TARGET CORP
Form 10-Q
August 28, 2013

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 August 3, 2013

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 S No £

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 S No £

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 S Accelerated filer £ Non-accelerated filer £ Smaller Reporting company £

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

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 23, 2013 were 631,124,948.

TARGET CORPORATION

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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 **August 3, 2013**	Three Months Ended July 28, 2012	Six Months Ended **August 3, 2013**	Six Months Ended July 28, 2012
Sales	**$ 17,117**	$ 16,451	**$ 33,823**	$ 32,989
Credit card revenues		328		657
Total revenues	**17,117**	16,779	**33,823**	33,646
Cost of sales	**11,745**	11,297	**23,308**	22,838
Selling, general and administrative expenses	**3,698**	3,588	**7,287**	6,981
Credit card expenses		108		228
Depreciation and amortization	**542**	531	**1,079**	1,060
Gain on receivables transaction			**(391)**	
Earnings before interest expense and income taxes	**1,132**	1,255	**2,540**	2,539
Net interest expense	**171**	184	**801**	366
Earnings before income taxes	**961**	1,071	**1,739**	2,173
Provision for income taxes	**350**	367	**629**	772
Net earnings	**$ 611**	$ 704	**$ 1,110**	$ 1,401
Basic earnings per share	**$ 0.96**	$ 1.07	**$ 1.74**	$ 2.12
Diluted earnings per share	**$ 0.95**	$ 1.06	**$ 1.72**	$ 2.10
Weighted average common shares outstanding				
Basic	**634.8**	656.7	**638.4**	661.5
Dilutive impact of share-based awards*(a)*	**7.2**	6.2	**7.3**	6.1
Diluted	**642.0**	662.9	**645.7**	667.6

(a) Excludes 0.1 million and 2.2 million share-based awards for the three and six months ended August 3, 2013, respectively, and 5.8 million and 8.7 million share-based awards for the three and six months ended July 28, 2012, respectively, because their effects were antidilutive.

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income

(millions) (unaudited)	Three Months Ended **August 3, 2013**	Three Months Ended July 28, 2012	Six Months Ended **August 3, 2013**	Six Months Ended July 28, 2012
Net earnings	**$ 611**	$ 704	**$ 1,110**	$ 1,401
Other comprehensive income/(loss), net of tax				
Pension and other benefit liabilities, net of taxes of **$8,** $9, **$34** and $19	**12**	14	**52**	28
Currency translation adjustment and cash flow hedges, net of taxes of $(2), $16, $7 and $0	**(100)**	(25)	**(129)**	1
Other comprehensive (loss)/income	**(88)**	(11)	**(77)**	29
Comprehensive income	**$ 523**	$ 693	**$ 1,033**	$ 1,430

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Financial Position

(millions)	**August 3, 2013**	February 2, 2013	July 28, 2012
Assets	**(unaudited)**		(unaudited)
Cash and cash equivalents, including short-term investments of **$249**, $130 and $830	**$ 1,018**	$ 784	$ 1,442
Inventory	**8,441**	7,903	7,733
Other current assets	**1,944**	1,860	1,700
Credit card receivables, held for sale		5,841	
Credit card receivables, net of allowance of **$0**, $0 and $365			5,540
Total current assets	**11,403**	16,388	16,415
Property and equipment			
Land	**6,213**	6,206	6,137
Buildings and improvements	**29,336**	28,653	27,394
Fixtures and equipment	**5,351**	5,362	5,192
Computer hardware and software	**2,532**	2,567	2,333
Construction-in-progress	**1,456**	1,176	1,260
Accumulated depreciation	**(13,483)**	(13,311)	(12,542)
Property and equipment, net	**31,405**	30,653	29,774
Other noncurrent assets	**1,354**	1,122	1,136
Total assets	**$ 44,162**	$ 48,163	$ 47,325
Liabilities and shareholders investment			
Accounts payable	**$ 7,078**	$ 7,056	$ 6,505
Accrued and other current liabilities	**3,705**	3,981	3,539
Current portion of long-term debt and other borrowings	**1,833**	2,994	3,285
Total current liabilities	**12,616**	14,031	13,329
Long-term debt and other borrowings	**12,655**	14,654	15,229
Deferred income taxes	**1,331**	1,311	1,173
Other noncurrent liabilities	**1,540**	1,609	1,697
Total noncurrent liabilities	**15,526**	17,574	18,099
Shareholders investment			
Common stock	**53**	54	54
Additional paid-in capital	**4,335**	3,925	3,721
Retained earnings	**12,285**	13,155	12,774
Accumulated other comprehensive loss			
Pension and other benefit liabilities	**(480)**	(532)	(596)
Currency translation adjustment and cash flow hedges	**(173)**	(44)	(56)
Total shareholders investment	**16,020**	16,558	15,897
Total liabilities and shareholders investment	**$ 44,162**	$ 48,163	$ 47,325

Common Stock Authorized 6,000,000,000 shares, $.0833 par value; 630,924,647, 645,294,423 and 653,907,367 shares issued and outstanding at August 3, 2013, February 2, 2013 and July 28, 2012, respectively.

Preferred Stock Authorized 5,000,000 shares, $.01 par value; no shares were issued or outstanding at August 3, 2013, February 2, 2013 or July 28, 2012.

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(millions) (unaudited)	Six Months Ended **August 3, 2013**	July 28, 2012
Operating activities		
Net earnings	**$ 1,110**	$ 1,401
Adjustments to reconcile net earnings to cash provided by operations		
Depreciation and amortization	**1,079**	1,060
Share-based compensation expense	**55**	48
Deferred income taxes	**(136)**	(92)
Bad debt expense*(a)*	**41**	95
Gain on receivables transaction	**(391)**	
Loss on debt extinguishment	**445**	
Noncash (gains)/losses and other, net	**(2)**	(1)
Changes in operating accounts:		
Accounts receivable originated at Target	**157**	116
Proceeds on sale of accounts receivable originated at Target	**2,703**	
Inventory	**(527)**	185
Other current assets	**(56)**	72
Other noncurrent assets	**47**	(9)
Accounts payable	**17**	(352)
Accrued and other current liabilities	**(403)**	(150)
Other noncurrent liabilities	**(30)**	98
Cash provided by operations	**4,109**	2,471
Investing activities		
Expenditures for property and equipment	**(1,917)**	(1,603)
Proceeds from disposal of property and equipment	**48**	18
Change in accounts receivable originated at third parties	**121**	176
Proceeds from sale of accounts receivable originated at third parties	**3,002**	
Cash paid for acquisitions, net of cash assumed	**(58)**	
Other investments	**73**	(18)
Cash provided by/(required for) investing activities	**1,269**	(1,427)
Financing activities		
Change in commercial paper, net	**(163)**	
Additions to long-term debt		1,971
Reductions of long-term debt	**(3,424)**	(1,011)
Dividends paid	**(463)**	(399)
Repurchase of stock	**(1,461)**	(1,130)
Stock option exercises and related tax benefit	**363**	183
Other		(16)
Cash required for financing activities	**(5,148)**	(402)
Effect of exchange rate changes on cash and cash equivalents	**4**	6
Net increase in cash and cash equivalents	**234**	648
Cash and cash equivalents at beginning of period	**784**	794
Cash and cash equivalents at end of period	**$ 1,018**	$ 1,442

(a) Includes net write-offs of credit card receivables prior to the sale of receivables on March 13, 2013, and bad debt expense on credit card receivables during the six months ended July 28, 2012.

See accompanying Notes to Consolidated Financial Statements.

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 Income/(Loss)	Total
January 28, 2012	669.3	$ 56	$ 3,487	$ 12,959	$ (681)	$ 15,821
Net earnings				2,999		2,999
Other comprehensive income					105	105
Dividends declared				(903)		(903)
Repurchase of stock	(32.2)	(3)		(1,900)		(1,903)
Stock options and awards	8.2	1	438			439
February 2, 2013	645.3	$ 54	$ 3,925	$ 13,155	$ (576)	$ 16,558
(unaudited)						
Net earnings				**1,110**		**1,110**
Other comprehensive income					**(77)**	**(77)**
Dividends declared				**(504)**		**(504)**
Repurchase of stock	**(21.9)**	**(2)**		**(1,476)**		**(1,478)**
Stock options and awards	**7.5**	**1**	**410**			**411**
August 3, 2013	**630.9**	**$ 53**	**$ 4,335**	**$ 12,285**	**$ (653)**	**$ 16,020**

Dividends declared per share were $0.43 and $0.36 for the three months ended August 3, 2013 and July 28, 2012, respectively. For the fiscal year ended February 2, 2013, dividends declared per share were $1.38.

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements (unaudited)

1. Accounting Policies

These financial statements should be read in conjunction with the financial statement disclosures contained in our 2012 Form 10-K. The same accounting policies are followed in preparing quarterly and annual financial data. All adjustments necessary for a fair presentation of quarterly operating results are reflected herein and are of a normal, recurring nature.

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. Credit Card Receivables Transaction

On March 13, 2013, we sold our entire U.S. consumer credit card portfolio to TD Bank Group (TD) and recognized a gain of $391 million. Consideration received included cash of $5.7 billion, equal to the gross (par) value of the outstanding receivables at the time of closing, and a $225 million beneficial interest asset. This transaction was accounted for as a sale, and the receivables are no longer reported in our Consolidated Statements of Financial Position. The beneficial interest asset effectively represents a receivable for the present value of future profit-sharing we expect to receive on the receivables sold. Concurrent with the sale of the portfolio, we repaid the nonrecourse debt collateralized by credit card receivables (2006/2007 Series Variable Funding Certificate) at par of $1.5 billion, resulting in net cash proceeds of $4.2 billion.

TD now underwrites, funds and owns Target Credit Card and Target Visa consumer receivables in the U.S. TD controls risk management policies and oversees regulatory compliance, and we perform account servicing and primary marketing functions. We earn a substantial portion of the profits generated by the Target Credit Card and Target Visa portfolios. Income from the TD profit-sharing arrangement and our related account servicing expenses are classified within SG&A expenses in the U.S. Segment.

The U.S. Segment earned credit card revenues prior to the close of the transaction and during the three and six months ended August 3, 2013 earned $183 million and $288 million, respectively, of profit-sharing income from TD. On a consolidated basis, this profit-sharing income is offset by a $29 million and $45 million reduction in the beneficial interest asset, for a net $154 million and $243 million impact for the three and six months ended August 3, 2013, respectively. These amounts are classified within SG&A expenses in the Consolidated Statements of Operations.

The $225 million beneficial interest asset recognized at the close of the transaction was reduced during the three and six months ended August 3, 2013 by $31 million and $45 million, respectively, of profit-sharing payments related to sold receivables. The beneficial interest asset also had a $2 million revaluation adjustment during the three months ended August 3, 2013, with no net revaluation adjustment for the six months ended August 3, 2013. As of August 3, 2013, $180 million of a beneficial interest asset remains and is recorded within other current assets and other noncurrent assets in our Consolidated Statements of Financial Position. Based on historical payment patterns, we estimate that the beneficial interest asset will be reduced over a four-year period following the close of the transaction, with larger reductions in the early years.

3. Fair Value Measurements

Fair value measurements are categorized into 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 available at the measurement date, 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 August 3, 2013			Fair Value at February 2, 2013			Fair Value at July 28, 2012		
(millions)	**Level 1**	**Level 2**	**Level 3**	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets									
Cash and cash equivalents									
Short-term investments	**$ 249**	**$**	**$**	$ 130	$	$	$ 830	$	$
Other current assets									
Interest rate swaps*(a)*					4			19	
Prepaid forward contracts	**73**			73			72		
Beneficial interest asset*(b)*			**91**						
Other noncurrent assets									
Interest rate swaps*(a)*		**74**			85			93	
Company-owned life insurance investments*(c)*		**297**			269			386	
Beneficial interest asset*(b)*			**89**						
Total	**$ 322**	**$ 371**	**$ 180**	$ 203	$ 358	$	$ 902	$ 498	$
Liabilities									
Other current liabilities									
Interest rate swaps*(a)*	**$**	**$**	**$**	$	$ 2	$	$	$ 7	$
Other noncurrent liabilities									
Interest rate swaps*(a)*		**45**			54			62	
Total	**$**	**$ 45**	**$**	$	$ 56	$	$	$ 69	$

(a) There was one interest rate swap designated as an accounting hedge in all periods presented. See Note 5 for additional information on interest rate swaps.

(b) A rollforward of the Level 3 beneficial interest asset is included in Note 2.

(c) Company-owned life insurance investments consist of equity index funds and fixed income assets. Amounts are presented net of nonrecourse loans that are secured by some of these policies. These loan amounts were $787 million at August 3, 2013, $817 million at February 2, 2013 and $667 million at July 28, 2012.

Position	Valuation Technique
Short-term investments	Carrying value approximates fair value because maturities are less than three months.
Prepaid forward contracts	Initially valued at transaction price. Subsequently valued by reference to the market price of Target common stock.
Interest rate swaps	Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (*e.g.*, interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit-risk adjustment is made on each swap using observable market credit spreads.
Company-owned life insurance investments	Includes investments in separate accounts that are valued based on market rates credited by the insurer.
Beneficial interest asset	Valued using a cash-flow based economic-profit model, which includes inputs of the forecasted performance of the receivables portfolio and a market-based discount rate. Internal data is used to forecast expected payment patterns and write-offs, revenue, and operating expenses (credit EBIT yield) related to the credit card portfolio. Changes in macroeconomic conditions in the United States could affect the estimated fair value. A one percentage point change in the forecasted credit EBIT yield would impact our fair value estimate by approximately $26 million. A one percentage point change in the forecasted discount rate would impact our fair value estimate by approximately $6 million. As described in Note 2, this beneficial interest asset effectively represents a receivable for the present value of future profit-sharing we expect to receive on the receivables sold. As a result, a portion of the profit-sharing payments we receive from TD will reduce the beneficial interest asset. As the asset is reduced over time, changes in the forecasted credit EBIT yield and the forecasted discount rate will have a smaller impact on the estimated fair value.

The carrying amount and estimated fair value of debt, a significant financial instrument not measured at fair value in the Consolidated Statements of Financial Position, was $12,484 million and $14,018 million, respectively, at August 3, 2013, $15,618 million and $18,143 million, respectively, at February 2, 2013, and $16,647 million and $19,666 million, respectively at July 28, 2012. The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments and would be classified as Level 2. The carrying amount and estimated fair value of debt excludes unamortized swap valuation adjustments and capital lease obligations.

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

4. 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.

Commercial Paper	Three Months Ended		Six Months Ended	
(dollars in millions)	**August 3, 2013**	July 28, 2012	**August 3, 2013**	July 28, 2012
Maximum daily amount outstanding during the period	**$ 920**	$ 620	**$ 1,465**	$ 620
Average daily amount outstanding during the period				