GAP INC
Form 10-K
March 19, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
þ Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended February 2, 2019
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 1-7562
THE GAP, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-1697231
(State of Incorporation)	(I.R.S. Employer Identification No.)
Two Folsom Street, San Francisco, California	94105
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: (415) 427-0100
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.05 par value	The New York Stock Exchange
(Title of class)	(Name of exchange where registered)

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	þ	Accelerated filer	¨	Non-accelerated filer	¨	Smaller reporting company	¨	Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of August 3, 2018 was approximately $7 billion based upon the last price reported for such date in the NYSE-Composite transactions.

The number of shares of the registrant's common stock outstanding as of March 13, 2019 was 378,598,205.

Documents Incorporated by Reference

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2019 (hereinafter referred to as the "2019 Proxy Statement") are incorporated into Part III.

Special Note on Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. All statements other than those that are purely historical are forward-looking statements. Words such as “expect,” “anticipate,” “believe,” “estimate,” “intend,” “plan,” “project,” and simil expressions also identify forward-looking statements. Forward-looking statements include, but are not limited to, statements regarding the following:

- structure and timing of completion of the planned separation transaction;
- process of completing the separation transaction, including estimated costs;
- anticipated strategic, financial, operational or other benefits of the separation transaction, including future financial performance of the independent companies following the proposed separation transaction;
- plans to restructure the Gap brand specialty fleet, including anticipated store closures and timing, impact to annualized sales, associated costs, and effect on annualized savings;
- investing in digital and customer capabilities, as well as store experience, to support growth;
- deploying a data driven decision making model;
- increasing productivity by leveraging our scale and streamlining operations and processes;
- continuing to integrate social and environmental sustainability into business practices;
- attracting and retaining great talent in our businesses and functions;
- continuing our investment in customer experience to drive higher customer engagement and loyalty;
- net store closings in fiscal 2019;
- impact of foreign currency exchange rate fluctuations in fiscal 2019;
- current cash balances and cash flows being sufficient to support our business operations, including expansion costs related to a building and a buildout of our Ohio distribution center;
- ability to supplement near-term liquidity, if necessary, with our $500 million revolving credit facility or other available market instruments;
- the impact of the seasonality of our operations;
- dividend payments in fiscal 2019;
- the impact if actuals differ substantially from estimates and assumptions used in accounting calculations and policies;
- recognition of revenue deferrals as revenue;
- the impact of recent accounting pronouncements;
- unrealized gains and losses from designated cash flow hedges;
- recognition of unrecognized share-based compensation expense;
- total gross unrecognized tax benefits;
- the impact of losses due to indemnification obligations;
- the outcome of proceedings, lawsuits, disputes, and claims; and
- the impact of changes in internal control over financial reporting.

Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause our actual results to differ materially from those in the forward-looking statements. These factors include, without limitation, the following:

- the risks associated with our plan to separate into two independent publicly-traded companies, including that the separation may not be completed in accordance with the expected plans or anticipated timeframe, or at all;
- the risk that our plan to separate into two publicly-traded companies may not achieve some or all of the anticipated benefits;
- the risk that we or our franchisees will be unsuccessful in gauging apparel trends and changing consumer preferences;
- the highly competitive nature of our business in the United States and internationally;
- the risk that failure to maintain, enhance and protect our brand image could have an adverse effect on our results of operations;
- the risk that the failure to attract and retain key personnel, or effectively manage succession, could have an adverse impact on our results of operations;
- the risk that our investments in customer, digital, and omni-channel shopping initiatives may not deliver the results we anticipate;
- the risk that if we are unable to manage our inventory effectively, our gross margins will be adversely affected;
- the risk that we are subject to data or other security breaches that may result in increased costs, violations of law, significant legal and financial exposure, and a loss of confidence in our security measures, which could have an adverse effect on our results of operations and our reputation;
- the risk that a failure of, or updates or changes to, our information technology ("IT") systems may disrupt our operations;
- the risks to our business, including our costs and supply chain, associated with global sourcing and manufacturing;
- the risk that changes in global economic conditions or consumer spending patterns could adversely impact our results of operations;
- the risks to our efforts to expand internationally, including our ability to operate in regions where we have less experience;
- the risks to our reputation or operations associated with importing merchandise from foreign countries, including failure of our vendors to adhere to our Code of Vendor Conduct;
- the risk that our franchisees' operation of franchise stores is not directly within our control and could impair the value of our brands;
- the risk that we or our franchisees will be unsuccessful in identifying, negotiating, and securing new store locations and renewing, modifying, or terminating leases for existing store locations effectively;
- the risk that foreign currency exchange rate fluctuations could adversely impact our financial results;
- the risk that comparable sales and margins will experience fluctuations;
- the risk that changes in our credit profile or deterioration in market conditions may limit our access to the capital markets and adversely impact our financial results or our business initiatives;

- the risk that trade matters could increase the cost or reduce the supply of apparel available to us and adversely affect our business, financial condition, and results of operations;
- the risk that changes in the regulatory or administrative landscape could adversely affect our financial condition and results of operations;
- the risk that natural disasters, public health crises, political crises, negative global climate patterns, or other catastrophic events could adversely affect our operations and financial results, or those of our franchisees or vendors;
- the risk that reductions in income and cash flow from our credit card arrangement related to our private label and co-branded credit cards could adversely affect our operating results and cash flows;
- the risk that the adoption of new accounting pronouncements will impact future results;
- the risk that we do not repurchase some or all of the shares we anticipate purchasing pursuant to our repurchase program; and
- the risk that we will not be successful in defending various proceedings, lawsuits, disputes, and claims.

Additional information regarding factors that could cause results to differ can be found in this Annual Report on Form 10-K and our other filings with the U.S. Securities and Exchange Commission (“SEC”).

Future economic and industry trends that could potentially impact net sales and profitability are difficult to predict. These forward-looking statements are based on information as of March 19, 2019, and we assume no obligation to publicly update or revise our forward-looking statements even if experience or future changes make it clear that any projected results expressed or implied therein will not be realized.

THE GAP, INC.
2018 ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

PART IV

Part I
Item 1. Business.
General
The Gap, Inc. (Gap Inc., the “Company,” “we,” and “our”) was incorporated in the State of California in July 1969 and was reincorporated under the laws of the State of Delaware in May 1988.
Gap Inc. is a leading global apparel retail company. We offer apparel, accessories, and personal care products for men, women, and children under the Old Navy, Gap, Banana Republic, Athleta, Intermix, and Hill City brands. Our portfolio of distinct brands across multiple channels and geographies, combined with our size and scale which allows for strategic and advantageous partnerships with our third-party vendors and suppliers throughout the organization, gives us a competitive advantage in the global retail marketplace.
Gap Inc. is an omni-channel retailer, with sales to customers both in stores and online, through Company-operated and franchise stores, websites, and third-party arrangements. Gap Inc. has Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, Italy, China, Hong Kong, Taiwan, and Mexico. We also have franchise agreements with unaffiliated franchisees to operate Old Navy, Gap, and Banana Republic stores throughout Asia, Europe, Latin America, the Middle East, and Africa. Under these agreements, third parties operate stores that sell apparel and related products under our brand names. Most of the products sold under our brand names are designed by us and manufactured by independent sources. We also sell products that are designed and manufactured by branded third parties, primarily at our Intermix brand.
Gap Inc. uses omni-channel capabilities to bridge the digital world and physical stores, creating world-class shopping experiences regardless of where or how our customers shop. The Company's suite of omni-channel services, including order-in-store, reserve-in-store, find-in-store, and ship-from-store, as well as mobile shopping experiences, are uniquely tailored across its portfolio of brands.
Old Navy. Old Navy is a global apparel and accessories brand that makes current American essentials accessible to everyone. The brand celebrates the democracy of style through on-trend, playfully optimistic, affordable and high-quality product. Old Navy is committed to creating incredible shopping experiences regardless of where, when and how customers choose to shop, including a fun store experience, a dynamic online channel and convenient omni-channel capabilities such as buy online, pick-up in store. Old Navy opened its first store in 1994 in the United States and since has expanded to more than 1,100 stores around the world, including Company-operated stores in Canada, China, and Mexico, as well as franchise stores. In 2018, Great Place to Work and FORTUNE magazine honored Old Navy as one of the “Best Workplaces in Retail” and “Best Workplaces for Diversity” for the third year in a row. In addition, through its cause platform ONward!, Old Navy supports the Boys & Girls Clubs of America to help turn learners into leaders.
Gap. Gap is one of the world's most iconic apparel and accessories brands anchored in optimistic, casual, American style. Founded in San Francisco in 1969, the brand's collections continue to build the foundation of modern wardrobes—all things denim, tees, button-downs, and khakis, along with must-have trends.
Gap is designed to build the foundation of modern wardrobes through every stage of life with apparel and accessories for adult men and women under the Gap name, in addition to GapKids, babyGap, GapMaternity, GapBody, and GapFit collections. Beginning in 1987 with the opening of the first store outside North America in London, Gap continues to connect with customers around the world through specialty stores, online, and franchise stores. In addition, we bring the brand to value-conscious customers, with exclusively designed collections for Gap Outlet and Gap Factory stores and online.
Banana Republic. Acquired with two stores in 1983 as a travel and adventure outfitter, Banana Republic is now a global apparel and accessories brand focused on delivering modern, versatile classics designed for a life with no boundaries. Curious, connected and out in the world, Banana Republic provides a wardrobe of favorites—clothing, eyewear, jewelry, shoes, handbags, and fragrances—all made for a life in motion with the finest materials and fabric innovations. Customers can purchase Banana Republic products globally in our specialty stores, online, and franchise stores.

Athleta. Athleta is a premium fitness and lifestyle brand creating versatile performance apparel to inspire a community of active, confident women and girls. Established in 1998 and acquired by Gap, Inc. in 2008, Athleta integrates technical features and innovative design across its women's collection to carry her through a life in motion, from yoga, training and sports, to everyday activities and travel. In 2016, the Company launched Athleta Girl, mirroring its signature performance in styles for the next generation. Customers can purchase Athleta products in the United States through its stores and catalogs, or globally online.

Athleta has been certified as a benefit corporation ("B Corp"), furthering our commitment to using our business as a force for good to drive social and environmental impact. We met rigorous standards across social and environmental performance, accountability, and transparency. Additionally, we amended Athleta's legal charter to become a Delaware public benefit corporation, further demonstrating its commitment to people and the planet. With this accreditation, Gap Inc. has become one of the largest publicly-traded retail companies with a B Corp certified subsidiary apparel brand. We plan to leverage the learnings from Athleta as a case study for Gap Inc., providing a benchmark and roadmap of potential opportunities for greater social and environmental impact across the enterprise.

Intermix. Intermix curates must-have styles from the most coveted emerging and established designers. Known for styling on-trend pieces in unexpected ways, Intermix delivers a unique point of view and an individualized approach to shopping and personal style. Customers can shop in stores in the United States and Canada, and online.

Hill City. Hill City is a high-performance men’s apparel brand offering technical clothing that transitions seamlessly through the day, from working out to work to weekend. Launched in 2018, the product line fuses a clean aesthetic with hidden technical innovation that is felt, rather than seen, allowing men to focus on more versatile pieces. Incubated alongside the Athleta business, Hill City also has been designated a B Corp certified brand by integrating sustainability throughout many of its products, using high-quality renewable, recycled fibers to create performance fabrics.

The range of merchandise displayed in each store varies depending on the selling season and the size and location of the store. Stores are generally open seven days per week (where permitted by law) and most holidays.

We ended fiscal 2018 with 3,194 Company-operated stores and 472 franchise store locations. For more information on the number of stores by brand and region, see the table included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this Form 10-K.

Old Navy, Gap, Banana Republic, and Athleta each have a private label credit card program and a co-branded credit card program through which frequent customers receive benefits. Private label and co-branded credit cards are provided by a third-party financing company, with associated revenue sharing arrangements reflected in Gap Inc. operations. We have a multi-tender loyalty rewards program, BRIGHT, active across each of these brands. We also issue and redeem gift cards through our brands.

Certain financial information about international operations is set forth under the heading "Segment Information" in Note 16 of Notes to Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this Form 10-K.

Merchandise Vendors

We purchase private label and non-private label merchandise from about 700 vendors. Our vendors have factories in about 40 countries. Our two largest vendors each accounted for about 6 percent of the dollar amount of our total fiscal 2018 purchases. Of our merchandise purchased during fiscal 2018, substantially all purchases, by dollar value, were from factories outside the United States. Approximately 28 percent of our fiscal 2018 purchases, by dollar value, were from factories in Vietnam. Approximately 21 percent of our fiscal 2018 purchases, by dollar value, were from factories in China. Product cost increases or events causing disruption of imports from Vietnam, China, or other foreign countries, including the imposition of additional import restrictions or taxes, or vendors potentially failing due to political, financial, or regulatory issues, could have an adverse effect on our operations. Substantially all of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars. Also see the sections entitled “Risk Factors—Our business is subject to risks associated with global sourcing and manufacturing," "Risk Factors—Risks associated with importing merchandise from foreign countries, including failure of our vendors to adhere to our Code of Vendor Conduct, could harm our business,” and “Risk Factors—Trade matters may disrupt our supply chain” in Item 1A, Risk Factors, of this Form 10-K.

2

Seasonal Business

Our business follows a seasonal pattern, with sales peaking during the end-of-year holiday period.

Brand Building

Our ability to develop and evolve our existing brands is a key to our success. We believe our distinct brands are among our most important assets. With the exception of Intermix, virtually all aspects of brand development, from product design and distribution to marketing, merchandising and shopping environments, are controlled by Gap Inc. employees. With respect to Intermix, we control all aspects of brand development except for product design related to third-party products. We continue to invest in our business and enhance the customer experience through significant investments in our supply chain and digital capabilities, investments in marketing, enhancement of our omni-shopping experience, remodeling of existing stores, and international expansion.

Trademarks and Service Marks

Old Navy, Gap, GapKids, babyGap, GapMaternity, GapBody, GapFit, Banana Republic, Athleta, Intermix, and Hill City trademarks and service marks, and certain other trademarks and service marks, have been registered, or are the subject of pending trademark applications, with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law.

Franchising

We have franchise agreements with unaffiliated franchisees to operate Old Navy, Gap, and Banana Republic stores in a number of countries throughout Asia, Europe, Latin America, the Middle East, and Africa. Under these agreements, third parties operate, or will operate, stores that sell apparel and related products under our brand names. For additional information on risks related to our franchise business, see the sections entitled “Risk Factors—Our efforts to expand internationally may not be successful” and “Risk Factors—Our franchise business is subject to certain risks not directly within our control that could impair the value of our brands” in Item 1A, Risk Factors, of this Form 10-K.

Inventory

The nature of the retail business requires us to carry a significant amount of inventory, especially prior to the peak holiday selling season when we, along with other retailers, generally build up inventory levels. We maintain a large part of our inventory in distribution centers. We review our inventory levels in order to identify slow-moving merchandise and broken assortments (items no longer in stock in a sufficient range of sizes or colors) and we primarily use promotions and markdowns to clear merchandise. Also see the sections entitled “Risk Factors—We must successfully gauge apparel trends and changing consumer preferences to succeed,” "Risk Factors—If we are unable to manage our inventory effectively, our gross margins could be adversely affected," and "Risk Factors—Our results could be adversely affected by natural disasters, public health crises, political crises, negative global climate patterns, or other catastrophic events" in Item 1A, Risk Factors, of this Form 10-K.

Competitors

The global apparel retail industry is highly competitive. We compete with local, national, and global apparel retailers. Also see the section entitled “Risk Factors—Our business is highly competitive” in Item 1A, Risk Factors, of this Form 10-K.

Employees

As of February 2, 2019, we had a workforce of approximately 135,000 employees, which includes a combination of part-time and full-time employees. We also hire seasonal employees, primarily during the peak holiday selling season.

To remain competitive in the retail apparel industry, we must attract, develop, and retain skilled employees in our design, merchandising, supply chain, marketing, and other functions, as well as in our stores and distribution centers. Competition for such personnel is intense. Our success is dependent to a significant degree on the continued contributions of key employees. Also see the section entitled “Risk Factors—The failure to attract and retain key personnel, or effectively manage succession, could have an adverse impact on our results of operations” in Item 1A, Risk Factors, of this Form 10-K.

Available Information
We make available on our website, www.gapinc.com, under “Investors,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after we electronically file or furnish them to the SEC.
Our Board of Directors Committee Charters (Audit and Finance, Compensation and Management Development, and Governance and Sustainability Committees) and Corporate Governance Guidelines are also available on our website under “Investors, Governance.” Our Code of Business Conduct can be found on our website under “Investors, Corporate Compliance, Code of Business Conduct Overview.” Any amendments and waivers to the Code will also be available on the website.
Information about our sustainability efforts is available online at www.gapincsustainability.com, which provides information on our policies, social impact and environmental programs, as well as our sustainability strategy and data. Also available at www.gapincsustainability.com is a Sustainability Accounting Standards Board (SASB) table, which provides comparable data for our industry.

Executive Officers of the Registrant
The following are our executive officers:
Name, Age, Position, and Principal Occupation:
Arthur Peck, 63, Director, and President and Chief Executive Officer, Gap Inc. since February 2015; President, Growth, Innovation, and Digital division from 2012 to January 2015; President, Gap North America from 2011 to 2012; Executive Vice President of Strategy and Operations from 2005 to 2011; President, Gap Inc. Outlet from 2008 to 2011.
Mark Breitbard, 51, President and Chief Executive Officer, Banana Republic since May 2017; Chief Executive Officer, The Gymboree Corporation from January 2013 to April 2017; President, Gap North America from 2012 to January 2013; Executive Vice President, Gap North America Merchandising from 2011 to 2012; Executive Vice President, GapKids and babyGap from 2010 to 2011.
Shawn Curran, 55, Executive Vice President, Global Supply Chain and Product Operations since October 2017; Executive Vice President, Global Supply Chain - Logistics and Product Operations from April 2016 to October 2017; Executive Vice President, Global Supply Chain from August 2015 to April 2016; Senior Vice President, Logistics from 2012 to August 2015.
Sebastian DiGrande, 52, Executive Vice President, Strategy and Chief Customer Officer since May 2016; Senior Partner and Managing Director, the Boston Consulting Group from 1996 to April 2016.
Neil Fiske, 57, President and Chief Executive Officer, Gap since June 2018; Chief Executive Officer, Billabong International from 2013 to June 2018; Retail and Restaurant Industry Partner, Onex Corporation from 2012 to 2013; Chief Executive Officer and President, Eddie Bauer from 2007 to 2012.
Julie Gruber, 53, Executive Vice President, Global General Counsel, Corporate Secretary, and Chief Compliance Officer since February 2016; Senior Vice President and General Counsel from March 2015 to February 2016; Vice President and Deputy General Counsel from 2007 to March 2015; Associate General Counsel from 2003 to 2007.
Brent Hyder, 54, Executive Vice President and Chief People Officer since February 2018; Executive Vice President, Global Talent and Sustainability from May 2017 to February 2018; Executive Vice President and Chief Operating Officer, Gap from June 2016 to May 2017; Senior Vice President, Human Resources, Gap from September 2014 to June 2016; Vice President and General Manager, Gap Japan from February 2013 to September 2014; Vice President, Human Resources from May 2007 to February 2013.
Teri List-Stoll, 56, Executive Vice President and Chief Financial Officer since January 2017; Executive Vice President and Chief Financial Officer, Dick’s Sporting Goods, Inc. from August 2015 to September 2016; Executive Vice President and Chief Financial Officer, Kraft Foods Group, Inc. from September 2013 to May 2015; Senior Vice President and Treasurer, Procter & Gamble Co. from 2008 to August 2013.

Sonia Syngal, 49, President and Chief Executive Officer, Old Navy since April 2016; Executive Vice President, Global Supply Chain and Product Operations from February 2015 to April 2016; Executive Vice President, Global Supply Chain from November 2013 to January 2015; Senior Vice President, Old Navy International from February 2013 to November 2013; Senior Vice President and Managing Director, Europe from 2011 to February 2013; Senior Vice President and General Manager, International Outlets from 2010 to 2011; Vice President of Global Production, Supply Chain - Outlet from 2006 to 2010.

Item 1A. Risk Factors.
Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including but not limited to the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods.
Our plan to separate into two independent publicly-traded companies is subject to various risks and uncertainties and may not be completed in accordance with the expected plans or anticipated timeline, or at all, and will involve significant time and expense, which could disrupt or adversely affect our businesses.
On February 28, 2019, we announced our intention to separate into two independent publicly-traded companies: Old Navy and a yet-to-be-named company ("NewCo"), which will consist of the Gap brand, Athleta, Banana Republic, Intermix and Hill City. We expect to effect the separation through a spin-off that is intended to generally be tax-free to the Company's shareholders for U.S. federal income tax purposes. The transaction is currently targeted to be completed in 2020 and is subject to certain conditions, including final approval by our Board of Directors, receipt of a tax opinion from counsel, and the filing and effectiveness of a registration statement with the U.S. Securities and Exchange Commission. The failure to satisfy all of the required conditions could delay the completion of the separation for a significant period of time or prevent it from occurring at all, and there can be no assurances regarding the ultimate timing or terms of the separation or that the separation will be completed. In addition, the separation is complex in nature, and unanticipated developments or changes, including changes in law, the macroeconomic environment, market conditions, the retail industry or political conditions may affect our ability to complete the transaction as currently expected, within the anticipated time frame or at all. Any changes to the transaction or delay in completing the transaction could cause us not to realize some or all of the expected benefits, or realize them on a different timeline than expected. In addition, although we intend for the separation to generally be tax-free to the Company's shareholders for U.S. federal income tax purposes, there can be no assurance that the transaction will so qualify. If the separation were ultimately determined to be taxable, the Company, the Company's shareholders and/or the new independent companies could incur income tax liabilities and/or indemnity obligations that could be significant.
We expect that the process of completing the separation will be time-consuming and involve significant costs and expenses, which may be significantly higher than what we currently anticipate and may not yield a benefit if the separation is not completed. Executing the separation will require significant time and attention from our senior management and employees, which could disrupt our ongoing business and adversely affect the financial results and results of operations. We may also experience increased difficulties in attracting, retaining and motivating employees and/or attracting and retaining customers during the pendency of the separation and following its completion, which could harm our businesses.
Any of these factors could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or the price of our common stock.

The separation may not achieve some or all of the anticipated benefits.
We may not realize some or all of the anticipated strategic, financial, operational or other benefits from the separation, and there is no assurance that following the separation, each separate company will be successful. As independent publicly-traded companies, Old Navy and NewCo will be smaller, less diversified companies and may be more vulnerable to changing conditions in the retail industry or changes in market conditions, which could materially adversely affect their respective businesses, financial conditions, results of operations. For example, Old Navy will no longer be part of a company that also includes a number of other specialty brands, and the NewCo businesses will no longer be part of a company that also operates Old Navy as a fast-growing brand that is a category leader in family apparel. These factors could have a material adverse effect on the business, financial condition, results of operations, cash flows and/or the price of the common stock of Old Navy and/or NewCo.

In addition, investors holding our common stock prior to the separation may hold our common stock because of a decision to invest in a company that operates both our Old Navy and specialty brands. If the separation transaction is completed, shares of common stock in each independent company held by those investors will represent an investment in a company with a different profile than that of Gap, and, as a result, some investors may sell our common stock prior to the separation or sell the common stock of one or both independent companies resulting from the separation. Further, there can be no assurance that the combined value of the common stock of the two publicly traded companies resulting from the separation will be equal to or greater than what the value of our common stock would have been had the separation not occurred.

We must successfully gauge apparel trends and changing consumer preferences to succeed.
Our success is largely dependent upon our ability to gauge the tastes of our customers and to provide merchandise that satisfies customer demand in a timely manner. However, lead times for many of our design and purchasing decisions may make it more difficult for us to respond rapidly to new or changing apparel trends or consumer acceptance of our products. The global apparel retail business fluctuates according to changes in consumer preferences, dictated in part by apparel trends and season. To the extent we misjudge the market for our merchandise or the products suitable for local markets or fail to execute trends and deliver product to market as timely as our competitors, our sales will be adversely affected, and the markdowns required to move the resulting excess inventory will adversely affect our operating results.

Our business is highly competitive.
The global apparel retail industry is highly competitive. We and our franchisees compete with local, national, and global department stores, specialty and discount store chains, independent retail stores, and online businesses that market similar lines of merchandise. We face a variety of competitive challenges in an increasingly complex and fast-paced environment, including:

- anticipating and quickly responding to changing apparel trends and customer demands;
- attracting customer traffic both in stores and online;
- competitively pricing our products and achieving customer perception of value;
- maintaining favorable brand recognition and effectively marketing our products to customers in several diverse market segments and geographic locations;
- anticipating and responding to changing customer shopping preferences and practices, including the increasing shift to digital brand engagement, social media communication, and online shopping;
- developing innovative, high-quality products in sizes, colors, and styles that appeal to customers of varying age groups and tastes;
- purchasing and stocking merchandise to match seasonal weather patterns, and our ability to react to shifts in weather that impact consumer demand;
- sourcing and allocating merchandise efficiently; and
- improving the effectiveness and efficiency of our processes in order to deliver cost savings to fund growth.

If we or our franchisees are not able to compete successfully in the United States or internationally, our results of operations would be adversely affected.

We must maintain our reputation and brand image.
Our brands have wide recognition, and our success has been due in large part to our ability to maintain, enhance and protect our brand image and reputation and our customers’ connection to our brands. Our continued success depends in part on our ability to adapt to a rapidly changing media environment, including our increasing reliance on social media and online dissemination of advertising campaigns. Even if we react appropriately to negative posts or comments about us and/or our brands on social media and online, our customers’ perception of our brand image and our reputation could be negatively impacted. In addition, customer sentiment could be shaped by our sustainability policies and related design, sourcing and operations decisions. Failure to maintain, enhance and protect our brand image could have a material adverse effect on our results of operations.

7

The failure to attract and retain key personnel, or effectively manage succession, could have an adverse impact on our results of operations.

Our ability to anticipate and effectively respond to changing apparel trends depends in part on our ability to attract and retain key personnel in our design, merchandising, sourcing, marketing, and other functions. In addition, several of our strategic initiatives, including our technology initiatives and supply chain initiatives, require that we hire and/or develop employees with appropriate experience. Competition for talent is intense, and we cannot be sure that we will be able to attract and retain a sufficient number of qualified personnel in future periods. If we are unable to retain, attract, and motivate talented employees with the appropriate skill sets, or if changes to our organizational structure, operating results, or business model adversely affect morale or retention, we may not achieve our objectives and our results of operations could be adversely impacted. In addition, the loss of one or more of our key personnel or the inability to effectively identify a suitable successor to a key role could have a material adverse effect on our business. In fiscal 2018, there were changes to our management team, including our new President and Chief Executive Officer of Gap brand. The effectiveness of new leaders in these roles, and any further transition as a result of these changes, could have a significant impact on our results of operations.

Our investments in customer, digital, and omni-channel shopping initiatives may not deliver the results we anticipate.

One of our strategic priorities is to further develop an omni-channel shopping experience for our customers through the integration of our store and digital shopping channels. Our omni-channel initiatives include cross-channel logistics optimization and exploring additional ways to develop an omni-channel shopping experience, including further digital integration and customer personalization. These initiatives involve significant investments in IT systems and significant operational changes. In addition, our competitors are also investing in omni-channel initiatives, some of which may be more successful than our initiatives. If the implementation of our customer, digital, and omni-channel initiatives is not successful, or we do not realize the return on our investments in these initiatives that we anticipate, our operating results would be adversely affected.

If we are unable to manage our inventory effectively, our gross margins could be adversely affected.

Fluctuations in the global apparel retail markets impact the levels of inventory owned by apparel retailers. The nature of the global apparel retail business requires us to carry a significant amount of inventory, especially prior to the peak holiday selling season when we build up our inventory levels. Merchandise usually must be ordered well in advance of the season and frequently before apparel trends are confirmed by customer purchases. We must enter into contracts for the purchase and manufacture of merchandise well in advance of the applicable selling season. As a result, we are vulnerable to demand and pricing shifts and to suboptimal selection and timing of merchandise purchases. In the past, we have not always predicted our customers' preferences and acceptance levels of our trend items with accuracy. If sales do not meet expectations, too much inventory may cause excessive markdowns and, therefore, lower-than-planned margins.

We have key strategic initiatives designed to optimize our inventory levels and increase the efficiency and responsiveness of our supply chain, including vendor fabric platforming, product demand testing, and in-season rapid response to demand. These initiatives involve significant systems and operational changes, and we have limited experience operating in this manner. If we are unable to implement these initiatives successfully, we may not realize the return on our investments that we anticipate, and our operating results could be adversely affected.

We are subject to data and security risks, which could have an adverse effect on our results of operations and consumer confidence in our security measures.
As part of our normal operations, we receive and maintain confidential, proprietary, and personally identifiable information, including credit card information, and information about our customers, our employees, job applicants, and other third parties. Our business employs systems and websites that allow for the secure storage and transmission of this information. However, despite our safeguards and security processes and protections, security breaches could expose us to a risk of loss or misuse of this information, litigation, and potential liability. The retail industry, in particular, has been the target of many recent cyber-attacks. We may not have the resources to anticipate or prevent rapidly evolving types of cyber-attacks. Attacks may be targeted at us, our vendors or customers, or others who have entrusted us with information. In addition, even if we take appropriate measures to safeguard our information security and privacy environment from security breaches, we could still expose our customers and our business to risk. Actual or anticipated attacks may disrupt or impair our technology capabilities, and may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third-party experts and consultants. Advances in computer capabilities, new technological discoveries, or other developments may result in the technology used by us to protect transaction or other data being breached or compromised. Measures we implement to protect against cyber attacks may also have the potential to impact our customers' shopping experience or decrease activity on our websites by making them more difficult to use. Data and security breaches can also occur as a result of non-technical issues, including intentional or inadvertent breach by our employees or by persons with whom we have commercial relationships that result in the unauthorized release of personal or confidential information. In addition, the global regulatory environment surrounding information security, cybersecurity, and privacy is increasingly demanding, with new laws, such as the European Union's General Data Protection Regulation (GDPR) and the California Consumer Privacy Act, which give customers the right to control how their personal information is collected, used and retained. Violating these rights, or failing to secure personal information could result in a violation of applicable privacy and other laws, significant legal and financial exposure, and a loss of consumer confidence in our security measures, which could have an adverse effect on our results of operations and our reputation.

Failures of, or updates or changes to, our IT systems may disrupt operations.
We maintain a complex network of legacy systems. We require continual maintenance, upgrades and changes, some of which are significant. Upgrades involve replacing existing systems with successor systems, making changes to existing systems, or cost-effectively acquiring new systems with new functionality. We are aware of inherent risks associated with maintaining and replacing these systems, including accurately capturing data and addressing system disruptions and believe we are taking appropriate action to mitigate the risks through testing, training, and staging implementation, as well as ensuring appropriate commercial contracts are in place with third-party vendors supplying or supporting our IT initiatives. However, there can be no assurances that we will successfully maintain or launch these systems as planned or that they will be implemented without disruptions to our operations. IT system disruptions or failures, if not anticipated and appropriately mitigated, or failure to successfully implement new or upgraded systems, could have a material adverse effect on our results of operations.

Our business is subject to risks associated with global sourcing and manufacturing.
Independent third parties manufacture all of our products for us. As a result, we are directly impacted by increases in the cost of those products.
If we experience significant increases in demand or need to replace an existing vendor, there can be no assurance that additional manufacturing capacity will be available when required on terms that are acceptable to us or that any vendor would allocate sufficient capacity to us in order to meet our requirements. In addition, for any new manufacturing source, we may encounter delays in production and added costs as a result of the time it takes to train our vendors in our methods, products, quality control standards, and environmental, labor, health, and safety standards. Moreover, in the event of a significant disruption in the supply of the fabrics or raw materials used by our vendors in the manufacture of our products, our vendors might not be able to locate alternative suppliers of materials of comparable quality at an acceptable price. Any delays, interruption, or increased costs in the manufacture of our products could result in lower sales and net income. In addition, certain countries represent a larger portion of our global sourcing. For example, approximately 28 percent and 21 percent of our merchandise, by dollar value, is purchased from factories in Vietnam and China, respectively. Accordingly, any delays in production and added costs in Vietnam or China could have a more significant impact on our results of operations.
Because independent vendors manufacture virtually all of our products outside of our principal sales markets, third parties must transport our products over large geographic distances. Delays in the shipment or delivery of our products due to the availability of transportation, work stoppages, port strikes, infrastructure congestion, or other factors, and costs and delays associated with transitioning between vendors, could adversely impact our financial performance. Operating or manufacturing delays, transportation delays, or unexpected demand for our products may require us to use faster, but more expensive, transportation methods such as aircraft, which could adversely affect our gross margins. In addition, the cost of fuel is a significant component of transportation costs, so increases in the price of petroleum products can adversely affect our gross margins.

Global economic conditions and any related impact on consumer spending patterns could adversely impact our results of operations.
The Company’s performance is subject to global economic conditions, as well as their impact on levels of consumer spending worldwide. Some of the factors that may influence consumer spending include high levels of unemployment, higher consumer debt levels, reductions in net worth based on market declines and uncertainty, home foreclosures and reductions in home values, fluctuating interest and foreign currency rates and credit availability, government austerity measures, fluctuating fuel and other energy costs, fluctuating commodity prices, and general uncertainty regarding the overall future economic environment. Consumer purchases of discretionary items, including our merchandise, generally decline during periods when disposable income is adversely affected or there is economic uncertainty. Adverse economic changes in any of the regions in which we and our franchisees sell our products could reduce consumer confidence, and thereby could negatively affect earnings and have a material adverse effect on our results of operations. In challenging and uncertain economic environments, we cannot predict whether or when such circumstances may improve or worsen, or what impact, if any, such circumstances could have on our business, results of operations, cash flows, and financial position.

Our efforts to expand internationally may not be successful.
Our current strategies include pursuing selective international expansion in a number of countries around the world through a number of channels. This includes our franchisees opening additional stores internationally. We have limited experience operating or franchising in some of these locations. In many of these locations, we face major, established competitors. In addition, in many of these locations, the real estate, employment and labor, transportation and logistics, regulatory, and other operating requirements differ dramatically from those in the places where we have more experience. Consumer tastes and trends may differ in many of these locations and, as a result, the sales of our products may not be successful or result in the margins we anticipate. If our international expansion plans are unsuccessful or do not deliver an appropriate return on our investments, our operations and financial results could be materially, adversely affected.

Risks associated with importing merchandise from foreign countries, including failure of our vendors to adhere to our Code of Vendor Conduct, could harm our business.
We purchase nearly all merchandise from third-party vendors in many different countries, and we require those vendors to adhere to a Code of Vendor Conduct, which includes environmental, labor, health, and safety standards. From time to time, contractors or their subcontractors may not be in compliance with these standards or applicable local laws. Although we have implemented policies and procedures to facilitate our compliance with laws and regulations relating to doing business in foreign markets and importing merchandise into various countries, there can be no assurance that suppliers and other third parties with whom we do business will not violate such laws and regulations or our policies. Significant or continuing noncompliance with such standards and laws by one or more vendors could have a negative impact on our reputation, could subject us to liability, and could have an adverse effect on our results of operations.

Our franchise business is subject to certain risks not directly within our control that could impair the value of our brands.
We enter into franchise agreements with unaffiliated franchisees to operate stores and, in limited circumstances, websites, in many countries around the world. Under these agreements, third parties operate, or will operate, stores and websites that sell apparel and related products under our brand names. The effect of these arrangements on our business and results of operations is uncertain and will depend upon various factors, including the demand for our products in new markets internationally and our ability to successfully identify appropriate third parties to act as franchisees, distributors, or in a similar capacity. In addition, certain aspects of these arrangements are not directly within our control, such as franchisee financial stability and the ability of these third parties to meet their projections regarding store locations, store openings, and sales. Other risks that may affect these third parties include general economic conditions in specific countries or markets, foreign exchange rates, changes in diplomatic and trade relationships, restrictions on the transfer of funds, and political instability. Moreover, while the agreements we have entered into and plan to enter into in the future provide us with certain termination rights, the value of our brands could be impaired to the extent that these third parties do not operate their stores in a manner consistent with our requirements regarding our brand identities and customer experience standards. Failure to protect the value of our brands, or any other harmful acts or omissions by a franchisee, could have an adverse effect on our results of operations and our reputation.

The market for prime real estate is competitive.
Our ability to effectively obtain real estate - to open new stores, distribution centers, and corporate offices nationally and internationally - depends on the availability of real estate that meets our criteria for traffic, square footage, co-tenancies, lease economics, demographics, and other factors. We also must be able to effectively renew our existing store leases. In addition, we may seek to downsize, consolidate, reposition, relocate, or close some of our real estate locations, which in most cases requires a modification of an existing store lease. Failure to secure adequate new locations, successfully modify or exit existing locations, or failure to effectively manage the profitability of our existing fleet of stores, could have a material adverse effect on our results of operations.
Additionally, the economic environment may at times make it difficult to determine the fair market rent of real estate properties within the United States and internationally. This could impact the quality of our decisions to exercise lease options at previously negotiated rents and the quality of our decisions to renew expiring leases at negotiated rents. Any adverse effect on the quality of these decisions could impact our ability to retain real estate locations adequate to meet our targets or efficiently manage the profitability of our existing fleet of stores and could have a material adverse effect on our financial condition or results of operations.

Our business is exposed to the risks of foreign currency exchange rate fluctuations and our hedging strategies may not be effective in mitigating those risks.
We are exposed to foreign currency exchange rate risk with respect to our sales, operating expenses, profits, assets, and liabilities generated or incurred in foreign currencies as well as inventory purchases in U.S. dollars for our foreign subsidiaries. Although we use financial instruments to hedge certain foreign currency risks, these measures may not succeed in fully offsetting the negative impact of foreign currency rate movements and generally only delay the impact of adverse foreign currency rate movements on our business and financial results.

We experience fluctuations in our comparable sales and margins.
Our success depends in part on our ability to improve sales, in particular at our largest brands. A variety of factors affect comparable sales or margins, including but not limited to apparel trends, competition, current economic conditions, the timing of new merchandise releases and promotional events, changes in our merchandise mix, the success of marketing programs, foreign currency fluctuations, industry traffic trends, and weather conditions. These factors may cause our comparable sales results and margins to differ materially from prior periods and from expectations. Our comparable sales, including the associated comparable online sales, have fluctuated significantly in the past on an annual and quarterly basis. Over the past fiscal year, our reported quarterly comparable sales have ranged from a high of positive 2 percent in the second quarter of fiscal 2018 to a low of negative 1 percent in the fourth quarter of fiscal 2018. Over the past five years, our reported gross margins have ranged from a high of 38.3 percent in fiscal 2017 and fiscal 2014 to a low of 36.2 percent in fiscal 2015. In addition, over the past five years, our reported operating margins have ranged from a high of 12.7 percent in fiscal 2014 to a low of 7.7 percent in fiscal 2016.
Our ability to deliver strong comparable sales results and margins depends in large part on accurately forecasting demand and apparel trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our broad and diverse customer base, managing inventory effectively, using effective pricing strategies, and optimizing store performance. Failure to meet the expectations of investors, securities analysts, or credit rating agencies in one or more future periods could reduce the market price of our common stock, cause our credit ratings to decline, and impact liquidity.

Changes in our credit profile or deterioration in market conditions may limit our access to the capital markets and adversely impact our financial position or our business initiatives.
In April 2011, we issued $1.25 billion aggregate principal amount of 5.95 percent notes due April 2021. As a result, we have additional costs that include interest payable semi-annually on the notes.
Our cash flows from operations are the primary source of funds for these debt service payments. In this regard, we have generated annual cash flow from operating activities in excess of $1 billion per year for well over a decade and ended fiscal 2018 with $1.1 billion of cash and cash equivalents on our balance sheet. We are also able to supplement near-term liquidity, if necessary, with our $500 million revolving credit facility. We continue to target a cash balance between $1.0 billion to $1.2 billion, which provides not only for our working capital needs, but also a reserve for unexpected business downturns. However, if our cash flows from operating activities decline significantly, we may be required to reprioritize our business initiatives to ensure that we can continue to service or refinance our debt with favorable rates and terms. In addition, any future reduction in our long-term senior unsecured credit ratings could result in reduced access to the credit and capital markets and higher interest costs and potentially increased lease or hedging costs.

In May 2016, Fitch Ratings and Standard & Poor's Rating Services downgraded their respective credit ratings of us from BBB- negative outlook to BB+ stable outlook. These downgrades, and any future reduction in our long-term senior unsecured credit ratings, could result in reduced access to the credit and capital markets, more restrictive covenants in future financial documents and higher interest costs, and potentially increased lease or hedging costs.
For further information on our debt and credit facilities, see Item 8, Financial Statements and Supplementary Data, Notes 4 and 5 of Notes to Consolidated Financial Statements of this Form 10-K.

Trade matters may disrupt our supply chain.
Trade restrictions, including increased tariffs or quotas, embargoes, safeguards, and customs restrictions against apparel items, as well as U.S. or foreign labor strikes, work stoppages, or boycotts, could increase the cost or reduce the supply of apparel available to us and adversely affect our business, financial condition, and results of operations. We cannot predict whether any of the countries in which our merchandise currently is manufactured or may be manufactured in the future will be subject to additional trade restrictions imposed by the United States or other foreign governments, including the likelihood, type, or effect of any such restrictions. For example, the current political landscape has introduced greater uncertainty with respect to future tax and trade regulations. In addition, we face the possibility of anti-dumping or countervailing duties lawsuits from U.S. domestic producers. We are unable to determine the impact of the changes to the quota system or the impact that potential tariff lawsuits could have on our global sourcing operations. Our sourcing operations may be adversely affected by trade limits or political and financial instability, resulting in the disruption of trade from exporting countries, significant fluctuation in the value of the U.S. dollar against foreign currencies, restrictions on the transfer of funds, and/or other trade disruptions. Changes in tax policy or trade regulations, such as the imposition of new tariffs on imported products, could have a material adverse effect on our business and results of operations.

Changes in the regulatory or administrative landscape could adversely affect our financial condition and results of operations.
Laws and regulations at the local, state, federal, and international levels frequently change, and the ultimate cost of compliance cannot be precisely estimated. In addition, we cannot predict the impact that may result from changes in the regulatory or administrative landscape.
Any changes in laws or regulations, the imposition of additional laws or regulations, or the enactment of any new or more stringent legislation that impacts employment and labor, trade, product safety, transportation and logistics, health care, tax, privacy, operations, or environmental issues, among others, could have an adverse impact on our financial condition and results of operations.

Our results could be adversely affected by natural disasters, public health crises, political crises, negative global climate patterns, or other catastrophic events.
Natural disasters, such as hurricanes, tornadoes, floods, earthquakes, and other adverse weather conditions; unforeseen public health crises, such as pandemics and epidemics; political crises, such as terrorist attacks, war, labor unrest, and other political instability; negative global climate patterns, especially in water stressed regions; or other catastrophic events, such as fires or other disasters occurring at our distribution centers or our vendors' manufacturing facilities, whether occurring in the United States or internationally, could disrupt our operations, including the operations of our franchisees, or the operations of one or more of our vendors. In particular, these types of events could impact our supply chain from or to the impacted region and could impact our ability or the ability of our franchisees or other third parties to operate our stores or websites. In addition, these types of events could negatively impact consumer spending in the impacted regions or, depending upon the severity, globally. Disasters occurring at our vendors’ manufacturing facilities could impact our reputation and our customers’ perception of our brands. To the extent any of these events occur, our operations and financial results could be adversely affected.

Reductions in income and cash flow from our credit card arrangement related to our private label and co-branded credit cards could adversely affect our operating results and cash flows.
A third-party, Synchrony Financial (“Synchrony”), owns and services our private label credit card and co-branded programs. Our agreement with Synchrony provides for certain payments to be made by Synchrony to us, including a share of revenues from the performance of the credit card portfolios. The income and cash flow that we receive from Synchrony is dependent upon a number of factors, including the level of sales on private label and co-branded accounts, the level of balances carried on the accounts, payment rates on the accounts, finance charge rates and other fees on the accounts, the level of credit losses for the accounts, Synchrony’s ability to extend credit to our customers as well as the cost of customer rewards programs. All of these factors can vary based on changes in federal and state credit card, banking, and commercial protection laws. The factors affecting the income and cash flow that the Company receives from Synchrony can also vary based on a variety of economic, legal, social, and other factors that we cannot control. If the income and cash flow that we receive from our consumer credit card program agreement with Synchrony decreases significantly, our operating results and cash flows could be adversely affected.

We are subject to various proceedings, lawsuits, disputes, and claims from time to time, which could adversely affect our business, financial condition, and results of operations.
As a multinational company, we are subject to various proceedings, lawsuits, disputes, and claims (“Actions”) arising in the ordinary course of our business. Many of these Actions raise complex factual and legal issues and are subject to uncertainties. Actions filed against us from time to time include commercial, intellectual property, customer, employment, and data privacy claims, including class action lawsuits. The plaintiffs in some Actions seek unspecified damages or injunctive relief, or both. Actions are in various procedural stages and some are covered in part by insurance. We cannot predict with assurance the outcome of Actions brought against us. Accordingly, developments, settlements, or resolutions may occur and impact income in the quarter of such development, settlement, or resolution. An unfavorable outcome could have an adverse impact on our business, financial condition and results of operations.
Item 1B. Unresolved Staff Comments.
None.
Item 2. Properties.
We have Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, Italy, China, Hong Kong, Taiwan, and Mexico. As of February 2, 2019, we had 3,194 Company-operated stores, which aggregated to approximately 36.7 million square feet. Almost all of these stores are leased, typically with one or more renewal options after our initial term. Terms vary by type and location of store.

We own approximately 1.1 million square feet of corporate office space located in San Francisco, San Bruno, Pleasanton, and Rocklin, California, of which approximately 184,000 square feet is leased to and occupied by others. We lease approximately 0.9 million square feet of corporate office space located in San Francisco, Rocklin, and Petaluma, California; New York and Brooklyn, New York; Albuquerque, New Mexico; and Toronto, Ontario, Canada. Of the 0.9 million square feet of leased corporate office space, approximately 40,000 square feet is subleased to and occupied by others. We also lease regional offices in North America and in various international locations. We own approximately 8.9 million square feet of distribution space located in Fresno, California; Fishkill, New York; Groveport, Ohio; Gallatin, Tennessee; Brampton, Ontario, Canada; and Rugby, England. Of the 8.9 million square feet of owned distribution space, approximately 117,000 square feet is leased to and occupied by others. We lease approximately 1.2 million square feet of distribution space located in Shanghai, China, Phoenix, Arizona; and Erlanger and Hebron, Kentucky. Third-party logistics companies provide logistics services to us through distribution warehouses in Chiba, Japan; and Shanghai and Hong Kong, China.

Item 3. Legal Proceedings.

We do not believe that the outcome of any current Action would have a material effect on our Consolidated Financial Statements.

Item 4. Mine Safety Disclosures.

Not applicable.

Part II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The principal market on which our stock is traded is the New York Stock Exchange under the symbol "GPS". Our website is www.gapinc.com. The number of holders of record of our stock as of March 13, 2019 was 6,133. The table below sets forth the dividends declared and paid for each of the fiscal quarters in fiscal 2018 and 2017.

	Dividends Declared and Paid Fiscal Year	
	2018	2017
1st Quarter	$0.2425	$0.23
2nd Quarter	0.2425	0.23
3rd Quarter	0.2425	0.23
4th Quarter	0.2425	0.23
	$0.97	$0.92

Stock Performance Graph

The graph below compares the percentage changes in our cumulative total stockholder return on our common stock for the five-year period ended February 2, 2019, with (i) the S&P 500 Index and (ii) the cumulative total return of the Dow Jones U.S. Retail Apparel Index. The total stockholder return for our common stock assumes quarterly reinvestment of dividends.

TOTAL RETURN TO STOCKHOLDERS
(Assumes $100 investment on 2/1/2014)
Total Return Analysis

	2/1/2014	1/31/2015	1/20/2016	1/28/2017	2/3/2018	2/2/2019
The Gap, Inc.	$ 100.00	$ 110.49	$ 68.20	$ 64.78	$ 95.32	$ 76.83
S&P 500	$ 100.00	$ 114.22	$ 113.46	$ 136.20	$ 172.17	$ 168.19
Dow Jones U.S. Apparel Retailers	$ 100.00	$ 121.10	$ 119.54	$ 117.82	$ 134.11	$ 145.75

Source: Research Data Group, Inc. (415) 643-6000 (www.researchdatagroup.com)

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table presents information with respect to purchases of common stock of the Company made during the fourteen weeks ended February 2, 2019 by The Gap, Inc. or any affiliated purchaser, as defined in Exchange Act Rule 10b-18(a)(3):

	Total Number of Shares Purchased (1)	Average Price Paid Per Share Including Commissions	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate dollar amount) of Shares that May Yet be Purchased Under the Plans or Programs (2)
Month #1 (November 4 - December 1)	537,024	$ 26.61	537,024	$371 million
Month #2 (December 2 - January 5)	1,931,440	$ 26.28	1,931,440	$320 million
Month #3 (January 6 - February 2)	1,298,418	$ 25.46	1,298,418	$287 million
Total	3,766,882	$ 26.04	3,766,882	

____

(1) Excludes shares withheld to settle employee statutory tax withholding related to the vesting of stock units.

(2) On February 25, 2016, we announced that the Board of Directors approved a $1 billion share repurchase authorization (the "February 2016 repurchase program"), which had no expiration date. On February 26, 2019, we announced that the Board of Directors approved a $1 billion share repurchase authorization (the "February 2019 repurchase program"), which supersedes the February 2016 repurchase program and has no expiration date.

Item 6. Selected Financial Data.

The following selected financial data are derived from the Consolidated Financial Statements of the Company. We have also included certain non-financial data to enhance your understanding of our business. The data set forth below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 and the Company’s Consolidated Financial Statements and related notes in Item 8 of this Form 10-K.

	Fiscal Year (number of weeks)				
	2018 (52) (b)	2017 (53) (c)	2016 (52)	2015 (52)	2014 (52)
Operating Results ($ in millions)					
Net sales	$16,580	$15,855	$15,516	$15,797	$16,435
Gross margin	38.1 %	38.3 %	36.3 %	36.2 %	38.3 %
Operating margin	8.2 %	9.3 %	7.7 %	9.6 %	12.7 %
Effective Tax Rate	24.1 %	40.4 %	39.9 %	37.5 %	37.3 %
Net income	$1,003	$848	$676	$920	$1,262
Cash dividends paid	$373	$361	$367	$377	$383
Per Share Data (number of shares in millions)					
Basic earnings per share	$2.61	$2.16	$1.69	$2.24	$2.90
Diluted earnings per share	$2.59	$2.14	$1.69	$2.23	$2.87
Weighted-average number of shares—basic	385	393	399	411	435
Weighted-average number of shares—diluted	388	396	400	413	440
Cash dividends declared and paid per share	$0.97	$0.92	$0.92	$0.92	$0.88
Balance Sheet Information ($ in millions)					
Merchandise inventory	$2,131	$1,997	$1,830	$1,873	$1,889
Total assets	$8,049	$7,989	$7,610	$7,473	$7,690
Working capital (a)	$2,077	$2,107	$1,862	$1,450	$2,083
Total long-term debt, less current maturities	$1,249	$1,249	$1,248	$1,310	$1,332
Stockholders’ equity	$3,553	$3,144	$2,904	$2,545	$2,983
Other Data ($ and square footage in millions)					
Cash used for purchases of property and equipment	$705	$731	$524	$726	$714
Percentage increase (decrease) in comparable sales	— %	3 %	(2)%	(4)%	— %
Number of Company-operated store locations open at year-end	3,194	3,165	3,200	3,275	3,280
Number of franchise store locations open at year-end	472	429	459	446	429
Number of total store locations open at year-end	3,666	3,594	3,659	3,721	3,709
Square footage of Company-operated store space at year-end	36.7	36.4	36.7	37.9	38.1
Percentage increase (decrease) in square footage of Company-operated store space at year-end	0.8 %	(0.8)%	(3.2)%	(0.5)%	2.4 %
Number of employees at year-end	135,000	135,000	135,000	141,000	141,000

(a) In fiscal year 2015, we adopted the Financial Accounting Standards Board, Accounting Standard Update No. 2015-17, Income Taxes. The adoption reduced the current portion of deferred tax assets as a result of classifying all net deferred tax assets as noncurrent as of January 30, 2016 on a prospective basis.

(b) Net sales for fiscal 2018 reflect the adoption of the new revenue recognition standard. Prior period amounts have not been restated and continue to be reported under accounting standards in effect for those periods. In fiscal year 2018, the effective tax rate reflects the benefits of the enactment of the Tax Cuts and Jobs Act on December 22, 2018.

(c) In fiscal year 2017, the Company recognized a net provisional tax impact of approximately $34 million, which represents the provisional tax impact of federal tax reform of $57 million, net of a related $23 million benefit related to legal entity structuring that was also impacted by tax reform. Fiscal 2017 results also include incremental sales attributable to the 53rd week.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are a global retailer offering apparel, accessories, and personal care products for men, women, and children under the Old Navy, Gap, Banana Republic, Athleta, Intermix, and Hill City brands. We have Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, Italy, China, Hong Kong, Taiwan, and Mexico. We have franchise agreements with unaffiliated franchisees to operate Old Navy, Gap, and Banana Republic stores throughout Asia, Europe, Latin America, the Middle East, and Africa. Under these agreements, third parties operate, or will operate, stores that sell apparel and related products under our brand names. Our products are also available to customers online through Company-owned websites and through the use of third parties that provide logistics and fulfillment services. In addition to operating in the specialty, outlet, online, and franchise channels, we also use our omni-channel capabilities to bridge the digital world and physical stores to further enhance our shopping experience for our customers. Our omni-channel services, including order-in-store, reserve-in-store, find-in-store, and ship-from-store, as well as enhanced mobile experiences, are tailored uniquely across our portfolio of brands. Most of the products sold under our brand names are designed by us and manufactured by independent sources. We also sell products that are designed and manufactured by branded third parties, primarily at our Intermix brand.

We identify our operating segments according to how our business activities are managed and evaluated. As of February 2, 2019, our operating segments included Old Navy Global, Gap Global, Banana Republic Global, Athleta, and Intermix. We have determined that each of our operating segments share similar economic and other qualitative characteristics, and therefore the results of our operating segments are aggregated into one reportable segment.

On February 28, 2019, the Company announced plans to restructure the specialty fleet and revitalize the Gap brand, including closing about 230 Gap specialty stores during fiscal 2019 and fiscal 2020. The Company believes these actions will drive a healthier specialty fleet and will serve as a more appropriate foundation for brand revitalization. During the two-year period, the Company estimates pre-tax costs associated with these closure actions to be about $250 million to $300 million, with the majority expected to be cash expenditures for lease-related costs. The remaining charges are expected to primarily include employee-related costs and the net impact of write-offs related to long-term assets and liabilities. The Company estimates an annualized sales loss of approximately $625 million as a result of these store closures, with resulting annualized pre-tax savings of about $90 million.

On February 28, 2019, the Company also announced that its Board of Directors approved a plan to separate the Company into two independent publicly-traded companies: Old Navy and a yet-to-be-named company (“NewCo”), which will consist of Gap brand, Athleta, Banana Republic, Intermix, and Hill City. The separation is intended to enable both companies to capitalize on their respective opportunities and act decisively in an evolving retail environment by creating distinct financial profiles, tailored operating priorities and unique capital allocation strategies. Both companies will be positioned to create value for customers, shareholders and employees with enhanced focus and flexibility, aligned investments and incentives to meet the unique strategic goals, and optimized cost structures to deliver growth. The transaction is targeted to be completed in 2020 and is subject to certain conditions, including final approval by the Company’s Board of Directors, receipt of a tax opinion from counsel, and the filing and effectiveness of a registration statement with the U.S. Securities and Exchange Commission.

During the first quarter of fiscal 2018, the Company adopted the new revenue recognition standard, Accounting Standards Codification ("ASC") 606, using the modified retrospective transition method and recorded an increase to opening retained earnings of $36 million, net of tax. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The adoption of this standard had a significant impact on the presentation of certain line items within the Consolidated Statements of Income, but did not have a material impact to operating income, net income or earnings per share for fiscal year 2018. The presentation changes primarily consist of $443 million for the fiscal year ended February 2, 2019 for revenue sharing associated with our credit card programs and breakage revenue for gift cards and credit vouchers, which now is recorded as net sales and previously was recorded as a reduction to operating expenses in our Consolidated Statements of Income; and $176 million for the fiscal year ended February 2, 2019, for reimbursements of loyalty program discounts associated with our credit card programs, which now is recorded as net sales and previously was recorded as a reduction to cost of goods sold and occupancy expenses in our Consolidated Statements of Income. See Note 1 of Notes to Consolidated Financial Statements for additional disclosures about the adoption of the new revenue standard.

On August 29, 2016, a fire occurred in one of the buildings at a Company-owned distribution center campus in Fishkill, New York ("the Fishkill fire"). In January 2018, we agreed upon a final settlement with our insurers and all insurance proceeds were received as of February 3, 2018.

Fiscal 2018 and 2016 consisted of 52 weeks versus 53 weeks in fiscal 2017. Net sales and operating results, as well as other metrics derived from the Consolidated Statement of Income, include the impact of the additional week; however, the comparable sales calculation excludes the 53rd week.

Financial results for fiscal 2018 are as follows:

- Net sales for fiscal 2018 increased 5 percent to $16.6 billion compared with $15.9 billion for fiscal 2017.
- Comparable sales for fiscal 2018 were flat.
- Gross profit for fiscal 2018 was $6.3 billion compared with $6.1 billion for fiscal 2017. Gross margin for fiscal 2018 was 38.1 percent compared with 38.3 percent for fiscal 2017.
- Operating margin for fiscal 2018 was 8.2 percent compared with 9.3 percent for fiscal 2017.
- Effective tax rate for fiscal 2018 was 24.1 percent compared with 40.4 percent for fiscal 2017.
- Net income for fiscal 2018 was $1,003 million compared with $848 million for fiscal 2017, and diluted earnings per share was $2.59 for fiscal 2018 compared with $2.14 for fiscal 2017. Diluted earnings per share for fiscal 2017 included about a $0.10 benefit from the gain from insurance proceeds related to the Fishkill fire and an unfavorable net provisional tax impact of federal tax reform of about $0.09.
- During fiscal 2018, we paid dividends of $373 million compared with $361 million during fiscal 2017.
- During fiscal 2018, share repurchases were $398 million compared with $315 million for fiscal 2017.

Our business priorities in fiscal 2019 are as follows:

- offering product that is consistently brand-appropriate and on-trend with high customer acceptance, with a focus on expanding our advantage in core businesses and loyalty categories; and leading customer-focused product innovation;
- preparing for successful separation;
- restructuring the Gap brand specialty fleet globally to create a healthier, more profitable base from which to grow;
- investing in digital and customer capabilities as well as store experience to create a unique and differentiated converged retail experience that attracts new customers, retains existing customers, and builds loyalty;
- increasing productivity by leveraging our scale and streamlining operations and processes throughout the organization;
- attracting and retaining strong talent in our businesses and functions; and

- continuing to integrate social and environmental sustainability into business practices to support long term growth.

In fiscal 2019, while we work through the plan for separation, we are focused on investing strategically in the business while maintaining operating expense discipline and driving efficiency through our productivity initiative. One of our primary objectives is to continue transforming our product to market process, with the development of a more efficient operating model. Furthermore, we expect to continue our investment in customer experience, both in stores and online, to drive higher customer engagement and loyalty across all of our brands and channels, resulting in market share gains. Finally, we will continue to invest in strengthening brand awareness, customer acquisition, and digital capabilities. Underpinning these strategies is a focus on utilizing data, analytics, and technology to respond faster while making decisions that will fuel market share gains and lead to a more nimble organization.

Results of Operations

Net Sales

See Item 8, Financial Statements and Supplementary Data, Note 16 of Notes to Consolidated Financial Statements for net sales by brand and region.

Comparable Sales ("Comp Sales")

Fiscal 2018 consisted of 52 weeks versus 53 weeks in fiscal 2017. Due to the 53rd week in fiscal 2017, in order to maintain consistency, comparable ("Comp") sales for the fifty-two weeks ended February 2, 2019, are compared to the fifty-two weeks ended February 3, 2018.

The percentage change in Comp Sales by global brand and for total Company, as compared with the preceding year, is as follows:

	Fiscal Year		
	2018	2017	2016
Old Navy Global	3 %	6 %	1 %
Gap Global	(5)%	(1)%	(3)%
Banana Republic Global	1 %	(2)%	(7)%
The Gap, Inc.	—%	3 %	(2)%

Comp Sales include merchandise sales in Company-operated stores and merchandise sales through online channels in those countries where we have existing comparable store sales. The calculation of The Gap, Inc. Comp Sales includes the results of Athleta and Intermix but excludes the results of our franchise business.

A store is included in the Comp Sales calculations when it has been open and operated by the Company for at least one year and the selling square footage has not changed by 15 percent or more within the past year. A store is included in the Comp Sales calculations on the first day it has comparable prior year sales. Stores in which the selling square footage has changed by 15 percent or more as a result of a remodel, expansion, or reduction are excluded from the Comp Sales calculations until the first day they have comparable prior year sales.

A store is considered non-comparable (“Non-comp”) when it has been open and operated by the Company for less than one year or has changed its selling square footage by 15 percent or more within the past year.

A store is considered “Closed” if it is temporarily closed for three or more full consecutive days or it is permanently closed. When a temporarily closed store reopens, the store will be placed in the Comp/Non-comp status it was in prior to its closure. If a store was in Closed status for three or more days in the prior year, the store will be in Non-comp status for the same days the following year.

Current year foreign exchange rates are applied to both current year and prior year Comp Sales to achieve a consistent basis for comparison.

Store Count and Square Footage Information

Net sales per average square foot is as follows:

	Fiscal Year		
	2018 (2)	2017 (3)	2016
Net sales per average square foot (1)	$341	$340	$334

____

(1) Excludes net sales associated with our online and franchise businesses. Online sales includes both sales through our online channels as well as ship-from-store sales.

(2) Reflects the adoption of ASC 606. Prior period amounts have not been restated and continue to be reported under accounting standards in effect for those periods.

(3) Fiscal 2017 includes incremental sales attributable to the 53rd week.

Store count, openings, closings, and square footage for our stores are as follows:

	February 3, 2018	Fiscal 2018		February 2, 2019	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Old Navy North America	1,066	79	6	1,139	18.6
Old Navy Asia	14	1	—	15	0.2
Gap North America	810	14	66	758	7.9
Gap Asia	313	34	15	332	3.1
Gap Europe	155	9	12	152	1.2
Banana Republic North America	576	9	29	556	4.7
Banana Republic Asia	45	3	3	45	0.2
Athleta North America	148	14	1	161	0.7
Intermix North America	38	—	2	36	0.1
Company-operated stores total	3,165	163	134	3,194	36.7
Franchise	429	90	47	472	N/A
Total	3,594	253	181	3,666	36.7
Increase over prior year				2.0 %	0.8 %

	January 28, 2017	Fiscal 2017		February 3, 2018	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Old Navy North America	1,043	32	9	1,066	17.7
Old Navy Asia	13	1	—	14	0.2
Gap North America	844	8	42	810	8.4
Gap Asia	311	52	50	313	3.0
Gap Europe	164	3	12	155	1.3
Banana Republic North America	601	5	30	576	4.9
Banana Republic Asia	48	1	4	45	0.2
Banana Republic Europe	1	—	1	—	—
Athleta North America	132	16	—	148	0.6
Intermix North America	43	—	5	38	0.1
Company-operated stores total	3,200	118	153	3,165	36.4
Franchise	459	34	64	429	N/A

Total	3,659	152	217	3,594	36.4
Decrease over prior year				(1.8)%	(0.8)%

Gap and Banana Republic outlet and factory stores are reflected respectively within each brand.

24

In fiscal 2019, we expect to open about 140 and close about 190 Company-operated store locations. Openings will be primarily focused on Old Navy and Athleta. Closures are primarily driven by the specialty fleet restructuring.

Net Sales Discussion

Our net sales for fiscal 2018 increased $725 million, or 5 percent, compared with fiscal 2017, primarily driven by the impact of significant presentation changes of $619 million resulting from the adoption of the new revenue recognition standard, and an increase in net sales for Old Navy Global and Athleta; partially offset by a decrease in net sales for Gap Global. The translation of net sales in foreign currencies to U.S. dollars had a favorable impact of about $17 million for fiscal 2018 and is calculated by translating net sales for fiscal 2017 at exchange rates applicable during fiscal 2018.

Our net sales for fiscal 2017 increased $339 million, or 2 percent, compared with fiscal 2016 primarily due to an increase in net sales at Old Navy Global and Athleta, partially offset by a decrease in net sales at Gap Global and Banana Republic Global. The translation of net sales in foreign currencies to U.S. dollars had an unfavorable impact of about $11 million for fiscal 2017 and is calculated by translating net sales for fiscal 2016 at exchange rates applicable during fiscal 2017. Fiscal 2017 includes incremental sales attributable to the 53rd week.

Cost of Goods Sold and Occupancy Expenses

($ in millions)	Fiscal Year		
	2018	2017	2016
Cost of goods sold and occupancy expenses	$10,258	$9,789	$9,876
Gross profit	$6,322	$6,066	$5,640
Cost of goods sold and occupancy expenses as a percentage of net sales	61.9 %	61.7 %	63.7 %
Gross margin	38.1 %	38.3 %	36.3 %