



# GAP, Inc. (Buy / High Risk)

Date: 11/01/2005  
Symbol: GPS  
Price: \$16.87

Michigan State University  
Student Investment  
Association

Brian Burnham  
Chris Letts  
Kevin Smith

Symbol: GPS  
Sector: Services  
Industry: Apparel Stores  
Industry Outlook: Hold

Market Cap: 14.81B  
Shares Outstanding:  
878.01M  
Avg. Daily Volume:  
4,969,580  
52-Wk Range: 15.90 - 23.75

DCF Valuation:

Net Profit Margin: 7.43%  
Return on Equity: 22.46%  
Dividend Yield: 1.10%  
Debt to Equity: .095  
Forward P/E: 12.05

**Growth Rates (5 yr.)**

	Company	Industry
Sales	10%	8%
EPS	10%	8%

**Company Efficiency/Profitability**

	Comp.	Ind.
ROE	22.45%	18.27
P/E	13.37	16.69
Price/Book	2.71	3.89
Net Margin	7%	6%

**Summary:** operates as a specialty retailing company. It offers casual apparel, accessories, and personal care products under the Gap, Banana Republic, and Old Navy brands.



**Revenues (Million \$)**

	2005	2004	2003	2002	2001
1Q	3668	3353	--	--	--
2Q	3721	3685	--	--	--
3Q	3980	3929	--	--	--
4Q	--	4886	--	--	--
Yr.	--	15854	14455	13848	13674

**Earnings Per Share (\$)**

	2005	2004	2003	2002	2001
1Q	.33	.22	.04	.13	.27
2Q	.21	.22	.06	.10	.21
3Q	.28	.28	.15	-.21	.21
4Q	.40	.37	.27	-.04	.31
Yr.	1.21	1.09	.54	-.01	1.00

**Company Highlights**

- More than 3,000 Stores worldwide (2800 stores in the U.S., 250 Stores in Europe, German, and Japan).
- Forth and Towne brand introduced in 2004 targeting women over the age of 35.
- Last month all retail sales were down. Gap sales were down 3% however comparable stores were down 6%.
- Long-term growth should be solid due to expansion in international market: Five new test stores and 2 Banana Republics being opened in Tokyo.
- The company provides a range of products, including denim, khakis, and T-shirts, fashion apparel, shoes, accessories, intimate apparel, and personal care products for men, women, teens, and children.

**Major Risks**

- We rate Gap High Risk reflecting the volatility of the company's operating activities, same store sales results and earnings primarily owing to the changing dynamics of the apparel retail market and fashion trends.
- Volatile comps could lead to stock price volatility: We believe that GPS shares are relatively more sensitive to comp sales volatility given the company's diminished square footage growth prospects and resulting dependence on comps for top-line growth.
- Challenged to meaningfully grow square footage. As the company nears peak operating margin and the end of its turnaround, top-line growth from sources other than comparable store sales becomes increasingly imperative.
- Risks to our opinion and target price include fashion, markdown and inventor risk, and dependence on key personnel.

**Analysts Opinion:** As a company, GAP will continue to move in tandem with the retail stores industry for at least the next decade. However, our analysis of Gap, Inc.'s discounted cash flows shows the shares may be quickly approaching their fair value.

