

RETAIL

TARGET

DEEP IN THE RED

\$204-MILLION OPERATING LOSS IN CANADA IN THE SECOND QUARTER

11.4 PER CENT SECOND-QUARTER DROP IN SAME-STORE SALES

'WE BIT OFF WAY TOO MUCH' — JOHN MULLIGAN, CFO

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RETAILING REPORTER

Canada has taught U.S. retail giant Target Corp. a tough lesson.

Instead of opening 124 stores in this country last year, the second-largest discounter in the United States should have launched just five to 10 outlets and "refined" the operations before rolling out more, chief financial officer John Mulligan said on Wednesday.

"We bit off way too much, too early," Mr. Mulligan said in a frank assessment of the company's first foray outside its U.S. home base. It came after the company posted weak second-quarter results and lowered its outlook for the year, partly because of its troubles in Canada. Customers complained of empty shelves and high prices. But, "that's all in hindsight ... We're focused on moving forward to fix this," he said.

Target's results in Canada,

which showed mounting losses and a sharp decrease in same-store sales, underscore the urgency to patch up its problems. The performance raises questions about Target's next steps under its new leaders, including whether it should close at least some of its worst stores in Canada if the situation doesn't improve quickly.

"I think the question is when they're going to do it, rather than if," Kelly Tackett, U.S. research director at London-based Planet Retail in New York, said of the

potential to shut some stores.

Some industry watchers have called on Target to cut its losses and leave Canada entirely to allow the retailer to focus on its key U.S. home market, including improving its digital efforts and returning to its traditional strength of being a cheap-chic style leader.

"Closing stores is always on the table in a circumstance like this," said Rick Pennycooke, president of retail real estate specialist Lakeshore Group in Toronto.

Target said its operating loss in Canada widened to \$204-million (U.S.) in the second quarter from \$169-million a year earlier while its gross margins were a mere 18.4 per cent - reflecting the effects of clearing excess inventory at heavy price discounts - compared with 31.6 per cent a year earlier and 30.4 per cent at the retail chain's U.S. division.

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Target: 'We have to have a sense of urgency here'

» Target Canada's same-store sales at existing outlets fell 11.4 per cent. Overall sales here jumped 63.1 per cent to \$449-million from a year earlier when just 48 stores were operating, compared with 130 today.

Brian Cornell, Target's new chief executive officer, said he visited some of its Canadian stores last week and is "aware that the expansion has been challenging."

"We have to have a sense of urgency here and a sense of pace," Mr. Cornell told an analyst conference call. "And while I want to study the business and certainly listen and learn from our team, no one is happy with our current performance."

Mr. Mulligan did not comment directly when asked whether Target will consider closing its weakest stores in Canada by the next fiscal year, saying the retailer is focused on improving its operations for the crucial fourth quarter, which includes holiday shopping.

"It's hard to judge any store at this point because we haven't put our best foot forward in any of the stores," Mr. Mulligan said. "The supply chain needs to be operating at a much better level and then we can worry about assessing stores."

But as far as hitting Target's 2017 goal for Canada of \$6-billion of sales and 80 cents a share of operating profit, "certainly that will prove difficult."

He described the retailer's inventory levels as "lumpy ... We have too much of some stuff and not enough of other things, which creates out-of-stocks in the

store."

And while U.S. sales are improving, helped by an early back-to-school business, they're "not where we need to be, by any measure," he said.

The Minneapolis-based discounter has struggled with a raft of problems in the past year, including its Canadian expansion as well as a massive data breach and soft U.S. sales.

The retailer's second-quarter profit dropped 61.7 per cent to \$234-million (U.S.) or 37 cents a share from \$611-million or 95 cents a year earlier. Total revenue rose 1.7 per cent to \$17.4-billion.

Last week, Mark Schindele, the new president in Canada, said he is focused on improving the backlogged supply chain to get products to stores faster; introducing new products and partnerships, including teaming up with celebrity designer Sarah Richardson next year for a new home decor line; and lowering some prices, including a broader price-matching policy.

"Target continues to struggle with retailing basics - right product, right time, right place - in both its U.S. and Canadian divisions," said Planet Retail's Ms. Tackett.

Still, Lakeshore Group's Mr. Pennycooke said shutting stores is costly for Target. Typical mall leases force a retailer to keep a store open or end up paying heavy penalties, he said.

"Closing stores is premature," added Michael Kehoe at retail consultancy Fairfield Commercial Real Estate in Calgary. "I think it's too early to pull the panic button."