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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Target Corporation Third Quarter Earnings Release Conference Call.

(Operator Instructions) As a reminder, this conference is being recorded Wednesday, November 15, 2023. 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 third quarter 2023 earnings conference call.

On the line with me today are Brian Cornell, Chair 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 insights on our third quarter performance, along with our outlook and priorities for the fourth quarter. Following their 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, including those described in this morning's earnings press release and 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 third quarter, and his priorities for the remainder of the year. Brian?

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

Thanks, John. For many years now, we have focused on building a durable business model that allows us to meet guests where they are, developing and enhancing the right tools and capabilities while investing heavily in our team, all in the service of providing an affordable, easy and joyful guest experience. And the flexibility of our multi-category model has served us incredibly well over the last few years, delivering unprecedented growth in both traffic and sales.

Today, our business generates well over $100 billion in annual revenue and is successfully navigating through a very challenging environment as consumers continue to rebalance their spending between goods and experiences and make tough choices in the face of persistent inflation. Even as our P&L is being impacted by multiple top line and bottom line challenges, including soft industry trends in discretionary categories, moderating inflation rates in Essentials and Food and Beverage and higher inventory shrink. We've seen a meaningful improvement in profitability compared with last year.

More specifically, our EPS through the first 3 quarters of 2023 was more than 40% higher than last year and more than 26% higher than in 2019. Importantly, even beyond this year's rapid progress, we believe we have a significant opportunity to grow both the top line and bottom line in the years ahead. So even as we remain cautious in our near-term outlook, we're not standing still. We're playing the long game, investing in our stores, our supply chain, our team, our digital capabilities and our assortment to provide the newness, value and convenience our guests want for this holiday season and beyond. At the heart of it all is our focus on being our guests' happy place and delivering the joyful shopping experience that makes Target, Target.

In the third quarter, Target's comparable sales were down 4.9%, in line with our expectations. Consistent with prior quarters and overall industry trends, discretionary categories were the driver of this decline, partially offset by net sales growth in our frequency categories. Between sales channels, store comp trends were somewhat stronger than in the digital channel. Among our digital fulfillment capabilities, same-day services saw high single-digit comp growth led by Drive-Up, which expanded 12%. Strength in these services was offset by continued softness in brown box delivery, which is most affected by the pullback in discretionary categories.

On the bottom line, our third quarter EPS of $2.10 was well above our expectations and more than 36% ahead of last year. This increase reflected the continued benefit of lower freight costs, disciplined inventory management by our team, favorable category and channel mix and the continued benefit of our work to enhance efficiency, which offset multiple pressures throughout our business. This is outstanding profit performance in the face of a very challenging environment, and I want to thank our entire team for their tireless efforts in support of our guests, our business and each other.

As you know, one of our top priorities this year was to rebuild our profitability following the unique challenges we faced in 2022. And while there's lots more work ahead of us, I'm really pleased with the progress the team has delivered so far this year. At the same time, I want to make it clear. We are not satisfied with the top line trends we've been seeing. Our #1 priority is to get back to sustainable growth in both traffic and sales, and we're committed to investing in long-term initiatives to deliver this growth.

As we assess the external environment, it's clear that consumers have been remarkably resilient. Yet at the same time, our research indicates that themes like uncertainty, caution, managing my time and budget and focusing on essentials while still finding ways to celebrate are all top of mind. Overall, consumers are still spending, but pressures like higher interest rates, the resumption of student loan repayments, increased credit card debt and reduced savings rates, have left them with less discretionary income, forcing them to make trade-offs in their family budgets.

For example, this year, we've seen more and more consumers delaying their spending until the last moment. Guests who previously bought sweatshirts or denim in August or September are deciding to wait until the weather turns cold before making a purchase. This is a clear indication of the pressures they're facing as they work to stretch their budgets until the next paycheck.

Consistent with these pressures, as we look at recent trends across the retail industry, dollar sales are being driven by higher prices with consumers buying fewer units per trip. In fact, overall unit demand across the industry has been down 2% to 4% in recent quarters. And the industry has experienced 7 consecutive quarters of declines in discretionary dollars and units. And while we're happy to see inflation rates moderating this year, if you compare industry pricing in key categories back to 2020, food at home pricing for families has increased 25% overall and in some areas, up to 30%. And if you're a parent raising a baby, you're facing increases of more than 30% on baby food and formula, too. And that's in addition to persistent increases in a variety of other categories.

So when you layer on the impact of higher energy prices, it all puts pressure on discretionary spending. As a result, this holiday season, we're focusing on highlighting the amazing value we've always provided in our end caps, promotions and the price points we feature in our marketing. As we built our plans for this holiday season, we maintained our cautious inventory positioning in markdown-sensitive categories. This provides our team the necessary flexibility to quickly adjust to volatile trends, something that has served us well all year.

But I want to be crystal clear. That does not mean we're backing off on newness. While we're cautious about the size of our inventory commitments, we're leaning into the amount of innovation featured in our assortment. And after several years in which our vendors were focused on raising production volumes in the face of unprecedented demand, we're encouraged by the focus on newness and innovation we're seeing from them. And as I've mentioned, throughout this holiday season, we'll be focused on highlighting value, helping families to celebrate the joy of the season in a way that fits their budget.

Beyond our assortment, as we work to provide a great guest experience, we've enhanced our training of retail fundamentals to our teams. This is an important shift after years of operating in an environment that was anything but normal. After all, given the large number of team members we've hired over the last few years, a meaningful number of them have never experienced ordinary sales trends.

As we've said many times, investments in our team are the most important ones we make. And today, we remain on our front foot, investing to ensure they can deliver a joyful industry-leading shopping experience. This holiday season, we'll be supplementing our existing team by hiring nearly 100,000 seasonal team members to meet expected demand and ensure we can deliver a joyful shopping experience.

So now as I get ready to hand the call over to Christina, I think it would be useful to pause and assess how this year has progressed in comparison to our expectations. As a reminder, at the beginning of this year, we said we were expecting a challenging environment with the sales guidance range centered around flat comparable sales. In terms of profitability, we said we expected to grow our full year operating income by $1 billion or more with an expected EPS range of $7.75 to $8.75.

So today, with 3 quarters of the year behind us, top line trends have obviously been tougher than expected, and we're firmly focused on getting back to growth. But the story on profitability has been very different. Through the first 3 quarters of this year, we've already grown operating income by more than $1 billion compared with last year despite unexpected headwinds from higher-than-expected shrink and softer-than-expected sales. We're encouraged with this performance against a challenging backdrop, which demonstrates the resilience of both our team and our business. I'm incredibly proud to be a member of this great team and excited about the growth we're positioned to deliver in the years ahead.

Now I'll turn the call over to Christina.

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

Thanks, Brian, and good morning, everyone. As we've shared for the past several quarters now, even as our guests face tough choices as they manage their budgets, they're also continuing to celebrate seasonal moments while showing their excitement for new product offerings and compelling value. After all, consumers are feeling the weight of multiple economic pressures and discretionary retail has borne the brunt of this weight for many quarters now.

In addition, consumers are facing newly emerging headwinds, including higher interest rates and the return of student loan payments. In the face of this mental and emotional tug of war, consumers are looking for a respite, which is why we are relentless in our pursuit to provide ease, inspiration, joy and comprehensive value every day. And while we are not satisfied with our current performance, I'm confident that our team's empathy and their continued focus on serving our guests' wants and needs, will pay dividends in the years ahead.

As Brian mentioned, our third quarter comparable sales decline reflected continued softness in discretionary categories, partially offset by growth in Beauty. Notably, comps within frequency categories slowed between Q2 and Q3, driven entirely by a deceleration in the comp benefit from growth in average retail. More specifically, in both Food and Beverage and Beauty and Essentials, the benefit from average pricing decelerated by about 3 percentage points between the second and third quarters as we move beyond the period of peak inflation from a year ago. As we've said, a lower inflation rate is welcome news as it will reduce pressure on consumer budgets, making room for them to expand back into discretionary categories over time.

Beauty-led performance in the quarter with comparable sales growth in the high single digits driven by strength across core Beauty and our Ulta Beauty at Target offerings. We're excited to launch Fenty Beauty by Rihanna in the third quarter, and it has quickly become one of our top-selling beauty brands across the chain. In Food and Beverage, comp sales were down slightly to last year. Seasonal candy, snacks and hosting solutions performed particularly well. Comp sales in Essentials declined in the low single digits despite strength in health care and baby categories.

Comp sales in our discretionary categories remained soft in the third quarter with declines ranging from the high single digits to low double digits. However, trends improved markedly compared with the second quarter, thanks to the agility of our team and their focus on listening and responding to our guests. Home saw a high single-digit comp decline, an improvement of more than 6 percentage points from the second quarter. Most notably, we saw strength in Back-to-School and college categories and a great response to our assortment of Stanley drinkware.

Additionally, within kitchenware, we launched our most recent owned brand, Figmint, and received an enthusiastic response from our guests. Figmint offers more than 250 items, ranging from enameled cookware to ceramic mixing bowls to kitchen gadgets all at a quality, aesthetic and value that can't be topped.

Apparel comparable sales also declined high single digits, an improvement of nearly 3 percentage points when compared with Q2. The business was strongest within new offerings, including our partnership with Kendra Scott jewelry, the latest All In Motion performance wear and new fall fashion sets within our women's categories. Hardlines comparable sales were down in the low teens. While we were encouraged by Back-to-School performance, demand for electronics remains particularly soft.

This quarter's performance demonstrates that while our results are not immune to macro conditions, when we focus on retail fundamentals, offer exciting new products at incredible value and respond to our guests' wants and needs in a timely manner, we remain relevant with our guests, even against the challenging backdrop. By leaning into seasonal moments like Back-to-School, Back-to-College and Halloween, we not only drove sales in the current quarter, we helped to build lasting affinity with our guests. This focus on celebrating the season creates an engaging experience that keeps Target top of mind.

And that's why we continue to offer events like our latest Target Circle week in early October, which added another 500,000 members to our loyalty platform, providing future opportunities to engage with these guests in deeper ways. Our goal this holiday season is to create the perfect combination of incredible value, inspiring and fresh products and a joyful shopping experience as you stroll the aisles in our stores or on the recently refreshed Target website and app.

We aim to deepen the relationships with our guests as they look to deck the halls and celebrate the joys that the holidays bring. As we do year round, we are leaning into the power of "and" this holiday season by not focusing only on one aspect of our strategy, but celebrating how they all work together to create a unique offering in a crowded retail landscape.

Our plans start with a celebratory experience that you feel the moment you walk into our stores or open the Target website or app, featuring on-trend and inspiring color pallets, imagery and in-store marketing that complements all the excitement and joy, we are creating with our national marketing campaigns. Guests will feel the holiday spirit before they even add their first item to the cart. The excitement builds with our assortment at unbeatable value only at Target-exclusive merchandise and our easy and convenient holiday solutions.

And through it all, we'll remain diligent on executing the necessary retail fundamentals our guests want and expect from us, including being in-stock on the must-have items of the season, offering unmatched value and pricing, highlighting our inspiring and differentiated merchandise assortment and making each trip easy and convenient regardless of where, when and how guests chooses to shop.

Whether a guest knows exactly what they're looking for or needs a bit of inspiration, we want to make the trip joyful, easy and welcoming. And we know families want to celebrate the holidays, but they're relying on us to help them do so affordably. With a combination of everyday low prices, compelling promotions and exciting savings events all season long, we aim to be the holiday destination for affordable joy.

So with Thanksgiving right around the corner, guests shopping our food and beverage area will discover how we're helping families celebrate with a Thanksgiving meal that includes all the family favorites for under $25, featuring $0.99 per pound Good & Gather turkeys and the must-have sides for just $5. As they explore our assortment, guests will discover exciting gifting options for every loved one.

In toys, guests will find the characters and items their kids want at prices designed to fit every budget, with over 2/3 of this season's toy assortment priced under $25. In addition, around 1 in 4 toy items is a Target exclusive, featuring everyone's favorite properties, including Barbie, Paw Patrol, Pokemon, Marvel, Teenage Mutant Ninja Turtles, LEGO and so much more. And so far, among the most popular toys in our assortment are All Things Target, including plush Bullseye dogs, Barbie First Job at Target Dolls and Target cash register and shopping cart toys, a nod to the Target brand love, even among our youngest guests.

And back by popular demand, we have an exciting array of toys from FAO Schwarz, including only-at-Target exclusives with 50% of the assortment under $20. With so many options to choose from, we are making it easier than ever to help narrow in on what will bring the biggest smiles this holiday season through exciting in-store displays and experiences. And on target.com as well as the Target app, guests can immerse themselves in a digital 360-degree room filled with the hottest toys for kids of all ages to try before they buy.

When the presents are taken care of, it will be time to deck the halls, and we're offering an array of holiday decor at even lower prices than ever before. Nearly 2/3 of the assortment will be priced under $20 with in-store and digital signing and displays, making it easy for guests to see how they can refresh their holiday decor affordably with $15 ornament sets, family baking solutions and Mondo Llama craft sets, $10 throw pillows and tree skirts and still much more.

And of course, the season is all about gathering with loved ones. Guests will find all the best entertaining, gifting and gathering solutions in this year's assortment, and we're launching more than 100 new items in Good & Gather and Favorite Day, with over half of these priced under $5.

Throughout the holiday season, guests can rest assured that they'll get the best price and quality, wherever and however they shop. We'll be offering incredible deals leading up to Black Friday, including 4 weeks of deals on tens of thousands of items with many up to 50% off. Target Circle members will receive exclusive promotions and offers to reward and deepen their love of All Things Target. Plus, we've added more personalization than ever before, giving them even more options to earn rewards. And of course, we'll offer our season-long price match guarantee, which assures guests that no matter when they shop, they'll get the best price of the season.

The holidays are so special to so many families, and they are made even brighter by everything our team members do for our guests and for each other. I'm so inspired by how each of our teams from marketing to merchandising to stores to supply chain are bringing their best to create something truly magical and uniquely target this holiday season. I want to thank the entire Target team around the world for being the not-so-secret weapon that will help us to win the holiday season.

As I get ready to end my remarks, John, I want to pause and thank you and acknowledge your countless contributions to the Target brand and team. I've greatly appreciated getting to work alongside you for so many years and know your legacy will be felt for many more.

With that, I'll turn the call over to you.

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

Thanks, Christina. Over the last 3.5 years, our operations have continually faced unusual and rapidly changing external conditions. In 2020 and 2021, after the onset of the pandemic, we couldn't secure enough inventory to satisfy the explosion in demand for our products, and we saw operating margin rates grow well beyond normal levels. Then in early 2022, the period of rapid growth in discretionary categories suddenly reversed, and we quickly moved from having too little inventory to having way too much. As a result, both our distribution centers and store backrooms filled up well beyond optimal levels and operating margin rates quickly moved to historical lows.

So this year, as Brian mentioned, a key priority was to optimize our inventory position so it was better aligned to the current size and growth rate of our business. We were confident that if we were successful in that effort, our operations will become more efficient, markdowns will come back down, and we'd see our profit rate recover back toward more sustainable long-term levels. And through the first 3 quarters of the year, despite unexpectedly soft top line trends, the team has delivered a more rapid recovery in our profitability than we'd even planned at the beginning of the year.

Looking ahead, we've maintained this cautious inventory posture and planning for the fourth quarter as well. More specifically, at the end of the third quarter, total inventory on our balance sheet was 14% lower than a year ago with discretionary category inventory down 19%. And importantly, while this ending inventory position was 29% higher than at the end of Q3 2019, that's aligned with growth we've seen on the sales line over those 4 years, making us feel really good about both the size and the health of our inventory position as we enter the holiday season.

In addition, even though we own a lot less inventory than a year ago, the team has delivered meaningfully improved reliability and in-stock metrics this year, and they made additional progress in Q3. More specifically, overall in-stocks in the third quarter improved nearly 1 percentage point compared with Q2 and more than 3 percentage points from a year ago. And notably, in-stocks in our highest volume stores saw an even greater year-over-year improvement.

In terms of our top-selling items, while the in-stock rate remained consistent between Q2 and Q3, that was after we grew the size of that list by about 75%, meaning that today, our top item list accounts for more than 1/3 of our total sales. Beyond these broader metrics, we also saw meaningful improvements in our seasonal in-stocks and a more than 6 percentage point improvement in new item in-stocks.

In our smaller stores, which on average have less shelf capacity and turn faster than the chain, in-stocks have improved by more than 2 percentage points between the first and third quarters. And today, our in-stock levels in those stores are slightly better than the overall chain. And finally, in the digital channel, the percent of items available for purchase has improved by more than 2 points compared with last year, reflecting an improvement of nearly 8 percentage points in Apparel.

Beyond the work of our team to deliver these outstanding improvements, we're benefiting from a more than 2-week reduction of import lead times compared with last year and a nearly 10 percentage point improvement in purchase order fill rates compared with a year ago. And with the combined benefit of a faster supply chain and a simultaneous reduction in inventory levels, all of our supply chain facilities stayed at or below our desired capacity thresholds through all 13 weeks of the third quarter this year compared with only 3 of 13 weeks in Q3 of 2022. So while we'll continue to focus on ways to consistently deliver higher in-stocks and reliability, I'm incredibly proud of what our team has accomplished so far this year.

So now before I turn the call over to Michael, I want to highlight how our team continues to deliver on their efforts to improve execution of everyday retail fundamentals as we prepare for the busiest shopping season of the year. One of the key areas of focus for our store teams this year was to ensure priority items remained available on our sales floors throughout the day. And this year, through these efforts, we've increased the amount of inventory available on our sales floors by more than $0.75 billion.

In addition, we've seen improvements in metrics relating to backroom inventory accuracy and the percent of new assortments set on time. In the digital channel, the percentage of orders picked and shipped on time and the average Drive-Up wait time have all improved from last year. Also in support of the digital business, the percent of items ordered but not found has declined from a year ago, meaning that we are fulfilling more items per order and canceling fewer, a key factor in guest satisfaction.

Since our goal is for Target to be the easiest place for our guests to shop, our teams have been focused on the front of store experience with the goal of providing consistently great service through the in-store checkout experience, along with drive-up and in-store pickup. And because our guests tell us they enjoy interacting with our team, since we've refocused on the front-end experience, we've seen more than a 6 percentage point increase in the usage of full service lanes across the chain. And we've seen sustained month-over-month improvement in the Net Promoter Score relating to interactions with our team at checkout. In addition, compared with last year, we've seen improvements in Net Promoter Scores for both Drive Up and in-store pickup on top of already high levels a year ago.

Beyond the front of store, in support of our efforts to highlight value and affordability, our team has been working to increase the number of store end caps featuring 1 or 2 price points. As a result, going into this holiday season, nearly 2/3 of our end caps were meeting the standard and conveying a simple, compelling and easy-to-understand value message.

Finally, I want to provide a quick update on our goal of hiring 100,000 seasonal team members to join our team and provide a great guest experience during the holiday season. I'm happy to report that our hiring stats this year have improved relative to last year. I'm confident our entire team will be energized and ready to support our guests throughout the busiest season of the year.

So now as I get ready to turn the call over to Michael, I want to quickly thank all of you for your continued interest and engagement with Target. I've been fortunate to meet and interact with many of you over the years beginning with my time as CFO and continuing with my time leading operations. I also want to say to the entire Target team, thank you for everything I've learned from you, for your enduring passion for retail and for your love of this iconic brand. I'll continue to be a huge supporter of this company and this team when I'm no longer on these calls. Because of all of you, I know that the company and our guests are in very good hands, and I'll be cheering on your efforts from the sidelines.

Now I'll turn the call over to Michael.

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

Thanks, John. Before I begin my formal remarks, I want to thank you for the positive impact you've made on this company, our strategy, our team and on me personally. I've been fortunate to work with you and learn from you since I first arrived at Target 20 years ago.

In the third quarter, total revenue was down 4.2%, reflecting a 4.3% decline in total sales and a 0.6% decline in other revenue. Within the other revenue line, declines in credit card revenue and a few smaller items were nearly offset by growth in Roundel ad revenue. Among the drivers of our third quarter comparable sales, traffic was down 4.1%, combined with a 0.8% decrease in average ticket.

While we're encouraged that our Q3 comp trend improved 0.5 point compared with Q2 and the traffic trend recovered a little bit faster, we're not at all satisfied with this result, and we're laser-focused on moving both traffic and sales trends back into positive territory. As Christina mentioned, our guests continue to shop around seasonal moments. So not surprisingly, Q3 comp performance was strongest around the Back-to-School and Back-to-College seasons. For the remainder of the quarter, we saw variability week by week with periods of relative strength around promotions.

Our third quarter gross margin rate of 27.4% was more than 2.5 points better than last year, driven by multiple benefits within merchandising, including meaningfully lower freight costs and favorable clearance markdowns. In addition, we benefited from year-over-year favorability in digital fulfillment and supply chain costs. And perhaps, surprisingly, merchandise mix drove a small rate benefit compared with last year as we continue to benefit from growth in higher-margin categories like Beauty and we saw the softest performance in very low-margin categories, like electronics.

Partially offsetting these tailwinds, the rising cost of inventory shrink represented a 40 basis point headwind to our third quarter gross margin rate. While we're encouraged that this impact was smaller than expected and better than we faced earlier in the year, growth in shrink remains a significant financial headwind, and we're determined to continue making progress in the years ahead.

While our Q3 guidance anticipated significant improvement in our gross margin rate, our actual performance was well above our expectations as the team delivered greater-than-expected progress on several fronts. At the top of that list is their continued agility in managing inventory, which delivered compelling benefits on both the gross margin and SG&A expense lines.

In addition, our team's ongoing efforts to identify long-term efficiency opportunities is already contributing to this quarter's better-than-expected performance. Beyond those drivers, a couple of macro factors came in better than expected including freight costs and the impact of inventory shrink.

On the SG&A line, our third quarter rate of 20.9% was just over 1 percentage point higher than last year. This growth reflected cost increases throughout our business, including continued investments in our team, along with the deleveraging impact of lower sales, partially offset by disciplined cost management throughout the organization. Our Q3 depreciation and amortization expense rate of 2.4% was about 10 basis points higher than a year ago, reflecting dollar growth of about 3%.

Altogether, our third quarter operating margin rate of 5.2% was more than a percentage point higher than last year. And notably, this year's rate was only about 20 basis points lower than the 5.4% our business delivered prior to the pandemic in the third quarter of 2019 despite the cumulative 110 basis point drag from shrink we faced since then.

Also important, given the growth in revenue that our team has delivered over that 4-year period, this year's Q3 operating margin dollars were more than 30% higher than in 2019. As a result, on the bottom line, both GAAP and adjusted earnings per share of $2.10 in this year's third quarter were more than 36% ahead of last year and more than 50% higher than in 2019.

Important to note, while the backdrop today remains tough, because of the long-term investments we continue to make and the efforts of our team to identify efficiency opportunities throughout our business, we have a lot more opportunity to grow both our top line and increase our profitability in the years ahead. And our team is already delivering strong profit performance, both compared to a year ago and versus our longer-term history as well.

Now I'll turn to capital deployment and reiterate our priorities, which have remained consistent for decades. We first look to fully invest in projects that meet our strategic and financial criteria. Then we look to support the dividend and build on our record of annual increases, which we've maintained for more than 50 years. And finally, we deploy any excess cash within the limits of our middle A credit ratings through share repurchase over time.

Regarding the first priority, capital investment through the first 3 quarters of the year was just under $4 billion, and we expect full year CapEx will be near the high end of the $4 billion to $5 billion range we laid out for the year. While we're still in the early stages of developing next year's capital plan, our current expectation is that next year's CapEx will be somewhat lower than this year in the $3 billion to $4 billion range, reflecting our current view of the optimal timing for key investments we're planning over the next several years. Regarding our second capital priority, we paid dividends of just over $0.5 billion in Q3, $10 million higher than last year, reflecting a per share dividend increase of 1.9%.

Regarding the last priority, we didn't repurchase any shares in the third quarter as we continue to focus on strengthening our balance sheet and restoring our debt metrics to levels that support our middle A credit ratings. And we continue to make meaningful progress on that journey as the combined benefits of higher profits and lower working capital have led to a meaningful improvement in operating cash flow. More specifically, our operations have generated more than $5.3 billion in cash through the first 3 quarters of the year, up dramatically from about $550 million through the first 3 quarters of 2022.

As always, I'll conclude my review of the quarter with our trailing 12-month after-tax ROIC, which was 13.9% in the third quarter, down from 14.6% a year ago. While an after-tax return in the low teens is quite healthy in absolute terms, it's meaningfully lower than the returns we expect to deliver over time. Importantly, we've seen sequential improvement in this metric over the last couple of quarters, and we're focused on continuing that momentum in the years ahead.

Now I'll turn to our guidance for the fourth quarter. On the top line, our expectations reflect our continued near-term caution, leading us to maintain our prior guidance for a mid-single-digit decline in Q4 comparable sales. On the bottom line, we're also maintaining a cautious posture, particularly because the fourth quarter is typically a very promotional season. As such, we're planning a wide range for our fourth quarter EPS of $1.90 to $2.60, which represents approximately flat growth to last year on the low end and growth of about 37% on the high end.

I also want to note that 2023 is a 53-week year. So the fourth quarter will include an extra week of sales and profits. We estimate that extra week will add about $1.7 billion in sales and result in about 30 basis points of operating margin rate leverage on the quarter. Note that it will not affect our comparable sales as we base that calculation on periods of equal length.

On top of the results, our team has already delivered through Q3, our fourth quarter guidance implies a full year EPS range that's very close to the original guidance range we provided at the beginning of the year, with a midpoint less than $0.05 from the center of the original range. That's an amazing outcome against the backdrop of a tougher-than-expected top line, and it's a testament to the tireless efforts of our team to stay nimble and successfully navigate through a volatile and unpredictable period.

In fact, given how strong our profit rate performance has been so far this year, we've been getting some questions about whether we're only focused on increasing our profit rate, and I want to pause and address that question head on. As John mentioned earlier, coming into this year, we were confident our team would deliver a significant increase in our profit rate by achieving better alignment between our inventory and our sales. In addition, a year ago, we first talked about the significant long-term efficiency opportunities we're pursuing, given that we've grown our revenue to more than $100 billion per year.

While that work is still in its early stages, the team has already delivered hundreds of millions of dollars of efficiency savings so far this year, significantly benefiting our profitability. But I want to make it clear, we are focused on growing profit dollars. And if we saw an opportunity to invest a portion of our current profit rate to gain sustainable long-term growth in dollars, we would gladly do that. Even more fundamentally, our first priority is to deliver long-term top line growth because the only way a retailer can sustainably deliver bottom line growth is by delivering top line growth as well.

At the same time, we're not interested in making any investments that might boost the top line in the short term, but which wouldn't lead to any sustainable growth. In fact, our experience has shown that many times, those kinds of short-term decisions are actually harmful over time.

So today, we remain focused on the long-term strategies that have been so successful in driving top line growth over the last half decade, including our work to enhance our assortment of both owned brands and national brands, our investments in our store assets and our team to deliver a reliable and differentiated shopping experience, investments in new stores and markets we've not previously served and in existing stores to keep them fresh and enhancing our digital experience, beginning with the website and Target app, all the way through to the fulfillment services we provide.

As we pursue those long-term initiatives, we also have opportunity to further grow our operating margin rate in the years ahead, and we don't believe those efforts are incompatible with each other. But more directly, based on where we are today, we believe we can successfully deliver both top line growth and rate improvement over time.

And as always, the basis for my confidence starts and ends with the Target team. They have delivered unprecedented growth over the last several years. And this year, they've made amazing progress in moving our profitability back toward the optimal level, all while focusing on building and maintaining long-term relationships with our guests. Our team is truly the best team in retail.

Now I'll turn the call back over to Brian.

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

Thanks, Michael. Before we turn to your questions, I want to pause and acknowledge John's incredible record of service to Target and thank him for his profound impact he's had on this company. I'm sure he'll be glad to know I'm not planning to recap his entire 27-year career this morning. But I do want to highlight the impact he's had since I arrived in 2014, an impact that literally began on my first day when John handed me a large binder, a recap of the comprehensive strategy review he and the Board conducted during his time as interim CEO.

That body of work was an invaluable resource that allowed me to hit the ground running. It serves as a blueprint for all the strategic changes we made in those early years. One of those changes was the creation of a Chief Operating Officer role, the first time we've had one at Target. And while John was already an outstanding CFO, I knew he was the right person for this new position. Since becoming COO in 2015, and John has led the transformation of our store portfolio from new stores or remodels through the operating model within those buildings.

Similarly, John is leading the transformation of our upstream supply chain completely changing the way our distribution network serves our stores. And of course, John's team developed and implemented our stores as hub strategy. When we launched stores as hubs, it was a completely unique approach in retail. It's a model that has changed the way we serve our guests, including Drive-Up service, now accounts for well over $7 billion in annual sales, $7 billion is larger than the total sales of some other prominent retailers.

But beyond the tangible operational changes John has led, it's his focus on team development and its impact on individual leaders that's been the most notable. John has served as both a formal and informal mentor to countless members of our team, and he's hired and developed an extraordinary group of leaders, including Mark Schindele in our stores and Gretchen McCarthy in our supply chain, both of whom are ready and well prepared to continue leading the work after John steps down.

Perhaps the strongest complement I can pay John is to say he will be missed as a colleague, and I will personally miss his partnership. But I know our operations will not miss a beat given how masterfully he's prepared everyone around him. And that goes for me, too. Since the day I arrived, John has been a trusted adviser, whose only goal was to do what was best for our guests, for this great company and for our team.

I should also reiterate that John will remain in his role through the end of this fiscal year and has agreed to continue in an advisory role until February of 2025. We'll share additional information on our succession plans for John early next year. I'm sure I speak for all of us when I sincerely thank John for all he's done for Target and wish him only the best in his retirement.

With that, we'll turn to Q&A. Christina, John, Michael and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Robby Ohmes with Bank of America.

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

First, I just want to say congrats to Brian and team Target on a great quarter in a really tough environment and to John Mulligan on just everything you've accomplished working at Target. But then my question is actually for Mr. Fiddelke. I was hoping that you could talk to us about how to think about the puts and takes on gross margin differences in, say, 4Q versus 3Q. You mentioned shrink was a little better. How should we think about that for the fourth quarter, also freight versus what you saw in the third quarter? What inventory management could bring in expectations for markdown ranges that we should think about for the fourth quarter, say, versus the third quarter, to give us something to think about.

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

Yes. Happy to start, Robby. And you had a couple of other drivers in your question. The Q3 relative benefits of shrink coming out in a little better than we thought, freight coming in healthy on a year-over-year basis were certainly contributing factors. But the one I just underscore is the continued benefit we see from our strong inventory position. The cautious approach we've taken to inventory and, frankly, the team's good work to drive more productivity with a better inventory position, that inventory position just reaps benefits across our operations. Our stores are more efficient, our DCs are more efficient. All systems run better with inventory where it sits today. And with inventory down 14% on the balance sheet as we exit the quarter, we feel really good about that inventory position heading into Q4.

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

And do you still expect shrink to be favorable year-over-year in the fourth quarter?

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

So that's probably worth spending just a second on so that we all interpret what we're likely to see in Q4 the right way. Given the pace of some of our accruals last year, we would expect shrink to not to be quarter-over-quarter headwind in Q4 that we've seen throughout the balance of the year. Important to note that, that doesn't mean we've turned the corner on shrink. We'll continue to watch those trends carefully, and we still saw year-over-year pressure in Q3 as the underlying shrink in the business is still a headwind on a year-over-year basis, but there's some things unique to last year in Q4 that are likely to make it less of a driver of year-over-year variance in that quarter.

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

Robby, I might build on Michael's comments around inventory. And we certainly feel very good about the actions we've taken and the reduction of inventory by 14%. But if you heard Christina earlier in the call, we've also been leaning into newness and feel really good about our position going into the holiday season with 10,000 new items, and we'll continue to lean in to meet demand during the holiday season. So I think the team has done an exceptional job of managing inventory. The benefits throughout our system have been realized in the third quarter. But we're playing to win in the fourth quarter. And I think Christina highlighted the amount of newness we have in our system and the great value we'll offer our guests throughout the holiday season.

Operator

Our next question comes from Rupesh Parikh with Oppenheimer.

Rupesh Dhinoj Parikh ***Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst***

Congrats on a nice quarter. So just for the holiday season, just curious if there's any early reads you can share and then any commentary just in terms of what you're seeing quarter-to-date.

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

Well, as you might expect, we're watching it day by day, almost hour by hour, but we're still really early in the season. The big days, the big weeks are still in front of us. So we'll launch it carefully. Again, I think we're prepared for a really solid holiday season, but it's just way too early to tell.

Rupesh Dhinoj Parikh ***Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst***

Great. And then maybe one follow-up question just on the CapEx. So expectations are lower for next year. Any specific buckets where you guys expect to reduce CapEx spending next year? Just any initial color you can share.

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

You can expect us to unpack that more as we get into the start of next year, Rupesh. But wanted to share our latest thinking of how we think the cadence by year flows, and as you heard me say in my remarks, importantly, we'll continue to invest in the things that will drive growth over time. We're really pleased with the almost $5 billion of investments this year and the returns those will drive. And we feel like that $3 billion to $4 billion number is the right number for next year based on what we see today, but more to come on that front.

Operator

The next question comes from Michael Lasser with UBS.

Michael Lasser ***UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines***

Best of luck to John Mulligan. With sales down around 5% in the third quarter and the guidance calling for a similar decline in the fourth quarter, one of the key debates, and using an example is, are customers not coming to Target right now because they're just not in the market for a coffeemaker, as an example? Or are they buying that coffeemaker somewhere else? And if the latter is the [key], how much more promotional will Target need to become in order to get the customer back?

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

Michael, I'm happy to start, and then I'll ask Christina to provide additional color. But one of the things that we've called out a number of times now is that there's tremendous pressure on the consumer's wallet and the impact of very sticky food and beverage inflation, which compared to prepandemic, food and beverage prices were up on average 25%. And that's certainly pressured consumers as they're making choices and certainly has forced them to make very tough choices when it comes to discretionary goods.

We've actually seen in the industry 7 consecutive quarters where discretionary goods have declined both in dollars and units. So there's an overall pressure in the marketplace. So you're seeing a consumer who is focused on managing their budget, buying those household essentials and then carefully shopping for those new items you just mentioned.

But Christina, why don't you give Michael some additional color on what we're seeing in some of those categories?

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

Yes. To build on what Brian said, certainly, when we do have hot promotions, the guest is responding. And the fourth quarter is always very competitive, and we'll be very well positioned with everyday low prices as well as promotions and investments in Circle, our loyalty program. I think the big difference for us this year and this fourth quarter is the amount of newness that we've invested in. If there's one thing that we've seen is in an environment where people are making choices and they might have some constraints with their budget, the motivation to buy is really, is this going to add value to my life? Is this something that is intriguing and feels relevant or is fashion forward or is really for me?

And doing more of the same just isn't going to get it done, which is why we've invested in newness. And you'll see that across the store. You'll see it as you walk in, first thing in our women's set. It's right on trend, it's colorful. The price points are very appealing. You walk around to our seasonal business. Right now, you can get everything (inaudible), your tree skirt to ornaments at a great value. Continue down the path to toys, you've got over 2/3 of our toys below $25. And then around the corner of our store to food, where you can get not only your Thanksgiving meal for under $25, but all the gifting solutions and special trades for Marks & Spencer, only rounded out at Beauty, which has been our strongest business year-to-date and for many years and find gifting solutions at every price point.

So we're really pleased with assortment we're putting forward and think this will certainly motivate the guest to buy.

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

And Michael, one point to clarify. While we've certainly called out the pressure we're seeing both from an industry standpoint and a Target standpoint in discretionary categories, in the third quarter alone, we generated over $25 billion of revenue. And as Michael referenced, on a full year basis, we'll generate over $100 billion of revenue. A significant portion of that comes from discretionary sales.

And as Christina pointed out, much of that's tied to combining great newness with affordability. And I think we're well positioned to continue to perform in those categories. So while we've seen some pressure, consumers continue to turn to Target for Apparel and Home, for discretionary categories and items. And I think we're well positioned with the amount of newness and value we'll offer during the holiday season.

Michael Lasser ***UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines***

My follow-up question is, Brian, over the last couple of years, Target has shown that it can drive sales growth. It's now showing that it can drive profitability. As you look towards 2024, when arguably the consumer is going to continue to face pressure, will your priority being on driving better sales performance or sustaining the profitability that Target has been able to achieve this year?

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

Michael, it's such a great question. And you heard me say this in my prepared comments, our focus is on obviously doing both. We're certainly not satisfied today with our top line performance, and we are laser-focused on improving traffic, on growing our top line and continuing to advance our profitability. So for Target, it's a combination of doing both. And as we finish this year and build our plans for 2024, you'll see us being focused on driving our top line, building traffic and continue to expand our profitability.

Operator

Our next question is from Edward Yruma with Piper Sandler.

Edward James Yruma ***Piper Sandler & Co., Research Division - MD & Senior Research Analyst***

John Mulligan, congratulations on all that you've done, and thanks for all the help over the years. Really just a couple of clarification questions. So Michael, on shrink, I know last year you had a significant accrual in the fourth quarter, you said that there's favorability, but just trying to understand the underlying trend. Are you seeing stabilization? And not to conflate 2 things, but I know you did call out kind of more usage of full-service lane. So trying to understand if you kind of at least start to flatten the curve on shrink. And then as a follow-up, on discretionary categories, obviously, nice to see the improvement in Apparel. Are you planning kind of continued improvement within that negative mid-single comp guide?

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

I'm happy to start with the shrink question, Ed. In the third quarter, we still saw year-over-year pressure, so about 40 basis points of year-over-year headwind. That's less pressure relatively than we saw in the first 2 quarters of the year, and it was a little better than we thought it'd be. And so those are encouraging signs of some progress in the right direction, but to be clear, still a year-over-year headwind in Q3. And so as we've said before, shrink's a lagging metric. We think progress there probably doesn't happen quickly. But we're focused on progress over time, and you'll see us continue to take the actions to get a better outcome there over time, but it's not one that we'd expect overnight.

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

And on the discretionary side, I said it in my prepared remarks, but there was an underlying shift in the third quarter compared to the second quarter with both Apparel and Home accelerating nicely. And so that's our continued goal, is to make sure that we present the right level of newness to build the business back to positive territory over the long term. We are, however, picking our bets. And so our cautionary planning to inventory has bought so much goodness in the total P&L on the operation that about -- it's about being choiceful and placing our bets.

Operator

Our next question is from Kate McShane with Goldman Sachs.

Katharine Amanda McShane ***Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst***

We wonder if you could talk to traffic trends by month throughout the quarter. And just wondered how much better traffic in the third quarter versus second quarter was driven by customers coming back after what we saw in June.

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

Yes. So when we think about what we see in traffic, as you heard in our prepared remarks, it was good to see sequentially traffic improve quarter-over-quarter at a slightly faster rate than the top line did. And we're excited about the work teams do, that balance of newness and value and the investments we continue to make in the business to turn traffic back in our favor over time. And so that's where you'll see us focused, Kate.

Katharine Amanda McShane ***Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst***

Okay. And then our follow-up question is just around promotions. Are you seeing any kind of increase in vendor support when it comes to promotions versus what you saw last year?

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

As we've talked about, the consumer is responding to promotions and so the market is responding accordingly. With that said, I'd say it's still a rational environment. And the healthy inventory position that we're in allows us to continue to offer great value to our guests without chasing empty calories.

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

Kate, I might offer just one more piece of context on traffic. Even with the tougher sales trends that we've seen so far year-to-date, through the first 3 quarters of this year versus prepandemic, traffic is up over 20% in total. And so we feel really good about the engagement that we've built with guests over the last few years. We think that's an asset and a base that will really benefit us well going forward.

Katharine Amanda McShane ***Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst***

And John Mulligan, congratulations.

Operator

Our 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***

And I wanted to ask, can you talk a little bit more about what you're seeing from unit perspective in terms of unit sales? And I know, as you mentioned in the transcript, that units are down a little bit. But are you starting to see any stabilization there? And how should we think about unit sales going forward? And also if you could touch on the Grocery aspect of that as well, I'd be curious -- or Essentials, I should say.

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

Yes. So Brian hit on this in his prepared remarks, that the industry has seen a slowdown in unit performance over many quarters in a row. And that is because the pressure on the consumer is really real and they're having to make those choices. I also shared in my remarks that in the frequency businesses, which we think of as Food and Beverage and Essentials and Beauty, that in the third quarter we saw prices come down so that we comped over the peak of inflation. The prices came down, that's an industry-wide phenomenon. And as a result, we did see some improvement in unit velocity. That's a good thing in the long run, is that when consumers can stretch their budget across more things that they want to buy and not have it tied up in any high prices. That's a good thing. But as Brian talked about, the inflation on these categories over the last several years, especially in Food, Household Essentials, even pets and baby, is meaningful. And that's going to take a while to overcome.

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

Operator, we've got time for 2 more questions today.

Operator

Our next question is from Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman ***Morgan Stanley, Research Division - Executive Director***

I want to go back to this market share -- or not market share, actually sales versus margin. And I'm curious if you can speak to market share, if that is a gauge you're looking at how -- what happened during the quarter. And is the decision around this trade-off, is it market share dependent? Are there certain categories you're looking at thinking about when to apply promotions or where to apply promotions?

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

So right now, with total consumer spending soft in the discretionary portfolio, we are not going to chase short-term benefit at the long term -- at the expense of long term. And so it's always a balance. We're always looking to drive both sales and profit. We've also been very clear that this year has -- we put profit on a high priority to recover from last 5 years. But as Brian said, the long-term gain -- the long-term game has to be both.

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

Again, I'll underscore the point Christina just made. Simeon, I think you know it's all about the balance. And we're always looking to balance our focus on sales and margin and profitability. Early in the year, we talked about the fact that we were going to plan discretionary categories cautiously in this environment. And we said appropriately. And I think that's played out well for us. But at the same time, we've been leaning into categories with strong demand in Food and Beverage, in Household Essentials, in Beauty.

We know today's consumers still celebrating seasons. So we lean into Back-to-School and Back-to-College and Halloween. And we know they're going to celebrate the holiday season. So we're leaning into those select categories where we know the guest is looking for newness, affordability, and they're going to celebrate those seasons. But that's what we do each and every day as a good retailer and is constantly a balance category by category of the focus on sales, on market share, on profitability. And I think as you saw in the third quarter, that's the way that [worked] for us.

Simeon Ari Gutman ***Morgan Stanley, Research Division - Executive Director***

And just quick follow-up, sortation centers. Do you have a sense of what the savings look like? Do you have enough scale and experience with them to know what the savings will be? And is that a '24 -- do we start to see the savings next year?

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

Well, you've opened up the door for John Mulligan to answer your question today, and I'm really glad you did.

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

Thanks for that, Simeon. I would start by saying we remain incredibly excited about sort centers. And with that, we have already started to see savings flow through the P&L. We haven't talked about it because I think -- it's been 3 years, but we are still early in the journey. I think there's still much to do in front of us. We're still optimizing routes. We're still just getting into much higher capacity vehicles, which will create more density, which will create more savings.

And then what we've said over the next few years, we've got at least 5 more of these to open. And then as we get the digital business growing again, hopefully, that number goes up as well. So we're still in the early days, but we remain very optimistic because we are seeing savings. It's much faster than the alternative, and we know the next best alternative, we are operating well below from a cost perspective.

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

Operator, we've got time for our final question.

Operator

Our final question comes from Chris Horvers with JPMorgan.

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

Congratulations to John. It's been an incredible journey, and I hope you have a wonderful retirement. So Mike, I'll follow up on the operating margin question for next year. Michael, maybe you could talk about the puts and takes as you think about next year. Clearly, the consumer is the question. But as you think about shrink versus maybe some incremental promotion when you're not so lean on the inventory side versus what you might see from Roundel and you also have the $2 billion to $3 billion cost savings program.

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

Thanks for the question, Chris. I think the punch line is we'll talk more about next year after we get through a really important holiday season. So that's our team's focus right now. And a lot of what will impact as we get there will be some of the things that you listed in your question. But more to come as we turn the page to next year once we get through a really important fourth quarter.

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

Yes. Thank you. So operator, that concludes our Q3 call. I want to thank everybody for joining us. I wish everybody a wonderful holiday season, and we look forward to seeing you in March.