Target (TGT)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Target – business

- Target Corporation operates general merchandise stores in the United States
    - Food
- 1,750 stores
- Target.com
- Credit cards – being sold

Target – business (cont'd)

- Competition:
  - WalMart
  - Costco
  - Etc.

Target – Misc thoughts

- What can go wrong?
  - Rising commodity prices potentially squeezing margins and low cost sales
- Opportunities:

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Not much. Close to low cost stores
  - What does it take to sustain the moats? Providing merchandise at low(est) cost with good shopping experience
  - Bargaining power of suppliers/customers? Not big.
- Is it a low risk business? Somewhat.
- Is there high uncertainty? Not very
- How capital intensive is the business? Shops
- Future growth – saturation?
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Probably not

Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Piotroski Score

Only applicable to Graham Cos – N/A to TGT

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9

Is it a good business?

- >10 year history of profits
- ROE:
  - 2009: 16.1 2010:16.2 2011: 18.8
- Margins
  - 2009: 3.4 2010:3.8 2011: 4.3
- Growing earnings: 3 year sales growth 2%, earnings growth 1%
- No dilution
- Weak balance sheet
  - Debt >> cash/short term investments
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - 10% ROIC

Is it a good business? Cash flow

- Strong operating cash flow and FCF:
  - 2011 2.9B earnings, 5.3B operating cash flow, 3.1B FCF (FCF = OCF – capital expenditures)
  - Free Cash Flow/Share higher than dividends paid

Is business cheap? – Buffettology calculations

- ROE 15% (but ROIC 10%)
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $8B
- Equity in 10 years = Equity*$(1+ROE)^9$ = $5.35B
- Market cap = 25B x P/E (15) = $120B
- Rate of return = 12% after tax (calculations omitted), only 4.5% at 10% ROIC

- 9 year earnings growth: 12%. Assuming 12% earnings growth: 15% share price growth.

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 2.9B
  - 5% growth for 5 years, leveling after that
    - 15% discount -> $23.4B current valuation (if you buy company at <$23.4B, you will get 15% return or higher)
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $26B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $35B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 2.9B / (32B+14B) = 6.3%

- What makes up the margin of safety? Low cost leader
- Is there a sufficient margin of safety? No

Is business cheap? – Graham investment considerations

- N/A for TGT – included for completeness
- 2 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)