GAP INC
Form 10-K
March 26, 2013

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, 2013

¨ 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	New York Stock Exchange, Inc.
(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:
Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
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 July 27, 2012 was approximately $6 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 19, 2013 was 465,307,163.
Documents Incorporated by Reference

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2013 (hereinafter referred to as the "2012 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 simila expressions also identify forward-looking statements. Forward-looking statements include, but are not limited to, statements regarding the following:

- our international expansion plans, including our plans to open Old Navy stores outside of North America, open additional Gap stores in China, and open additional international outlet stores;
- continued growth of online sales internationally;
- our ability to maintain a strong financial profile with ample liquidity;
- the outcome of proceedings, lawsuits, disputes, and claims;
- improving sales with healthy merchandise margins;
- investing in our business;
- growing earnings per share;
- returning excess cash to shareholders;
- diluted earnings per share in fiscal 2013;
- growing sales with healthy merchandise margins;
- managing our expenses in a disciplined manner;
- growing revenues through new brands, channels, and geographies;
- continuing to open franchise stores worldwide;
- opening additional Athleta stores;
- the number of new store openings and store closings in fiscal 2013;
- net square footage change in fiscal 2013;
- the number of new franchise stores in fiscal 2013;
- impact of returning to a 52-week fiscal year in fiscal 2013;
- impact of foreign exchange rate fluctuations;
- operating margin in fiscal 2013;
- the effective tax rate in fiscal 2013;
- current cash balances and cash flows being sufficient to support our business operations, including growth initiatives and planned capital expenditures;
- our ability to supplement near-term liquidity, if necessary, with our revolving credit facility;
- depreciation and amortization in fiscal 2013;
- capital expenditures in fiscal 2013;
- our plan to increase our dividend in fiscal 2013;
- the estimates and assumptions we use in our accounting policies;
- the impact on our income tax provision of any changes in our estimated tax liability;
- the adoption of accounting standards updates in fiscal 2013;
- the extension of our portfolio of brands and further penetration of the higher-end apparel market;
- the assumptions used to estimate the grant date fair value of stock options issued;
- the expected amount of future lease payments;
- our intention to utilize undistributed earnings of our foreign subsidiaries;
- total gross unrecognized tax benefits;
- expected payments to International Business Machines Corporation ("IBM"); and
- the impact of losses due to indemnification obligations.

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 risk that the adoption of new accounting pronouncements will impact future results;
- the risk that changes in general economic conditions or consumer spending patterns could adversely impact our results of operations;
- the highly competitive nature of our business in the United States and internationally;
- the risk that we or our franchisees will be unsuccessful in gauging apparel trends and changing consumer preferences;
- the risk to our business associated with global sourcing and manufacturing, including sourcing costs, events causing disruptions in product shipment, or an inability to secure sufficient manufacturing capacity;
- the risk that our efforts to expand internationally may not be successful;
- the risk that our franchisees will be unable to successfully open, operate, and grow the Company’s franchised stores or operate their stores in a manner consistent with our requirements regarding our brand identities and customer experience standards;
- 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 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 updates or changes to our information technology (“IT”) systems may disrupt our operations;
- the risk that our IT services agreement with IBM could cause disruptions in our operations and have an adverse effect on our financial results;
- the risk that actual or anticipated cyber-attacks, and other cybersecurity risks, may cause us to incur increasing costs;
- the risk that natural disasters, public health crises, political crises, or other catastrophic events could adversely affect our operations and financial results;
- the risk that acts or omissions by our third-party vendors, including a failure to comply with our code of vendor conduct, could have a negative impact on our reputation or operations;
- the risk that we do not repurchase some or all of the shares we anticipate purchasing pursuant to our repurchase program;
- the risk that we will not be successful in defending various proceedings, lawsuits, disputes, claims, and audits; and
- the risk that changes in the regulatory or administrative landscape could adversely affect our financial condition, strategies, and results of operations.

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 26, 2013, 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.
2012 ANNUAL REPORT ON FORM 10-K
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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, children, and babies under the Gap, Old Navy, Banana Republic, Piperlime, Athleta, and Intermix brands. Our global portfolio of distinct brands across multiple channels and geographies gives us a competitive advantage in the global retail marketplace. We operate in the specialty, outlet, online, and franchise channels.

Gap Inc. has Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, China, and Italy. We also have franchise agreements with unaffiliated franchisees to operate Gap and Banana Republic stores throughout Asia, Australia, Eastern 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. We have grown our franchise store base to 312 stores in 40 countries at the end of fiscal 2012. Our products are also available to customers online in over 80 countries. 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, especially at our Piperlime and Intermix brands.

Gap. Founded in 1969, Gap is our flagship brand and remains one of the most iconic apparel brands in the marketplace today. The brand stands for casual, American style and offers classic apparel at accessible price points to help customers express their individuality. In addition to designing its own merchandise, Gap offers limited capsule collections in partnership with some of the fashion industry’s best-loved designers and other third-party merchandise from time to time.

Gap entered the children’s apparel market in 1986 with GapKids and in 1989 with babyGap. Maternity apparel was later added to the collection. In 1998, we launched GapBody, which offers loungewear, sleepwear, intimates, and active apparel for women. Today, Gap products are available globally in our specialty and outlet stores, online, and in franchise stores.

Banana Republic. Banana Republic is a global apparel and accessories brand that focuses on delivering modern, covetable workplace style for both men and women. The brand offers versatile workwear that can be styled for any occasion - from desk to dinner. Banana Republic also partners with notable fashion designers to offer exclusive limited-edition collections inspired by the designers' distinct styles and trends.

Acquired in 1983 with two stores, Banana Republic has evolved to offer collections that include apparel, handbags, shoes, jewelry, personal care products, and eyewear for men and women at higher price points than Gap. Today, customers can purchase Banana Republic products in our specialty and outlet stores, online, and in franchise stores.

Old Navy. Old Navy opened its first store in 1994, offering fun, fashion, and value to the whole family. The brand offers customers on-trend clothing and accessories, as well as updated basics for adults, children, and babies, at great prices in a unique and energizing shopping environment. Customers can purchase Old Navy products in stores and online, which includes online-exclusive items such as a plus-size line. In July 2012, the brand opened its first store outside of North America in Odaiba, Japan.

Piperlime. Launched in 2006, Piperlime offers a mix of private-label and branded apparel and jewelry as well as leading brands in shoes and handbags. The brand inspires customers with a fresh and unique mix of products, brands, and price points, as well as favorite picks and tips on how to wear the season's trends from famous guest editors. Customers can shop online and in the brand's first store, which opened in the SoHo neighborhood of New York in September 2012.

Athleta. Acquired in September 2008, Athleta is Gap Inc.’s premier brand in the rapidly growing women's active apparel market. Athleta offers high-quality, stylish, and functional apparel, footwear, and accessories across a wide variety of sports and fitness activities, including crossover apparel and casualwear. Customers can purchase Athleta products online, in stores, and through catalogs.

Intermix. Gap, Inc. acquired Intermix Holdco Inc. ("Intermix") on December 31, 2012. Intermix is known for its tasteful mixing of luxury and contemporary fashion and offering the most coveted existing and up-and-coming designer brands. In addition to its array of seasonal must-haves, Intermix also offers exclusive designer product. Customers can shop in stores in the United States and Canada and online.

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All sales are tendered for cash, debit cards, credit cards, or personal checks. We also issue and redeem gift cards through our brands. Gap, Banana Republic, and Old Navy 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.

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 2012 with 3,407 Company-operated and franchise store locations. For more information on the number of stores by brand and region, see the table in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Part II, Item 7 of this Form 10-K.

During fiscal 2012, we operated two reportable segments: Stores and Direct.

Certain financial information about our reportable segments and international operations is set forth under the heading “Segment Information” in Note 16 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K.

Merchandise Vendors

We purchase private label and non-private label merchandise from over 1,000 vendors. Our vendors have facilities in about 40 countries. No vendor accounted for more than 5 percent of the dollar amount of our total fiscal 2012 purchases. Of our merchandise purchased during fiscal 2012, approximately 98 percent of all units were produced outside the United States, while the remaining 2 percent of all units were produced domestically. Approximately 26 percent of our merchandise units were produced in China. Product cost increases or events causing disruption of imports from China or other foreign countries, including the imposition of additional import restrictions 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, including our costs and supply chain, is subject to risks associated with global sourcing and manufacturing” and “Risk Factors—Trade matters may disrupt our supply chain” in Item 1A of this Form 10-K.

Seasonal Business

Our business follows a seasonal pattern, with sales peaking over a total of about eight weeks 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 Piperlime and 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 Piperlime and Intermix, we control all aspects of brand development except for product design related to third-party products. We continue to invest in our brands and enhance the customer experience through significant investments in marketing, enhancement of our online shopping sites, international expansion, remodeling of existing stores, and continued focus on customer service.

Trademarks and Service Marks

Gap, GapKids, babyGap, GapBody, Banana Republic, Old Navy, Piperlime, Athleta, and Intermix trademarks and service marks, and certain other trademarks, 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 Gap and Banana Republic stores in a number of countries throughout Asia, Australia, Eastern 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. We continue to increase the number of countries in which we enter into these types of arrangements as part of our strategy to expand internationally. 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 and could impair the value of our brands" in Item 1A of this Form 10-K.

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Inventory

The nature of the retail business requires us to carry a significant amount of inventory, especially prior to 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 markdowns to clear merchandise. Also see the section entitled “Risk Factors—We must successfully gauge apparel trends and changing consumer preferences to succeed” in Item 1A of this Form 10-K.

Competitors

The global apparel retail industry is highly competitive. We compete with local, national, and global apparel retailers. We are also faced with competition in European, Japanese, Chinese, and Canadian markets from established regional and national chains, and our franchisees face significant competition in the markets in which they operate. Also see the section entitled “Risk Factors—Our business is highly competitive” in Item 1A of this Form 10-K.

Employees

As of February 2, 2013, we had a workforce of approximately 136,000 employees, which includes a combination of part-time and full-time employees. We also hire seasonal employees, primarily during the peak end-of-year holiday period. We consider our relationship with our employees to be good.

To remain competitive in the apparel retail industry, we must attract, develop, and retain skilled employees in our design, merchandising, marketing, and other functions. 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—We must successfully gauge apparel trends and changing consumer preferences to succeed” in Item 1A of this Form 10-K.

Available Information

We make available on our website, www.gapinc.com, under “Investors, Financial Information, SEC Filings,” 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 Nominating Committees) and Corporate Governance Guidelines are also available on our website under “Investors, Governance.” The Code of Business Conduct can be found on our website under “Investors, Corporate Compliance, Code of Business Conduct.” Any amendments and waivers to the code will also be available on the website.

Executive Officers of the Registrant

The following are our executive officers:

Name, Age, Position, and Principal Occupation:

Michelle Banks, 49, Executive Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer since March 2011; Senior Vice President, General Counsel, Corporate Secretary, and Chief Compliance Officer from March 2008 to March 2011; Senior Vice President and General Counsel from November 2006 to March 2008; Vice President from March 2005 to November 2006; Associate General Counsel from February 2003 to March 2005; Senior Corporate Counsel from January 1999 to February 2003.

Jack Calhoun, 48, Global President, Banana Republic Brand since November 2012; President, Banana Republic North America from 2007 to October 2012; Executive Vice President, Merchandising and Marketing, Banana Republic North America from 2003 to 2007.

Colin Funnell, 51, Executive Vice President, Global Supply Chain since September 2011; Senior Vice President, Supply Chain Strategy, Strategic Sourcing, and Global Logistics from June 2010 to August 2011; Senior Vice President, Corporate Operations and Logistics from 2008 to June 2010; Senior Vice President, Logistics from 2006 to

2007; Senior Vice President, Global Production and Old Navy Supply Chain from 2004 to 2005.

John T. (Tom) Keiser, 47, Executive Vice President and Chief Information Officer since January 2010; Executive Vice President and Chief Information Officer of The Limited Brands, Inc., an apparel company, from 2006 to October 2009; Senior Vice President, INSIGHT Program of The Limited Brands, Inc. from 2004 to 2006.

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Stefan Larsson, 38, Global President, Old Navy Brand since October 2012; Head of Global Sales, H&M Hennes & Mauritz AB from 2010 to 2012; Head of Global Expansion, H&M Hennes & Mauritz AB from 2009 to 2010; Head of Operations, Global Expansion, H&M Hennes & Mauritz AB from 2007 to 2009; Regional Manager, U.S. West Coast, H&M Hennes & Mauritz AB from 2005 to 2007.
Glenn Murphy, 51, Chairman and Chief Executive Officer since August 2007; Chief Executive Officer of Shoppers Drug Mart Corporation, a drug store chain, from 2001 to 2007.
Art Peck, 57, President, Growth, Innovation, and Digital division since November 2012; President, Gap North America from February 2011 to November 2012; Executive Vice President of Strategy and Operations from May 2005 to February 2011; President, Gap Inc. Outlet from October 2008 to February 2011; Acting President, Gap Inc. Outlet from February 2008 to October 2008; Senior Vice President of The Boston Consulting Group, a business consulting firm, from 1982 to May 2005.
Eva Sage-Gavin, 54, Executive Vice President, Global Human Resources and Corporate Affairs since February 2010; Executive Vice President, Human Resources, Communications and Global Responsibility from April 2008 to February 2010; Executive Vice President, Human Resources and Communications from February 2007 to April 2008; Executive Vice President, Human Resources from March 2003 to February 2007.
Sabrina Simmons, 49, Executive Vice President and Chief Financial Officer since January 2008; Executive Vice President, Corporate Finance from September 2007 to January 2008; Senior Vice President, Corporate Finance and Treasurer from March 2003 to September 2007; Vice President and Treasurer from September 2001 to March 2003.
Stephen Sunnucks, 55, Global President, Gap Brand since November 2012; President, Gap Inc. International from April 2011 to November 2012; President, Gap Inc. Europe and International Strategic Alliances from April 2009 to April 2011; President, Gap Inc. Europe from June 2005 to April 2009.

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.

Global economic conditions and the impact on consumer spending patterns could adversely impact our results of operations.

The Company’s performance is subject to global economic conditions and their impact on levels of consumer spending worldwide. Some of the factors influencing 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 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 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 a challenging and uncertain economic environment, 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 business is highly competitive.

The global apparel retail industry is highly competitive. We 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 including:

- anticipating and quickly responding to changing apparel trends and customer demands;
- attracting customer traffic;
- competitively pricing our products and achieving customer perception of value;
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- maintaining favorable brand recognition and effectively marketing our products to customers in several diverse market segments;
- developing innovative, high-quality products in sizes, colors, and styles that appeal to customers of varying age groups and tastes;

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- sourcing merchandise efficiently; and
- providing strong and effective marketing support.

In addition, our franchisees face significant competition in the markets in which they operate. If we or our franchisees are not able to compete successfully in the United States or internationally, our results of operations could be adversely affected.

Furthermore, beginning in fiscal 2013, we will combine all channels and geographies under one global leader each for Gap, Banana Republic, and Old Navy. We do not have experience operating under this new global brand structure. If we are not successful in competing effectively under this structure, our results of operations could be adversely affected.

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 purchases are long, which 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. Some of our past product offerings have not been well received by our broad and diverse customer base. Merchandise misjudgments could have a material adverse effect on our operating results.

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, marketing, and other functions in the context of our new global brand structure announced in October 2012. Competition for this personnel 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.

Fluctuations in the global apparel retail business especially affect the inventory owned by apparel retailers, as merchandise usually must be ordered well in advance of the season and frequently before apparel trends are evidenced by customer purchases. In addition, 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. 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.

Our business, including our costs and supply chain, is subject to risks associated with global sourcing and manufacturing.

Independent third parties manufacture nearly all of our products for us. As a result, we are directly impacted by increases in the cost of those products. For example, cotton prices rose substantially during fiscal 2011, which put significant pressure on our average unit costs and gross margins.

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.

Because independent vendors manufacture nearly 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. Manufacturing 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 in transportation costs, so increases in the price of petroleum products can adversely affect our gross margins.

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Our efforts to expand internationally may not be successful.

Our current strategies include moving to a global brand structure and pursuing continued international expansion in a number of countries around the world through a number of channels. Beginning in fiscal 2013, we will combine all channels and geographies under one global leader each for Gap, Banana Republic, and Old Navy. Each global brand president will oversee their brand's specialty, outlet, online, and franchise operations. We currently plan to open additional Old Navy stores outside of North America, open additional Gap stores in China, open additional international outlet stores, and continue to grow online sales internationally. We have limited experience operating 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 experience. Moreover, 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. In addition, we are exposed to foreign currency exchange rate risk with respect to our sales, profits, assets, and liabilities denominated in currencies other than the U.S. dollar. Although we use instruments to hedge certain foreign currency risks, these measures may not succeed in offsetting all of the negative impact of foreign currency rate movements on our business and results of operations. 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.

Our franchise business is subject to certain risks not directly within our control and could impair the value of our brands.

We enter into franchise agreements with unaffiliated franchisees to operate stores in many countries around the world. Under these agreements, third parties operate, or will operate, stores 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 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, changes in diplomatic and trade relationships, 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 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, in recent years, we have been seeking to downsize, consolidate, reposition, 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 or successfully modify 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 retail 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 results of operations.

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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 and margins, including 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, and weather conditions. These factors may cause our comparable sales results 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, quarterly, and monthly basis. Over the past 24 months, our reported monthly comparable sales have ranged from an increase of 10 percent in July 2012 to a decrease of 10 percent in March 2011. Over the past five years, our reported gross margins have ranged from a high of 40.3 percent in fiscal 2009 to a low of 36.2 percent in fiscal 2011. In addition, over the past five years, our reported operating margins have ranged from a high of 13.4 percent in fiscal 2010 to a low of 9.9 percent in fiscal 2011.
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 and cause our credit ratings to decline.

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.
In the first quarter of fiscal 2011, given favorable market conditions and our history of generating consistent and strong operating cash flow, we made the strategic decision to issue debt. In April 2011, we issued $1.25 billion aggregate principal amount of 5.95 percent notes due April 12, 2021. As a result, we have additional costs that include interest payable semiannually on the notes. We also entered into a $400 million five-year term loan due April 2016, which was funded in May 2011 and repaid in full in August 2012.
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 operations in excess of $1 billion per year for the past decade and ended fiscal 2012 with $1.5 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 of about $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 operations 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 on future financings.
We remain committed to maintaining a strong financial profile with ample liquidity. Proceeds from the debt issuance were used for general corporate purposes including share repurchases.
For further information on our debt and credit facilities, see Item 8, Financial Statements and Supplementary Data, Notes 5 and 6 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 and other foreign governments, including the likelihood, type, or effect of any such restrictions. 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.

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Updates or changes to our IT systems may disrupt operations.
We continue to evaluate and implement upgrades and changes to our IT systems, 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 replacing these systems, including accurately capturing data and 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 launch these systems as planned or that they will occur without disruptions to our operations. IT system disruptions, 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 IT services agreement with IBM could cause disruptions in our operations and have an adverse effect on our financial results.
We have entered into the eighth year of a ten-year non-exclusive services agreement under which IBM operates certain significant aspects of our IT infrastructure. Under the original agreement, this included supporting our mainframe, server, network and data center, and store operations, as well as help desk, end user support, and some disaster recovery. Since the original agreement in January 2006, we have amended the agreement to take back certain services originally performed by IBM. These returned services include services related to management of our server and data center environment, along with disaster recovery, circuit expense billing, database administration services, and help desk services for stores worldwide. All other services remain with IBM per the original agreement. Our ability to realize the expected benefits of this arrangement is subject to various risks, some of which are not within our complete control. These risks include, but are not limited to, disruption in services and the failure to protect the security and integrity of the Company’s data under the terms of the agreement. We are unable to provide assurances that some or all of these risks will not occur. Failure to effectively mitigate these risks, if they occur, could have a material adverse effect on our operations and financial results.

We are subject to cybersecurity risks and may incur increasing costs in an effort to minimize those risks.
Our business employs systems and websites that allow for the secure storage and transmission of proprietary or confidential information regarding our customers, employees, job applicants, and others, including credit card information and personal identification information. Security breaches could expose us to a risk of loss or misuse of this information, litigation, and potential liability. We may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. Attacks may be targeted at us, our customers, or others who have entrusted us with information. Actual or anticipated attacks 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. In addition, 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. Any compromise or breach of our security could result in a violation of applicable privacy and other laws, 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.

Our results could be adversely affected by natural disasters, public health crises, political crises, or other catastrophic events.
Natural disasters, such as hurricanes, tornadoes, floods, earthquakes, and other adverse weather and climate conditions; unforeseen public health crises, such as pandemics and epidemics; political crises, such as terrorist attacks, war, and other political instability; or other catastrophic events, whether occurring in the United States or internationally, could disrupt our operations, the operations of our franchisees, or the operations of one or more of our vendors. In particular, these types of events could impact our product 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. To the extent any of these events occur, our operations and financial results could be adversely affected.

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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 outside of the United States and we require those vendors to adhere to a code of vendor conduct and other environmental, labor, health, and safety standards for the benefit of their workers. From time to time, contractors or their subcontractors may not be in compliance with these standards or applicable local laws. Significant or continuing noncompliance with such standards and laws by one or more contractors could have a negative impact on our reputation and an adverse effect on our 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 regulations, the imposition of additional 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.

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, China, and Italy. As of February 2, 2013, the Company-operated stores aggregated approximately 36.9 million square feet. Almost all of these stores are leased, with one or more renewal options after our initial term. Economic terms vary by type of location.

We own approximately 1.2 million square feet of corporate office space located in San Francisco, San Bruno, and Rocklin, California, of which approximately 448,000 square feet is leased to and occupied by others. We lease approximately 915,000 square feet of corporate office space located in San Francisco, Rocklin, Petaluma, and Los Angeles, California; New York, New York; Albuquerque, New Mexico; and Toronto, Ontario, Canada. We also lease regional offices in North America and in various international locations. We own approximately 8.6 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 8.6 million square feet of owned distribution space, 100,000 square feet is leased to others. We lease approximately 2.4 million square feet of distribution space located in Phoenix, Arizona; Grove City, Ohio; Northern Kentucky; Bolton, Ontario, Canada; and Stafford, England. Third-party logistics companies provide logistics services to us through distribution warehouses in Chiba, Japan; Shanghai and Hong Kong, China; and Edison, New Jersey.

In January 2013, we announced that we will not renew our lease agreement for a significant portion of the Northern Kentucky distribution space when it expires in June 2013.

Item 3. Legal Proceedings.

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, data privacy, and securities-related 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. However, 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.

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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. The number of holders of record of our stock as of March 19, 2013 was 7,894. The table below sets forth the market prices and dividends declared and paid for each of the fiscal quarters in fiscal 2012 and 2011.

	Market Prices				Dividends Declared and Paid	
	Fiscal 2012		Fiscal 2011		Fiscal Year	
	High	Low	High	Low	2012	2011
1st Quarter	$28.77	$18.53	$23.35	$18.94	$0.125	$0.1125
2nd Quarter	$30.17	$25.02	$23.73	$17.41	0.125	0.1125
3rd Quarter	$37.85	$29.39	$19.68	$15.08	0.125	0.1125
4th Quarter	$36.15	$29.84	$20.41	$17.62	0.125	0.1125
					$0.50	$0.45

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, 2013, with (i) the cumulative total return of the Dow Jones U.S. Retail Apparel Index and (ii) the S&P 500 Index. The total stockholder return for our common stock assumes quarterly reinvestment of dividends.

TOTAL RETURN TO STOCKHOLDERS
(Assumes $100 investment on 2/3/2008)

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Total Return Analysis

	2/2/2008	1/31/2009	1/30/2010	1/29/2011	1/28/2012	2/2/2013
The Gap, Inc.	$100.00	$59.61	$102.81	$105.47	$106.47	$188.59
S&P 500	$100.00	$61.37	$81.71	$99.84	$104.05	$121.51
Dow Jones U.S. Apparel Retailers	$100.00	$53.55	$101.41	$125.79	$149.75	$187.51

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, 2013 by The Gap, Inc. or any affiliated purchaser, as defined in Exchange Act Rule 10b-18(a)(3):

	Total Number of Shares Purchased	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 (1)
Month #1 (October 28 - November 24)	604,798	$34.72	604,798	$518 million
Month #2 (November 25 - December 29)	16,400,381	$31.52	16,400,381	—
Month #3 (December 30 - February 2)	808,029	$31.41	808,029	$975 million
Total	17,813,208	$31.63	17,813,208	

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(1) On February 23, 2012, we announced that the Board of Directors approved a $1 billion share repurchase authorization. This authorization was completed by the end of December 2012. On January 3, 2013, we announced that the Board of Directors approved a new $1 billion share repurchase authorization. The new authorization has no expiration date.

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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.

	Fiscal Year (number of weeks)				
	2012 (53)	2011 (52)	2010 (52)	2009 (52)	2008 (52)
Operating Results ($ in millions)					
Net sales	$15,651	$14,549	$14,664	$14,197	$14,526
Gross margin	39.4 %	36.2 %	40.2 %	40.3 %	37.5 %
Operating margin	12.4 %	9.9 %	13.4 %	12.8 %	10.7 %
Net income	$1,135	$833	$1,204	$1,102	$967
Cash dividends paid	$240	$236	$252	$234	$243
Per Share Data (number of shares in millions)					
Basic earnings per share	$2.35	$1.57	$1.89	$1.59	$1.35
Diluted earnings per share	$2.33	$1.56	$1.88	$1.58	$1.34
Weighted-average number of shares—basic	482	529	636	694	716
Weighted-average number of shares—diluted	488	533	641	699	719
Cash dividends declared and paid per share	$0.50	$0.45	$0.40	$0.34	$0.34
Balance Sheet Information ($ in millions)					
Merchandise inventory	$1,758	$1,615	$1,620	$1,477	$1,506
Total assets	$7,470	$7,422	$7,065	$7,985	$7,564
Working capital	$1,788	$2,181	$1,831	$2,533	$1,847
Total long-term debt, less current maturities (1)	$1,246	$1,606	$—	$—	$—
Stockholders’ equity	$2,894	$2,755	$4,080	$4,891	$4,387
Other Data ($ and square footage in millions)					
Purchases of property and equipment	$659	$548	$557	$334	$431
Acquisition of business, net of cash acquired (2)	$129	$—	$—	$—	$142
Percentage increase (decrease) in comparable sales (3)	5 %	(4)%	2 %	(3)%	(12)%
Number of Company-operated store locations open at year-end	3,095	3,036	3,068	3,095	3,149
Number of franchise store locations open at year-end	312	227	178	136	114
Number of store locations open at year-end (4)	3,407	3,263	3,246	3,231	3,263
Square footage of Company-operated store space at year-end	36.9	37.2	38.2	38.8	39.5
Percentage decrease in square footage of Company-operated store space at year-end	(0.8)%	(2.6)%	(1.5)%	(1.8)%	(0.3)%

Number of employees at year-end	136,000	132,000	134,000	135,000	134,000

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(1) In April 2012, we made the first scheduled payment of $40 million related to our $400 million term loan and in August 2012, we repaid the remaining $360 million balance in full.

(2) On September 28, 2008, we acquired all of the outstanding capital stock of Athleta, a women's sports and active apparel company, for an aggregate purchase price of $148 million. On December 31, 2012, we acquired all of the outstanding capital stock of Intermix, a multi-brand specialty retailer of luxury and contemporary apparel and accessories, for an aggregate purchase price of $129 million.

(3) Beginning in fiscal 2011, we report comparable sales including the associated comparable online sales. Comparable sales for fiscal 2010 have been recalculated to include the associated comparable online sales. Comparable sales for fiscal 2009 and 2008 exclude online sales.

(4) Includes Company-operated and franchise store locations.

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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, children, and babies under the Gap, Old Navy, Banana Republic, Piperlime, Athleta, and Intermix brands. We have Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, and beginning in November 2010, China and Italy. We also have franchise agreements with unaffiliated franchisees to operate Gap and Banana Republic stores in many other countries around the world. Under these agreements, third parties operate, or will operate, stores that sell apparel and related products under our brand names. In addition, our products are available to customers online in over 80 countries. 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, especially at our Piperlime and Intermix brands.

We identify our operating segments based on the way we manage and evaluate our business activities. As of February 2, 2013, we have two reportable segments: Stores and Direct.

We are pleased with our fiscal 2012 results. We delivered against our stated priorities to drive increased sales with healthy merchandise margins, prudently invest in our business, grow earnings per share, and return excess cash to shareholders. We delivered positive comparable sales in North America for Gap, Banana Republic, and Old Navy in each of the four quarters of fiscal 2012. We executed on key expansion initiatives with 25 new Athleta stores, more than 30 new Gap stores in China, and our first Old Navy store in Japan. We generated $1.3 billion of free cash flow and distributed $1.3 billion to shareholders through dividends and share repurchases. Free cash flow is defined as net cash provided by operating activities less purchases of property and equipment. For a reconciliation of free cash flow, a non-GAAP (generally accepted accounting principles) financial measure, from a GAAP financial measure, see the Liquidity and Capital Resources section.

Fiscal 2012 consisted of 53 weeks versus 52 weeks in fiscal 2011 and 2010. 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 2012 are as follows:

- Net sales for fiscal 2012 increased $1.1 billion to $15.7 billion compared with $14.5 billion for fiscal 2011.
- Comparable sales, which include the associated comparable online sales, for fiscal 2012 increased 5 percent compared with a 4 percent decrease last year.
- Direct net sales for fiscal 2012 increased by 24 percent to $1.9 billion compared with $1.6 billion for fiscal 2011.
- Gross profit for fiscal 2012 was $6.2 billion compared with $5.3 billion for fiscal 2011. Gross margin for fiscal 2012 was 39.4 percent compared with 36.2 percent for fiscal 2011.
- Operating expenses for fiscal 2012 increased $393 million to $4.2 billion compared with $3.8 billion for fiscal 2011 and increased 0.6 percent as a percentage of net sales.
- Operating margin for fiscal 2012 was 12.4 percent compared with 9.9 percent for fiscal 2011. Operating margin is defined as operating income as a percentage of net sales.
- Net income for fiscal 2012 was $1.1 billion compared with $833 million for fiscal 2011. Diluted earnings per share increased 49 percent to $2.33 for fiscal 2012 compared with $1.56 for fiscal 2011.
- In fiscal 2012, we generated free cash flow of $1.3 billion compared with free cash flow of $815 million for fiscal 2011.
- During fiscal 2012, we repurchased about 34 million shares for $1.0 billion and paid cash dividends of $240 million.

In October 2012, we announced a new global brand structure that will guide our long-term growth strategies and shape our future management structure. Beginning in fiscal 2013, we will combine all channels and geographies under one global leader each for Gap, Banana Republic, and Old Navy. Each global brand president will oversee their brand's specialty, outlet, online, and franchise operations. Our newer brands (Piperlime, Athleta, and Intermix) will be managed within our new Growth, Innovation, and Digital division as part of the new structure.

Our business and financial priorities for fiscal 2013 are as follows:

- grow sales with healthy merchandise margins;
- manage our expenses in a disciplined manner;

- deliver operating margin expansion and earnings per share growth; and
- return excess cash to shareholders.

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In addition to increasing sales within our existing business, we also plan to grow revenues through our new brands, channels, and geographies, including the following:

- opening additional stores in Asia with a focus on Gap China and Old Navy Japan;
- expanding our global outlet presence;
- continuing to open franchise stores worldwide; and
- opening additional Athleta stores.

In fiscal 2013, we expect diluted earnings per share to be in the range of $2.52 to $2.60.

Results of Operations

Net Sales

Net sales primarily consist of retail sales, online sales, and franchise revenues.

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

Comparable Sales

The percentage change in comparable ("Comp") sales by brand and region and for total Company, including the associated comparable online sales, as compared with the preceding year, is as follows:

	Fiscal Year	
	2012	2011
Gap North America	6 %	(4)%
Old Navy North America	6 %	(3)%
Banana Republic North America	5 %	(1)%
International	(3)%	(7)%
The Gap, Inc.	5 %	(4)%

The percentage change in Comp store sales by brand and region and for total Company, excluding the associated comparable online sales, as compared with the preceding year, is as follows:

	Fiscal Year	
	2012	2011
Gap North America	4 %	(6)%
Old Navy North America	5 %	(6)%
Banana Republic North America	3 %	(2)%
International	(4)%	(9)%
The Gap, Inc.	3 %	(6)%

Only Company-operated stores are included in the calculations of Comp sales. Gap and Banana Republic outlet Comp sales are reflected within the respective results of each brand. The calculation of total Company Comp sales excludes the results of our franchise business, Piperlime, Athleta, and Intermix.

A store is included in the Comp sales calculations when it has been open and operated by Gap, Inc. for at least one calendar 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 Gap, Inc. for less than one calendar 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 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.

Online Comp sales are defined as sales through online channels in all countries where we have existing Comp store sales.

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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		
	2012	2011	2010
Net sales per average square foot (1)	$364	$337	$342

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(1) Excludes net sales associated with our online, catalog, and franchise businesses.

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

	January 28, 2012	Fiscal 2012		February 2, 2013	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Gap North America	1,043	30	83	990	10.2
Gap Europe	193	6	1	198	1.7
Gap Asia	152	45	6	191	1.9
Old Navy North America	1,016	26	32	1,010	17.6
Old Navy Asia	—	1	—	1	—
Banana Republic North America	581	22	13	590	4.9
Banana Republic Asia	31	9	2	38	0.2
Banana Republic Europe	10	—	—	10	0.1
Athleta North America	10	25	—	35	0.2
Piperlime North America	—	1	—	1	—
Intermix North America (1)	—	—	—	31	0.1
Company-operated stores total	3,036	165	137	3,095	36.9
Franchise	227	98	13	312	N/A
Total	3,263	263	150	3,407	36.9
Increase (decrease) over prior year				4.4 %	(0.8)%

	January 29, 2011	Fiscal 2011		January 28, 2012	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Gap North America	1,111	23	91	1,043	10.7
Gap Europe	184	14	5	193	1.7
Gap Asia	135	22	5	152	1.5
Old Navy North America	1,027	32	43	1,016	18.1
Banana Republic North America	576	14	9	581	4.9
Banana Republic Asia	29	3	1	31	0.2
Banana Republic Europe	5	5	—	10	0.1
Athleta North America	1	9	—	10	—
Company-operated stores total	3,068	122	154	3,036	37.2
Franchise	178	52	3	227	N/A
Total	3,246	174	157	3,263	37.2
Increase (decrease) over prior year				0.5 %	(2.6)%

(1) On December 31, 2012, we acquired all of the outstanding capital stock of Intermix. The 31 stores acquired were not included as store openings for fiscal 2012; however, they are included in the ending number of store locations as of February 2, 2013.

Gap and Banana Republic outlet stores are reflected in each of the respective brands. In addition, we have franchise agreements with unaffiliated franchisees to operate Gap and Banana Republic stores throughout Asia, Australia, Eastern Europe, Latin America, the Middle East, and Africa.

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In fiscal 2013, we expect to open about 190 Company-operated store locations (about 160 net of repositions) and close about 110 Company-operated store locations (about 80 net of repositions). We expect square footage for Company-operated stores to increase about 1 percent for fiscal 2013. We expect our franchisees to open about 75 franchise stores in fiscal 2013.

Net Sales Discussion

Our net sales for fiscal 2012 increased $1.1 billion compared with fiscal 2011 due to an increase in net sales of $735 million related to our Stores reportable segment and an increase in net sales of $367 million related to our Direct reportable segment. Fiscal 2012 consisted of 53 weeks.

- For the Stores reportable segment, our net sales for fiscal 2012 increased $735 million compared with fiscal 2011. The increase was primarily due to an increase in Comp store sales, excluding the associated comparable online sales, for North America and incremental sales for new international stores; partially offset by the unfavorable impact of foreign exchange of $43 million. The foreign exchange impact is the translation impact if net sales for fiscal 2011 were translated at fiscal 2012 exchange rates.
- For the Direct reportable segment, our net sales for fiscal 2012 increased $367 million compared with fiscal 2011. The increase was due to growth in our online business across all brands and the incremental sales related to new Athleta stores.

In fiscal 2012, our net sales (including Direct) for the U.S. and Canada were $13.3 billion, an increase of $914 million compared with $12.4 billion for fiscal 2011. In fiscal 2012, our net sales (including Direct and franchise), outside of the U.S. and Canada were $2.4 billion, an increase of $188 million compared with $2.2 billion for fiscal 2011.

Our net sales for fiscal 2011 decreased $115 million, or 1 percent, compared with fiscal 2010 due to a decrease in net sales of $376 million related to our Stores reportable segment, partially offset by an increase in net sales of $261 million related to our Direct reportable segment.

- For the Stores reportable segment, our net sales for fiscal 2011 decreased $376 million, or 3 percent, compared with fiscal 2010. The decrease was primarily due to a decrease in Comp store sales, excluding the associated comparable online sales, of 6 percent for fiscal 2011 compared with fiscal 2010, partially offset by the favorable impact of foreign exchange of $156 million and an increase in franchise sales. The foreign exchange impact is the translation impact if net sales for fiscal 2010 were translated at fiscal 2011 exchange rates.
- For the Direct reportable segment, our net sales for fiscal 2011 increased $261 million, or 20 percent, compared with fiscal 2010. The increase was due to the growth in our online business across all brands and the incremental sales related to the introduction of international online sales in fiscal 2010.

In fiscal 2011, our net sales (including Direct) for the U.S. and Canada were $12.4 billion, a decrease of $353 million, or 3 percent, compared with $12.7 billion for fiscal 2010. In fiscal 2011, our net sales (including Direct and franchise) outside of the U.S. and Canada were $2.2 billion, an increase of $238 million, or 12 percent, compared with $1.9 billion for fiscal 2010.

In fiscal 2013, we will return to a 52-week fiscal year which could potentially impact the seasonality of net sales throughout the year as a result of the calendar shift of our fiscal quarters in fiscal 2013 compared with fiscal 2012. In addition, we expect foreign exchange rate fluctuations to have a meaningful impact on our net sales generated internationally. For example, if the Japanese yen continues to weaken against the U.S. dollar, our yen-based sales translated into U.S. dollars will vary significantly from prior years and could negatively impact our total Company net sales growth.

Cost of Goods Sold and Occupancy Expenses

($ in millions)	Fiscal Year 2012	2011	2010
Cost of goods sold and occupancy expenses	$9,480	$9,275	$8,775
Gross profit	$6,171	$5,274	$5,889
Cost of goods sold and occupancy expenses as a percentage of net sales	60.6 %	63.8 %	59.8 %

Gross margin	39.4 %	36.2 %	40.2 %

Cost of goods sold and occupancy expenses decreased 3.2 percentage points in fiscal 2012 compared with fiscal 2011.

- Cost of goods sold decreased 2.0 percentage points in fiscal 2012 compared with fiscal 2011. The decrease in cost of goods sold as a percentage of net sales was primarily driven by decreased cost of merchandise as well as improved product acceptance resulting in improved regular price margins.

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- Occupancy expenses decreased 1.2 percentage points in fiscal 2012 compared with fiscal 2011. The decrease in occupancy expenses as a percentage of net sales was primarily driven by higher net sales without a corresponding increase in occupancy expenses.

Cost of goods sold and occupancy expenses increased 4.0 percentage points in fiscal 2011 compared with fiscal 2010.

- Cost of goods sold increased 3.7 percentage points in fiscal 2011 compared with fiscal 2010. The increase in cost of goods sold as a percentage of net sales was primarily driven by increased cost of merchandise primarily due to higher cotton prices.
- Occupancy expenses increased 0.3 percentage points in fiscal 2011 compared with fiscal 2010. The increase in occupancy expenses as a percentage of net sales was primarily driven by lower net sales for the Stores reportable segment without a corresponding decrease in occupancy expenses, partially offset by higher net sales for the Direct reportable segment without a corresponding increase in occupancy expenses.

Operating Expenses and Operating Margin

($ in millions)	Fiscal Year 2012		2011		2010	
Operating expenses	$4,229		$3,836		$3,921	
Operating expenses as a percentage of net sales	27.0	%	26.4	%	26.7	%
Operating margin	12.4	%	9.9	%	13.4	%

Operating expenses increased $393 million, or 0.6 percentage points, in fiscal 2012 compared with fiscal 2011. The increase in operating expenses was primarily due to higher marketing expenses driven largely by investments in Gap brand marketing and customer relationship marketing, store payroll and other store-related expenses, and higher bonus expense.

Operating expenses decreased $85 million, or 0.3 percentage points, in fiscal 2011 compared with fiscal 2010. The decrease in operating expenses was primarily due to higher income from fees earned under the private label and co-branded credit card agreements, partially offset by an increase in marketing expenses.

In fiscal 2013, we expect operating margin to be about 13%.

Interest Expense (Reversal)

($ in millions)	Fiscal Year 2012	2011	2010	
Interest expense (reversal)	$87	$74	$(8	)

Interest expense for fiscal 2012 and 2011 primarily consists of interest expense related to our $1.25 billion long-term debt, which was issued in April 2011, and $400 million term loan, which was funded in May 2011 and repaid in full in August 2012.

Interest expense for fiscal 2010 includes an interest expense reversal of $15 million from the reduction of interest expense accruals resulting primarily from the filing of a U.S. federal income tax accounting method change application and the resolution of the Internal Revenue Service's review of the Company's federal income tax returns and refund claims for fiscal 2001 through 2006.

Income Taxes

($ in millions)	Fiscal Year 2012		2011		2010	
Income taxes	$726		$536		$778	
Effective tax rate	39.0	%	39.2	%	39.3	%

The decrease in the effective tax rate for fiscal 2012 compared with fiscal 2011 was the result of slight changes in the individual components of the effective tax rate. The changes were primarily due to the impact of higher federal tax credits, which were partially offset by an increase in our state taxes as a result of changes in the mix of state earnings in fiscal 2012.

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While the effective tax rate for fiscal 2011 decreased slightly compared with fiscal 2010, there were changes in individual components of the effective tax rate. State and other income taxes decreased primarily due to changes in state tax laws and increases in state and federal tax credits. The decreases in these components were offset by the tax impact of foreign operations, which increased primarily due to operating losses in China and Hong Kong for fiscal 2011 (for which no tax benefit has been provided), and their greater impact due to lower Gap Inc. pre-tax income for fiscal 2011, as well as the unfavorable impact of a change in the mix of income between domestic and foreign operations.

We currently expect the fiscal 2013 effective tax rate to be about 39 percent. The actual rate will ultimately depend on several variables, including the mix of income between domestic and international operations, the overall level of income, the potential resolution of outstanding tax contingencies, and changes in tax laws and rates.

Liquidity and Capital Resources

Our largest source of operating cash flows is cash collections from the sale of our merchandise. Our primary uses of cash include merchandise inventory purchases, occupancy costs, personnel-related expenses, purchases of property and equipment, payment of taxes, and share repurchases. In addition to share repurchases, we also continue to return excess cash to our shareholders in the form of dividends.

In the first quarter of fiscal 2011, we made the strategic decision to issue debt in the aggregate amount of $1.65 billion. Given favorable market conditions and our history of generating consistent and strong operating cash flow, we took this step to provide a more optimal capital structure. We remain committed to maintaining a strong financial profile with ample liquidity. Proceeds from the debt issuance were available for general corporate purposes, including share repurchases. During fiscal 2012, we repaid our $400 million, five-year, unsecured term loan in full.

We consider the following to be measures of our liquidity and capital resources:

($ in millions)	February 2, 2013	January 28, 2012	January 29, 2011
Cash and cash equivalents and short-term investments	$1,510	$1,885	$1,661
Debt	$1,246	$1,665	$3
Working capital	$1,788	$2,181	$1,831
Current ratio	1.76:1	2.02:1	1.87:1

As of February 2, 2013, about half of our cash and cash equivalents were held in the U.S. and are generally accessible without any limitations.

We believe that current cash balances and cash flows from our operations will be sufficient to support our business operations, including growth initiatives and planned capital expenditures, for the next 12 months and beyond. We are also able to supplement near-term liquidity, if necessary, with our $500 million revolving credit facility.

Cash Flows from Operating Activities

Net cash provided by operating activities during fiscal 2012 increased $573 million compared with fiscal 2011, primarily due to the following:

- an increase in net income in fiscal 2012 compared with fiscal 2011;
- an increase related to income taxes payable, net of prepaid income taxes and other tax-related items, in fiscal 2012 compared with fiscal 2011 primarily due to the timing of tax payments;
- an increase related to accrued expenses and other current liabilities in fiscal 2012 compared with fiscal 2011 primarily due to a higher bonus accrual in fiscal 2012 compared with fiscal 2011; and
- an increase related to accounts payable in fiscal 2012 compared with fiscal 2011 primarily due to the volume and timing of payments; partially offset by
- an increase in merchandise inventory in fiscal 2012 compared with fiscal 2011 primarily due to the timing of inventory receipts.

Net cash provided by operating activities during fiscal 2011 decreased $381 million compared with fiscal 2010, primarily due to the following:

- a decrease in net income in fiscal 2011 compared with fiscal 2010.

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We fund inventory expenditures during normal and peak periods through cash flows from operating activities and available cash. Our business follows a seasonal pattern, with sales peaking over a total of about eight weeks during the end-of-year holiday period. The seasonality of our operations, combined with the calendar shift of weeks in fiscal 2013 compared with fiscal 2012 as a result of the 53rd week in fiscal 2012, may lead to significant fluctuations in certain asset and liability accounts between fiscal year-end and subsequent interim periods.

In fiscal 2013, we expect depreciation and amortization, net of amortization of lease incentives, to be about $475 million.

Cash Flows from Investing Activities

Our cash outflows for investing activities are primarily for capital expenditures and purchases of investments, while cash inflows are primarily proceeds from maturities of investments. Net cash used for investing activities during fiscal 2012 increased $390 million compared with fiscal 2011, primarily due to the following:

- $50 million of net purchases of short-term investments in fiscal 2012 compared with $100 million of net maturities in fiscal 2011;
- $129 million used for the acquisition of Intermix in fiscal 2012; and
- $111 million more property and equipment purchases in fiscal 2012 compared with fiscal 2011.

Net cash used for investing activities during fiscal 2011 increased $25 million compared with fiscal 2010, primarily due to the following:

- $25 million less net maturities of short-term investments in fiscal 2011 compared with fiscal 2010.

In fiscal 2012, capital expenditures were $659 million. In fiscal 2013, we expect capital expenditures to be about $675 million.

Cash Flows from Financing Activities

Our cash outflows from financing activities consist primarily of the repurchases of our common stock, repayments of debt, and dividend payments. Cash inflows primarily consist of proceeds from the issuance of debt and proceeds from issuances under share-based compensation plans, net of withholding tax payments. Net cash used for financing activities during fiscal 2012 increased $879 million compared with fiscal 2011, primarily due to the following:

- $1.6 billion of proceeds from our issuance of long-term debt in fiscal 2011; and
- $400 million of payments of long-term debt in fiscal 2012; partially offset by
- $1.1 billion less repurchases of common stock in fiscal 2012 compared with fiscal 2011.

Net cash used for financing activities during fiscal 2011 decreased $1.5 billion compared with fiscal 2010, primarily due to the following:

- $1.6 billion of proceeds from our issuance of long-term debt in fiscal 2011; partially offset by
- $133 million more repurchases of common stock in fiscal 2011 compared with fiscal 2010.

Free Cash Flow

Free cash flow is a non-GAAP financial measure. We believe free cash flow is an important metric because it represents a measure of how much cash a company has available for discretionary and non-discretionary items after the deduction of capital expenditures, as we require regular capital expenditures to build and maintain stores and purchase new equipment to improve our business. We use this metric internally, as we believe our sustained ability to generate free cash flow is an important driver of value creation. However, this non-GAAP financial measure is not intended to supersede or replace our GAAP result.

The following table reconciles free cash flow, a non-GAAP financial measure, from a GAAP financial measure.

	Fiscal Year		
($ in millions)	2012	2011	2010
Net cash provided by operating activities	$1,936	$1,363	$1,744
Less: Purchases of property and equipment	(659)	(548)	(557)
Free cash flow	$1,277	$815	$1,187

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Long-Term Debt

In April 2011, we issued $1.25 billion aggregate principal amount of 5.95 percent notes (the “Notes”) due April 2021 and received proceeds of $1.24 billion in cash, net of underwriting and other fees. Interest is payable semi-annually on April 12 and October 12 of each year and commenced on October 12, 2011. We have an option to call the Notes in whole or in part at any time, subject to a make whole premium. The Notes agreement is unsecured and does not contain any financial covenants.

In April 2011, we also entered into a $400 million, five-year, unsecured term loan due April 2016, which was funded in May 2011. Repayments of $40 million were payable on April 7 of each year, commencing on April 7, 2012, with a final repayment of $240 million due on April 7, 2016. In addition, interest was payable at least quarterly based on an interest rate equal to the London Interbank Offered Rate (“LIBOR”) plus a margin based on our long-term senior unsecured credit ratings. In April 2012, we repaid $40 million on the term loan and in August 2012, we repaid the remaining $360 million reducing the outstanding balance on the term loan to zero.

Credit Facilities

We have a $500 million, five-year, unsecured revolving credit facility (the “Facility”), which is scheduled to expire in April 2016. The Facility is available for general corporate purposes including working capital, trade letters of credit, and standby letters of credit. The Facility fees fluctuate based on our long-term senior unsecured credit ratings and our leverage ratio. If we were to draw on the Facility, interest would be a base rate (typically LIBOR) plus a margin based on our long-term senior unsecured credit ratings and our leverage ratio on the unpaid principal amount. To maintain availability of funds under the Facility, we pay a facility fee on the full facility amount, regardless of usage. As of February 2, 2013, there were no borrowings under the Facility. The net availability of the Facility, reflecting $30 million of outstanding standby letters of credit, was $470 million as of February 2, 2013.

On April 7, 2011, we obtained long-term senior unsecured credit ratings from Moody’s Investors Service (“Moody’s”) and Fitch Ratings (“Fitch”). Moody’s assigned a rating of Baa3, and Fitch assigned a rating of BBB-. Standard & Poor’s Rating Service (“Standard & Poor’s”) continues to rate us BB+. As of February 2, 2013, there were no changes in these credit ratings. Any future reduction in the Moody’s or Standard & Poor’s ratings would increase any future interest expense if we were to draw on the Facility. If a one notch reduction in our Moody’s or Standard & Poor’s ratings were to occur during fiscal 2013, the increase in our interest expense for fiscal 2013 would be immaterial.

We also have two separate agreements to make unsecured revolving credit facilities available for our operations in China (the “China Facilities”). The China Facilities are uncommitted and are available for borrowings, overdraft borrowings, and the issuance of bank guarantees. The 196 million Chinese yuan China Facilities expired in the third quarter of fiscal 2012 and they were subsequently renewed with an increased availability of 250 million Chinese yuan ($40 million as of February 2, 2013) and no expiration date. As of February 2, 2013, there were no borrowings under the China Facilities. There were 24 million Chinese yuan ($4 million as of February 2, 2013) in bank guarantees related to store leases under the China Facilities as of February 2, 2013. The China Facility agreements do not contain any financial covenants.

As of February 2, 2013, we also had a $50 million, two-year, unsecured committed letter of credit agreement with an expiration date of September 2014. As of February 2, 2013, we had no material trade letters of credit issued under this letter of credit agreement. Trade letters of credit represent a payment undertaking guaranteed by a bank on our behalf to pay a vendor a given amount of money upon presentation of specific documents demonstrating that merchandise has shipped.

The Facility and letter of credit agreement contain financial and other covenants including, but not limited to, limitations on liens and subsidiary debt, as well as the maintenance of two financial ratios—a minimum annual fixed charge coverage ratio of 2.00 and a maximum annual leverage ratio of 2.25. As of February 2, 2013, we were in compliance with all such covenants. Violation of these covenants could result in a default under the Facility and letter of credit agreement, which would permit the participating banks to terminate our ability to access the Facility for letters of credit and advances, terminate our ability to request letters of credit under the letter of credit agreement, require the immediate repayment of any outstanding advances under the Facility, and require the immediate posting of cash collateral in support of any outstanding letters of credit under the letter of credit agreement.

Dividend Policy
In determining whether and at what level to declare a dividend, we consider a number of factors including sustainability, operating performance, liquidity, and market conditions.
We increased our annual dividend, which had been $0.45 per share for fiscal 2011, to $0.50 per share for fiscal 2012. We intend to increase our annual dividend to $0.60 per share for fiscal 2013.

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Share Repurchases

Between February 2010 and February 2012, the Board of Directors authorized a total of $5.25 billion for share repurchases, all of which was completed by the end of December 2012. In January 2013, we announced that the Board of Directors approved a new $1 billion share repurchase authorization, of which $975 million was remaining as of February 2, 2013.

During fiscal 2012, we repurchased approximately 34 million shares for $1.0 billion, including commissions, at an average price per share of $29.89.

Contractual Cash Obligations

We are party to many contractual obligations involving commitments to make payments to third parties. The following table provides summary information concerning our future contractual obligations as of February 2, 2013. These obligations impact our short-term and long-term liquidity and capital resource needs. Certain of these contractual obligations are reflected in the Consolidated Balance Sheet, while others are disclosed as future obligations.

	Payments Due by Period				
($ in millions)	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	Total
Long-term debt (1)	$—	$—	$—	$1,250	$1,250
Interest payments on long-term debt	74	149	149	260	632
Liabilities for unrecognized tax benefits (2)	7	—			