



The Gap Inc. (GPS)

Updated March 26th, 2024 by Felix Martinez

Key Metrics

Current Price:	\$28	5 Year CAGR Estimate:	-5.9%	Market Cap:	\$10.4 B
Fair Value Price:	\$14	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	04/09/24
% Fair Value:	202%	5 Year Valuation Multiple Estimate:	-13.2%	Dividend Payment Date:	05/01/24
Dividend Yield:	2.2%	5 Year Price Target	\$18	Years of Dividend Growth:	1
Dividend Risk Score:	D	Retirement Suitability Score:	F	Rating:	Sell

Overview & Current Events

The Gap Inc. is an American clothing and accessories retailer worldwide. The company was founded in 1982 by Nick Taylor, Donald Fisher, and Doris F. Fisher and is headquartered in San Francisco, California. The company has a market capitalization of \$10.4 billion. The Gap operates six business lines: Gap, Banana Republic, Old Navy, Intermix, Hill City, and Athleta. The company has 3,380 store locations in over 40 countries, of which 2,743 are company operated.

The company reported fourth-quarter results for Fiscal Year (FY)2023 on March 7th, 2024. Richard Dickson, the company's President and CEO, lauded the fourth quarter's performance, citing surpassing expectations across pivotal metrics and achieving notable market share gains. Dickson underscored the company's unwavering commitment to financial and operational discipline, emphasizing ongoing efforts to revitalize its portfolio of brands for sustained profitable growth and shareholder value creation amidst prevailing industry challenges. Fiscal year 2023 encompassed 53 weeks compared to the prior year's 52 weeks, impacting the financial results. In the fourth quarter of fiscal 2023, net sales reached \$4.3 billion, marking a modest 1% increase over the preceding year, with significant contributions from the improved performance of Old Navy and Gap. However, the fiscal year saw a 5% decline in net sales, totaling \$14.9 billion, attributed in part to the divestiture of Gap China. While store sales experienced a downturn, online sales remained robust, accounting for a substantial portion of total net sales. Gap Inc. also highlighted operational efficiencies, reflected in enhanced margins and prudent expense management strategies. Despite the challenges, Gap Inc. reported encouraging balance sheet metrics, including a 54% increase in cash and cash equivalents compared to the prior year. Moreover, the company's strategic initiatives resulted in adjusted operating income of \$606 million for the fiscal year, underpinning a positive trajectory amidst dynamic market conditions. The brand performance varied, with Old Navy and Gap demonstrating improvements, while Banana Republic and Athleta faced some headwinds. In conclusion, Gap Inc.'s financial resilience, coupled with its strategic vision and operational agility, positions it to navigate evolving market conditions and pursue sustainable growth in the competitive apparel industry landscape.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$2.87	\$2.23	\$1.69	\$2.14	\$2.59	\$0.93	(\$1.78)	\$0.67	(\$0.60)	\$1.43	\$1.38	\$1.76
DPS	\$0.86	\$0.91	\$0.92	\$0.92	\$0.97	\$0.97	\$0.24	\$0.48	\$0.60	\$0.60	\$0.60	\$0.60
Shares¹	421.0	397.0	399.0	389.0	378.0	371.0	374.0	383.0	367.0	376.0	376.0	376.0

The Gap has been experiencing operating margin compression over the past ten years. Operating margins ranged between 9.9% and 13.4% from 2009 to 2014. The subsequent four years saw operating margins decrease to 7.7% and 9.6%. For FY2023, the operating margin was 3.8. However, we believe that diluted earnings per share will start to increase over the next three years. Earnings are expected to be \$1.76 per share for the company in FY2029. This compared unfavorably to what the company earned in FY2017 and FY2018. The company currently pays a dividend of \$0.60 per share for the year while expecting to earn \$1.38 per share for 2024. Thus, this will give a payout ratio of 34%.

¹ Shares are in Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	14.5	15.3	12	12.4	11.3	10.1	-	38.3	-	16.5	20.2	10.0
Avg. Yld.	2.1%	2.7%	3.8%	3.5%	3.3%	4.9%	0.0%	3.3%	4.4%	3.2%	2.2%	3.4%

We expect the effects of revitalizing the brands and optimizing store operating profits to begin after completing store closures in 2023. Consumer confidence has also taken a hit because of high inflation. Hence, we expect a 5-year growth estimate of 5% over the next five years. This growth estimate will change as time goes on. Considering expectations of a marginal earnings decline in the near term and subsequent growth, we assume a fair 2029 P/E of 10x instead of the historical average PE of 16.3x. The company has a PE of 20.2x, which is higher than our fair value PE.

Safety, Quality, Competitive Advantage, & Recession Resiliency

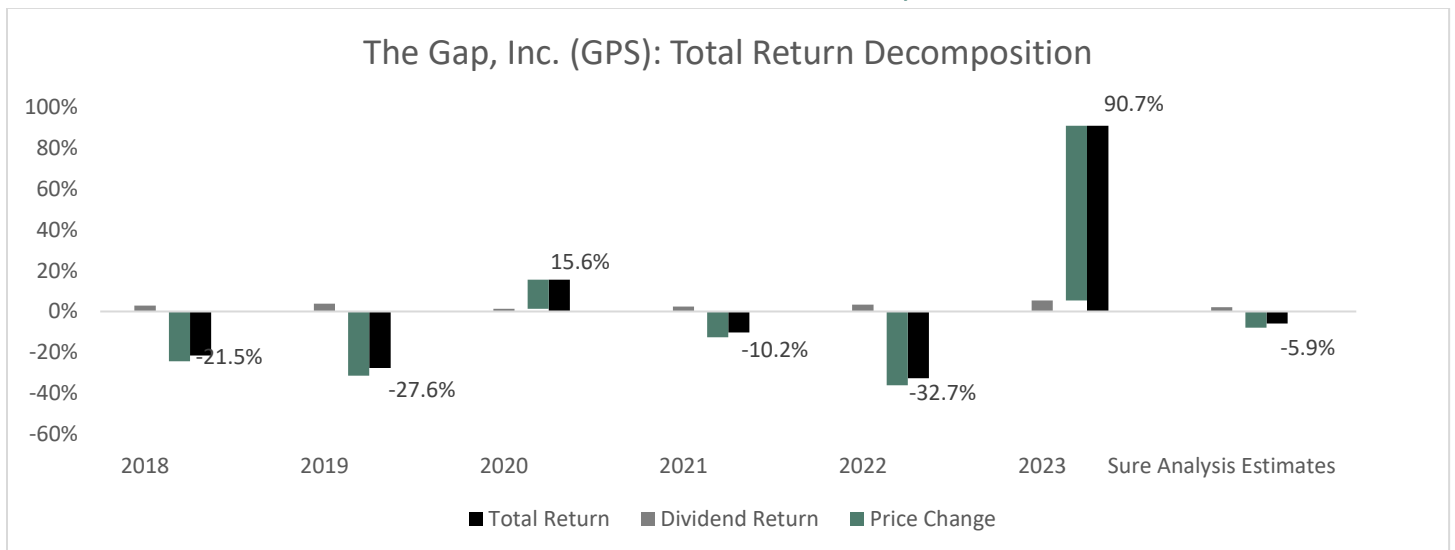
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	30%	41%	54%	43%	37%	104%	-14%	72%	-100%	42%	43%	34%

The Gap Inc. manages a portfolio of brands and has the size and capital strength to acquire new brands to bolster its business or engage in aggressive share repurchases. Inorganic growth through acquisitions may represent an upside to investors. The Gap can also capitalize on the retail industry's weaknesses by buying distressed brands and assets. An example would be purchasing the high-end children's clothing line Janie and Jack from a bankrupt retailer, Gymboree, for \$35 million. The company's balance sheet has improved with a debt/equity ratio of 2.1. Also, during the last financial crisis, Gap displayed resiliency in its business. It reported a net income of \$967 million in 2008 and \$1,102 million in 2009 while maintaining its dividend during those years.

Final Thoughts & Recommendation

The company is undergoing a transformation in which costs will be incurred to restructure the business and grow through organic initiatives or inorganic acquisitions. We estimate 5% EPS growth annually over the next five years. The Gap has a -(5.9)% expected total return over the next five years. This is due to higher valuation. Thus, we rate the company a Sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	16,435	15,797	15,516	15,855	16,580	16,383	13,800	16,670	15616	14890
Gross Profit	6,289	5,720	5,640	6,066	6,322	6,133	4,705	6,637	5359	5775
Gross Margin	38.3%	36.2%	36.3%	38.3%	38.1%	37.4%	34.1%	39.8%	34.3%	38.8%
D&A Exp.	564	592	593	559	578	557	507	504	540	522
Operating Profit	2,083	1,524	1,191	1,479	1,362	574	-862	810	-69	560
Op. Margin	12.7%	9.6%	7.7%	9.3%	8.2%	3.5%	-6.2%	4.9%	-0.4%	3.8%
Net Profit	1,262	920	676	848	1,003	351	-665	256	-202	502
Net Margin	7.7%	5.8%	4.4%	5.3%	6.0%	2.1%	-4.8%	1.5%	-1.3%	3.4%
Free Cash Flow	1,415	868	1,195	649	676	366	-155	115	-78	1112
Income Tax	751	551	448	576	319	177	-437	67	63	54

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	7,690	7,473	7,610	7,989	8,049	13,679	13,769	12,761	11386	11040
Cash & Equivalents	1,515	1,370	1,783	1,783	1,081	1,364	1,988	877	1215	1873
Acc. Receivable	275	282	335	282	321	316	363	399	340	289
Inventories	1,889	1,873	1,830	1,997	2,131	2,156	2,451	3,018	2389	1995
Goodwill & Int.	272	272	204	204	201	230	170	297	288	279
Total Liabilities	4,707	4,928	4,706	4,845	4,496	10,363	11,155	10,039	9153	8449
Accounts Payable	1,173	1,112	1,243	1,181	1,126	1,174	1,743	1,951	1320	1349
Long-Term Debt	1,353	1,731	1,313	1,249	1,249	1,249	2,216	1,484	1836	1488
Total Equity	2,983	2,545	2,904	3,144	3,553	3,316	2,614	2,722	2233	2595
LTD/E Ratio	0.45	0.68	0.45	0.40	0.35	0.38	0.85	0.55	0.82	0.57

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	16.2%	12.1%	9.0%	10.9%	12.5%	3.2%	-4.8%	1.9%	-1.7%	4.5%
Return on Equity	41.8%	33.3%	24.8%	28.0%	30.0%	10.2%	-22.4%	9.6%	-8.2%	20.8%
ROIC	28.7%	21.4%	15.9%	19.7%	21.8%	7.5%	-14.2%	5.7%	-4.9%	12.3%
Shares Out.	421.0	397.0	399.0	389.0	378.0	371.0	374.0	383.0	367.0	376.0
Revenue/Share (\$)	37.35	38.25	38.79	40.04	42.73	43.34	36.90	43.52	42.55	39.60
FCF/Share (\$)	3.22	2.10	2.99	1.64	1.74	0.97	-0.41	0.30	-0.21	2.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise. 2018 refers to the fiscal year period ending February 2, 2019. <https://suredividend.typeform.com/to/xYFki7>

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