

St John's University Undergraduate
Student Managed Investment Fund
Presents:

Target Corporation
Stock Analysis



November 11, 2003

Recommendation: Purchase 300 shares of Target stock at market value
Industry: Retail
Analysts: Jennifer Tang – jtang225@yahoo.com
Michael Vida – mvida24@hotmail.com

Share Data:

Price - \$39.15
Date – November 6, 2003
Target Price – \$44.58
52 Week Price Range – \$25.60 - \$41.80
Market Capitalization – \$35.40 billion
Revenue 2002 – \$43.917 billion
Projected EPS Growth – 15%
ROE 2002 – 17.51%

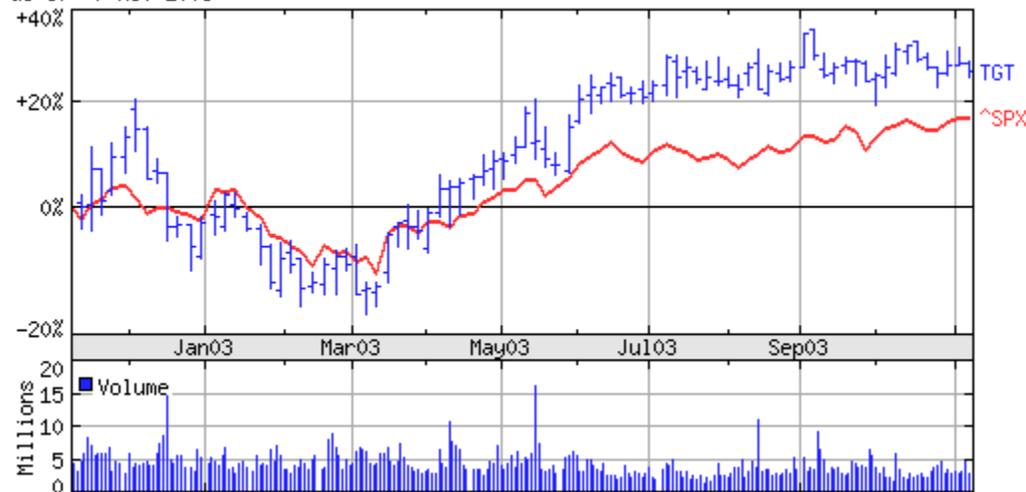
Fundamentals:

P/E (2/03) – 21.63
P/E (2/04E) – 21.96
P/E (2/05E) – 22.95
Book Value/Share – \$11.03
Price/Book Value – \$3.60
Dividend Yield – 0.72%
Shares Outstanding – 910.9 million

Stock Chart:

S&P 500 INDEX (STANDARD & POOR)
as of 7-Nov-2003

Splits: ▼



Executive Summary

After analyzing Target Corp's financials, industry and future outlook, we recommend the purchase of 300 shares of the company's stock at market order. As a leading discount retailer, only behind Walmart, Target has made considerable growth in the industry over the past few years. Target offers an array of merchandise from women's apparel, household products, toys and even food. One of the strengths of Target lies in its development of private brands, which helps create a strong image of the store in the customers' minds. The company is able to further lower its costs through direct sourcing, buying merchandise at lower prices and strengthening its bargaining position with suppliers. While Target Corp hasn't seen as much success with its other operations of Marshall Fields and Mervyn's as it has with its namesake store, the company plans to invest resources into these two areas to turn around results. Target remains optimistic it will further penetrate the domestic retail market.

Target Corp's current stock price of \$39.15 is lower than the target price of \$44.58 according to our valuation models. Accordingly, Target's stock is currently undervalued. Ratio analysis also demonstrates steady results from Target's core businesses. In addition, the technical analysis indicates positive results. For these reasons, we are confident that Target will serve as a strong addition to the Student Managed Fund Portfolio.

Overview¹

Target Corporation is a general merchandiser retailer in the United States. It is composed of three operating segments, which include Target, Mervyn's, and Marshall Fields. It is an upscale discount chain that aims to provide quality products at smart prices in clean, spacious and customer-friendly stores. As of February 1, 2003 (fiscal year end 2002), there were 1,147 Target stores operating in 48 states. Mervyn's is a promotional, middle market, neighborhood department store with 264 operating stores as of February 1, 2003. Marshall Field's is a traditional department store chain operating 64 stores in eight states as of February 1, 2003. The Company also offers credit to qualified guests in each of its business segments. These credit card programs strategically support Target's core retail operations and are an integral component of each business segment.

Target Stores

Target stores strive to be the best place to buy high-quality merchandise at low prices in surroundings that make shopping fun. It is the place to find the latest trends at the best prices. Back in 1961, Dayton's department store identified a demand for a store that sold less expensive goods in a quick, well-situated format. Target came into existence as a result. The first Target store opened on May 1, 1962 in Roseville, Minnesota, a suburb of St. Paul. More than 1,147 Target stores have followed and now operate in 48 states, including Target Greatland stores, and SuperTarget stores. Typical Target stores average 126,000 square feet in size and Greatland stores are 145,000 square feet. SuperTarget stores are 175,000 square feet. Target stores provide employment for approximately 192,000 people. Target store headquarters is located in

¹ Taken from 10-K and investor relations website.

Minneapolis, Minnesota, with regional offices in Los Angeles, California; Dallas, Texas; Minneapolis, Minnesota; Richmond, Virginia; and Troy, Michigan.

Target now handles a website that caters to all customers and tries to attract as much sales as does the store. As technology advances so will Target's retail business.

Mervyn's

Mervyn's is headquartered in the San Francisco Bay Area. It is a family-friendly, promotional, neighborhood department store focused on offering big brands at small prices. Mervyn's is committed to fashion, service and value for time-pressed, price-conscious guests looking for fresh, creative ideas in apparel and home décor. Mervyn's carries hundreds of top national brands such as Adidas, Cuisinart, Dockers, Fieldcrest, Haggar, Kitchen Aid, i.e.i, Levi's, Martex, Nike, Nine & Company, Samsonite, Union Bay, and Van Heusen, as well as trend-right fashions for the entire family and the home. In addition, Mervyn's provides a variety of popular designs and merchandise selections from its own private label collections including Cambridge Classics, Caress, Cheetah, High Sierra, Hillard & Hanson, Sierra Home Collections, and Sprockets. Founded in 1949 by Mervin G. Morris, the first Mervyn's store opened in San Lorenzo, California with only 2,800 square feet and two employees. Now part of Target Corporation, Mervyn's operates 264 stores in 14 states, employing 28,000 team members and generating more than \$4 billion in revenues. With approximately 21.4 million retail square feet overall, Mervyn's stores range in size from 60,000 to 167,000 square feet and are located primarily in regional malls, community shopping centers, and freestanding locations.

Mervyn's caters to its targeted guest - a woman with children, between the ages of 25-49, who shops for herself, her home and her family.

Marshall Field's

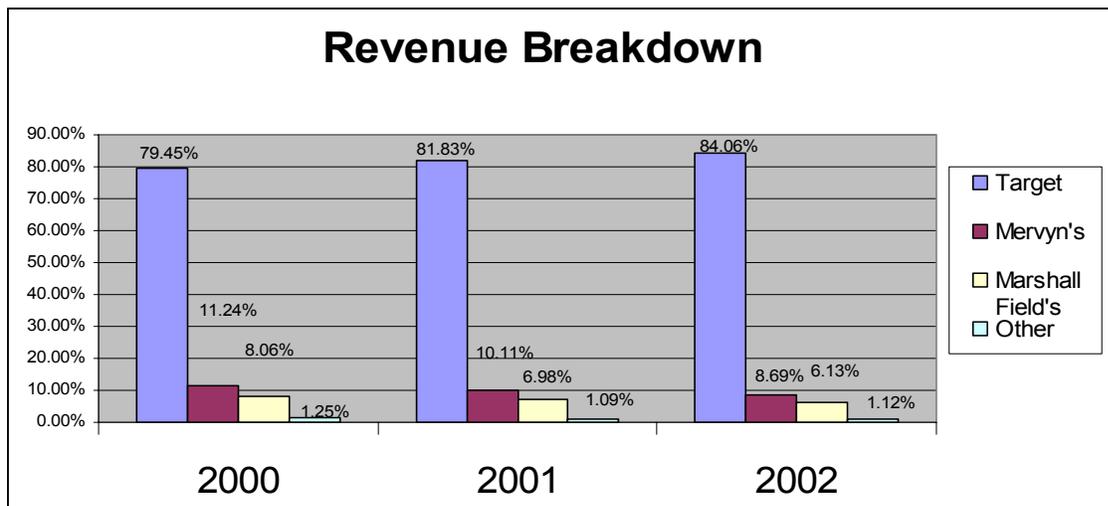
Marshall Field's focus revolves around the guest by opening its doors to welcome in customers. This guest-focused approach has inspired millions of shoppers across the Midwest and beyond to look to Marshall Field's for fashion leadership, superb guest service and a commitment to community involvement. There are 64 Marshall Field's stores, located in Illinois, Indiana, Minnesota, Michigan, North Dakota, Ohio, South Dakota and Wisconsin. Approximately 35,000 team members work in Marshall Field's stores. The corporate headquarters are located in Minneapolis and regional offices in Chicago and Detroit.

Breakdown of Revenue

Target's Revenue is broken down amongst its segments. Target, an upscale discount chain contributed 84 percent, of total 2002 revenue, which amounted to \$36.917 billion and has increased every year going back to 2000. Mervyn's contributed 9 percent of total revenue, which amounted to \$3.816 billion and Marshall Fields contributed 6 percent of total revenues which amounted to 2.691 billion. There was also a percentage of revenue associated with other business, which amounted to \$493 million, which account for 1% of revenue. This decreased in 2001 but has gone back up in 2002. These charts break down revenue over the last 3 years. The

revenue from Mervyn's and Marshall Fields has been declining and because of this Target has introduced several incentives to try to attract more business to these stores. These charts break down revenue over the last 3 years.

	2000	% Breakdown	2001	% Breakdown	2002	% Breakdown
Target	29278	79.45%	32588	81.83%	36917	84.06%
Mervyn's	4142	11.24%	4027	10.11%	3816	8.69%
Marshall Field's	2969	8.06%	2778	6.98%	2691	6.13%
Other	462	1.25%	433	1.09%	493	1.12%
Total Revenues	36851	100.00%	39826	100.00%	43917	100.00%



Recent News and its Affect on Target

This is some recent news on Target that has significance on our valuation and trends with the company:

- **Isaac hits his target²**-For the Brooklyn-born [Isaac Mizrahi], creating inexpensive women's clothing for Target is a way to test his theory that one can have an impact on fashion even without making a \$20,000 dress that gets worn once at the Emmys. He hopes to accomplish it on the backs of the humble millions who just want something nice to wear to work for under \$50.
- **Target Corp.'s Mervyn's and Nickelodeon Team Up to Introduce New Line of Dora the Explorer Merchandise May 20, 2003³**
 Mervyn's, a unit of Target Corp., announced a new partnership with Nickelodeon to offer an exclusive line of clothing and accessories for girls called "aDORable" featuring Dora the Explorer beginning May 11, 2003 at all 265 Mervyn's stores. In the Kids department, the assortment will include short, skort, and pant sets with the Dora character, Boots, and Map represented. In Accessories, backpacks (like Dora's) and handbags will be part of the aDORable line.

² Information taken from Newsweek

³ Info taken from Msn.com

This has significance because it shows that Target Corp continues to introduce products that will attract young women which will allow for growth of sales. The ability to create new products will help Target against competitors and increase sales to help meet expectations for the year.

- **Target Corporation October Sales Up 7.9 Percent⁴** --MINNEAPOLIS, Nov. 6 -- Target Corporation (NYSE: TGT) today reported that its net retail sales for the four weeks ended November 1, 2003 increased 7.9 percent to \$3.374 billion from \$3.126 billion for the four-week period ended November 2, 2002. Comparable-store sales increased 1.6 percent from fiscal October 2002."Sales at Target Corporation were below plan in October, reflecting exceptionally weak sales at both Mervyn's and Marshall Field's," said Bob Ulrich, chairman and chief executive officer of Target Corporation. "Sales at Target Stores were on plan for the month."

This is significant because Target is still trying to work out a plan to help revitalize sales in Marshall Fields and Mervyns. The plan still has to take time to take effect since sales are still down for these two segments. However, Target has met its expectations with its Target Stores and because of this it remains optimistic about 3rd quarter earnings expectations. This optimism is significant because it will help in determining if Target remains on track to meet end of year earnings.

Forecast for Target⁵

As Target looks forward into 2003, the company believes it will see another year of profitable market share growth. Target has expanded its operations consistently between 8-10% per year. In the future, the company will focus on its Super Target megastores to bring in additional customers. Target's strong merchandising, including private brands, and distribution improvements will certainly help the company in the future. By adding established brand names, such as Isaac Misrahi and Mossimo, Target appeals to a higher clientele than its competitors. The corporation's revenues are driven by its Target operations, so in order to rejuvenate the other two store chains, funds will need to be redistributed across the entire company. Relationships with new suppliers will offer customers more exclusive and a greater variety of merchandise. In addition, the recent news following Wal-Mart's hiring of illegal immigrant workers and Kmart's file for bankruptcy help put Target into a favorable light.

Industry Analysis⁶

Industry Overview

The general retail industry plays a significant factor in the health of the U.S. economy. According to the U.S. Department of Commerce, retail trade accounted for 31% of U.S. gross domestic product (GDP) in 2002. Total retail sales of merchandise for personal use were \$3.27 trillion in 2002, which is up 3.1% from 2001 figures.

⁴ Taken from Target Press Releases on investor relations website.

⁵ Taken from 10-K

⁶ S&P 500 Report-Retailing

This industry is separated into three types of mass merchandisers – the department store, the general merchandiser and the discounter. However, these three categories often overlap in their product offerings.

In the early 1920's, department stores originally offered a wide array of merchandise. However over time, these retailers became known for offering a more concentrated product selection, such as women's apparel, accessories, cosmetics and fragrances. Well-known department stores include Macy's and Nordstrom. Meanwhile, general merchandise stores tend to carry a wider-ranging assortment of products than most department stores. Also known as broadline retailers, these general merchandisers often blur the boundaries of what a typical retail store should offer its customers.

In today's market, discounters are becoming quite popular. The industry consists of discount department stores, discount specialty shops and membership (warehouse) clubs. Discounters, such as Target and Wal-Mart, are able to carry a high volume of merchandise while still offering a wide variety of products, including apparel and accessories, home furnishings, small appliances and electronics. Today, the three largest discounters are Wal-Mart, Target and Kmart. Although Kmart had to considerably downsize its operations after filing Chapter 11 in early 2002, it still remains a lingering figure in the industry. Discounters are not limited to a low-income target market. For instance, Target considers itself to be an upscale discounter for its variety in private brands, slightly higher prices and store layout with wide aisles. The company goes after a more affluent market with customers' median income of \$43,000. Meanwhile, Kmart and Wal-Mart tend to target customers with a median income below \$25,000.

Life Cycle of Retail Industry

The retail industry is in the mature stage of its life cycle. This assumption implies that the largest competitors already own a significant market share and it's hard for newer, smaller companies to enter the already saturated market. Market maturity occurs as industry sales level off or grow at a steady pace. Kmart's financial problems led the company to close 57 of its 117 supercenter and 260 regular locations, which allow \$2.4 billion in revenue to be available to competitors. This move allows other super retailers, mainly Wal-Mart and Target to add to their market shares. As a mature, highly saturated market, the retail industry faces slow growth. Merchandisers are unable to raise their prices for there's always another competitor that can offer the same product for a cheaper price. Accordingly, it is necessary for such retailers to drive down internal costs to improve its economies of scale.

Target operates domestically throughout the U.S., mainly concentrated in the Northwest. Even in Target's most densely populated states, the company has been able to expand its capacity by 40%, which signals Target still has room to penetrate the market. Target stores have been expanding at an average annual growth rate of 8-10%. Over the short-term, Target plans to focus especially on the Northeastern portion of the U.S., including New York, Rhode Island and Connecticut. This future sketch of Target shows that although it belongs to a mature retail industry, the company overall is still quite young with potential to grow.

Market Trends

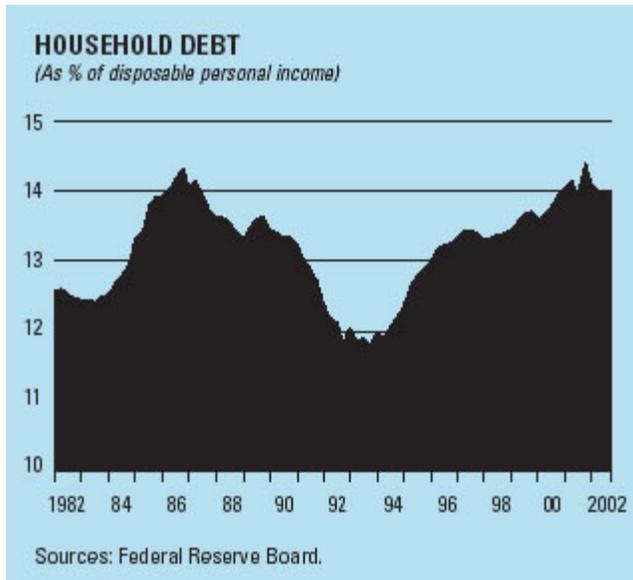
The retail industry faces difficulties situated around three trends. First, the retail industry is extremely competitive. Stores must maintain an adequate stock of inventory, as well as the latest styles that the public wants. Through innovative technology advances, such as a better merchandise tracking system, retailers can adjust its product offerings to lure customers away from competitors. It can lower its inventory turnover. For instance, Wal-Mart's "everyday low prices" and Target's "expect more, pay less" campaigns have been extremely successful. As the world's largest retailer, Wal-Mart has strong relationships with its vendors to receive the greatest discount, which can be extended to its customers. Target has slowly expanded its market share.

In addition, consumer spending has remained fairly flat for the economy hasn't performed well lately and to changing demographics. More Americans prefer "one-stop shopping" for they are on time constraints due to the demands of family or work. Retailers must understand the lifestyles of its target markets in order to accommodate and tailor its merchandise selection to the public. Convenience is key via a full stock of merchandise, speedy checkout and good service.

Finally, consumers turn away from department stores and direct their expenditures at lower-priced, value-driven retailers. Value can be obtained through a combination of price, quality, service and convenience. Discounters turn to name brands exclusive to that particular chain. Target sees benefits from its exclusive brands, such as Mossimo, Woolrich home accessories and apparel from designers Told Oldham and most recently Isaac Misrahi.

Credit Card Operations Boost Profits

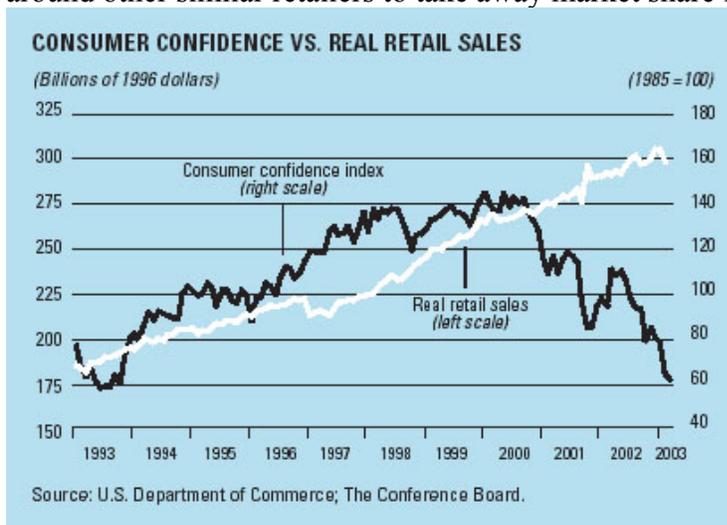
A retailer's credit card operations can greatly help or hurt the firm's profits. Retailers with proprietary credit card operations, such as Target and Kohls, have undergone scrutiny from investors since Sears revealed its inability to collect \$222 million in accounts. However, Target's credit card division only contributes 15% of the company's operating profits. On the other hand, Sears drew 60% of its operating profits from credit cards. Effective proprietary credit card programs can show great benefits through finance charges. In addition, credit card customers tend to spend more than cash customers do. The retailer can increase its sales by analyzing the information it receives from its credit card operations. It can target customers for special events and promotions by seeing the person's past spending habits. By extending this program, the company creates customer loyalty. However, the costs of overseeing such a huge operation is expensive. Collection of delinquent accounts poses a significant problem. The retailer must record such bad debt and allowances on its income statements. By increasing reserves to help offset these bad accounts, the profitability of the firm decreases.



This chart shows that household debt has increased over the past few years. More people use credit cards as a form of payment. Despite the advantages of extending credit to their customers, retailers face a high risk of delinquent payment accounts. Some customers even file for bankruptcy to avoid the high debt they've rung up.

Location is Everything

Another factor that contributes to a retailer's success is its location. A good location attracts traffic, which boosts sales. A retailer faces the difficult decision of whether to lease its stores or to buy the property. Leasing allows the retailer flexibility in the future if the firm doesn't want to commit to the area for a long period of time. Perhaps that particular location isn't profitable at all and the firm wants to pull out of that market as soon as it can. Competition in the retail industry is intense and flexibility is a definite plus. Retailers may intentionally build stores around other similar retailers to take away market share from the competition.



Future Outlook

The expectations for the retail industry remain positive. Despite setbacks earlier this year due to a slow holiday shopping season, a weak labor market, war with Iraq and rising oil prices, the industry shows potential growth. According to the U.S. Department of Commerce, consumer short-term expectations have improved considerably. The consumer confidence index rose from 61.4 to 81.0 during April 2003 reflecting the consumers anticipating better business conditions and a better job market over the next year. Accordingly, this research shows that there is a favorable near-term outlook for consumer spending, especially for retail sales.

Analysis of Competitive Forces – Michael Porter Method

Rivalry

In terms of rivalry, the retail industry faces intense competition. People are being more careful with their money, and as a result, they tend to allocate less for discretionary spending. Purchase decisions are now based on need and value. As more consumers search for bargains, discounters have picked up market share at the expense of department stores, including Federated, and other specialty retailers. There is a focus on differentiating quality and service among the industry. The firm that can accommodate its customers' needs will be the most successful. It is also important for each retailer to develop its brand names to attract potential customers. For instance, Target's exclusive brands include Mossimo apparel and designer outfits by Isaac Mizrahi. These clothing items are reasonably priced compared to department stores, so people are attracted to these products. Such a move as launching a new apparel line with the approval of a top designer encourages rivals to follow the same tactic.

Threat of New Entrants

The threat of new entrants always enters a company's mind for they were once new to the industry as well. While it is difficult to enter an already mature retail market, if successful, the firm can reap great rewards. Often new entrants face numerous barriers to entry, such as:

- Cost of Capital – The cost of capital to start up a new store location is great. A new firm may face difficulty in obtaining loans from local banks. Investors may be wary of taking on such a new entity, so this limits ways that the new firm can raise capital. After obtaining the capital, the firm must decide if it should buy or lease the land, as well as which contractors to hire. Limitations regarding store space and layout are important considerations as well.
- Distribution Channel – Retailers serve as the middleman between the supplier of goods and the consumer. An essential element to a retailer's success is the ability to anticipate and to get the merchandise that the customers want. Already established firms, such as Wal-Mart, have already structured their relationships with suppliers. Accurate ordering and tracking of stocked items make inventory management possible. Newer retailers must work hard to establish relationships with their distribution channels.

- Economies of Scale – Larger companies tend to have a better chance to survive in such a competitive industry. Discounters and wholesalers, such as Costco, have access to more resources and can therefore reach customers by offering cheaper products in bulk. It is important to maintain a high inventory turnover for as soon as the customer makes a purchase, the shelves will be restocked. Efficiency is a key factor in regard to offering a large product variety, quick checkout times and so on.

Threat of Substitute Products

Substitute products are defined as goods that serve as replacements for other products to satisfy the same needs. Today many department stores have lost market share to more affordable discounters. In addition, successful discount retailers, such as Target and Wal-Mart, must charge comparable prices. If not, then customers may look elsewhere. As long as the consumer feels appreciated, he will tend to stick with one particular store. Brand loyalty plays an important factor in retaining customers who are familiar with the store's standard layout, products and distribution channels.

Bargaining Power of Suppliers

Retailers experience high-volume, fast turnover business, so it is necessary to establish strong relationships with its numerous suppliers. Suppliers want access to these retailers for they can reach a large market base. Suppliers can reach a deal with retailers to carry more of their newer products by selling another product at a cheaper price. Retailers respond to the bargaining power of suppliers by developing their own private-label products. These retailers will not have to deal with the hassle of negotiating contracts with suppliers.

Bargaining Power of Buyer

Consumers look into these discounters for a so-called "one stop shopping" trip. The buyers know what they want and how far they are willing to search for the item. Therefore, it is important for the retailer to anticipate or obtain a sense of what the consumer wants upon entering their store. Discount retailers must especially want to be aware of what its competitor offers on sale. If the buyer finds out he can purchase the same product at a lower price at the competitor, then this might be lost market share.

Target Strategy within the Industry⁷

Target has focused on merchandise differentiation and fashion excitement and intensified its focus on being in-stock and priced right throughout the store to compete with its competitors and the industry as a whole. Its job is about creating value for shareholders, for its team members and for the people in the communities in which it does business. It does by several ways.

First Target has leveraged its strategic positioning and financial services expertise, strengthened its relationships with existing guests and enhanced overall financial results through the

⁷ Taken from Annual Report

disciplined management and growth of credit card operations. This allows Target to maintain its competitive advantage within this business.

Secondly, Target has invested over \$3.2 billion to improve shopper's experience in the store. It has done this by remodeling, opening new stores, and improving technology and distribution infrastructure to improve shopping. It wants to maintain the ease of shopping in a clean, convenient and enjoyable environment. All these things help Target not only improve its market share but maintain it as well.

Thirdly, Target matches Wal-Mart's prices on identical and similar items in local markets and price differentiated products at deep discounts compared to other benchmark competitors. It is inherent in its "Expect More. Pay Less" brand promise and in its commitment to consistently delight its guests. It offers compelling prices and in-stock reliability on a broad assortment of commodity products, with the fashion freshness and merchandise excitement of designers like Amy Coe, David Kirk and Isaac Mizrahi with the quality and trend of trusted brands that include Waverly, Calphalon and Baby Tykes by Carter's

Finally Target has maintained a strategy of convenience. It wants to be as close to customers as it can be. It tries to put its stores in places that people can reach with little travel. It maintains that location is one of its top priorities to grow in earnings and to grow in market share.

Skill and Competence of Management⁸

Target has a long-standing commitment to please its customers, which explains management's innovative strategies to support its "Expect More, Pay Less" philosophy. Often, Target promotes within the company. Since Target Corp is comprised of three operating segments – Target, Marshall Fields and Mervyn's, there is ample opportunity to move across the company. This policy of encouraging inventive and team-oriented managers makes it generally unnecessary for Target to hire executive officers from outside the company. The vast majority of the management team began their careers as full-time or part-time hourly Target employees who have gone through the ranks at Target over the years. Bob Ulrich, the CEO, and most of Target Corp's executive officers have 10 to 30 years of service. The majority of Target Corp's senior management are around the average age of 50, which shows that these leaders are more modern and up to date with the current situation in the retail industry.

Management⁹

Top management plays an important factor in contributing to a corporation's success. By providing employees with a clear direction or set of goals, management can tackle different problems and issues with greater ease.

Robert J. Ulrich is the Chairman of the Board, Chief Executive Officer and Chairman of the Executive Committee of Target Corp. He began as a merchandising trainee in the corporation's department store division since 1967. Only 59 years old, he became Chairman and Chief

⁸ Taken from 10-K

⁹ Taken from wsj.com

Executive Officer of Target Stores in 1987 and was elected Chairman and Chief Executive Officer of the Corporation in 1994. His total annual compensation, along with salary and bonuses, is \$6,970,448.

Douglas A. Scovanner is the Chief Financial Officer and Executive Vice President since February 2000. Prior from 1994 to 2000, he was Senior Vice President and CFO of Registrant. At 47 years old, Scovanner made \$1,496,975 in total annual compensation last year.

The following top executives lead Target Corp's three core businesses.

Linda L. Ahlers has been the President of Marshall Field's, a division of Target Corp, since 1996. Before then, she was Executive Vice President of Merchandising for Marshall Fields from August 1995 to March 1996. She is 52 years old and has ample experience in the retail industry.

Diane L. Neal holds the current position of President at Mervyns since 2001. At 46 years old, Neal used to be the Divisional Merchandise Manager of Target Stores from 1999 to 2001.

Gregg W. Steinhafel is the President of Target Stores. He is 48 years old and has held this position at Target since 1999. Prior to this, Steinhafel was Executive Vice President of Target Stores from 1994 to 1999. Earlier this year, his total annual compensation, including salary and bonuses, was \$2,339,447.

Other members of management include Bart Butzer, Paul L Singer, Todd V. Blackwell and Michael R. Francis. Bart Butzer has been the Executive VP of Target Stores since April 2001. He was President of Mervyn's from 1997 to 2001 and Regional Senior VP of Target Stores from 1991 to 1997. His total annual compensation was \$1,602,082. Butzer is 46 years old.

Paul L. Singer is the Senior Vice President, Technology Services and Chief Information Officer as of 2000. He is 49 years old. Prior to his term as CIO, Singer was the Information Services of Registrant from 1999 to 2000 and VP of Information Services from 1993 to 1999.

Todd V Blackwell is the Executive VP of Human Resources and Assets Protection. He is 41 years old. Blackwell has extensive experience within the corporation. He has held the positions of Senior Vice President, Human Resources of Registrant from September 2000 to February 2003; Senior Vice President, Stores of Mervyn's from December 1998 to September 2000 and Regional Vice President, Stores of Mervyn's from August 1995 to December 1998.

Michael R. Francis is 40 years old. He has been Executive Vice President, Marketing of Registrant since February 2003. Prior to this term, he was Senior Vice President, Marketing of Registrant from January 2001 to February 2003; Senior Vice President, Marketing and Visual Merchandising of Marshall Field's from April 1996 to January 2001 and Senior Vice President, Marketing of Marshall Field's from January 1995 to April 1996.

Relative Industry Valuation

The chart below shows the industry's performance to the S&P 500 over the last three months. It has outperformed the S&P 500 but it still maintains about the same shape as the index. The peaks and valleys are almost identical. However, the industry has had a higher return than the S&P 500 for the past three months.



Source: www.bigcharts.com

The retail industry, as shown, has underperformed in comparison to the S&P 500 index until March of this year. Both indexes demonstrate upward trends, which are very promising. This chart also shows that the retail industry and S&P 500 index share a positive correlation for they have similar peaks and valleys.



Source: www.bigcharts.com

According to these charts, we believe that the S&P 500 index serves as a good benchmark to compare with the retail industry. These past 6 months have demonstrated that the retail industry has been outpacing the market.

Financial Ratio Analysis

The following calculations are based on Target's past 4 years annual data from the 10K and Hoovers. Some are calculated by us. (Dollars are listed in thousands)

Liquidity Ratios: Liquidity refers to the firm's ability to pay its bills over a short period of time. These expenses may be planned or unplanned. A firm should maintain reasonable liquid assets to meet these unexpected demands for cash. These ratios, also known as short-term solvency ratios, give potential lenders and investors an idea of the firm's competence to meet its debts.

Current Ratio	
Target 1999	1.108
Target 2000	1.159
Target 2001	1.367
2002	
Target	1.586
Wal-Mart	0.98
Federated Dept. Stores	1.96
Industry	1.19
Market	1.46
Target 08/2003	1.72

Current Ratio: The current ratio measures the company's ability to pay its short-term liabilities from its liquid assets, which can easily be converted to cash. For Target, it has improved drastically from its low number of \$1.10 to \$1.586 of current assets to current liabilities. Not only that, it has improved on this number for the first half of the year. It definitely has the ability to convert its current assets to cash. It also is outperforming its competitor of Wal-Mart tremendously. However compared to Federated Department Stores it is still lower. Comparing it to the industry and the market it is still very high. As Target improves on this number it will make its competitive position even stronger.

Quick Ratio	
Target 1999	0.45
Target 2000	0.4850
Target 2001	0.737
2002	
Target	0.9573
Wal-Mart	0.20
Federated Dept Stores	1.00
Industry	0.30
Market	1.00
Target 8/2003	1.03

Quick Ratio: Also known as the acid-test ratio, the quick ratio measures the company's ability to pay off its short-term obligations from current assets, excluding inventories. As the least liquid current asset, inventories can turn out to be damaged, obsolete or lost, thus this adjustment needs to be taken into consideration. A quick ratio greater than 1 implies that the firm does not need to rely on its inventories as much as other firms to pay-off its short-term debt. Again, Target has drastically improved on this number. It has increased from \$.45 to a lofty \$.9573 per \$1 worth of short-term debt. For the first half of the year this number has also shown tremendous improvement reaching \$1.03 per \$1 worth of short-term debt. Against Wal-Mart, Target has outperformed it according to this ratio. Against Federated, Target is slightly lesser but looking at the first half Target has outperformed Federated. Against the market and the industry, Target remains between the range of .30 for the industry and 1.00 for the market.

Cash Ratio	
Target 1999	0.0376
Target 2000	0.0564
Target 2001	0.0707
2002	
Target	0.1004
Wal-Mart	0.0846
Federated Dept Stores	0.1988
Target 8/2003	0.061

Cash Ratio: The cash ratio measures the extent to which a corporation or other entity can quickly liquidate assets and cover short-term liabilities, and therefore is of interest to short-term creditors. It is also called liquidity ratio or cash asset ratio. For Target it has greatly improved on this number from 1999 and now as of 2002 stands at 0.1004 cents per \$1 of liabilities. This is very good because means that it is improving the amount of cash it has to pay off short-term debt. For the first half of the year it is also performing better than previous years and may yet

exceed 2002 levels. As for against its competition of Wal-Mart and Federated Department Stores, Target exceeds Wal-Mart and is much smaller than Federated Department Stores when it comes to the cash ratio. It can still improve on this number and have a much better standing amongst investors.

Acct Receivable Turnover	
Target 1999	Not applicable
Target 2000	N/A
Target 2001	9.56
2002	
Target	8.85
Wal-Mart	120.02
Federated Dept Stores	5.80
Industry	57.50
Market	7.00
Target 08/2003	7.48

Accounts Receivable Turnover: The accounts receivable turnover ratio indicates the number of times that accounts receivables are cycled during a given period, usually a year. In other words, the AR turnover reflects how fast a company can collect on its sale of inventory and reloan this amount throughout the year. Wal-Mart by far has the highest accounts receivables turnover rate at 120.02. This reflects Wal-Mart ability to collect on its sales from customers. Target has a strong turnover ratio despite its fluctuations over the past few years. Prior to 2000, Target used to sell off its receivables to Target Credit Card Master Trust. Now since the national release of Target Visa in 2001, accounts receivables are listed on the balance sheet. As Target expands its credit card operations, this figure should increase in the next fiscal year.

Inventory Turnover	
Target 1999	6.06
Target 2000	5.93
Target 2001	6.10
2002	
Target	6.14
Wal-Mart	7.60
Federated Dept Stores	2.40
Industry	7.40
Market	7.80
Target 8/2003	4.34

Inventory Turnover: Inventory turnover measures the number of times that the average inventory of finished goods was sold during a year. It is calculated by taking the cost of goods

sold divided by average inventory from the most recent and previous year's balance sheets. A high inventory turnover ratio indicates the firm is efficiently managing its inventory. Target has maintained about the same numbers through the four years at about 6x. For the first half of the year it has maintained a number of around 4. Against its competitor of Wal-Mart it has maintained the about less than 1 and against FD it has maintained a number that is in excess of about 4. Against the industry and the market, it has maintained a number of about less than 1. This is all very good for Target because it shows that it is able to turnover inventory quickly and put out the new stuff.

# of Days Sales in Inventory	
Target 1999	60.23
Target 2000	61.55
Target 2001	59.84
2002	
Target	59.44
Wal-Mart	48.02
Federated Dept Stores	152.08
Target 8/2003	64.31

Number of Days Sales in Inventory: Days sales in inventory ratio provides an estimate of the number of days, on average, that it takes to sell inventory. The value of inventory in the ratio includes the value of work in progress. For Target, it has ranged from about 59 days to 60 days over the four-year period. This means that it takes Target about 60 days to sell its inventory and come in with new inventory to sell. It has gone up in this number for the first half of the year and this means that sales were not as high as reflected in its earnings for the first half of the year. The reason for this is the economy was only beginning its recovery and therefore the amount of customers was smaller than usual. However, these numbers should improve as the holiday season comes around. Against Wal-Mart and Federated Department Stores, Wal-Mart has done better in moving inventory than Target. Federated Department Stores has done a lot worse. Target can improve on these numbers and become more competitive.

Leverage Ratio	
Target 1999	2.92
Target 2000	2.98
Target 2001	3.07
2002	
Target	3.03
Wal-Mart	2.32
Federated Dept Stores	2.47
Industry	2.34
Market	6.03
Target 8/2003	2.95

Leverage Ratio: The leverage ratio shows how much a company has borrowed. A higher ratio shows creditors that the firm has a higher degree of leverage for it has borrowed more to support the company's functions. Target has borrowed more because its leverage ratio is high. The reason for this is its expansion into larger city markets especially New York. However the numbers for its competitors are lower and this is a sign that they may or not be expanding as much. Against the market it is very low and against the industry it is slightly higher. These numbers will probably remain the same as Target continues its expansion.

Operating Ratios: Operating ratios determine if a firm is utilizing its resources in the most efficient manner. A company's income level affects its ability to sell equity and obtain debt, thus affecting the firm's potential growth.

Total Asset Turnover	
Target 1999	1.96
Target 2000	1.89
Target 2001	1.64
2002	
Target	1.53
Wal-Mart	2.70
Federated Dept Stores	1.00
Industry	2.60
Market	1.40
Target 8/2003	1.43

Total Asset Turnover: Total asset turnover measures how efficiently a company uses its average total assets to generate sales. As an operating performance ratio, total asset turnover is important for it demonstrates a company's ability to generate a satisfactory income so its stockholders will continue to invest in the firm. Target has gone down in this number over the past four years from a high of 1.96x to 1.53x. Sales for Target are not increasing as fast as the number of assets within the corporation. Over recent years, Target has expanded its stores at a rapid rate, and it has taken time for sales to catch up. In comparison to Wal-Mart and Federated Department Stores, Target has outperformed Federated and underperformed against Wal-Mart. Against the industry, it is very below the average but it is greatly above the market, which is at 1.40x.

Gross Profit Margin (%)	
Target 1999	31.67
Target 2000	30.60
Target 2001	30.61
2002	
Target	31.51
Wal-Mart	23.49
Federated Dept Stores	44.48
Industry	24.37
Market	49.07
Target 8/2003	32.10

Gross Profit Margin: The gross profit margin is a measurement of a company's manufacturing and distribution efficiency during the production process. The gross profit tells an investor the percentage of revenue left after subtracting the cost of goods sold. It is interesting to note that Target is more efficient than the industry benchmark, while Wal-Mart is less efficient. However, it appears that Federated Department Stores is retaining more of every dollar in sales after costs of goods sold than Target and Wal-Mart. Target's figures as of the first half of the fiscal year proves to be improving on past years' results.

Operating Profit Margin (%)	
Target 1999	5.74
Target 2000	5.65
Target 2001	5.64
2002	
Target	6.26
Wal-Mart	5.35
Federated Dept Stores	6.27
Industry	5.06
Market	5.43
Target 08/2003	5.53

Operating Profit Margin: The operating profit margin shows how effective a company controls its costs and expenses associated with their normal business operations. Target's OPM has remained consistent over the past 4 years. Its OPM improved from 2001 to 2002 due to the stronger supplier relationships, restructuring of stores and more effective inventory management. Federated has similar operating profit margins, while Wal-Mart is below Target's figures. Wal-Mart has large overhead costs to maintain its many stores. It appears that Target is on the right track for its OPM has performed well for first half of the fiscal year as of August 2003.

Net Profit Margin (%)	
Target 1999	3.39
Target 2000	3.43
Target 2001	3.43
2002	
Target	3.76
Wal-Mart	3.47
Federated Dept Stores	4.03
Industry	3.25
Market	2.50
Target 8/2003	3.76

Net Profit Margin: The net profit margin is an indication of how effective a company is at cost control. The higher the net profit margin is, the more effective the company is at converting revenue into actual profit. The net profit margin is a good way of comparing companies in the same industry, since such companies are generally subject to similar business conditions. Target has greatly improved on this number over the last four years. It has improved and reached the high number of 3.76% in 2002 from its low of 3.39% in 1999. For the first half of 2003 it has maintained these numbers. This is good because it means that Target is able to generate profit. In comparison to Wal-Mart and Federated Department Stores, it has outperformed Wal-Mart and underperformed against Federated Department Stores. Against the industry and market it has outperformed both and this is a good sign because it shows it remains competitively ahead of rivals.

Return on Assets (%)	
Target 1999	6.67
Target 2000	6.48
Target 2001	5.67
2002	
Target	5.78
Wal-Mart	8.49
Federated Dept Stores	4.40
Target 08/2003	2.72

Return on Assets: Return on Assets indicates how many dollars of profits can be achieved for each dollar of assets under control. It measures a company's earnings in relation to all of the resources it has at its disposal making it one of the most stringent and excessive tests of return to shareholders. Target's return on assets ranges from \$5 to \$6, which is comparable to Wal-Mart and Federated. It is underperforming compared to Wal-Mart, but outperforms Federated.

Return on Equity (%)	
Target 1999	19.51
Target 2000	19.38
Target 2001	17.40
2002	
Target	17.51
Wal-Mart	20.30
Federated Dept Stores	10.70
Industry	19.70
Market	6.10

Return on Equity: Return on Equity is one of the most important profitability measures. ROE reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. A business that has a high return on equity is more likely to be one that is able to generate cash internally. ROE encompasses the three main "levers" by which management can better the corporation (profitability, asset management, and financial leverage). ROE has gone down over the past four years and the reason this is clear from the Dupont Analysis (discussed below). It has gone down because of changes in TOA. In comparison to Wal-Mart and Federated Department Stores, Target has outperformed Federated and underperformed against Wal-Mart. As for the industry and the market, it has underperformed the industry and outperformed the market by a substantial margin. It can improve on these numbers and remain more competitive in the industry.

Du Pont Analysis

ROE = Asset Turnover * Net Profit Margin * Equity Multiplier

$$\frac{\text{Net Income}}{\text{Equity}} = \frac{\text{Sales}}{\text{Total Assets}} * \frac{\text{Net Income}}{\text{Sales}} * \frac{\text{Total Assets}}{\text{Equity}}$$

FY 2002:

$$\frac{\$1,654}{\$9,443} = \frac{\$43,917}{\$28,603} * \frac{\$1,654}{\$43,917} * \frac{\$28,603}{\$9,443}$$

$$0.17515620 = 1.53598385 * 0.0376619532 * 3.029016202$$

$$0.17515620 = 0.17515620$$

FY 2001:

<u>\$1,368</u> =	<u>\$39,826</u> *	<u>\$1,368</u> *	<u>\$24,104</u>
\$7,860	\$24,104	\$39,826	\$7,860
0.174045=	1.648836632*	0.034349199*	3.07302799
0.174045=	0.174045		

FY 2000:

<u>\$1,264</u> =	<u>\$36,851</u> *	<u>\$1,264</u> *	<u>\$19,490</u>
\$6,519	\$19,490	\$36,851	\$6,519
0.1938948=	1.890764495*	0.0343002903*	2.98972235
0.1938948=	0.1938948		

FY 1999:

<u>\$1,144</u> =	<u>\$33,702</u> *	<u>\$1,144</u> *	<u>\$17,143</u>
\$5,862	\$17,143	\$33,702	\$5,862
0.1951552=	1.965933617*	0.033944573*	2.92448523
0.1951552=	0.1951552		

The Du Pont model shows that ROE is affected by operating efficiency (see profit margin), asset use efficiency (see total asset turnover) and financial leverage (see equity multiplier). From this analysis it can be seen that TOA has driven ROE the past four years since this is where the biggest changes have occurred. Over the period NPM and the equity multiplier (leverage ratio) have improved to reach the highs for the period.

Risk Analysis: When running a business, there's always a potential risk that the company may not succeed. In order to first start up this company, the owners may have to borrow huge amounts of debt, which must be paid off in the future. Analysts and investors must pay particular close attention to these ratios to determine the future financial health of a company to pay off such outstanding debt.

Debt to Equity Ratio	
Target 1999	0.856
Target 2000	0.996
Target 2001	1.144
2002	
Target	1.18
Wal-Mart	0.60
Federated Dept Stores	0.68
Industry	0.60
Market	1.45
Target 8/2003	1.18

Debt to Equity Ratio: Total debt to equity ratio helps to determine the risk of the firm to investors. The higher the number the more risky the firm becomes for investors and therefore a higher return is demanded. The number has increased gradually for Target over the period. This shows that it has a higher risk and therefore investors will demand a higher rate of return. The reason for the high numbers is as Target expands into new markets it will have to borrow more therefore increase the amount of debt it has. Against Wal-Mart and Federated Department Stores it has higher number than both and this means that Wal-Mart and Federated are primarily financed through equity. The same can be said for the industry. Against the market, Target's numbers are lower and this reflects that market is more heavily finance by debt. Target will probably maintain higher numbers because as it continues to expand it will probably borrow more.

Total Debt Ratio	
Target 1999	0.6580
Target 2000	0.6655
Target 2001	0.6739
2002	
Target	0.6698
Wal-Mart	0.5840
Federated Dept. Stores	0.6010
Target 8/2003	0.6610

Total Debt Ratio: This measures how much debt a company has compared to how many assets it has. Target has remained between the range of about 65.80% to 67.39% for the four-year period. It can be said that the reason for these high numbers is again due to more borrowing of capital to finance building and leasing more property for new stores. As for the first half of the year Target has maintained about the 66.10% debt financed well within the range of the four-year period. As for the competition, Target has maintained numbers that are slightly higher than Wal-Mart and Federated Department Stores. This ratio will remain high as Target continues its expansion.

Earnings or Cash Flow Ratios: Cash flow simply means the difference between the number of dollars that came into a firm and the number that went out. For instance, these cash flow ratios help determine if the firm can pay out its earnings to creditors and stockholders.

P/E Ratio	
Target 1999	50.4x
Target 2000	32.89x
Target 2001	24.23x
2002	
Target	20.08x
Wal-Mart	29.93x
Federated Dept. Stores	14.92x
Industry	26.43x
Market	38.28x
Target 8/2003	21.67x

Price to Earnings Ratio: This is the most common measure of how expensive a stock is. The value is the same whether the calculation is done for the whole company or on a per-share basis. The higher the P/E ratio, the more the market is willing to pay for each dollar of annual earnings. For Target in the previous three years it has traded at a high P/E ratio and now trades at a relatively lower ratio. The reason for this was probably the outlook for the retail industry was probably not that good and now that the economy has improved this number should drastically go up as optimism returns. Against Wal-Mart and Federated Department Stores, it has traded at a discount to Wal-Mart and a premium to Federated Department Stores. This is because Wal-Mart is the industry leader. As for the industry and the market, Target trades at a discount to both. As the year continues Target's P/E should increase to a higher level.

Interest Coverage	
Target 1999	5.86x
Target 2000	5.81x
Target 2001	5.66x
2002	
Target	5.55x
Wal-Mart	13.90x
Federated Dept. Stores	4.32x
Industry	12.10x
Market	2.10x
Target 8/2003	4.82x

Interest Coverage: Interest coverage tells how many times over company can service their debt. Target has declined in this number but still has maintained good numbers and shows that it can service its debt. However, it has declined below 5 for the first half of the year to 4.82x.

However, this is probably just reflective for half a year and probably will improve as the rest of the year continues. Against Wal-Mart and Federated Department Stores, it has underperformed Wal-Mart and has outperformed Federated. A reason why it may have underperformed Wal-Mart is because Wal-Mart is so much bigger than Target. As for the industry and market, it is significant to say that it has underperformed the industry and outperformed the market. Target can improve on these numbers as it grows in size and market power.

CF/Long-Term Debt	
Target 1999	0.049
Target 2000	0.063
Target 2001	0.062
2002	
Target	0.074
Wal-Mart	0.030
Federated Dept Stores	0.024
Target 8/2003	0.039

Cash Flows to Long-term Debt: This ratio measures the ability of a firm to repay its long-term debt by way of cash flow. A higher value in comparison to competitors demonstrates that the firm has efficiently covered its long-term debts. These results demonstrate that Target has improved on its ability to meet its long-term obligations. Target has expanded its operations over the past few years for it has shown to be capable of generating ample cash flows. Its results as of Aug 2003 shows that Target is on par with past years performance. By far Target has the highest CF/Long-Term Debt compared to Wal-Mart and Federated Dept Stores, which is a definite plus in its favor.

CF/Debt Ratio	
Target 1999	0.044
Target 2000	0.055
Target 2001	0.055
2002	
Target	0.068
Wal-Mart	0.016
Federated Dept Stores	0.018
Target 8/2003	0.036

Cash Flows to Debt Ratio: The CF/Debt ratio measures the ability of a firm to repay all of its debt. Target demonstrates similar results as its CF/Long-term debt ratio. Each year, the company has been able to increase its capacity to meet debts. It has increased its CF/Debt ratio nearly 30% in a short period of time from 0.044 in 1999 to 0.068 in 2003. Target outpaces its competition Wal-Mart and Federated, in this area by nearly doubling their results. CF ratios are important for it shows that, in this case Target, has funds available when necessary to meet unexpected demands for cash.

Total Market Value of Target

The market value for Target as of November 7, 2003 is \$35.38 billion according to Hoover's. This number changes every day as the price of shares fluctuates.

Valuation Models (The next page contains the two models)

Our valuation of Target began with using a regression analysis to calculate the beta of the stock in comparison to the S&P 500 using the weekly return from the past 3 years. We found Target's beta to be 1.132247, which is riskier than the market's beta of 1.00. This beta will be used in a later valuation. (Refer to Addendum attached at the end of this report for regression analysis.)

We next went on to calculate the required rate of return using the Capital Asset Pricing Model (CAPM). Using a beta of 1.132247, a risk-free rate of 4.39 – the current yield on a 10-year T-bond, and the historical market return of 10%, we obtained a required return on Target of 10.74%. This figure is the rate of return required for us to invest in Target instead of a risk-free asset, such as the 10-year T-Bond.

Relative Valuation

The relative value calculation on Target required numerous steps. Using Target's closing price of \$39.15 on Thursday, November 6, and dividing it by our estimated earnings per share for 2003 and 2004, which is taken from our income statement forecast, we obtained the forward P/E on 2003 EPS of 21.96 and for 2004 it is 22.95. Therefore, based on our 2003 EPS forecast, Target is currently trading at 21.96 times 2003 earnings and trading at 22.95 times 2004 earnings. We then calculated Target's six-year average P/E, 33.45, based on P/E data calculated. Doing the same for the S&P 500, we obtained an average P/E of 25.20. Dividing 33.45 by 25.20 revealed that Target's six-year average P/E is approximately 1.33 times the S&P 500 P/E over the six-year period. However, Target's current P/E is 21.63, meaning that our calculation reveals that Target is trading at premium to S&P 500's current P/E. Our estimated P/E implies that Target for 2003 will probably trade at 1.125x the S&P 500 Forward P/E of 21.96 and for 2004 it will probably reach a higher premium and trade at 1.36x at 22.95. The reason why we expect Target to trade at a premium is because of high expectations over the next two years that earnings will rise substantially.

Dividend Discount Model

The dividend discount model began with using the earnings forecasted from the 2003-04 income statement. We got 28.5x as our estimate forward P/E and by multiplying it by our forecasted earnings of 4.05, we found an end-of-year 2008 target price of \$115.64. We then used the dividend discount model to find the intrinsic value of Target. Earnings per share grew at 15% and dividends per share at 7.5%. The dividend discount model gave us an intrinsic value of \$43.23 for Target. Comparing this value to Target's stock price at the close of trading on November 6, 2003, \$39.15, we can state that Target is undervalued. This is also a positive sign.

Overall, the use of both valuation models has revealed that Target is undervalued, which confirms our buy recommendation on the stock.

Target				Stock Valuation							
		Beta		1.132247							
		Risk Free rate		4.39%	10 year T-Bond						
		Market Return		10%							
			CAPM:	10.74%	= Rf + Beta*(Rm-Rf)						
DDM			Company's A's Expected Dividends								
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	
EPS	1.224	1.384	1.504	1.81	2.03	2.32	2.668	3.0682	3.5284	4.0577	
DPS	0.2	0.215	0.22	0.24	0.258	0.2774	0.2982	0.32051	0.3446	0.3704	
Payout Ratio	16.34%	17.57%	17.97%	19.61%	21.08%	22.66%	24.36%	26.19%	28.15%	30.26%	
	Forward P/E in 2008			28.5							
	Target Price, Year End 2008			115.644293 = 31.52*\$4.27(2008 EPS)							
					$(0.2/(1+0.1074)+(0.215/((1+0.1074)^2)+(0.22/(1+0.1074)^3)+(0.24/(1+0.1074)^4)+(0.258/(1+0.1074)^5)+(0.27735/(1+0.1074)^6)+(0.2982/(1+0.1074)^7)+(0.3205/(1+0.1074)^8)+(0.34455/(1+0.1074)^9)+(0.37039/(1+0.1074)^10)+((127.89/(1+0.1074)^10))$						
	DDM		Intrinsic Value	43.2308509	=						
										using dividends up to 2008	
<u>Relative Valuation</u>											
Target Corporation Stock Price as of 11/6/2003 =	\$39.15										
Current EPS =	\$1.81										
Current P/E Ratio =	21.63										
Current P/E on S&P 500	19.52		17.36								
	2003		2004								
Estimated Earnings	\$2.02	Estimated Earnings	\$2.32								
Forward P/E = Current P	19.38	Price/EPS 2004E	16.875								
	If Target trades at 1.125x P/E of S&P 500		If Target trades at 1.36x P/E of S&P 500								
Estimated 2003 P/E=	21.96	Estimated 2004 P/E	22.95	(both calculated from analysis comparing to S&P 500)							
Target Price = P/E 2003E * EPS 2003E											
Target Price =	\$44.36		\$53.24								

Risk Factors

Numerous factors can affect the operations of a merchandise retailer. The business needs to minimize its risk factors to the best of its ability in order to maintain and improve upon its market share in the industry. The following threats can influence the company's operations.

General Economic and Industry Conditions

Certain economic factors are beyond the scope of the retailer's control. Examples include interest rates, recession, inflation, consumer debt levels, tax rates and unemployment trends. These factors influence consumer confidence in ways that impact their spending levels. Any changes in these general economic and industry conditions may sway consumers to allocate less discretionary income towards household purchases. For instance, an increase in consumer debt and tax rates forces customers to reevaluate their buying habits. Unnecessary purchases can be put off indefinitely into the future.

Competitive Pressures

The retail industry faces extreme competition. Businesses in the market compete for customers, employees, suppliers, locations, products and services. For instance, Target believes that its brand names, service and distribution channels are growing stronger to compete with the power of Wal-Mart. It plans to open 400 Super Target locations by the year 2010. However in addition to Wal-Mart, other retailers like Costco and Federated threaten Target as well. Other competitors include Internet and catalog businesses, drug stores, supermarkets and department stores. Certain products may be cheaper at a different store, so it is important for retailers to evaluate competitors' prices in the market. If successful in the retail market, a firm can obtain a slice of the total retail sales of merchandise for personal use, which was \$3.27 trillion in 2002

Consumer Trends

It is difficult to predict what customers will want. Changes in consumer tastes, preferences, spending patterns and other demographic shifts impact the firm's future performance. Retailers that carry apparel are especially vulnerable to the latest trend risk. Target has a higher exposure to this risk since its large department of ladies and children's apparel account for 25% of sales. These firms should carry a variety of products, where if one area does not perform well in one quarter, other segments can pick up the slack. Wal-Mart's strength lies in the fact that it carries an array of products from apparel, home appliances to food. In addition, retailers should also note that certain products might only appeal to particular regions and not others. It is up to the company's research to help determine what the customer will choose next

Seasonal Patterns

The seasonality of shopping patterns makes retailers vulnerable to such trends. Consumer sales are strongest in the second half of the year due to back to school and holiday shopping. Target makes a significant amount of its profits during this time interval, but this does not mean to say

that holiday sales will always be possible. Shopping around this time of the year has been slow in recent years. In general, retailers have been hit the hardest for they often rely on holiday sales to boost slow revenues for the rest of the year.

Labor Conditions

The company's performance depends on attracting and retaining a quality work force that works well in a team-oriented environment. Many jobs at these retailers are entry-level, such as cashiers and stockers, so the turnover rate tends to be quite high. These businesses must obey minimum wage legislation, offer healthy work conditions and benefits to make the employees feel appreciated. If unsatisfied, the employees can form labor strikes that can greatly hurt the business' profitability and public image.

Foreign Exchange Exposure

Leading discount retailers, such as Wal-Mart and Target, face exposure to foreign exchange rates. The company is exposed to foreign payables to its international merchandise suppliers. For instance, changes in the exchange rates between the dollar and yen can significantly impact the firm's liabilities on the balance sheet. In order to secure their position in the foreign market, these retailers need to hedge against the risk of operating internationally. If not, then the company needs to decide whether to absorb this increase in price into its operations or to extend this to the ultimate customer.

Product Sourcing

Retailers must establish strong relationships with their suppliers in order to pass on the discount to their customers. Acting as a middleman, retailers attempt to win the best deal from domestic and international vendors. Due to tariffs, transportation costs, language and political barriers, it may be difficult to retailers to reach certain markets. For instance, standards acceptable in one country may not comply with rules in the U.S. Target holds itself to the highest quality of production. Any potential threat to the operations of the business is considered.

Inventory and Supply Chain Management

Over the past few years, discount retailers face the challenge of managing their inventory level efficiently. In such a high level, fast paced environment, it is pertinent for the firm to use the latest technology to keep track of merchandise. Target takes a two-step approach to managing inventory levels. First it attempts to identify and separate fast-moving products and slow-moving merchandise. For instance, perishable food and household cleaning supplies have different turnover rates. Next, Target's supply chain tracking system allows suppliers to track inventory movements online. The retailer can replenish its stock of merchandise at a fast pace.

Credit Card Operations

By establishing its own proprietary credit card, a retailer is susceptible to customers' ability to pay debt and finance charges. Payment patterns and default rates are difficult to predict. Past credit history shows insight to the customer's payment tendencies, but still there are

uncontrollable economic, legal and social factors to consider. Changes that adversely impact Target's ability to extend credit and collect payments can negatively impact the company, as shown in the case of Sears, who drew 60% of its operating profits from credit cards. Meanwhile, Target collects only 15% of operating profits from credit cards.

Investment Drivers for Target Corp

Target is a good investment for the future because it is small company and it has must potential for growth. The environment for growth is very strong to since the economy has seen a huge turnaround over the last few quarters and there is hope that this is reflective of even better times to come.

Target also has an advantage when it comes to attracting customers since it sells a variety of products and tries to hire the best workers for the job. Customer service is very important and is key to its mission of being committed to its guests. Target also is conveniently located near customers and this helps to attract all types of customers. It also has its own designers to help attract the high end customer as well.

As technology advances, Target is at the top when it comes to these advancements. It has an updated management information system that helps not only to keep track of trends and but which customers continue to come back time after time. Target tries to keep the setting of its stores designed to accommodate those trends.

The explosion of e-commerce should also gives Target a boost, as shoppers buy on the Web and have the purchases shipped home or to the office. It has open a site which links all of its stores and provides not only the ability to make purchases online but to find where stores are located. It also has collaborated with Amazon.com and provides link to this site.

Overall Target has the ability to become even more of a dominant player in the retail industry and is a solid investment from fundamental and valuation point of view.

Technical Analysis

1-Year Chart

TARGET CORP
as of 7-Nov-2003



Technical Analysis allows us to analyze the company's stock performance versus moving averages and helps determine trends, support levels and resistance levels. In the beginning of the one-year chart, \$25 was the support level and the resistance level was \$35 up until March 2003. Now Target trades at a support level of \$30 and a resistance level of \$40 for the months of March 2003 to November 2003. It broke up through the 50-day moving average in March 2003 signaling a buy signal. Then in October, it broke down through the 50-day moving average signaling a sell signal. However, it currently has crossed the 50-day moving average slightly in November 2003 signaling that it may be a potential buy. The reasons for the movement in March was the announcement of a decline in sales and the Winter of 2003 didn't meet sales expectations. Target would be unable to fulfill most of its profit plan for the first quarter. The reason for the upward movement in May was the positive announcement that sales were up and the introduction of new brands including the women's apparel line by Isaac Mizrahi. Finally the reason for the close reflection to the 50 day SMA is there is still a bit of uncertainty about what the Q3 will bring since for Q2 Target was one cent short of expectations.

2-Year Chart

TARGET CORP

as of 7-Nov-2003



Copyright 2003 Yahoo! Inc.

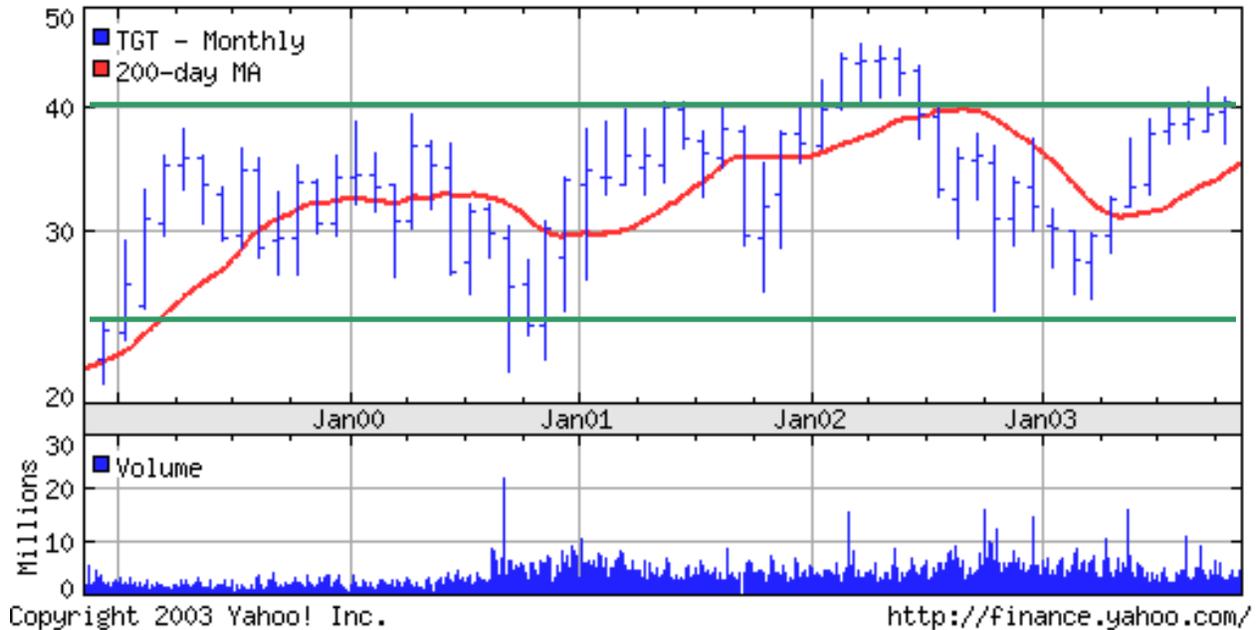
<http://finance.yahoo.com/>

As shown in this 2-year chart, the resistance level was \$45 and the support level was \$30 for January 2002 to October 2002. Then from November 2002 to present time, the resistance level is \$40 and the support level \$25. As for the 50-day moving average from January 2002 to May 2002, Target was above this average for earnings are released early in the year. Also, Kmart filed for Chapter 11 in January 2002. Target also anticipates strong spring sales. Then, it fell below the average implying a sell signal in June 2002. The reason why was due to Target's growing reliance on credit-card income, which may have rattled investors. Some industry observers believe the company has no place else to turn besides the credit card business. Between June 2002 and April 2003, there was no general signal whether Target should be a buy or a sell. Target moved up and down in comparison to previous months. Now from April 2003 to present time, Target has remained above the 50-day moving average signaling that the stock remains a current buy. Now as for the 100-day moving average, from January 2002 to May 2002, Target was above the moving average, which shows the stock was a buy. From June 2002 to April 2003, Target was below the 100-day moving average in general. Since May 2003, Target has remained above the moving average signaling that it is a current buy. The reason for this is for 2002 earnings are released early in the year and the outlook for the company remains positive.

5-Year Chart

TARGET CORP

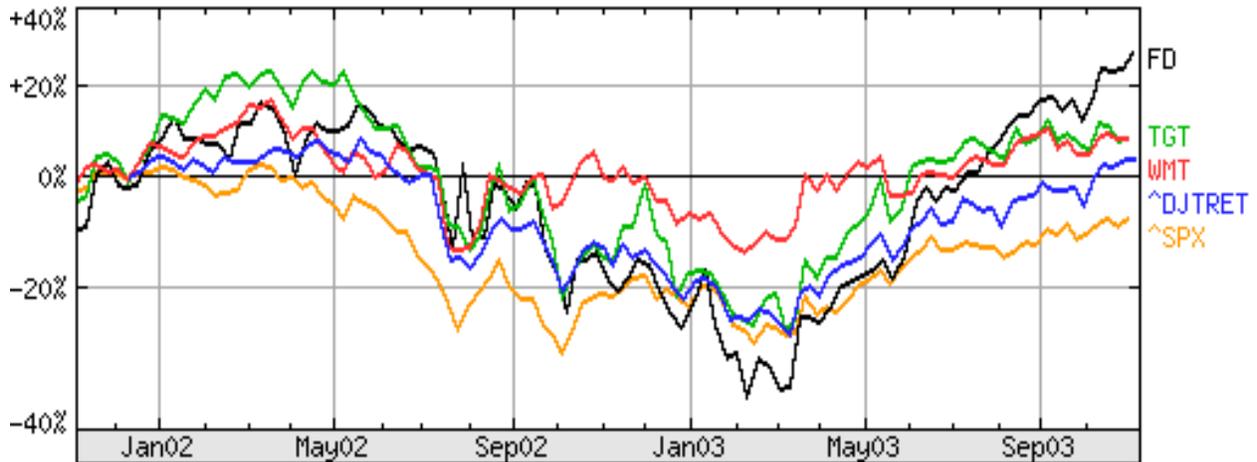
as of 7-Nov-2003



According to the 5-year chart, the resistance level was \$40 and the support level was \$25. Currently, Target remains steady around the \$40 level. As for the 200-day moving average, from January 1999 to September 1999, Target was a buy. Afterwards, it was uncertain from October 1999 to February 2000. Then it was a sell from March 2000 to January 2001. From January 2001 to August 2001, Target was a buy. From August 2001 to December 2001, the stock was a sell. Then from January 2002 to June 2002, Target was a buy. From June 2002 to March 2003, Target has been a sell. We see a trend here for the beginning of each year as earnings are announced investors react favorably. However, from March 2003 to present time, Target is a buy as the slow economy picks up momentum.

Comparison to competitors and market (2 yrs)

S&P 500 INDEX (STANDARD & POOR)
as of 4-Nov-2003



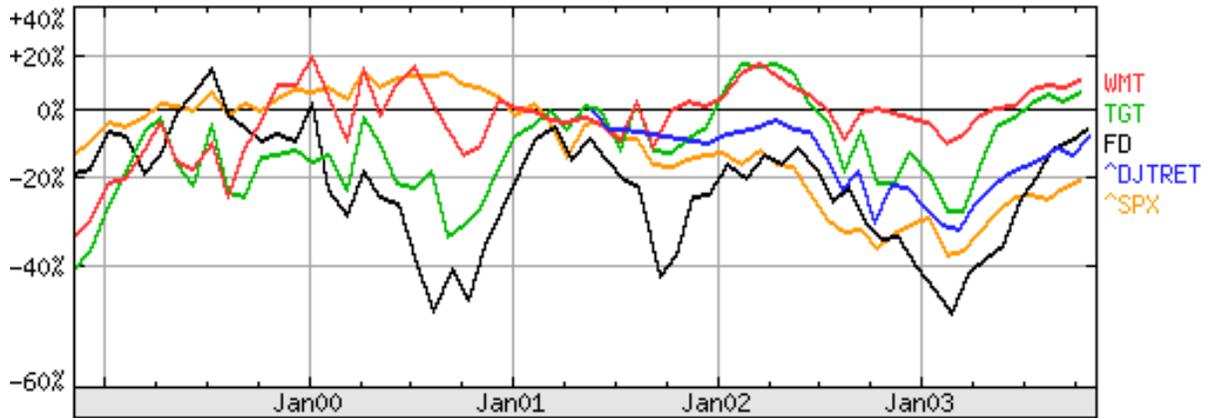
Copyright 2003 Yahoo! Inc.

<http://finance.yahoo.com/>

The chart above compares the performance of Target to the S&P 500 index and the Dow Jones retail index, both which include discounters like Target and Walmart. Federated Department Stores and Walmart are also compared. Hoovers lists Walmart and Federated as Target's two largest competitors. This one year chart shows that Federated Department Stores has outperformed Target and Walmart. However, Target and Walmart remain close competitors. It appears that Target has a return about 10% against the S&P 500, which has a -10% return. Only Federated Department Stores has fared better than Target showing 20-25% return.

5-Year Chart

S&P 500 INDEX (STANDARD & POOR)
as of 4-Nov-2003



Copyright 2003 Yahoo! Inc.

<http://finance.yahoo.com/>

The 5-year chart shows a similar scenario within the industry. Target has consistently performed above all except Wal-Mart. For the most part, Target has had a positive return. Over a 5-year period, Federated has underperformed. Target has sustained a return from a low -40% in 1999 to a high 10% in 2003. As of present time, Target maintained this amount. The future remains optimistic for positive returns.

Overall, our technical analysis demonstrates a favorable outlook for Target compared to the industry, moving averages and its competitors.

Conclusions

Based on the analysis of Target Corp's stock, we have arrived at the following conclusions:

- Target Corp stock is undervalued. According to our valuation models, at a price of \$39.15 as of Thursday, November 6, 2003, Target is trading lower than our target price of \$44.58 and lower than its intrinsic value of \$43.23. Although this stock, which has a beta of 1.132, is riskier than the market, we feel that our research, industry and technical analysis supports why Target shows growth potential in the future.
- Target Corp is a well-diversified company. It is not merely a discount retailer like its main store Target, but also features the department stores of Mervyn's and Marshall Fields. Hopefully, the situation will turn around for these two smaller chains in the near future through more innovative marketing strategies. Meanwhile, the corporation's main operating segment – Target – has consistently increased its revenue every year, which drives the entire company. Expansion of Super Target stores should help the firm obtain a greater market share. Overall Target Corp holds a relatively strong position in the market as the #2 domestic retailer. It will certainly expand its client base more in the future due to more favorable changes in the retail industry and economy in general.
- This company's motto of "Expect More, Pay Less" extends across its operations. It will continue to attract new customers via its private brands, company website, credit card operations and other innovations. For instance, Target remains above the competition in regard to offering the trendiest apparel and accessories. In addition, the company website in conjunction with Amazon.com exposes the company to more customers via the web, which is not possible through a regular mortar and stone store. The credit card business is a lucrative business that reaps great financial rewards as well as important information to monitor customer behavior and trends. Target will continue to diversify its financial services segment via each operation featuring its own proprietary card. Overall, the company is still fairly small and looks to grow at a rapid rate in the future, especially in the Northeast.

Recommendations

Our research, analysis and conclusions offer the following recommendations:

- We recommend the purchase of 300 shares of Target Corp at market order.
- We propose that Target be integrated into the St John's University Student Managed Investment Fund. Target Corp would help diversify the portfolio for the fund does not currently hold a strong holding in retail stocks. Likewise, Target Corp appears to be a fairly stable investment that shows potential for long-term growth, especially as there is a favorable turnaround for the economy. Each year the firm has consistently earned a profit. Therefore, a stock like Target agrees with the philosophy of this Student Managed Investment Fund.

The following calculation shows how we formed beta for our CAPM model.

REGRESSION ANALYSIS FOR TGT

Covariance Matrix

	Target	S&P 500
Target	0.0043	
S&P 500	0.00094	0.0008264

The covariance measures how two assets move together. The covariance between Target and the S&P500 market is fairly close to zero, 0.00094, so there isn't much of a relationship between these two assets.

Correlation Matrix

	Target	S&P 500
Target	1	
S&P 500	0.49664	1

Correlations range from -1 to +1, so our variance of 0.49664 shows that Target and the S&P500 market portfolio share a direct relationship, but are not perfectly correlated.

Regression Output

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.49664
R Square	0.24665
Adjusted R Square	0.24298
Standard Error	0.05716
Observations	207

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.2193114	0.22	67.119	2.72E-14
Residual	205	0.6698377	0		
Total	206	0.8891491			

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95%	Upper 95%
Intercept	0.00026	0.0039776	0.07	0.94798	-0.007582	0.008102	0.007582	0.008102
X Variable 1	1.13225	0.1382033	8.19	2.7E-14	0.859765	1.404729	0.859765	1.404729

Beta - From our regression analysis, we determined that the beta for TGT's stock in comparison to the market portfolio (represented by the S&P500) is 1.13225. This shows that TGT is riskier than the S&P500.

This beta will be used in our CAPM calculation for TGT.