BUSINESS: The Gap, Inc. operated 3,059 corporate-owned specialty stores, as well as about 37 million square feet of space as of February 22, 2013. Gap and GapKids (990 U.S. and 389 foreign stores) sell jeans, sweatshirts, sweatsuits, and related apparel. Banana Republic (636 stores; 38 in Asia) sells upscale casual wear. Old Navy (1,020 stores) focuses on children's clothing, as well as some women's and men's merchandise. Ankeny (201 stores) is a U.S. operation, and Navy (101 stores) is a Canadian subsidiary.gap.com

A few challenges, which should prove to be temporary, halted The Gap's upward same-store sales momentum. The comp sales decrease for September (fiscal 2013's third quarter) ended November 2nd) was 3% versus investors' expectations of a slight increase. In contrast, this metric improved 6% during the same period last year and 2% this past August. Management cited increased economic uncertainty toward the end of September (apparently focused on U.S. budget funding) and weakness in its overall apparel women's business. Sales of men's clothing, though, were up modestly, year to year. In light of the initial signs of a poorer retail environment and the continued upshift in the year of our August report, we've lowered both our fiscal 2013 and fiscal 2014 share-earnings estimates by $0.10, to $2.65 and $3.00, respectively.

The share price has dropped about 20% from its record peak of $46.56 reached in early August. That reversal was considerably accelerated following The Gap's latest sales release. On a positive note, the company raised its quarterly dividend by a nickel, to $0.20 per share, and the current yield is a decent 2.2%. Too, its longer-term share-earnings growth prospects are sound, in our view. Thus, we think the recent quotation might be a possible entry point for this good-quality stock. Its appreciation potential for the pull to 2016–2018 is comfortably above the Value Line median.

The retailer's expansion focus is mainly on foreign markets. Since fiscal 2010, it established operations in ten countries, including China and Canada, and expects that total to grow to 40. The number of company-owned and franchise units has increased by 50%, to about 800, while self-owned space in North America decreased 7%.

The annual pace of share repurchases related to fiscal 2016–2018 will likely be far more moderate than over the past three years. During the latter period, The Gap's repurchases totaled $5.2 billion, which were partly funded with new debt, and the share count dropped 213 million (31.5%). Our relatively moderate expectation for the coming years in this regard assumes no further debt and considers the doubling of the dividend since fiscal 2010.

John D. Cohan, November 1, 2013

Company's Financial Strength

A+ Stock's Price Stability

70 Price Growth Persistence

60 Earnings Predictability

80

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