billion, plus or minus $200 million in the U.S. Retail segment. Kathy, do you want to comment on the inventory?

Kathryn Tesija

Certainly, yes. So overall, I think our inventory is in good condition as we enter the second quarter. We have very strong in-stock levels. As you mentioned, it is up. Our average inventory per store at costs versus last year is up about 6%, and it's really spread across categories so it's not lumpy or things that would worry me in terms of a markdown risk. So in total, I think it's good quality.

Peter Benedict - Robert W. Baird & Co. Incorporated

Okay, that's helpful. And then one follow-up, if I could. Doug, on the D&A, it was -- you'd leveraged in the quarter down about 1% year-over-year, how should we think about those rates trending over the balance of the year, particularly as I think, we get towards the back half of the year probably it'd be some Canada stuff that's impacting that?

Douglas Scovanner

Yes, let's stick with the U.S. Retail segment for a minute and talk about Canada separately. Over the last 12 months, we reinvested capital about in line with our annualized depreciation and amortization expense, and that's why year-over-year in dollars, there isn't much change. Certainly, one of the underlying factors is that both in the last 12 months and in the prior 12 months, there's quite a bit of accelerated depreciation due to our PFresh remodeling program. You may recall that when we first launched this program, we talked about the incremental $100 million or so of accelerated depreciation as we're writing off and replacing store fixtures and other store-based assets before their economic life, before their book life is exhausted. So in both cases, maybe 5% of the annual figure is due to this accelerated depreciation phenomenon, certainly less than that in the quarter because there is seasonal impact to the accelerated depreciation. Turning to Canada, as we move into the back half of the year, we'll have amortization expense associated with the $1,825,000,000 of premium that we're paying to acquire the leases. And in addition, the stores that we intend to occupy for accounting purposes will highly likely be leases capitalized on our financial statements and therefore, not only do we end up with amortization expenses of premium but also depreciation expense on the underlying leases. A combination of those 2 for the year that are already embedded in the comments that I made about Canadian dilution, call it maybe $40 million to $50 million.

Operator

Your next question comes from the line of Bob Drbul with Barclays Capital.

Robert Drbul - Barclays Capital

Just have 2 questions. The first one is on the e-commerce business, were the investments necessary in the potential top line benefits around the sole ownership and the responsibility for the e-commerce business as that business transitioned?

Gregg Steinhafel

Well, we don't disclose the investments that we've made in the technology in this overall re-platforming effort. I mean, it's been quite extensive over a multiyear period because Amazon has been the host for many, many years, and it's been a very significant undertaking for us it but it's one of the faster-growing parts of our business and we expect it to accelerate beyond even the fast pace that it is today when we launch the site fully later this fall.

Douglas Scovanner

And Bob, one thing I would add is the Amazon arrangement that we have today is largely a variable arrangement so it doesn't change margin dynamics at meaningfully higher or lower rates of sale. And by pulling it in house, we're essentially investing a generally fixed amount that would create a problem if sales fell and will create a benefit, perhaps a very large one, if sales were to increase, especially if they were to increase a lot.

Robert Drbul - Barclays Capital

Okay, that's helpful, thanks. And the other question I have is back again on the 5% Reward program. When you look at the success that you're having with the top customers, can you talk about the ability to sort of penetrate the non-top 10% customers and sort of what you think the hurdles are to sort of get even more penetration up for the other customer base?

Douglas Scovanner

I think you're looking in the wrong place. Right now, the penetration of the top 10% with this program is very, very low. I think the path to prosperity lies in continuing to harvest more and more and more of the top 10%. I mean bear in mind, when we say that the sales lift among this top 10% who take up the card is 40% to 50%, it means that if we were successful in putting one of those cards in the hands of every one of our top 10 guests, who collectively today represent nearly 1/2 of our sales, we'd have a 40% or 50% sales lift on 1/2 of our base. We'd have an instant overnight 20% or 25% increase in our sales. The key to prosperity is continuing to market the program to the guests who already have a strong affinity for the brand and have the means and intent to spend a lot more when enabled with this vehicle.

Operator

Your final question comes from the line of Dan Binder with Jefferies.

Daniel Binder - Jefferies & Company, Inc.

Question on the allowance as a percentage of receivables. When I go back to pre-recession, I think you were probably somewhere around 7%, not quite at that level but around 7%. It looks like today, you're around 9% and I'm just curious based on what you're seeing and the progress there, what you think the likely level could look like at the end of this year?

Douglas Scovanner

I think that your observation is totally sound, and it is within the realm of possibility that our allowance by the end of this year could approach the figure you just discussed. 7% of gross receivables by year end is maybe not the center point of expectations but is clearly within the range of possibilities.

Daniel Binder - Jefferies & Company, Inc.

Okay, great. And then if I could, a follow-up on or a separate question on price increases. You mentioned that the market was pretty rational in the areas, I guess, pertaining to cotton or cotton-related type, apparel-type products. I was curious in the case of food, what you're seeing in the marketplace as cost of goods rise for certain types of food products? Do you regard the market as being fairly rational?

Kathryn Tesija

Yes. We see it rational across-the-board, not just cotton or fabric-based products, but across food and several other categories where we've seen some increases.