Pros and Cons for Investing in Target

Target faces stiff headwinds from Amazon and other major rivals. But it's not going down easy.

By Brian O'Connell, Contributor | March 12, 2018, at 9:00 a.m.

Target Corporation (NYSE: TGT) has had, well, a target on its back since missing quarterly profit expectations even as it remains committed to a new $7 billion company investment initiative designed, in a large part, to take on Amazon (AMZN) in the digital retail sales and delivery space.

Can Target stock thrive in today's retail environment?

The Minneapolis-based big-box retailer operates 1,828 stores across the U.S., competing directly against Macy's (M), Kohl's Corp. (KSS), Walmart (WMT) and Best Buy (BBY), as well as digital sales giant Amazon.

The company is facing challenges in the form of stagnating sales and a public relations nightmare stemming from a massive data breach that exposed 41 million customer accounts in 2013. Last year, TGT paid $18.5 million in fines after court challenges from 41 U.S. states due to the data breach.

Still, physical store and online sales are up at Target, giving the company some wind in its sales as it steers a course toward a more aggressive business model – one that many big retailers in the age of Amazon are embracing, with varying degrees of success.

How is that campaign going? And can Target investors expect a decent run-up in TGT stock? Let's take a look.

TGT stock at a glance. Target stock is hovering around the $70-per-share level in mid-March, with an estimated one-year target price of $76 per share.

The company is counting on a big corporate reinvestment campaign to boost its financial fortunes.

Last year, Target announced that it would invest $7 billion in its operations by 2020, and that it would also double the amount of its small-format stores and drive their grocery prices lower to better compete with the likes of Kroger (KR) and Walmart.

As part of that initiative, Target has poured $1 billion into its digital retail platform, including faster (and free) delivery options. Wage hikes stemming from last December's tax reform bill have added to TGT's spending spree.

Recently, Target also fired a salvo aimed directly at Amazon – a free, guaranteed delivery deal for purchases over $35 and for consumers who own a Target REDcard. The delivery service comes with a twist – instead of relying on an Amazon-like network of high-functioning fulfillment centers, TGT will deliver goods straight from its store – or, as John Mulligan, chief operating officer at Target calls them, "mini-fulfillment centers."

While those initiatives are ambitious, it's too early to frame their impact on company sales.

Of late, though, Target's financials haven't been all that impressive.

Target recently reported mixed quarterly results with earnings per share (EPS) of $1.37, down 5.5 percent year-over-year, with revenue of $22.8 billion, up 10 percent year-over-year. Target also projected fiscal 2018 full year revenue of $72.18 billion, up just 0.4 percent from the fiscal 2017 year that ended in January, and below 2013 to 2016 levels.

Pros of buying Target stock. Target trackers say the company's $7 billion spending initiative should be well received by investors, and should put TGT stock on an upward glide path. But roadblocks lay ahead for Target, and investors should weigh those challenges, too.

"Target is obviously investing in the future in hopes of defending themselves against online giant Amazon and discount giant Wal-Mart," says Benjamin Lau, chief investment officer at Apriem Advisors. "The company's efforts to remodel stores and boost online sales have yielded some strong results recently, but they came at a cost, as in the short-term, the company is seeing a decline in profit margins."

Others take a longer-term view, noting that fiscal year 2017 was an investment year for Target to position for the future.

“TGT increased investments in price, labor, new exclusive private label brands, digital capabilities and supply chain management,” says Cindy Frick, senior equity research analyst at USAA. “Target expects fiscal year 2019 to be a year of acceleration and transition. In fiscal year 2018, TGT plans to accelerate digital fulfillment options, supply chain investments, store remodels, small format stores and continued wage increases while maintaining more stable gross margins and SG&A as a percentage of sales rates.”

Cons of investing in TGT stock. A big part of Target’s online plan is to drive down the costs of fulfilling online orders, largely through grocery delivery company Shipt, which it purchased back in mid-December, Lau says.

“The company’s online business has seen some strong growth, at 20 to 30 percent in the past few quarters, but it remains a small fraction (less than 5 percent) of total revenues,” Lau says, noting his firm is "cautious” on TGT.

“We feel it is highly unlikely that its online business will threaten Amazon, nor will its brick and mortar stores threaten Wal-Mart," Lau say. "While Target has a loyal client base, we think it will be stuck in the middle with lower growth for the foreseeable future.”

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The question for TGT stock is whether the company can properly position itself in an evolving retail landscape and maintain margins, while driving positive sales comps and traffic.

“Target and the big box retail sector has evolved to offer brick-and-mortar stores, as well as their own e-commerce sites,” Frick says. “The big-box retail companies that can effectively compete with AMZN or have less overlap in sales with AMZN and meet consumer needs will continue to maintain or gain market share. Walmart is well positioned with a greater percentage of sales from food," while Target is the opposite, Frick says.

Another, more threatening problem for Target is also a familiar one – the novelty is starting to wear off for long-time customers.

“American Customer Satisfaction Index (ACSI) data show that customer satisfaction is directly linked to stock market performance, so it's important to factor in customer satisfaction levels when assessing quarterly earnings for a company like Target,” says David VanAmburg, managing director of the American Customer Satisfaction Index. “In 2017, ACSI found that Target's customer satisfaction score dropped 3 percent, from 79 to 77 (on a 1-100 scale). “Given this decrease in customer satisfaction for the big-box retailer, it's not surprising to see that Target's earnings were below expectations,” VanAmburg says.

The bottom line. The retail industry is restructuring as e-commerce has changed its business model, says Tenpao Lee, professor of economics at Niagara University.

“Target is trying to catch up with its online business,” Lee says. “Whether TGT can survive or not will depend on its ability to innovate a new way to serve and retain its customers.”

The problem is, Amazon has more money and more time to do its learning. Target, meanwhile, must relearn retail on the fly, and that’s not an encouraging development for TGT investors – even as Target continues to throw haymakers at its biggest rival.