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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation First Quarter Earnings Release Conference Call. (Operator Instructions)

As a reminder, this conference is being recorded, Wednesday, May 18, 2022. I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

John Hulbert - *Target Corporation - VP of IR*

Good morning, everyone, and thank you for joining us on our first quarter 2022 earnings conference call.

On the line with me today are Brian Cornell, Chairman and Chief Executive Officer; Christina Hennington, Chief Growth Officer; John Mulligan, Chief Operating Officer; and Michael Fiddelke, Chief Financial Officer. In a few moments, Brian, Christina, John and Michael will provide their perspective on our first quarter performance and our outlook and priorities for the second quarter and beyond. Following the remarks, we'll open the phone lines for a question-and-answer session.

This morning, we're joined on this conference call by investors and others who are listening to our comments via webcast. Following the call, Michael and I will be available to answer your follow-up questions.

And finally, 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 most recently filed 10-K. Also in these remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on the quarter and his perspective on our outlook. Brian?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Thanks, John, and good morning, everyone. Our first quarter results demonstrate the underlying strength of the relationship we've built with our guests at a time when our team is working through multiple cost pressures affecting our business. As expected, our business continued to grow in the first quarter, on top of huge gains a year ago, underlying the resilience of both the consumer and the ability of our team to serve them. However, due to a host of factors, this growth was challenged by unusually high costs, resulting in profitability well below what we expected to be and where we expect to operate over time.

First quarter comparable sales grew by 3.3%, on top of 23% growth a year ago. This marked our 20th consecutive quarter of comparable sales increases. 11 of those quarters were before the pandemic, followed by the rapid acceleration we saw in 2020. We're also encouraged that traffic continues to fuel our growth, increasing nearly 4% in the quarter, on top of 17% growth a year ago.

Our first quarter gross margin rate was well below our expectations, reflecting a combination of factors that prove to be very different than expected, driven by a rapidly shifting macro backdrop and changing consumer behavior. More specifically, we saw much higher-than-expected freight and transportation costs and a more dramatic change in our sales mix than we anticipated. This resulted in excess inventory, much of it in bulky categories, which put additional strain on an already stretched supply chain. Christina, John and Michael will share more details shortly.

And while we have a lot of work ahead of us to restore profitability to the level where we expect to operate over time, I want to thank the team for maintaining their laser focus on the guest experience. We've spent years growing Target's relationship with our guests, which is fueling the traffic and sales growth we're seeing today. In sustaining that guest focus, we're confident we'll see deeper loyalty and profitable sales growth in the years ahead.

On our sales channels, first quarter comps were balanced between store and digital as each increased a little more than 3%. Within our digital channel, growth continues to be led by our same-day services and Drive-Up in particular which delivered growth in the mid-teens this year on top of more than 100% growth a year ago.

Since Q1 of 2019, prior to the pandemic, first quarter sales have grown more than 40% or just over $7.4 billion. Broken down by channel, store sales accounted for about $4.1 billion of this increase, while digital sales grew another $3.3 billion, having expanded by more than 250% over that time.

From a category perspective, we continue to benefit from our balanced multi-category portfolio, which allows us to flexibly serve our guests as their wants and needs change. More specifically, in the first quarter, we continue to see strong growth and market share gains in food and beverage and essential categories. We also benefited from double-digit comp growth in Beauty, reflecting our ongoing work to enhance presentation, assortment and service, including our new and expanding partnership with Ulta Beauty. The results of this partnership have exceeded our initial expectations, driving higher productivity and sales in both Beauty area, and adjacent categories in the store, where we've added an Ulta Beauty experience.

In our other 3 core merchandise categories: Apparel, Home and Hardlines, we saw a rapid slowdown in the year-over-year sales trends beginning in March, when we began to annualize the impact of last year's stimulus payments. While we anticipated a post-stimulus slowdown in these categories and we expect the consumer to continue refocusing their spending away from goods and into services, we didn't anticipate the magnitude of that shift.

As I mentioned earlier, this led us to carry too much inventory, particularly in bulky categories, including kitchen appliances, TVs and outdoor furniture. And with very little slack capacity after 2 years of unprecedented growth, we faced elevated cost to store and had begun rightsizing our inventory position.

Nevertheless, we're still seeing healthy overall spending by our guests, even as their spending continues to evolve. Notably, we continue to see meaningful spending surges around holidays, including Easter in April and Mother's Day a couple of weeks ago.

Also notable, in comparing this year's weekly sales to pre-pandemic levels at the beginning of 2019, we're actually seeing stronger 3-year growth trends in recent weeks compared with the beginning of the first quarter, even in categories where we saw a rapid slowdown on a 1-year basis. These encouraging longer-term growth trends demonstrate the continued resilience of the American consumer and the trust they place in Target even as they face multiple challenges.

Not surprising, when we talk to our guests, they often express their concerns about a host of rapidly changing conditions, ranging from geopolitics to the high and persistent inflation they've been experiencing, particularly in food and energy. At the same time, guests are focused on getting back to many of the habits and behaviors they suspended during the heart of the pandemic, including travel, out-of-home activities and social gatherings. And importantly, even as the mix of what they're buying continues to evolve, their spending capacity continues to benefit from elevated saving rates, high employment and healthy wage growth.

So as we continually adapt our offering to best serve our guests in a rapidly changing environment, today, we're focused more than ever on providing value across our multi-category assortment, presenting options that are affordable and accessible to a broad and diverse base of guests across a wide range of household incomes. And even as we face multiple cost pressures, our team is working tirelessly to maintain prices wherever possible.

But of course, while it's always the last lever we pull, external conditions led us to raise prices across a broad set of items in multiple categories. But as you've clearly seen in recent quarters, overall costs have been rising much faster than retail prices, resulting in year-over-year declines in our gross margin rates. While we're not happy about the near-term pressure this causes on the profit line, we strongly believe these decisions will benefit our business over time.

And as we carefully monitor how prices and quality stack up versus the competition, our guests are telling us they appreciate the value and experience we're providing. More importantly, our guests are showing their appreciation, with more footsteps in our stores and more clicks on our site, resulting in continued traffic and sales growth on top of record growth a year ago.

As we look ahead, we'll maintain this focus on value, helping them to save time and money in a rapidly evolving environment. For those who are focused on driving fewer miles in response to record high gas prices, our broadened unit merchandise assortment, combined with our low prices, offer a smart way to save time and miles by consolidating shopping trips.

Of course, for guests who are looking for money-saving options when they're shopping for their families, our $30 billion portfolio of owned brands offer outstanding quality and savings across every one of our merchandising categories. And because saving time is valuable in any environment, we're continuing to invest in expanding the scope of our reliable and convenient same-day services, including our Drive-Up and in-store pickup services, which we offer our guests at no charge.

Just as we've designed our merchandise portfolio to flexibly serve our guests, our operations have managed through extreme volatility over the last few years. Rapid growth amounting to tens of billions of dollars, combined with unprecedented shifts in demand across categories, channels and services, has created a host of challenges for our team, which they've handled with incredible energy and focus. And while we entered this year hopeful that volatility would begin to moderate, we've experienced the extreme opposite in Q1, and we don't see current conditions improving right away.

In the face of this volatility, our team continues to focus on the guest experience, working to ensure that anything our team is handling behind the scenes doesn't affect what our guests see and feel. So as we look ahead, it is clear that many of these pressures will persist in future quarters, but that hasn't affected our long-term plans and expectations, including our confidence in the ability of our business to grow mid-single digits and maintain an operating margin of 8% or higher over time.

In the meantime, even as we navigate to restore profitability from the impact of these short-term challenges, we're continuing to invest in projects designed to deliver continued profitable long-term growth. Our business model and team have proven their ability to successfully navigate through extreme volatility. And we're confident our business will emerge even stronger from these challenges we're facing today. Just as our investments in early 2017 were followed by profitable growth in later years, we're confident the decisions we're making today, combined with our investments in future growth, will pay off handsomely over time.

With that, I'll turn it over to Christina.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Thanks, Brian, and good morning, everyone.

Just a few months ago, at our Financial Community Meeting, my presentation outlined our strategic vision as a company. While I covered many facets of our strategy that day, where I started then is where I want to start again today, with our guests. We frequently get questions about how our guests are feeling given the current economic environment, how their shopping habits are evolving and what's top of mind for them.

Our guest base encompasses every slice of the American population given that we serve nearly 20 million guests on average each and every week. And the breadth of their individual decisions as they navigate a rapidly changing macro environment is just as broad, making the answers to those questions that much more complex.

A guest might be telling us that they're worried about inflation and rising gas prices. But they're also looking to splurge on new shoes or some accent pillows for their home. Another guest remains worried about COVID, but they're still planning to resume travel and looking forward to summer outings like Little League games and barbecues with friends. Many guests are sharing their uncertainty of the overall state of the economy, but are feeling more positive about their personal finances. With so much on their minds and a wide array of wants and needs, it has never been more important for Target to be flexible and provide ease, safety, inspiration and solutions for all of our guests.

In the first quarter, we invested in delivering a great guest experience to build and maintain the trust and love for the Target brand. And those decisions came with substantial costs. I'll share more on this shortly. Our first quarter results reinforce the power of our multi-category portfolio, which allows us to lean into those ever-changing wants and needs.

More and more, we are seeing our guests' increasing mobility and love of newness play out in their Target purchases as baskets shift more toward experiences and going-out categories. This includes notable strength in fashion forward apparel, prepaid cards, toys and travel. While apparel basics moderated in the quarter, trend-based apparel accelerated meaningfully as increasingly, people are returning to the office or dining out with friends. We're also seeing robust growth in Beauty, driven by particular strength in going-out categories like sunscreen, color cosmetics and fragrance. Luggage grew more than 50% as the world continues to reopen, and we reunite with the places and people we have missed visiting.

And our owned brand portfolio continues to grow faster than total sales, as it has quarter-after-quarter for years now. We continuously benefit from the growing guest affinity for our owned brands, which are designed to drive trips to Target, not simply to provide another option when guests are already in a store. Our guests appreciate the value, quality and great design they have come to expect and love from Target owned brands, even as they continue to appreciate our national brand options and partnerships as well.

As Brian outlined, our team delivered just over 3% in comparable sales growth in the first quarter, in line with expectations, reflecting strong traffic and unit share gains. First quarter growth was strongest in frequently purchased categories, including Food & Beverage, Beauty and Essentials.

Food & Beverage, which delivered low double-digit growth this quarter was strong across the entire assortment. Over the last 3 years, first quarter Food & Beverage sales have increased by nearly $1.8 billion, accounting for nearly 1/4 of our total sales growth over that time. Market share gains in this category are being driven by unit share growth, most notably in our owned brand offerings, as more of our guests turn to Good & Gather and Favorite Day for their meal solutions.

Beauty has been one of our fastest-growing categories for years now and grew again in the low double digits in Q1 as guests spend more time outside of the home and want to look and feel their best. Since the first quarter of 2019, Beauty sales have expanded by more than 45%, the vast majority of which occurred before our rollout of the Ulta Beauty at Target experience, evidence that there is still plenty of room for growth in this category.

Essentials grew in the high single digits in Q1, having added well over $1 billion in first quarter sales over the last 3 years. Notably, nearly $0.5 billion of that growth happened after 2020, when we saw explosive demand for categories like household paper, over-the-counter and cleaning supplies.

Across our other core categories: Apparel, Home and Hardlines, we saw small declines in comparable sales this quarter. In Apparel, despite unfavorable weather across most of the country, comp sales remained nearly flat to last year, having grown more than 60% in the first quarter a year ago and nearly $1 billion since the first quarter of 2019.

In Home, even after a small pullback in Q1 comps, sales remain more than 40% higher than the first quarter of 2019, equating to more than $1.2 billion in growth over that time. Our seasonal categories continue to excel as our guests turn to Target for all of their holiday and celebratory solutions, leading to all-time records in the recent Valentine's Day and Easter seasons.

And notably, guests are finding new ways to enjoy and celebrate the spaces they've invested in over the past few years. Having already renovated their homes with purchases in categories like furniture and small appliances, guests are now refreshing their homes with smaller touches, driving demand in categories like decor, candles and seasonal assortments; further evidence, not just of the strength in our multi-category portfolio, but the breadth of what we offer within categories as well.

Hardlines saw a slight pullback in Q1, but has grown more than $1.3 billion since the first quarter of 2019. Within Hardlines, guests have been refocusing their spending away from electronics like TVs and into experiences for both kids and adults, which led to strength in our toys, travel and prepaid card categories.

As Brian mentioned, first quarter gross margin performance was well below our expectations. This was driven by a number of factors, the most impactful of which was softer than expected sales in several categories, resulting in too much inventory in those areas. As we developed our plans for the quarter, our task was to anticipate how spending would change under circumstances no one had ever seen before given that we were about to compare over 2 years of historically high federal stimulus payments. As such, we relied on numerous forecasts and estimates, both internal and external, to help determine our view for the quarter. Despite this careful approach, the mix of actual demand materialized differently than we had anticipated.

In addition, as supply grew and demand shifted away from bigger, bulkier products like furniture, TVs and more, we needed to make difficult trade-off decisions. We could keep this product knowing it would sell over time or we can make room for fast-growing categories like Food & Beverage, Beauty, and personal care and Household Essentials. To preserve the quality of on-shelf presentations and support the guest experience, we chose the latter, leading to incremental markdowns that reduced our gross margin. While these were difficult decisions, we believe they'll pay off in the long term, given that building long-term loyalty remains our top priority.

As we look ahead, we'll continue to do all we can to support our guests, providing them great value, an unbeatable selection of necessities and affordable luxuries and a shopping experience that sparks a smile and provides a temporary escape. The second quarter offers many opportunities for our team to help all families discover the joy of everyday life. And this summer's assortment features some of our most inclusive offerings yet.

First, in May, we are celebrating Asian American and Pacific Islander Heritage Month by highlighting Asian founders and creators, amplifying their voices with stories of how their unique cultures influence the creation of their products and businesses. With June right around the corner, we're excited to honor our LGBTQ+ community as we celebrate Pride Month. This uplifting and always relevant assortment offers bold product, inclusive marketing and everyday affirmation that authentically represents and celebrates community and culture. And of course, we just finished celebrating mom in May and have plenty of options to honor dads in June, along with many other opportunities to celebrate the joys of summer.

And speaking of joy, we're ecstatic about our recently announced expanded partnership with actress, author and social media phenomenon, Tabitha Brown, a beacon of positivity, inspiration and joy. Having collaborated with her on social media for years, we're excited to grow our partnership with Tabitha and feature 4 limited time-only collections set to launch over the next year, starting with an exclusive apparel and accessories line of more than 75 items this June that are sure to lift both style and spirit.

Before I pass things over to John, I want to thank our teams across our stores, distribution centers and headquarters locations all around the globe for their unwavering leadership and service to our guests and to each other. Without them, we would not be able to continue growing our business and serving our guests each and every day. Despite the volatility and rapid shifts in consumer demand, the macro environment and the global supply chain, our business remains strong, and we're confident in both our long-term strategy and our team's ability to navigate through this dynamic period.

We continue to focus on serving our guests in all that we do through our ability to provide relevance and joy in our assortment, the delivery of a positive one-of-a-kind inspiring guest experience and by building lasting, deepened affinity over time. We're lucky to have the best team in retail to make all of this come to life, and I look forward to all we will do together in the second quarter and beyond.

With that, I'll pass things over to John.

John J. Mulligan - *Target Corporation - Executive VP & COO*

Thanks, Christina. Over the last couple of years, our team has been focused on 2 separate and related issues, namely, beginning with the acceleration in sales in early 2020, our inventory wasn't growing fast enough to keep up with the expansion of our sales volume. And as a result, we weren't maintaining in-stock levels consistent with our standards.

Following 2 years of efforts to catch up, by the time we entered 2022, we had made considerable progress. Overall inventory levels were aligned with both the level of sales we had already achieved and our near-term growth expectations. As a result, we began to see improvements in both in-stocks and product availability. However, conditions have remained far from perfect. Some items and categories remained spotty, typically driven by vendors who are facing multiple constraints in their businesses.

A separate challenge our team has been facing, which became more acute in the back half of 2021, is driven by capacity constraints in both the global and domestic freight markets. These issues continue to make it more difficult and more expensive to move inventory where we need it to be. Our team has done a great job managing through these challenges. And as you've seen from our recent gross margin results, our P&L has reflected those higher freight costs.

Coming into this year, we anticipated we'd see continued tight conditions and elevated costs in freight markets. But the actual conditions and costs have been much more challenging than expected. More specifically, first quarter freight and transportation costs came in hundreds of millions of dollars higher than our already elevated expectations. And for the full year, we're now expecting about $1 billion of incremental freight costs, even compared to our expectations only 3 months ago.

Among the reasons for this incremental pressure, record high fuel costs are a meaningful driver as well as the global shipping market, where costs have stayed unusually high and where we sometimes need to rely on the spot market to secure adequate capacity. Compounding these near-term pressures on our gross margin rate, volatility in both consumer demand and delivery times placed additional stress on our supply chain in Q1, one that was already running lean on capacity in light of the growth we've seen over the last 2 years.

As Brian and Christina mentioned, this quarter, we ended up carrying too much inventory in several categories where the slowdown in sales was more pronounced than expected, including home, electronics, sporting goods and apparel. In addition, capacity pressures were compounded by the fact that in several of these categories, including kitchen appliances, furniture and outdoor living, items are bulkier than average and require higher-than-average amounts of storage capacity.

As our team collaborated with Christina's team to work through this excess inventory, we made decisions with an eye on preserving the guest experience. Rather than jamming store sales floors with excess product, which would have made them more difficult to shop, our team secured temporary storage capacity instead. And as Christina mentioned, rather than carrying items beyond their relevant season, her team made the tougher call and marked items down to clear them and keep our presentations fresh and inspiring.

While these were difficult decisions in the moment, we have no doubt they are the right long-term choices. However, they involved higher costs, resulting directly from the actions we chose to take and indirectly in terms of team member hours required to manage the extra volume. As Michael will discuss in more detail, while we don't expect these conditions to persist over time, they'll continue to impact our Q2 results before conditions begin improving later in the year.

More specifically, as we move beyond the front half of the year, we'll have had enough time to adjust inventory levels and receipt volumes to match the pace of sales, even in longer lead time categories. In addition, capacity in our supply chain will continue to build throughout the year as the new buildings we opened last fall continue to ramp up their productivity while we work to open additional buildings in the years ahead.

Beyond this ongoing work to expand the upstream supply chain, we continue to add downstream capacity in our sortation centers, which increase speed and reduced the unit cost of last mile delivery. Following our successful test of the concept in the Minneapolis market, we now have 6 sortation centers open and operating, with plans to open 3 more by the end of the year.

While the newly opened centers are still ramping up their capacity, in total, our 6 sortation centers handled 4.5 million packages in Q1, a number that's expected to grow significantly throughout the year. Each of these facilities already has volume flowing to our national carrier partners, including the ability to sort USPS packages individually by post office, creating a high-speed, low-cost delivery option in the metro areas surrounding each center.

In addition, we've begun rolling out our lowest cost delivery option, Target last-mile delivery, at our Atlanta sortation center and will soon expand that capability to the other 4 recently opened facilities. For this capability, we collaborate with our partners at Shipt, whose drivers sign up to deliver batches of orders that have been sorted hyperlocally down to the neighborhood level. This provides a fast, efficient, reliable and low-cost delivery option for our business, benefiting both our guests and the P&L. While we're excited about the results these centers are already delivering, this initiative is in the very early stages, and we have plans to continue opening centers and ramping up this new capability for years to come.

Beyond investments in the supply chain, we're also excited about the investments we're making in our stores, allowing them to become more productive, more fun and more inspiring to shop. For the year, we have plans to complete remodel projects in nearly 400 stores. And through the first quarter, we had already mobilized on just under half of those projects, keeping us on pace for the year. Just under 200 of this year's projects will be traditional full remodels in which we transform every part of the store, from wall to wall and floor to ceiling, updating the shopping experience to make it more inspiring for our guests and more efficient for our team to operate.

Beyond those full remodels, we're planning to complete just over 200 fulfillment remodels in 2022 as well. These projects are focused on the operations of the store and their ability to support our same-day services. More specifically, these projects make changes within the 4 walls of the store to add capacity for same-day orders and incorporate features to enhance our pickup and Drive-Up capabilities.

When warranted, these remodels include the addition of walk-in coolers and freezers near the front of the store, adding reliable capacity for our team to fulfill fresh, refrigerated and frozen items through our pickup and Drive-Up services. In addition, with many of these projects, we add a dedicated door for our team members to use when delivering Drive-Up orders to the parking lot. We're also adding canopies, more prominent signing and more Drive-Up spaces in our parking lots, making the Drive-Up process safer and easier for both our team members and our guests.

Beyond these existing store investments, we continue to open new stores around the country. In the first quarter, we opened 7 locations, all smaller formats, in markets ranging from Jackson Hole in Wyoming to Times Square in New York. We continue to be pleased with the performance of our new stores and our ability to flexibly serve guests in new neighborhoods. And for our stores and markets that were temporarily affected by COVID, including college locations, tourist destinations and dense urban areas, we've seen continued rapid recovery in sales volumes as activity ramps up in those markets following periods of lockdown over the last 2 years.

Similar to the pressures we've been experiencing in our merchandise costs, our construction team has been dealing with volatility in the price of raw materials and labor in our new store and remodel projects. And like our merchandising partners, they've done a great job working around those costs and constraints, keeping projects on track while maintaining their focus on delivering a great guest experience.

So as I get ready to hand the call over to Michael, I want to pause and thank the entire operations team, from our stores, to supply chain, and our properties team to our partners at Shipt. The growth we've seen in our business and the expansion of our capabilities over the last 2 years has been both energizing and inspiring, but it certainly hasn't been easy for our team. They've handled growth well beyond what any of us would have expected 2 years ago, even as they worked around new challenges and unexpected obstacles.

One of the joys of the last year has been the ability for me to once again get out in the field, traveling to our stores and distribution facilities around the country, and experiencing firsthand the energy and positive attitude our team brings to work. They're united in their support of our guests, for our brand and for each other. Every day, they bring our company purpose to life. And every day, I am inspired by what they accomplish.

Now I'll turn the call over to Michael.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Thanks, John. I want to start my remarks today where John just ended and add my thanks to our entire team. Even with all of the challenges they've been facing, they refused to get distracted. Instead, they maintained their focus on our company purpose, to help all families discover the joy of everyday life. Our team shows up to work every day with a passion for serving all families and for serving each other.

As John mentioned, it's been a joy in recent months to be able to travel once again, meet with teams across the country and hear what's on their minds. And the optimism and energy of our team is infectious. I can feel that whenever I meet with the team, and obviously, our guests can feel it when they shop, which explains why our first quarter traffic has increased more than 20% over the last 2 years.

In the first quarter, our comp increase of 3.3% was supported by a traffic increase of 3.9%, partially offset by a small decrease in average ticket. Among our fulfillment channels, store sales grew slightly faster than digital in the quarter. Within digital, same-day services continue to drive our growth, and accounted for well over half of our first quarter digital sales; within our same-day services, Drive-Up accounts for the majority of sales, and it continues to grow the fastest. In fact, of the $3.3 billion in first quarter digital sales that we've added since 2019, Drive-Up accounts for nearly half of that growth.

On the first quarter gross margin line, we saw a rate decline of about 4.3 percentage points compared with last year. Among the causal factors, merchandising actions drove about 3 percentage points of the decline, driven by the combined impact of impairments, markdowns and other actions taken to rightsize our inventory position in categories that were too heavy, along with the impact of higher freight costs.

Among other drivers, higher supply chain costs accounted for a little over one percentage point of this year's rate decline, reflecting the impact of higher headcount and compensation in our distribution centers. Sales mix accounted for the remainder of the decline, worth about 10 basis points of pressure.

On the SG&A expense line, we benefited from fixed cost leverage and strong expense control throughout the quarter, which helped to offset the impact of inflation-driven cost increases in multiple expense lines. Within compensation, the continued impact of team investments was offset by lower incentive compensation compared with last year.

On the D&A expense line, we saw about 10 basis points of benefit in Q1, reflecting leverage on strong revenue growth. Altogether, our first quarter operating margin rate of 5.3% was about 4.5 percentage points lower than last year. While we expected this year's rate would be well below last year, our actual performance in the quarter was far lower than we anticipated, driven by the unexpectedly high costs we incurred on the gross margin line.

Turning now to capital deployment, I'll start where I always do, by reiterating our priorities, which have remained consistent for decades. First, we fully invest in our business and projects that support our strategic and financial criteria. Second, we support the dividend and look to build on our 50-year record of annual dividend growth. And finally, we return any remaining excess cash within the limits of our middle A credit ratings through share repurchases over time.

Beginning with the top priority, first quarter CapEx was just under $1 billion, keeping us on track to spend $4 billion to $5 billion for the year. While our teams continue to face multiple challenges, including supply shortages, shipping delays and permitting and inspection delays in some communities, they're doing a great job of working around these obstacles and keeping projects moving.

In addition, as John mentioned, unexpected inflationary pressures are affecting some of our capital projects, which will impact our total spending for the year. As I mentioned at our recent Financial Community Meeting, we're excited to make progress on our capital projects, which continue to move our business forward. And today, given the team's efforts to advance this year's projects, I believe we'll reach the high end of our $4 billion to $5 billion plan for the year.

Moving to our second priority. We paid dividends of $424 million in the first quarter, up about 25% from last year. reflecting a 32% increase in the per share dividend, partially offset by a decline in share count. We plan to recommend that our Board approve a healthy increase in the quarterly dividend, in the mid-teens to low 20% range later this year, keeping 2022 on track to be our 51st consecutive year of annual dividend increases.

And finally, regarding share repurchases. Given our strong leverage metrics coming into the year, we entered into an accelerated repurchase plan in the first quarter, which will result in the retirement of up to $2.75 billion of our stock by the time the plan settles in June. In addition to this ASR, we repurchased another $10 million in shares in the first quarter.

While we anticipate having continued ample capacity to return capital through share repurchases this year, given the current supply chain challenges we're facing and their impact on working capital, we now expect our total repurchases this year will be lower than the $7 billion we returned in 2021. As always, we'll adjust our pace, up or down, based on external conditions, business performance and cash flow, with a goal of maintaining our middle A credit ratings.

So now I want to turn to our after-tax return on invested capital, which measures both our profitability and the efficiency of our CapEx decisions over time. In the first quarter, we reported a trailing 12-month after-tax ROIC of 25.3%. While this is a very strong number, indicative of the underlying health of our business, it was much lower than expected, near the very low end of where we expect to operate over time.

Now let's turn to our guidance. In terms of the top line, based on our first quarter results and the trends we've seen so far in May, we continue to expect full year revenue growth in the low to mid-single-digit range. In terms of our profitability, given the unexpected cost headwinds that we're currently facing, we now believe our full year operating margin rate will be well below our prior guidance of 8% or higher. More specifically, given the elevated level of volatility we're currently facing and multiple sources of uncertainty going forward, we see a range of potential outcomes, centered around a 6% operating margin rate for the full year.

As John mentioned, in the second quarter, we expect the challenges we faced in the first quarter will continue to impact our near-term profit performance. And our team is focused on doing everything necessary to ensure we enter the fall season with an appropriate level of inventory by category. As such, we expect a Q2 operating margin rate in a wide range, centered around our first quarter rate to 5.3%, well below where we'd expect to operate under normal conditions.

As we move into the back half of the year, we continue to expect our profit performance will begin to improve. In particular, as John mentioned, we expect to have worked through the excess inventory positions that hampered our Q1 performance and which we expect to impact our gross margin in Q2. That said, we don't expect the external environment will be anything close to normal in the back half of the year. In particular, we don't expect to see any meaningful reduction in global supply chain pressures until 2023 at the earliest. So the elevated costs we've been facing will continue to affect our profitability for the remainder of the year.

But let me be clear about a couple of things. First, we are not happy with our current profit performance, and our team is laser-focused on helping to quickly restore our business performance to where it should be operating over time. That said, nothing that is happening today has changed our long-run expectations regarding the ability of our business to grow nor has it changed our view of the long-run potential of our business to deliver an operating margin rate of 8% or higher over time.

And today, as we navigate these near-term challenges, we are fortunate to have an incredibly healthy underlying business, one that can stand up to the significant headwinds we're facing and come out stronger on the other side. We have ample financial capacity to continue making long-term investments, in new stores, remodels, supply chain, and of course, in our team, all with a focus on serving and delighting our guests, driving deeper loyalty, and building on the top line growth we've seen in recent years and which continues today.

After all, even after a significant pullback from last year, first quarter earnings per share were more than 40% higher than in the first quarter of 2019 prior to the beginning of the pandemic. While that doesn't mean we're where we want to be operating today, it shows we have a strong foundation from which we can recover from today's challenging environment and restore our operating margins to 8% or higher over time, consistent with our long-term financial algorithm. And given the loyalty and momentum we've established with our guests and the power of the investments we continue to make, we expect to continue growing the top line, even as we regain the level of profitability we expect our business will generate over time.

Now I'll turn it back over to Brian for some closing remarks.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Thanks, Michael. Before we move to your questions, I want to take a few minutes to reinforce why we're confident in the ability of our team and our durable business model to successfully navigate today's volatile environment and deliver continued profitable market share growth in the years ahead.

As Michael covered, even as elevated costs put meaningful pressure on our near-term financial performance, our business today remains profitable and very healthy, and it continues to grow. Since the first quarter of 2019, both our revenue on the top line and our EPS on the bottom line have each grown by more than 40%. Underlying that growth, we benefited from strong increases in both guest traffic and average ticket over the last 3 years, meaning the guests have found more reasons to visit our stores and our site and purchase more when they shop. This is the definition of a durable business model, one that can stand up to the unexpected pressures and remain healthy and growing.

When I think about the critical drivers of our long-term success, there are 2 things that rise to the top of that list: our team; and the relationship we've developed with our guests. And when I think about the quality of our team, I don't believe that it's ever been better.

Over the last 5 years, we've made significant, purposeful investments to ensure we're hiring, elevating and retaining the best team in retail. These investments begin with paying benefits. But we've also found new ways to enhance the work experience and provide pathways for advancements, all in keeping with our Target forward goals to create an equitable and inclusive workforce and workplace. So even as we work tirelessly to restore our business to its long-term profitability, you should expect us to continue investing in our team, because we'll never achieve our longer potential without them.

We have the same perspective regarding relationships with our guests. Over the last 5 years, we've made a number of deliberate decisions that were designed to deepen the relationship between Target and our guests. These decisions have resulted in ever-increasing traffic, translating to growth on both the top line and the bottom.

So in the quarter just ended, when our team was facing potential trade-offs between a guest experience and incurring short-term costs, I am proud to say that they maintained their focus on the guest experience. That's because our team is laser-focused on our long-term financial performance, which depends on building and maintaining an ever-deepening relationships with our guests.

So with that, I want to thank you for listening into our call today. And now Christina, John, Michael and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

I have a question and as well as a follow-up. So first question is, in the first quarter of 2020, you took a large inventory impairment that you were able to get back in the second quarter. Now understanding it's a different environment that we face in this quarter, but the question is, how much lingering markdown risk could there be in 2Q? Maybe how large was the impairment? And why wouldn't this capture the risk in the first quarter? And how are you framing out the potential gross margin decline in 2Q?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. Thanks for the question, Chris. We still got some inventory to work through. And so you saw some of that pain in Q1. And our gross margin guidance of Q2 of operating -- or sorry, our operating margin guidance of a 5.3%, give or take, a wide range around that, contemplates the work we still think we have to do on the inventory side in the second quarter. Importantly, we believe taking those actions in Q1 and Q2 set us up well for the balance of the year. We've got some big important seasons in front of us: back to school, back to college. It will be fall and holiday before we know it, and so we're taking the right actions now to preserve a guest experience that continues to be strong. You saw it in traffic in Q1, and we're excited about what we see as a start of Q2 on the top line as well.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Okay. And then as a follow-up, can you expand a little bit more on what changed in your implied operating margin outlook for the back half? You mentioned supply chain costs. Are these now about $1 billion for the year? Are these now big enough to offset the air freight pressures in the back half, particularly 3Q? And then did you also change your mix assumption? And to what extent are you baking in more promotions and clearance relative to a few months ago?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. You hit on 2 of the bigger factors that will be at play in the back half of the year. As we've discussed, we see about $1 billion of freight and transportation pressure, outside of what we would describe even at the start of Q1. But we do expect, and we continue to take product in early intentionally to protect against supply chain disruption. We expect to see some offset as we don't anniversary the same level of air freight that we saw in the back half of the year.

When it comes to mix, I mentioned in my remarks about a 10 basis point drag from margin rate mix. The biggest shift from a category perspective is just the change in some of the categories at the top of the guest shopping list. And some of those categories where we've got some inventory to work through are the ones we'll work through in the first half of the year, and will be better positioned heading into the second half.

Operator

The next question comes from Karen Short with Barclays.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

I had 2 questions. So the first is, I'm just curious on your philosophy with respect to the fact that you had an Analyst Day on March 1 and had some insight into the trends that you were seeing. So can you maybe just update us on your philosophy on maybe giving a pre-announcement? Because, I mean, I think it did come up with Walmart yesterday as well. So you're in good camp on things changing very quickly with the consumer and with the cost side of the equation. So that's my first question. And then I just had a quick follow-up.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Karen, as we stand in front of you and others in March, we did not anticipate the rapid shifts we've seen over the last 60 days. We did not anticipate that transportation and freight costs would soar the way they have as fuel prices have risen to all-time highs. While we were certainly anticipating the impact of overlapping stimulus and consumer and guest returning to more normal activities, we did not expect to see the dramatic shift in many categories that we've talked about, the shift from categories like TVs to luggage, from small appliances to toys, and guests celebrating, being out with friends. That certainly impacted our business in the first quarter, and we expect that to continue in Q2. And we certainly didn't anticipate the impact that would have on our supply chain costs.

So things changed rapidly after we stood on stage in New York. We own that. It's what we're adjusting as we build our plans for the balance of the year. And we're committed to improving our operating performance over the second, third and fourth quarter and getting ourselves back on track for a more normalized environment in 2023.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And then my second question is, obviously, we -- you have the higher sales productivity. That should be sustainable. So that should also translate into a sustainably higher operating margin structure, right, longer term, which is what you guided to. But that's the biggest question, obviously, that investors are asking today given what you just reported and what your guide reflects. So maybe if you could just give a little more color on why -- and the puts -- not the puts and takes, but the -- I guess, a stair step function to get back to your algorithm on the 8% operating margin.

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

You hit the nail on the head in your question. The sustainability of scale benefits, especially as you've seen in SG&A leverage, that should be sticky, and we would expect it to be sticky. We've got some work to do on the margin line, and Q1 and Q2 outlook reflects that. But as we work through some of that inventory liability, as we let the levers we have to pull react to the current environment, to Brian's note, some of that snuck up on us in the first quarter, and we'll work through some of that over time. But we continue to have a lot of confidence that the long-term run rate of profitability for the business is in the 8% range, give or take. And it's our work to do the hard work to get back to that path.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Karen, just finished my -- one of the things that hasn't changed since we were together in March and gives us great confidence as we go forward is the relationship we have with the guest. While we've certainly seen significant cost pressures since the start of this quarter, the guest continues to reward us with footsteps in our stores and growing traffic, more visits to our site. We feel very good about putting over 3% comps on top of 23% last year. The fact that traffic grew by almost 4% on top of 17% last year gives us great confidence that while we're facing some operating challenges, we've made that invisible for the guests. And we protected the guest experience as they shop our stores and visit our site.

That gives us tremendous confidence that, that guest will continue to reward us, particularly as we provide great value and affordability during a time of need. So that continues to give us confidence, not in just this year, but in our out-year forecast.

Operator

The next question is from Kate McShane with Goldman Sachs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I wondered if you could help us understand a little bit more the slightly down average ticket during the quarter. Just given the level of inflation that we did see on the cost side and the prices that you may have passed through, are there any pricing actions here that can help offset some of these margin pressures further? Or can we expect higher prices than what we saw in Q1?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Sure. Thanks for the question, Kate. As we shared in remarks, the headline story for us is traffic growth. But if you -- as you decompose ticket, we did see a low single digit increase in ASPs, offset by a reduction in units per basket. As you've heard us probably say many times before, a lot goes into that ASP number. It's a little bit product mix, it's a little bit how much inflation is in the environment. And so a little trickier to decompose there, but that's just a little more color on what we saw in the basket.

We continue to be laser-focused on that traffic number. That's a great indicator for us of how -- what we're doing is resonating with the guests and to continue growing the top line by growing and deepening engagement with Target. That positions us well for the back part of the year, and that positions us to have the top line that we want as we rightsize the profit picture over time.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Okay. And with regards to the operating margin guidance, and granted that I know you've kind of anchored it to the 5.8% and it being a wide range around that, is there any way you can dimensionalize how much lower do you think the margin can go or what the bottom of that range might be in your scenario analysis?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. There's -- I mean, obviously, there's a lot of factors at play as we look at Q2 and the balance of the year. I think we used the language, we wouldn't expect it to be normal for the balance of this year. So our best view of those factors is in our Q2 guide of 5.3%, plus or minus, a wide range around that, and in our guide of 6% for the year.

Operator

The next question is from Scott Mushkin with R5 Capital.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

So I guess the first thing I wanted to talk about a little bit is the inflation that consumers are seeing, particularly in those everyday items like utilities, food. How do you think the consumer is going to react over time? I know people talk about peak inflation, but from our vantage, it probably doesn't occur till maybe late summer. And how concerned are you that consumer demand holds up?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Well, Scott, obviously, we're watching this on almost a daily basis. And while we can't project into the future, I wish I had that crystal ball in front of me, we can tell you what we saw during the quarter and the start of May, where we just continue to see a resilient consumer. Our traffic numbers are up to start the second quarter. They're shopping multiple categories. And they're appreciating both the newness that we're providing, the seasonal relevance in our stores and in our assortment and the value we're providing. And we think that's critically important to our success over time.

So I'd love to give you an outlook on what's going to happen with the consumer and how do they respond to ongoing inflationary pressure. But I can tell you, the traffic we saw in our stores and the visits in our site in the first quarter, the way that's continuing in May 1 tells us that we've built extraordinary trust over the last couple of years. And we're continuing to be rewarded by a guest and the consumer as we work into the second quarter.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

So as a follow-up to that, Brian. I guess when you guys look at your business and the volatility that we're seeing and the potential the consumer could weaken, I know you're not seeing it yet, when do you start getting more aggressive on your costs to take action to maybe bring things down if you see things? How quickly can you move? And when do you start to do that?

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Well, Scott, we work each and every day to make sure we're finding efficiency throughout our operation. And certainly, coming out of the first quarter, we are doubling down on finding operating efficiencies and greater effectiveness in the organization. We know we've got to be really agile. And I think it's been one of our strengths over the last few years and certainly pronounced during the pandemic, that we have to be able to respond to a changing environment, whether it's the consumer changes, the economic changes around us.

And we'll continue to make sure we're focusing on agility, maintaining that relationship with the guests, growing market share even in a volatile environment and making sure we just deepen that relationship with our guests, which we think, long term, along with investing in our team, is the most successful way for us to create value for our shareholders.

Operator

The next question is from Joe Feldman with Telsey Advisory Group.

Joseph Isaac Feldman - *Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst*

I think earlier in the scripted remarks, Christina had made a comment that consumers seem more positive about their finances. And I was just curious if you could share a little more color behind that, like what you're seeing or hearing in your survey work.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. I'd be happy to, Joe. We have been -- the last couple of years, we have been highly engaged in trying to understand the consumer. We've been through a series of chapters of consumer behavior shifts almost every 2 months for 2-plus years, honestly. And what we're seeing is that the consumer has taken control of their environment more so because the macro environment feels out of control.

And so despite the fact that they might have worries about inflation, they're in charge. And they're making decisions based on their preferences and what they value, which means going back out, if that's what they want to do, traveling because they've missed it, seeing their friends and family again. And it's about moderating those behavior shifts and accommodating our assortment and our messaging and our relevance based on how those shifts happen. And so it's really important to stay close to the consumer and not expect that past behavior as an indicator of the future.

Joseph Isaac Feldman - *Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst*

Got it. And then just a follow-up again on the gross margin pressure you guys are seeing. Should we assume things gradually improve as the year progresses? Because presumably, you'll be lapping some of that pressure from last year. Prior to this quarter, I mean, historically, you guys have always had a pretty steady gross margin on an annual basis anyway, around 28%. And so is there any reason to think we won't kind of naturally come right back to that as we cycle through these pressures?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. You're certainly pointing in the right direction there, Joe. We've given the kind of explicit expectations for Q2, but implied in the full year is an improving profitability picture that will come through margin in the balance of the year. To focus on the annual in the long run there is a theme that I've come back to over and over. Quarterly margin is going to have more volatility than one might think. But in the long run, we're pleased with what we see as the potential of the profitability of the business. And we'll be on a path in the back half of this year to take steps in that direction for sure.

Operator

The next question is from Edward Kelly with Wells Fargo.

Edward Joseph Kelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Yes. Brian, I wanted to ask you about pricing. Beyond the inventory issue, much of the pressure seems cost related in areas like supply chain. Can you talk about the potential to pass these costs through to consumers and the time frame this may occur? I mean we are hearing from probably your biggest competitor, I guess, plans to do this. If there's any hesitation, maybe talk about why.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Yes. Joe, we absolutely are looking at this very carefully. And you should expect us to surgically pass along cost where appropriate. But we're also laser-focused on protecting our value position in this environment and making sure we provide great affordability to the guests in a time of need.

So we'll take a very balanced perspective on that. But I think we've got to start with doing the right thing for our guests and making sure we continue to provide the value that they look for from Target each and every day while we manage the cost environment and determine where and when we can pass along costs selectively.

Edward Joseph Kelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And then just a follow-up. Inventory per store is up a lot over 2019 before, pre-pandemic. And a lot has obviously changed, and your sales are a lot higher. But can you talk about where this should be? Maybe quantify the amount of excess that's still sitting in inventory today and where the most work needs to be done. And then what are you doing going forward to adjust things like cancellations? Or is it just really sort of adjusting ordering going forward?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes, Ed. The -- it's a good question. There's a few things going on if you look at the level of inventory on our balance sheet. One is we've got some categories where we need to work through some inventories. We've already talked about that piece. There's a little bit of product cost inflation sitting in that number, too. But I will say, given our desire to make sure we're landing some product earlier and protect against supply chain volatility, for the near term here, you should expect kind of that new normal of sales growth to inventory growth to include some working capital investments as we land some of that product sooner to make sure we've got it for the guest.

And so those are the 3 big factors that we're watching. Obviously, the first of those factors, we'll work to make some progress on here in the second quarter to get us in line with what we expect sales trends to look like for the back part of the year. But old normal might not be the current run rate in the near term as we work to secure product, land it early and avoid some of the disruptions that have caused out of stocks over the last year.

John J. Mulligan - *Target Corporation - Executive VP & COO*

Yes. And just to pile on a little bit, I think all things being equal, we would say, given how much larger we are, we turn -- everything would turn faster. But I think Michael hit on it, I don't think 2019 is a reasonable compare. Given the, frankly, slowness in the supply chain, lead times are longer. And that means we carry more inventory at any given time because of those lead times.

And so we aren't where we want to be right now, for sure. Like Michael said, we're lumpy, and we need to work through that, we will. But in general, the increase in turns that we would naturally see being a larger business with more sales is going to be offset by lead times that have increased virtually across every part of the supply chain.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

Operator, we have time for one more question today.

Operator

Our last question comes from Robbie Ohmes with Bank of America.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

Two quick follow-ups. The first is, if you guys isolate groceries, so Household Essentials and Food & Beverage, how was gross margin in that area of your business versus expectations? Is that seeing similar kind of pressure?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

We feel good about the gross margin performance in grocery. And just Food & Beverage in general has been such a steady top line grower, share gainer quarter after quarter. And so the strength that we've built in that category, I think, makes the economics in Food & Beverage work in the right direction. We've talked a lot, and I think it's important as we think about consumer looking for value, the strength of the owned brands in Food & Beverage, Good & Gather and Favorite Day and the guest response we've seen to those 2 owned brands has just been incredible. And that's great from a guest preference perspective. It's also good for margin.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

And the ability to cover the cost increases coming through on the national brands has been healthy?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

Yes. We're obviously looking at that across all categories and making sure that we're providing great value to our guests in spite of those inflationary cost pressures. No different approach in food and beverage, where we're looking to get that balance right there, too.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

And then just quickly, on the traffic, which is -- was really healthy against -- I think it was plus 17 last year, any sense of new customers versus frequency?

Michael J. Fiddelke - *Target Corporation - Executive VP & CFO*

So it's always a little bit of a mix of both when we're doing our job, right? But the thing that we come back to when it comes to driving traffic is just driving deeper and deeper engagement. And you've heard us talk in the past with over 100 million Target Circle guests. That's just one more way that we can continue to drive preference in a personalized way and build deeper and deeper engagement with Target over time.

And you can see that coming through in the traffic results we see, not just in this quarter, but over the past couple of years. And that gives us a lot of optimism that what we're doing is resonating with the guests, and that should bode well for the balance of the year and beyond.

A. Christina Hennington - *Target Corporation - Executive VP & Chief Growth Officer*

Yes, Robbie, and if I could just add 2 cents to that. The breadth of our growth across our guest base was very broad. All income levels, demographic levels, it was broad. And that's because of our commitment to continue to be more and more relevant over time using the tools that Michael talked about, but really our commitment to being consumer-centric.

Brian C. Cornell - *Target Corporation - Chairman of the Board & CEO*

All right. Operator, with that, we're going to conclude our call today. I really appreciate everyone participating. And we look forward to talking to you soon. So thank you.