TARGET CORP
Form 10-Q
August 24, 2016
2016DLPFINQFILING

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 30, 2016

Commission File Number 1-6049

TARGET CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota	41-0215170
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1000 Nicollet Mall, Minneapolis, Minnesota	55403
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 612/304-6073
Former name, former address and former fiscal year, if changed since last report: N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller Reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes o No x

Indicate the number of shares outstanding of each of registrant's classes of common stock, as of the latest practicable date. Total shares of common stock, par value $0.0833, outstanding at August 18, 2016 were 574,864,718.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Statements of Operations

(millions, except per share data) (unaudited)	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Sales	$ 16,169	$ 17,427	$ 32,364	$ 34,546
Cost of sales	11,102	12,051	22,286	23,962
Gross margin	5,067	5,376	10,078	10,584
Selling, general and administrative expenses	3,249	3,495	6,402	7,009
Depreciation and amortization	570	551	1,116	1,090
Earnings from continuing operations before interest expense and income taxes	1,248	1,330	2,560	2,485
Net interest expense	307	148	722	305
Earnings from continuing operations before income taxes	941	1,182	1,838	2,180
Provision for income taxes	316	409	599	756
Net earnings from continuing operations	625	773	1,239	1,424
Discontinued operations, net of tax	55	(20)	73	(36)
Net earnings	$ 680	$ 753	$ 1,312	$ 1,388
Basic earnings / (loss) per share				
Continuing operations	$ 1.07	$ 1.21	$ 2.10	$ 2.23
Discontinued operations	0.09	(0.03)	0.12	(0.06)
Net earnings per share	$ 1.17	$ 1.18	$ 2.22	$ 2.17
Diluted earnings / (loss) per share				
Continuing operations	$ 1.07	$ 1.21	$ 2.08	$ 2.21
Discontinued operations	0.09	(0.03)	0.12	(0.06)
Net earnings per share	$ 1.16	$ 1.18	$ 2.20	$ 2.16
Weighted average common shares outstanding				
Basic	582.2	635.8	590.3	638.3
Dilutive impact of share-based awards	4.6	5.2	5.0	5.4
Diluted	586.8	641.0	595.3	643.7
Antidilutive shares	0.2	—	0.1	—
Dividends declared per share	$ 0.60	$ 0.56	$ 1.16	$ 1.08

Note: Per share amounts may not foot due to rounding.

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Comprehensive Income

(millions) (unaudited)	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net earnings	$ 680	$ 753	$1,312	$ 1,388
Other comprehensive income, net of tax				
Pension and other benefit liabilities, net of taxes of $3, $5, $8 and $76	5	8	12	117
Currency translation adjustment and cash flow hedges, net of taxes of $0, $1, $1 and $1	—	—	5	1
Other comprehensive income	5	8	17	118
Comprehensive income	$ 685	$ 761	$1,329	$ 1,506

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Financial Position

(millions)	July 30, 2016	January 30, 2016	August 1, 2015
Assets	(unaudited)		(unaudited)
Cash and cash equivalents, including short term investments of $303, $3,008 and $1,985	$ 1,480	$ 4,046	$ 2,742
Inventory	8,631	8,601	8,261
Current assets of discontinued operations	83	322	133
Other current assets	1,309	1,161	2,104
Total current assets	11,503	14,130	13,240
Property and equipment			
Land	6,111	6,125	6,120
Buildings and improvements	27,315	27,059	26,726
Fixtures and equipment	5,282	5,347	5,145
Computer hardware and software	2,504	2,617	2,550
Construction-in-progress	232	315	494
Accumulated depreciation	(16,510)	(16,246)	(15,452)
Property and equipment, net	24,934	25,217	25,583
Noncurrent assets of discontinued operations	17	75	420
Other noncurrent assets	834	840	950
Total assets	$ 37,288	$ 40,262	$ 40,193
Liabilities and shareholders' investment			
Accounts payable	$ 6,811	$ 7,418	$ 6,944
Accrued and other current liabilities	3,544	4,236	3,768
Current portion of long-term debt and other borrowings	647	815	841
Current liabilities of discontinued operations	1	153	60
Total current liabilities	11,003	12,622	11,613
Long-term debt and other borrowings	12,063	11,945	11,817
Deferred income taxes	754	823	1,192
Noncurrent liabilities of discontinued operations	19	18	276
Other noncurrent liabilities	1,872	1,897	1,353
Total noncurrent liabilities	14,708	14,683	14,638
Shareholders' investment			
Common stock	48	50	53
Additional paid-in capital	5,562	5,348	5,271
Retained earnings	6,579	8,188	9,099
Accumulated other comprehensive loss			
Pension and other benefit liabilities	(576)	(588)	(444)
Currency translation adjustment and cash flow hedges	(36)	(41)	(37)
Total shareholders' investment	11,577	12,957	13,942
Total liabilities and shareholders' investment	$ 37,288	$ 40,262	$ 40,193

Common Stock Authorized 6,000,000,000 shares, $.0833 par value; 574,801,225, 602,226,517 and 630,446,029 shares issued and outstanding at July 30, 2016, January 30, 2016 and August 1, 2015, respectively.

Preferred Stock Authorized 5,000,000 shares, $.01 par value; no shares were issued or outstanding at July 30, 2016, January 30, 2016 or August 1, 2015.

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Cash Flows

(millions) (unaudited)	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Operating activities		
Net earnings	$1,312	$ 1,388
Earnings / (losses) from discontinued operations, net of tax	73	(36)
Net earnings from continuing operations	1,239	1,424
Adjustments to reconcile net earnings to cash provided by operations:		
Depreciation and amortization	1,116	1,090
Share-based compensation expense	67	54
Deferred income taxes	(79)	(45)
Loss on debt extinguishment	422	—
Noncash (gains) / losses and other, net	(14)	26
Changes in operating accounts		
Inventory	(29)	18
Other assets	140	156
Accounts payable and accrued liabilities	(1,466)	(683)
Cash provided by operating activities—continuing operations	1,396	2,040
Cash provided by operating activities—discontinued operations	92	823
Cash provided by operations	1,488	2,863
Investing activities		
Expenditures for property and equipment	(684)	(710)
Proceeds from disposal of property and equipment	14	13
Proceeds from sale of business	—	8
Other investments	1	38
Cash required for investing activities—continuing operations	(669)	(651)
Cash provided by investing activities—discontinued operations	—	19
Cash required for investing activities	(669)	(632)
Financing activities		
Additions to long-term debt	1,979	—
Reductions of long-term debt	(2,611)	(54)
Dividends paid	(666)	(665)
Repurchase of stock	(2,238)	(1,251)
Stock option exercises	151	271
Cash required for financing activities	(3,385)	(1,699)
Net (decrease) / increase in cash and cash equivalents	(2,566)	532
Cash and cash equivalents at beginning of period	4,046	2,210
Cash and cash equivalents at end of period	$1,480	$ 2,742

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Shareholders' Investment

(millions, except per share data)	Common Stock Shares	Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) / Income	Total
January 31, 2015	640.2	$ 53	$ 4,899	$ 9,644	$ (599)	$ 13,997
Net earnings	—	—	—	3,363	—	3,363
Other comprehensive income	—	—	—	—	(30)	(30)
Dividends declared	—	—	—	(1,378)	—	(1,378)
Repurchase of stock	(44.7)	(4)	—	(3,441)	—	(3,445)
Stock options and awards	6.7	1	449	—	—	450
January 30, 2016	602.2	$ 50	$ 5,348	$ 8,188	$ (629)	$ 12,957
(unaudited)						
Net earnings	—	—	—	1,312	—	1,312
Other comprehensive income	—	—	—	—	17	17
Dividends declared	—	—	—	(680)	—	(680)
Repurchase of stock	(30.4)	(2)	—	(2,241)	—	(2,243)
Stock options and awards	3.0	—	214	—	—	214
July 30, 2016	574.8	$ 48	$ 5,562	$ 6,579	$ (612)	$ 11,577

See accompanying Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements (unaudited)

1. Accounting Policies

These financial statements should be read in conjunction with the financial statement disclosures in our 2015 Form 10-K. We use the same accounting policies in preparing quarterly and annual financial statements. All adjustments necessary for a fair presentation of quarterly operating results are reflected herein and are of a normal, recurring nature. Certain prior-year amounts have been reclassified to conform to the current year presentation. Unless otherwise noted, amounts presented within the Notes to Consolidated Financial Statements refer to our continuing operations.

Due to the seasonal nature of our business, quarterly revenues, expenses, earnings, and cash flows are not necessarily indicative of the results that may be expected for the full year.

2. Discontinued Operations

As part of a March 2016 settlement between Target Canada Co. and certain other wholly owned subsidiaries of Target (collectively Canada Subsidiaries) and all of their former landlords, we agreed to subordinate a portion of our intercompany claims and make certain cash contributions to the Target Canada Co. estate in exchange for a full release from our obligations under guarantees of certain leases of the Canada Subsidiaries. The settlement was contingent upon the Canada Subsidiaries' creditors' and the court's approval of a plan of compromise and arrangement to complete the controlled, orderly, and timely wind-down of the Canada Subsidiaries (Plan). During the second quarter of 2016, a Plan was approved. The net pretax financial impact of the settlement and Plan was materially consistent with amounts previously recorded in our financial statements. For the three and six months ended July 30, 2016, net earnings from discontinued operations primarily reflect tax benefits from investment losses in Canada recognized upon court approval of the Canada Subsidiaries' liquidation plan. During the second quarter of 2016, we made cash contributions of $27 million to the Target Canada Co. estate and received cash distributions of $160 million.

Assets and Liabilities of Discontinued Operations

(millions)	July 30, 2016	January 30, 2016	August 1, 2015
Income tax benefit	$ 41	$ 77	$ 234
Receivables from Canada Subsidiaries	59	320	319
Total assets	$ 100	$ 397	$ 553
Accrued liabilities	$ 20	$ 171	$ 336
Total liabilities	$ 20	$ 171	$ 336

3. Restructuring Initiatives

In 2015, we initiated a series of headquarters workforce reductions intended to increase organizational effectiveness and provide cost savings that can be reinvested in our growth initiatives. As a result, we recorded $11 million and $114 million of severance and other benefits-related charges within selling, general, and administrative expenses (SG&A) during the three and six months ended August 1, 2015. The vast majority of these expenses required cash expenditures and were not included in our segment results. An accrual for restructuring costs of $14 million was included in other current liabilities as of August 1, 2015. No balance remained as of July 30, 2016.

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4. Fair Value Measurements

Fair value measurements are reported in one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

Fair Value Measurements - Recurring Basis		Fair Value at		
(millions)	Pricing Category	July 30, 2016	January 30, 2016	August 1, 2015
Assets				
Cash and cash equivalents				
Short-term investments	Level 1	$303	$ 3,008	$ 1,985
Other current assets				
Prepaid forward contracts	Level 1	31	32	36
Beneficial interest asset	Level 3	13	19	29
Interest rate swaps[a]	Level 2	—	12	25
Other noncurrent assets				
Interest rate swaps[a]	Level 2	28	27	16
Beneficial interest asset	Level 3	6	12	19
Liabilities				
Other current liabilities				
Interest rate swaps[a]	Level 2	—	8	16

[a] See Note 7 for additional information on interest rate swaps.

Significant Financial Instruments not Measured at Fair Value [a]	July 30, 2016		January 30, 2016		August 1, 2015	
(millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Debt [b]	$11,712	$13,542	$11,859	$13,385	$11,854	$13,365

[a] The carrying amounts of certain other current assets, accounts payable, and certain accrued and other current liabilities approximate fair value due to their short-term nature.

[b] The carrying amount and estimated fair value of debt exclude unamortized swap valuation adjustments and capital lease obligations.

5. Notes Payable and Long-Term Debt

We obtain short-term financing from time to time under our commercial paper program, a form of notes payable. No balances were outstanding at any time during 2016 or 2015.

In April 2016, we issued unsecured fixed rate debt of $1 billion at 2.5% that matures in April 2026 and $1 billion at 3.625% that matures in April 2046. During the first and second quarter of 2016, we used cash on hand and proceeds from these issuances to repurchase $565 million and $824 million of debt, respectively, before its maturity at a market value of $820 million and $981 million, respectively. We recognized a loss on early retirement of approximately $261 million and $161 million in first and second quarter, respectively, which was recorded in net interest expense in our Consolidated Statements of Operations.

6. Data Breach

In prior periods we have separately reported on our accrual for estimated probable losses and cumulative expenses with respect to the data breach we experienced in the fourth quarter of 2013 (the Data Breach). As of the date of this filing we have resolved the most significant claims relating to the Data Breach and there were no material changes to our loss contingency assessment relating to the few remaining claims during the second quarter. We do not expect there to be any material changes to the assessment of our exposure from this event, and we will no longer be providing separate reporting with respect to the Data Breach.

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7. Derivative Financial Instruments

Our derivative instruments primarily consist of interest rate swaps, which are used to mitigate interest rate risk. As a result of our use of derivative instruments, we have counterparty credit exposure to large global financial institutions. We monitor this concentration of counterparty credit risk on an ongoing basis. See Note 4 for a description of the fair value measurement of our derivative instruments and their classification on the Consolidated Statements of Financial Position.

As of July 30, 2016 and August 1, 2015, interest rate swaps with notional amounts totaling $1,000 million and $1,250 million, respectively, were designated as fair value hedges. No ineffectiveness was recognized during the three months ended July 30, 2016 or August 1, 2015.

Periodic payments, valuation adjustments, and amortization of gains or losses on our derivative contracts had the following effect on our Consolidated Statements of Operations:

Derivative Contracts - Effect on Results of Operations (millions)		Three Months Ended		Six Months Ended	
Type of Contract	Classification of (Income)/Expense	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Interest rate swaps	Net interest expense	$ (8)	$ (9)	$(16)	$ (18)

The amount remaining on unamortized hedged debt valuation gains from terminated or de-designated interest rate swaps that will be amortized into earnings over the remaining lives of the underlying debt totaled $8 million, $15 million, and $25 million, at July 30, 2016, January 30, 2016, and August 1, 2015, respectively.

8. Share Repurchase

Under our current $10 billion share repurchase program, we have repurchased 125.0 million shares of common stock through July 30, 2016 at an average price of $70.57, for a total investment of $8.8 billion.

Share Repurchases	Six Months Ended [(a)]	
(millions, except per share data)	July 30, 2016	August 1, 2015
Total number of shares purchased	30.4	15.2
Average price paid per share	$73.70	$81.41
Total investment	$2,243	$1,240

Note: Excludes shares withheld to settle employee statutory tax withholding related to the vesting of share-based awards.

(a) Includes 0.2 million and 0.1 million shares delivered upon the noncash settlement of prepaid contracts during the six months ended July 30, 2016 and August 1, 2015, respectively. These contracts had an original cash investment of $12 million and $3 million, respectively, and aggregate market value of $13 million and $7 million. These contracts are among the investment vehicles used to reduce our economic exposure related to our nonqualified deferred compensation plans. Note 10 provides the details of our positions in prepaid forward contracts.

9. Share-Based Compensation

During the first quarter of 2016, we adopted Accounting Standards Update (ASU) No. 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). As a result of adoption, we recognized $1 million and $18 million of excess tax benefits related to share-based payments in our provision for income taxes for the three and six months ended July 30, 2016. These items were historically recorded in additional paid-in capital. In addition, for each period presented, cash flows related to excess tax benefits are classified as an operating activity along with other income tax cash flows. Cash paid on employees' behalf related to shares withheld for tax purposes is classified as a financing activity. Retrospective application of the cash flow presentation requirements resulted in increases to both net cash provided by operations and net cash required for financing activities of $74 million for the six months ended August 1, 2015. Our compensation expense each period continues to reflect estimated forfeitures.

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10. Pension and Other Benefits

Pension Benefits

We provide pension plan benefits to certain eligible team members.

Net Pension Benefits Expense	Three Months Ended		Six Months Ended	
(millions)	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Service cost	$ 20	$ 27	$ 41	$ 55
Interest cost	35	39	69	77
Expected return on assets	(65)	(65)	(129)	(130)
Amortization of losses	13	19	25	42
Amortization of prior service cost	(3)	(3)	(6)	(6)
Settlement charges	—	—	—	2
Total	$ —	$ 17	$ —	$ 40

Other Benefits

We offer unfunded nonqualified deferred compensation plans to certain team members. We mitigate some of our risk of these plans through investing in vehicles, including company-owned life insurance and prepaid forward contracts in our own common stock, that offset a substantial portion of our economic exposure to the returns of these plans. These investment vehicles are general corporate assets and are marked to market with the related gains and losses recognized in the Consolidated Statements of Operations in the period they occur.

The total change in fair value for contracts indexed to our own common stock recognized in earnings was pretax (loss)/income of ($2) million and $1 million for the three and six months ended July 30, 2016, respectively, and pretax income of $1 million and $4 million for the three and six months ended August 1, 2015, respectively. During the six months ended July 30, 2016 and August 1, 2015, we made no investments in prepaid forward contracts in our own common stock. Adjusting our position in these investment vehicles may involve repurchasing shares of Target common stock when settling the forward contracts as described in Note 8. The settlement dates of these instruments are regularly renegotiated with the counterparty. At July 30, 2016, January 30, 2016 and August 1, 2015, we held asset positions in prepaid forward contracts for 0.4 million shares of our common stock, for a total cash investment of $17 million, $18 million and $18 million ($41.11 per share) and a contractual fair value of $31 million, $32 million and $36 million, respectively.

11. Accumulated Other Comprehensive (Loss) / Income

(millions)	Cash Flow Hedges	Currency Translation Adjustment	Pension and Other Benefits	Total
January 30, 2016	$ (19)	$ (22)	$ (588)	$ (629)
Other comprehensive income before reclassifications	—	2	3	5
Amounts reclassified from AOCI	3 [(a)]	—	9 [(b)]	12
July 30, 2016	$ (16)	$ (20)	$ (576)	$ (612)

(a) Represents gains and losses on cash flow hedges, net of $1 million of taxes.

(b) Represents amortization of pension and other benefit liabilities, net of $6 million of taxes.

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12. Segment Reporting

Our segment measure of profit is used by management to evaluate performance and make operating decisions. We operate as a single segment that includes all of our continuing operations, which are designed to enable guests to purchase products seamlessly in stores, online or through mobile devices.

Business Segment Results	Three Months Ended	Six Months Ended
(millions)		