# GAP INC.



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**Team Number: 6** 

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### **Investment Summary**

Investment Recommendation

- BUY GAP 3.875 10/1/2031 (BB / Ba3) trading at 91.954 with 5.500% yield and ~175.6 bps OAS (as of Nov 21, 2025).
- Gap's balance sheet and operational turnaround under new leadership support reasonable credit tightening.
- > Target OAS: ~160 bps, Base-case est. total return: ~6.38% p.a.

Strong Brand
Portfolio and
Improving Sales
Growth

- Gap benefits from a multi-brand model spanning Old Navy, Gap, Banana Republic and Athleta, serving distinct customer segments and price points.
- Recent quarters show renewed sales growth at Old Navy and the Gap brand, supported by product simplification and better marketing execution.
- ➤ Online channels contributed ~38% of FY 2024 net sales, up from 34% in FY 2023, highlighting digital strength.

Improving Operational Efficiency

- Gap Inc. continues improving operational efficiency through its upgraded inventory management and omni-channel fulfillment systems.
- Automation in distribution centers and better SKU allocation between online and stores have lifted gross margin and EBITDA margin. The Company leverages a unified e-commerce platform across brands, driving strong digital profitability.

Healthy Capital
Structure

- ➤ Gap has \$1.5 B long-term debt and ~3.4× gross leverage, below peers.
- Management maintains strong credit metrics and ample liquidity (\$2.3B cash + \$2.2B revolver availability).
- Limited refinancing needs before 2029 and consistent free cash-flow generation underpin low default risk and stable ratings.



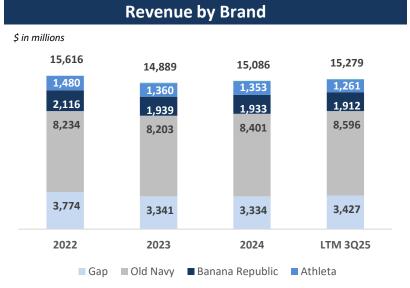
# 1. Company Overview



## Gap is a multinational clothing and accessories retailer

- Founded: 1969 in San Francisco, CA by Don & Doris Fisher.
- ➤ 3,569 store locations in ~40 countries, incl. 2,506 company-operated and 1,063 franchise locations.
- Net sales \$15.1B. Stores \$9.33B (~62%) and Online \$5.75B (~38%), with all brands gaining market share in 2024.
- EBITDA margin 7.4% for FY 2024.
- ➤ Gap operates an omni-channel, assetlight model with franchise agreements.
- Company sources globally; in FY 2024 <10% of merchandise (by \$) was from China.
- Ba3 (Outlook) / BB (Outlook)







# Gap maintains a conservative capital structure with limited secured debt and manageable maturities

- We view the 2031 notes as an attractive place in the capital structure given a healthy yield and limited near-term refinancing risk.
- Only \$1.5 B of senior unsecured notes are outstanding, split evenly between 2029 and 2031, supporting modest leverage and no sizeable maturity walls.
- Operating lease liabilities (~\$4.1 B) make up the majority of total obligations, as is typical for retailers, and are covered by strong cash generation.
- The entirety of the \$2.2B ABL revolver remains undrawn.

CAPITALIZATION TABLE								
\$ in millions								
Facility	Amount	Coupon	Maturity	Price	YTW	OAS	Rating	As Mult. Of EBITDA
Senior Secured Debt:								
\$2.2B ABL Revolver	-	S + 125	7/13/2027	100.00				
<b>Total Senior Secured Debt</b>	-							-
Senior Unsecured Debt:								
2029 Notes	750	3.625%	10/1/2029	94.371	5.257%	168 bps	BB / Ba3	
2031 Notes	750	3.875%	10/1/2031	91.954	5.500%	176 bps	BB / Ba3	
<b>Total Senior Unsecured Debt</b>	1,500							0.9x
Other Debt								
Operating Lease Liabilities	4,101							
Total Debt	5,601							3.4x
Less Cash	(2,262)							
Equity Market Cap	9,261							
Enterprise Value	12,600							7.7x
LTM EBITDA	1,642							

<sup>(1)</sup> All figures in LTM, as of November 1, 2025; Prices as of November 21, 2025

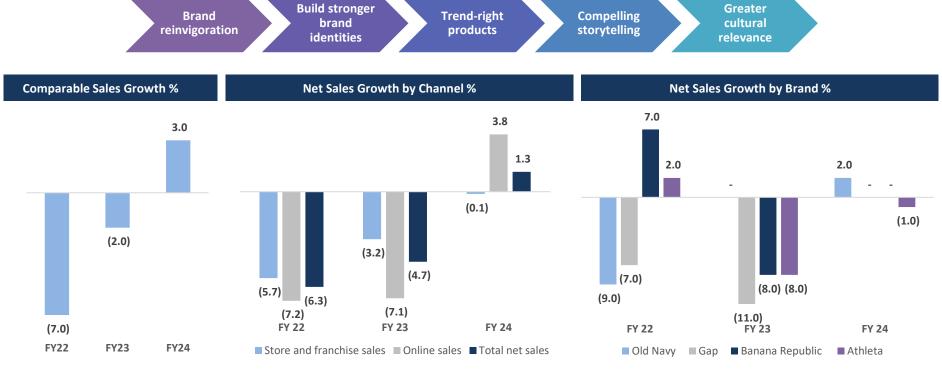


# 2. Investment Thesis



# Thesis 1: Strengthening Brand Foundation and Improving Sales Growth

- Gap benefits from a multi-brand model spanning Old Navy, Gap, Banana Republic, and Athleta, serving distinct customer segments and price points.
- Recent quarters show renewed sales growth at Old Navy and the Gap brand, supported by product simplification and better marketing execution.
- ➤ Online channels contributed ~38% of FY 2024 net sales, up from 34% in FY 2023, highlighting digital strength.

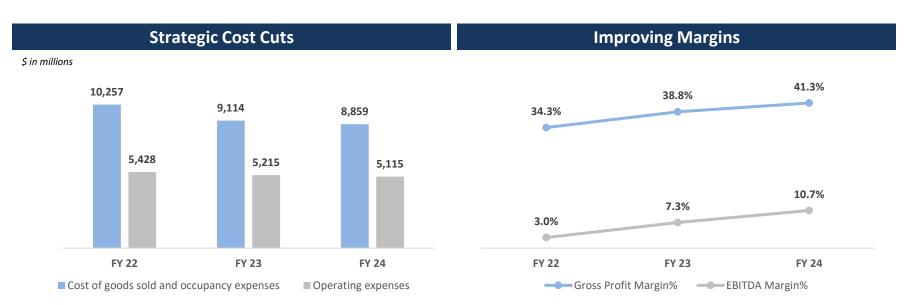




## **Thesis 2: Improving Operational Efficiency**

- ➤ Gap continues improving operational efficiency through its upgraded inventory management and omnichannel systems. The Company leverages a unified e-commerce platform across brands, driving strong digital profitability. Automation in distribution centers and better SKU allocation between online and stores have lifted gross margin and EBITDA margin.
- ➤ The firm is restructuring fixed cost base, strengthening supply chain, modernizing media mix model, and investing in technology driving both efficiency and effectiveness.







### **Thesis 3: Healthy Capital Structure**

### Creditor-friendly capital allocation policy drives strong cash flow and credit metrics.

# Credit Facility Repayment History

➤ Since the \$350 million repayment of revolving credit facility borrowings during FY2023, the firm has no new borrowings for consecutive two years. As the firm has maintained a relatively high cash balance, the facility is unlikely to be largely re-utilized.

# Limited Repayment Pressure

➤ The firm is expected to maintain adequate liquidity over the next 12 months (est. \$1-1.5 billion of balance sheet cash). There are only two senior unsecured bonds (\$750 million each), which will mature in 2029 and 2031 respectively.

# Capital Allocation Priorities

- Management's priority is to use its strong cash balance to: 1) invest organically in the business (est. \$500-600 million CapEx per year), 2) pay consistent dividends to shareholders (est. \$0.66 per year), 3) continue buying back shares (~\$250 million authorized amount outstanding).
- The management does not expect to engage in M&A over the next 12 months, to avoid disrupting the momentum gained from its recent turnaround efforts.



# **Light Debt Obligations**

## **Key Assumptions**

Base ➤ Sales growth at ~1.5% CAGR	Bull	➤ Sales growth at ~2.5% CAGR	Bear	➤ Sales growth at ~0.1% CAGR
Avg. Gross Margin at 41.4%		Avg. Gross Margin at 42.1%		Avg. Gross Margin at 39.9%
Avg. Operating Expenses as a % of Sales at 33.0%		Avg. Operating Expenses as a % of Sales at 32.2%		Avg. Operating Expenses as a % of Sales at 34.7%
<ul> <li>Avg. Inventory Turnover 85.4 days</li> <li>CapEx as a % of Sales at 3.3%</li> </ul>		<ul><li>Avg. Inventory Turnover 79.4 days</li><li>CapEx as a % of Sales at 3.5%</li></ul>		<ul><li>Avg. Inventory Turnover 94.6 days</li><li>CapEx as a % of Sales at 3.2%</li></ul>

\$ in millions	2022A	2023A	2024A	2025E	2026E	2027E	2028E	2029E	2027 Bull	2027 Bear
Net Sales	15,616	14,889	15,086	15,342	15,572	15,883	16,201	16,525	16,408	15,235
EBITDA	471	1,082	1,612	1,586	1,704	1,958	1,960	1,996	2,266	1,627
Net Income (Loss)	(202)	502	844	804	906	1,118	1,214	1,260	1,352	858
Cash From Operating Activities	607	1,532	1,486	1,291	1,512	1,767	1,829	1,887	2,016	1,401
Free Cash Flow	443	1,121	1,070	817	1,019	1,268	1,278	1,297	1,444	954
Total Assets	11,386	11,044	11,885	12,131	12,505	13,086	13,825	14,625	13,785	12,112
Long-term Debt	1,836	1,488	1,490	1,500	1,500	1,500	1,500	1,500	1,500	1,500
EBITDA Margin	3.0%	7.3%	10.7%	10.3%	10.9%	12.3%	12.1%	12.1%	13.8%	10.7%
Total Debt + Leases / EBITDA	12.8x	5.0x	3.4x	3.3x	3.0x	2.5x	2.5x	2.4x	2.2x	3.1x
Net Debt + Leases / EBITDA	10.2x	3.3x	1.9x	1.7x	1.2x	0.6x	0.2x	(0.2)x	0.3x	1.4x
EBITDA / Interest Expense	5.4x	12.0x	18.5x	18.2x	19.6x	22.5x	22.5x	22.9x	26.0x	18.7x



Risks	Mitigants
Exposure to discretionary spending	While Gap is exposed to consumer pullback during downturns, the Company operates across value-oriented brands like Old Navy. This positioning provides resilience during consumer downturns relative to higher-ticket discretionary retailers.
Higher input costs from tariff escalations	Over half of Gap's product is sourced from Asia, exposing the Company to future tariff escalations. Management outlined a \$100-\$150M tariff mitigation plan focused on supplier diversification. Currently < 10% of merchandise comes from China with a target of capping individual country exposure to 25% by 2026.
Execution of operational turnaround	Q3 2025 gross margin contracted ~30 bps to 42.4% and inventory grew 6% YoY, highlighting execution risk amid costs and tariff pressure. Management is tightening purchasing discipline, improving inventory management, and maintaining flexible sourcing to match demand. Additionally, Gap has had positive comp growth for seven consecutive quarters.



# 3. Valuation



# Our base case valuation calls for ~160bps target spread within one year, for a total annualized return of ~6.38%

Bear	Base	Bull
Widens to 180bps for ~5.59% total return p.a.	<b>Tightens</b> to 160 bps for ~6.38% total return p.a.	<b>Tightens</b> to 150bps for ~6.78% return p.a.

Trigger	Moody's	S&P	Bear	Base	Bull
Rating/ Outlook Upgrade	<ul> <li>Consistent improvement in margins and good liquidity</li> <li>Debt/EBITDA sustained below 2.25x</li> <li>Interest coverage sustained above 5.0x</li> </ul>	<ul> <li>Improving profitability or cash flow</li> <li>S&amp;P adjusted EBITDA margin sustained more than 16%</li> </ul>	Partially Met	Partially Met	Partially Met
Rating/ Outlook Downgrade	<ul> <li>Stagnant operating margins, liquidity deteriorates, or financial strategies become detrimental to creditors</li> <li>Debt/EBITDA sustained above 3.5x</li> <li>Interest coverage sustained below 3.5x</li> </ul>	<ul> <li>More aggressive financial policy (significantly increase in dividends or share repurchases)</li> <li>S&amp;P adjusted EBITDA margin falling well below 16% and leverage increasing from current levels to the mid-2x area</li> </ul>	Not Met	Not Met	Not Met

GAP FIXED INCOME COMPARABLE	S										
Issuer	Bond	Amt Out (\$)	OAS Spread	Coupon	Maturity Date	Yield	Price Net D	ebt / EBITDA	S&P	Moody's	Fitch
GAP Inc.	GAP 3.875 10/01/2031	750,000,000	176 bps	3.875%	10/1/2031	5.500%	91.954	1.9x	BB	Ba3	N/A
Retail Comparables											
Bath & Body Works Inc.	BBWI 6.625 10/01/30	844,063,000	232 bps	6.625%	10/1/2030	6.228%	101.013	3.2x	BB+	Ba2	N/A
VF Corp.	VFC 2.95 04/23/30	750,000,000	235 bps	2.950%	4/23/2030	5.947%	88.511	5.1x	BB	Ba3	N/A
Victoria's Secret Co.	VSCO 4.625 07/15/29	600,000,000	243 bps	4.625%	7/15/2029	6.002%	95.548	5.0x	BB-	B1	N/A
Ross Stores Inc.	ROST 1.875 04/15/31	500,000,000	77 bps	1.875%	4/15/2031	4.445%	87.797	0.4x	BBB+	A2	N/A
Dicks Sporting Goods	DKS 3.15 01/15/32	750,000,000	96 bps	3.150%	1/15/2032	4.713%	91.744	1.8x	BBB	Baa2	N/A
Fixed Income Indices											
Bloomberg U.S. Corporate High	Yield Bond Index	_	306 bps	6.580%	4.77 Years	6.898%	·			·	
Bloomberg High Yield Retailers Total Return Index			373 bps	6.930%	5.11 Years	7.541%					

Source: Bloomberg, Capital IQ, Moody's Investor Service, S&P Global Ratings, as of Nov 21, 2025.



## **Comp Historical Trading**

- > GAP's current spread appears undervalues compared to peer average
- Spread should be trading closer to 160bps

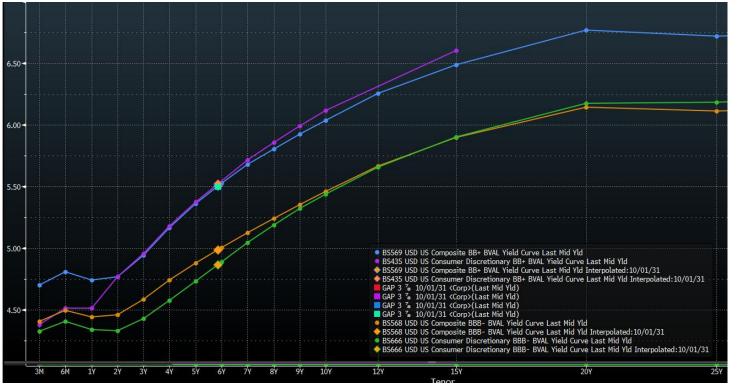




## **Yield Curve for Further Upgrade Potential**

Considering strong financial positions, if GAP has the future potential to be back to IG BBB-, there is 51.4 bps of compression (compared to US Composite BBB- yield curve), and 63.5 bps of compression (compared to US Consumer Discretionary BBByield curve).

Yield Curve Interpolated @10/01/2031	BB+	GAP 31	BBB-
US Composite	5.504%	F F00%	4.986%
US Consumer Discretionary	5.522%	5.500%	4.865%





# **Appendix**



### **Tariff Impacts**

- Sourcing is concentrated in Vietnam and Indonesia (~46%) combined. While tariffs can apply to any sourcing market, recent U.S. tariff actions have primarily targeted China rather than Southeast Asian suppliers.
- Exposure to China has been reduced to <10% in 2024 and managements expects <3% exposure exiting 2025, which limits direct tariff risk.
- Management stated its goal is for no single country to exceed 25% of sourcing by 2026, which further diversifies political risk.
- Management guidance suggests 100-110 bps tariff impact on operating margin.

Country	FY2024 Sourcing Share
Vietnam	~27%
Indonesia	~19%
China	<10% (management guiding to <3% by end of 2025)
Others (India, Sri Lanka, Bangladesh)	Individually <10% each

Tariffs represent a manageable headwind for the Company, rather than a balance sheet risk, given limited China exposure and demonstrated mitigation progress.



# We estimate that GAP's Senior Unsecured Bonds have a full recovery value of 100%.

Gap has no secured debt outstanding under its asset-based revolver. The 2031 Senior Notes benefit from a clean capital structure, strong liquidity position, and conservative leverage profile.

LIQUIDATION ANALYSIS			
\$ in millions		2025E	
Assets	Book Value	Recovery %	Recovery (\$)
Cash and Cash Equivalents	2,625	100%	2,625
Merchandise Inventory	2,147	65%	1,396
Other Current Assets	798	10%	80
<b>Total Current Assets</b>	5,570		4,100
Property, Plant and Equipment	2,536	45%	1,141
Operating Lease Assets	3,059	5%	153
Other Long-Term Assets	967	60%	580
<b>Total Liquidation Value</b>	12,131		5,974

WATERFALL ANALYSIS	
\$ in millions	Recovery Value
Total Liquidation Value	5,974
Less Liquidation Costs	(299)
Less: Secured Debt	
Distributable Value to Unsecured C	laims 5,676
Senior Notes Due 2029	750
Senior Notes Due 2031	750
<b>Total Senior Unsecured Claims</b>	1,500
<b>Recovery to Senior Unsecured Clair</b>	ns (%) 100%

### **Financial Strategy Details**

- ➤ Gap maintains a conservative balance sheet with over \$2B in cash and no secured borrowings, providing strong liquidity and flexibility.
- Management remains committed to shareholder returns, continuing dividends and repurchases to offset dilution.

### **Key Covenants and Callability**

- ABL facility includes a springing fixedcharge coverage test (≥ 1.0×) only if availability falls below 10 % of the borrowing base or \$150M.
- Standard restrictions on additional indebtedness, liens, and sale-leaseback transactions.
- ➤ 2031 Notes are callable starting 10/1/26 @ \$104.625. Amortizes to par call on 10/1/28.



# HALLENGE Fundamental Comparison The University of North Carolina

Ticker	GAP	Median	VSCO	VFC	ROST	GES	DKS	BBWI
Market Cap	9.3B	6.3B	2.9B	6.3B	56.6B	885.0M	18.7B	3.0B
P/E	11.2x	15.6x	15.6x	18.2x	27.8x	17.3x	14.9x	4.5x
EV/EBITDA TTM	7.7x	10.6x	9.4x	8.5x	18.9x	4.6x	11.5x	5.3x
T12M Revenue	15.3B	9.5B	6.3B	9.5B	21.0B	3.1B	13.8B	7.4B
T12M EBITDA	1.6B	1.5B	535.7M	1.1B	3.1B	452.6M	1.9B	1.5B
T12M EBITDA Margin	10.8%	13.8%	8.6%	11.0%	14.2%	14.6%	13.8%	20.0%
Free Cash Flow to Total Debt	0.1	0.1	0.1	0.1	0.4	0.2	0.2	0.2

Source: Bloomberg, as of Nov 21, 2025.



## **Model Output: Income Statement, FCF and Credit Metrics**

FISCAL YEAR	2022A	2023A	2024A I	LTM Q3 2025	2025E	2026E	2027E	2028E	2029E
\$ in millions									
INCOME STATEMENT									
Net Sales	15,616	14,889	15,086	15,279	15,342	15,572	15,883	16,201	16,525
Cost of Goods Sold & Occupancy Expenses	(10,257)	(9,114)	(8,859)	(9,013)	(9,113)	(9,218)	(9,212)	(9,429)	(9,617)
Gross Profit	5,359	5,775	6,227	6,266	6,229	6,353	6,671	6,772	6,907
Operating Expenses	(5,428)	(5,215)	(5,115)	(5,121)	(5,124)	(5,139)	(5,210)	(5,314)	(5,420)
EBIT	(69)	560	1,112	1,145	1,105	1,215	1,461	1,458	1,487
Depreciation & Amortization	540	522	500	497	482	489	497	502	509
EBITDA	471	1,082	1,612	1,642	1,586	1,704	1,958	1,960	1,996
% Margin	3.0%	7.3%	10.7%	10.7%	10.3%	10.9%	12.3%	12.1%	12.1%
Impairment Charges	51	7	1	1	-	-	-	-	-
Stock Based Compensation	37	80	126	41	123	125	127	130	132
Other Non-Cash Items	(61)	(94)	3	4	(60)	-	-	-	
Adjusted EBITDA	498	1,075	1,742	1,688	1,649	1,829	2,086	2,090	2,128
% Margin	3.2%	7.2%	11.5%	11.0%	10.7%	11.7%	13.1%	12.9%	12.9%
Cash Taxes	388	(49)	(237)	(256)	(253)	(271)	(318)	(261)	(271)
Change in NWC	242	515	12	(173)	(58)	(9)	24	(16)	(15)
CapEx	(685)	(420)	(447)	(444)	(522)	(529)	(524)	(535)	(545)
Free Cash Flow	443	1,121	1,070	815	817	1,019	1,268	1,278	1,297
FCF Conversion Rate	89.0%	104.3%	61.4%	48.3%	49.5%	55.7%	60.8%	61.2%	61.0%
CREDIT METRICS									
Total Debt	1,840	1,490	1,490	1,490	1,500	1,500	1,500	1,500	1,500
Less Cash	(1,215)	(1,873)	(2,335)	(2,262)	(2,625)	(3,083)	(3,768)	(4,495)	(5,259)
Net Debt	625	(383)	(845)	(772)	(1,125)	(1,583)	(2,268)	(2,995)	(3,759)
Lease Liabilities	4,184	3,953	3,985	4,101	3,804	3,628	3,489	3,381	3,299
Net Debt + Lease Liabilities	4,809	3,570	3,140	3,329	2,679	2,044	1,221	386	(460)
Interest Expense	88	90	87	65	87	87	87	87	87
Total Debt / EBITDA	3.9x	1.4x	0.9x	0.9x	0.9x	0.9x	0.8x	0.8x	0.8x
Net Debt / EBITDA	1.3x	(0.4)x	(0.5)x	(0.5)x	(0.7)x	(0.9)x	(1.2)x	(1.5)x	(1.9)x
Total Debt + Leases / EBITDA	12.8x	5.0x	3.4x	3.4x	3.3x	3.0x	2.5x	2.5x	2.4x
Net Debt + Leases / EBITDA	10.2x	3.3x	1.9x	2.0x	1.7x	1.2x	0.6x	0.2x	(0.2)x
Interest Coverage	5.4x	12.0x	18.5x	25.3x	18.2x	19.6x	22.5x	22.5x	22.9x



## **Model Forecast Assumptions**

### Forecast reflects steady revenue recovery, stable gross margins, and limited store base contraction.

FISCAL YEAR	2022A	2023A	2024A	2025E	2026E	2027E	2028E	2029E
Sales Growth	(6.3)%	(4.7)%	1.3%	1.7%	1.5%	2.0%	2.0%	2.0%
Gross Profit Margin	34.3%	38.8%	41.3%	40.6%	40.8%	42.0%	41.8%	41.8%
Operating Margin	(0.4)%	3.8%	7.4%	7.2%	7.8%	9.2%	9.0%	9.0%
EBITDA Margin	3.0%	7.3%	10.7%	10.3%	10.9%	12.3%	12.1%	12.1%
CapEx	685	420	447	522	529	524	535	545
CapEx as a % of Sales	4.4%	2.8%	3.0%	3.4%	3.5%	3.4%	3.4%	3.4%

- ➤ Gap stabilizes around ~3,500 stores globally, with Old Navy driving the Company's turnaround and revenue growth.
- Low-single-digit same-store sales growth expected through FY26, supported by assortment improvement, better inventory management, and disciplined promotions.
- Store footprint to contract modestly, as management continues rationalizing underperforming locations.
- Gross margins stabilize around 42 %, with a temporary contraction in FY25 from tariff-related cost pressures before modest improvement from sourcing diversification and lower freight costs in FY27+.
- EBITDA margin expansion driven by SG&A savings, normalized freight, and improved inventory efficiency, as management highlights continued operating leverage from a leaner cost base.
- ➤ CapEx to remain disciplined at ~\$500–550M annually, focused on store refreshes and digital investment.