GAP INC
Form 10-Q
June 08, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended April 30, 2011

¨ **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 or other jurisdiction of incorporation or organization)	**(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

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 (§232.405 of this chapter) 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 Exchange Act).

Yes ¨ No þ

The number of shares of the registrant s common stock outstanding as of May 31, 2011 was 550,426,338.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

THE GAP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

($ and shares in millions except par value)	April 30, 2011	January 29, 2011	May 1, 2010
ASSETS			
Current assets:			
Cash and cash equivalents	$ 2,417	$ 1,561	$ 2,056
Short-term investments	50	100	425
Merchandise inventory	1,713	1,620	1,534
Other current assets	690	645	649
Total current assets	4,870	3,926	4,664
Property and equipment, net of accumulated depreciation of $5,111, $5,010, and $4,832	2,559	2,563	2,585
Other long-term assets	598	576	696
Total assets	$ 8,027	$ 7,065	$ 7,945
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 1,053	$ 1,049	$ 1,052
Accrued expenses and other current liabilities	952	996	894
Income taxes payable	85	50	145
Total current liabilities	2,090	2,095	2,091
Long-term liabilities:			
Long-term debt	1,246		
Lease incentives and other long-term liabilities	920	890	947
Total long-term liabilities	2,166	890	947
Commitments and contingencies (see Note 11)			
Stockholders equity:			
Common stock $0.05 par value			
Authorized 2,300 shares; Issued 1,106 shares for all periods presented; Outstanding 569, 588, and 667 shares	55	55	55
Additional paid-in capital	2,865	2,939	2,920
Retained earnings	11,934	11,767	11,050
Accumulated other comprehensive income	200	185	146
Treasury stock, at cost (537, 518, and 439 shares)	(11,283)	(10,866)	(9,264)
Total stockholders equity	3,771	4,080	4,907
Total liabilities and stockholders equity	$ 8,027	$ 7,065	$ 7,945

See Accompanying Notes to Condensed Consolidated Financial Statements

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THE GAP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	00000000	00000000
	13 Weeks Ended	
($ and shares in millions except per share amounts)	**April 30, 2011**	**May 1, 2010**
Net sales	$ 3,295	$ 3,329
Cost of goods sold and occupancy expenses	1,991	1,928
Gross profit	1,304	1,401
Operating expenses	918	927
Operating income	386	474
Interest expense (reversal)	6	(10)
Interest income	(1)	(1)
Income before income taxes	381	485
Income taxes	148	183
Net income	$ 233	$ 302
Weighted-average number of shares - basic	583	668
Weighted-average number of shares - diluted	588	676
Earnings per share - basic	$ 0.40	$ 0.45
Earnings per share - diluted	$ 0.40	$ 0.45
Cash dividends declared and paid per share	$ 0.1125	$ 0.10

See Accompanying Notes to Condensed Consolidated Financial Statements

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THE GAP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	0000000	0000000
	13 Weeks Ended	
($ in millions)	**April 30, 2011**	**May 1, 2010**
Cash flows from operating activities:		
Net income	$ 233	$ 302
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	151	166
Amortization of lease incentives	(22)	(19)
Share-based compensation	17	27
Tax benefit from exercise of stock options and vesting of stock units	9	7
Excess tax benefit from exercise of stock options and vesting of stock units	(10)	(8)
Non-cash and other items	16	13
Deferred income taxes	2	(14)
Changes in operating assets and liabilities:		
Merchandise inventory	(80)	(58)
Other current assets and other long-term assets	(42)	(53)
Accounts payable	(7)	16
Accrued expenses and other current liabilities	(106)	(180)
Income taxes payable, net of prepaid and other tax-related items	36	132
Lease incentives and other long-term liabilities	34	(2)
Net cash provided by operating activities	231	329
Cash flows from investing activities:		
Purchases of property and equipment	(127)	(107)
Purchases of short-term investments		(325)
Maturities of short-term investments	50	125
Change in restricted cash		2
Change in other long-term assets	(2)	
Net cash used for investing activities	(79)	(305)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	1,246	
Payments of long-term debt issuance costs	(11)	
Proceeds from share-based compensation, net of withholding tax payments	28	45
Repurchases of common stock	(518)	(299)
Excess tax benefit from exercise of stock options and vesting of stock units	10	8
Cash dividends paid	(66)	(67)
Net cash provided by (used for) financing activities	689	(313)
Effect of foreign exchange rate fluctuations on cash	15	(3)
Net increase (decrease) in cash and cash equivalents	856	(292)
Cash and cash equivalents at beginning of period	1,561	2,348

Cash and cash equivalents at end of period	$	2,417	$	2,056
Non-cash investing activities:				
Purchases of property and equipment not yet paid at end of period	$	48	$	59
Supplemental disclosure of cash flow information:				
Cash paid for interest during the period	$	1	$	
Cash paid for income taxes during the period	$	94	$	56

See Accompanying Notes to Condensed Consolidated Financial Statements

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THE GAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The Condensed Consolidated Balance Sheets as of April 30, 2011 and May 1, 2010, the Condensed Consolidated Statements of Income for the thirteen weeks ended April 30, 2011 and May 1, 2010, and the Condensed Consolidated Statements of Cash Flows for the thirteen weeks ended April 30, 2011 and May 1, 2010 have been prepared by The Gap, Inc. (the Company, we, and our), without audit. In the opinion of management, such statements include all adjustments (which include only normal recurring adjustments) considered necessary to present fairly our financial position, results of operations, and cash flows as of April 30, 2011 and May 1, 2010 and for all periods presented. The Condensed Consolidated Balance Sheet as of January 29, 2011 has been derived from our audited financial statements.

Beginning July 31, 2010, we included restricted cash in other current assets in the Condensed Consolidated Balance Sheets. Accordingly, restricted cash of $17 million as of May 1, 2010 has been included in other current assets to conform to the current period presentation.

We identify our operating segments based on the way we manage and evaluate our business activities. We have two reportable segments: Stores and Direct.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted from these interim financial statements. We suggest that you read these Condensed Consolidated Financial Statements in conjunction with the Consolidated Financial Statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 29, 2011.

The results of operations for the thirteen weeks ended April 30, 2011 are not necessarily indicative of the operating results that may be expected for the fifty-two week period ending January 28, 2012.

Note 2. Goodwill and Intangible Assets

Goodwill and intangible assets consist of the following and are included in other long-term assets:

($ in millions)	April 30, 2011	January 29, 2011	May 1, 2010
Goodwill	$ 99	$ 99	$ 99
Trade name	$ 54	$ 54	$ 54
Intangible assets subject to amortization	$ 15	$ 15	$ 15
Less: Accumulated amortization	(13)	(12)	(9)
Intangible assets subject to amortization, net	$ 2	$ 3	$ 6

All of the assets above have been allocated to the Direct reportable segment.

During the thirteen weeks ended April 30, 2011 and May 1, 2010, there were no changes in the carrying amount of goodwill or the trade name. Intangible assets subject to amortization, consisting primarily of customer relationships, are being amortized over a weighted-average amortization period of four years. Amortization expense for intangible assets subject to amortization was $1 million for each of the thirteen week periods ended April 30, 2011 and May 1, 2010 and is recorded in operating expenses in the Condensed Consolidated Statements of Income. For the remainder of fiscal 2011, we expect amortization expense for intangible assets subject to amortization to be $1 million.

As of April 30, 2011, future amortization expense for intangible assets subject to amortization is $1 million for fiscal 2012. Subsequent to fiscal 2012, there will be no amortization expense for existing intangible assets subject to amortization.

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Note 3. Debt

In April 2011, we issued $1.25 billion aggregate principal amount of 5.95 percent notes (the Notes) due April 12, 2021 and received proceeds of $1.24 billion in cash, net of underwriting and other fees. The net proceeds are available for general corporate purposes, including repurchases of our common stock. Interest is payable semi-annually on April 12 and October 12 of each year, commencing on October 12, 2011. We have an option to call the Notes in whole or in part at any time at our expense. The Notes agreement is unsecured and does not contain any financial covenants. The amount recorded in long-term debt in the Condensed Consolidated Balance Sheets for the Notes is equal to the aggregate principal amount of the Notes, net of the unamortized discount. The estimated fair value of the Notes was $1.26 billion as of April 30, 2011 and was based on the quoted market price of the Notes as of the last business day of the thirteen week period ended April 30, 2011.

In April 2011, we also entered into a $400 million, five-year, unsecured term loan due April 2016 with an interest rate equal to the London Interbank Offered Rate (LIBOR) plus a margin based on our long-term senior unsecured credit ratings. The term loan agreement contains 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 fixed charge coverage ratio and a leverage ratio. Violation of these covenants could result in a default under the term loan agreement, which would require the immediate repayment of outstanding amounts. The loan was funded in May 2011.

In conjunction with our financings, we obtained new 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+. Any future reduction in the Moody s and Standard & Poor s ratings would increase our interest expense related to our $400 million term loan.

Note 4. Fair Value Measurements

Effective January 30, 2011, we adopted enhanced disclosure requirements for fair value measurements. There were no purchases, sales, issuances, or settlements related to recurring level 3 measurements during the thirteen weeks ended April 30, 2011.

There were no transfers into or out of level 1 and level 2 during the thirteen weeks ended April 30, 2011 and May 1, 2010.

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Financial Assets and Liabilities

Financial assets and liabilities measured at fair value on a recurring basis and cash equivalents and short-term investments held at amortized cost are as follows:

($ in millions)	April 30, 2011	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 814	$	$ 814	$
Short-term investments	50		50	
Derivative financial instruments	4		4	
Deferred compensation plan assets	30	30		
Total	$ 898	$ 30	$ 868	$
Liabilities:				
Derivative financial instruments	$ 69	$	$ 69	$

($ in millions)	January 29, 2011	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 604	$	$ 604	$
Short-term investments	100		100	
Derivative financial instruments	4		4	
Deferred compensation plan assets	27	27		
Total	$ 735	$ 27	$ 708	$
Liabilities:				
Derivative financial instruments	$ 37	$	$ 37	$

($ in millions)	May 1, 2010	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

			1)				
Assets:							
Cash equivalents	$	1,193	$	50	$	1,143	$
Short-term investments		425		175		250	
Derivative financial instruments		17				17	
Deferred compensation plan assets		25		25			
Total	$	1,660	$	250	$	1,410	$
Liabilities:							
Derivative financial instruments	$	21	$		$	21	$

We have highly liquid investments classified as cash equivalents and short-term investments. These investments are classified as held-to-maturity based on our positive intent and ability to hold the securities to maturity. We value these investments at their original purchase prices plus interest that has accrued at the stated rate. The May 1, 2010 fair value table has been updated to include cash equivalents and short-term investments in level 2.

Derivative financial instruments primarily include foreign exchange forward contracts. The principal currencies hedged against changes in the U.S. dollar are Euro, British pounds, Japanese yen, and Canadian dollars. The fair value of the Company s derivative financial instruments is determined using pricing models based on current market rates. Derivative financial instruments in an asset position are recorded in other current assets or other long-term assets in the Condensed Consolidated Balance Sheets. Derivative financial instruments in a liability position are recorded in accrued expenses and other current liabilities or lease incentives and other long-term liabilities in the Condensed Consolidated Balance Sheets.

We maintain a deferred compensation plan that allows eligible employees to defer compensation up to a maximum amount. Plan investments are recorded at market value and are designated for the deferred compensation plan. The fair value of the Company s deferred compensation plan assets is determined based on quoted market prices, and the assets are recorded in other long-term assets in the Condensed Consolidated Balance Sheets.

Nonfinancial Assets

We review the carrying value of long-lived assets, including lease rights, key money, and intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Long-lived assets are considered impaired if the estimated undiscounted future cash flows of the asset or asset group are less than the carrying value. For impaired assets, we recognize a loss equal to the difference between the carrying value of the asset or asset group and its estimated fair value. The estimated fair value of the asset or asset group is based on estimated discounted future cash flows of the asset or asset group using a discount rate commensurate with the risk. The asset group is defined as the lowest level for which identifiable cash flows are available.

There were no material impairment charges recorded for long-lived assets for the thirteen weeks ended April 30, 2011 and May 1, 2010.

We review the carrying value of goodwill and the trade name for impairment annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment review of goodwill involves comparing the fair value of a reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, a second step is required to measure the goodwill impairment loss. The second step includes hypothetically valuing all the tangible and intangible assets of the reporting unit as if the reporting unit had been acquired in a business combination. Then, the implied fair value of the reporting unit s goodwill is compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of the goodwill, we recognize an impairment loss in an amount equal to the excess, not to exceed the carrying amount. A reporting unit is an operating segment or a business unit one level below that operating segment, for which discrete financial information is prepared and regularly reviewed by segment management. We have deemed our reporting unit of goodwill to be our Direct operating segment, which is the level at which segment management regularly reviews operating results and makes resource allocation decisions. The fair value of the reporting unit used to test goodwill for impairment is estimated using the income approach.

The trade name is considered impaired if the estimated fair value of the trade name is less than the carrying value. If the trade name is considered impaired, we recognize a loss equal to the difference between the carrying value and the estimated fair value of the trade name. The fair value of the trade name is determined using the relief from royalty method.

There were no impairment charges recorded for goodwill or the trade name for the thirteen weeks ended April 30, 2011 and May 1, 2010.

Note 5. Derivative Financial Instruments

We operate in foreign countries, which exposes us to market risk associated with foreign currency exchange rate fluctuations. Our risk management policy is to hedge a significant portion of forecasted merchandise purchases for foreign operations, forecasted intercompany royalty payments, and intercompany obligations that bear foreign exchange risk using foreign exchange forward contracts. The principal currencies hedged against changes in the U.S. dollar are Euro, British pounds, Japanese yen, and Canadian dollars. We do not enter into derivative financial contracts for trading purposes. Cash flows from derivative financial instruments are classified as cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows.

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Cash Flow Hedges

We designate the following foreign exchange forward contracts as cash flow hedges: (1) forward contracts used to hedge forecasted merchandise purchases denominated primarily in U.S. dollars made by our international subsidiaries whose functional currencies are their local currencies; and (2) forward contracts used to hedge forecasted intercompany royalty payments denominated in Japanese yen and Canadian dollars received by entities whose functional currencies are U.S. dollars. We make merchandise purchases on a monthly basis, and we enter into foreign exchange forward contracts to hedge forecasted merchandise purchases and related costs generally occurring in 12 to 18 months. We make intercompany royalty payments on a quarterly basis, and we enter into foreign exchange forward contracts to hedge intercompany royalty payments generally occurring in 9 to 15 months.

During the thirteen weeks ended April 30, 2011, we entered into and settled treasury rate lock agreements in anticipation of our 5.95 percent fixed-rate Notes of $1.25 billion on April 12, 2011. Prior to the issuance of our Notes, we were subject to changes in interest rates, and we therefore locked into fixed-rate coupons to hedge against the interest rate fluctuations.

There were no material amounts recorded in the Condensed Consolidated Statements of Income for the thirteen weeks ended April 30, 2011 or May 1, 2010 as a result of hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or the discontinuance of cash flow hedges because the forecasted transactions were no longer probable.

Net Investment Hedges

We also use foreign exchange forward contracts to hedge the net assets of international subsidiaries to offset the foreign currency translation and economic exposures related to our investment in the subsidiaries.

There were no amounts recorded in the Condensed Consolidated Statements of Income for the thirteen weeks ended April 30, 2011 or May 1, 2010 as a result of hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or the discontinuance of net investment hedges.

Not Designated as Hedging Instruments

In addition, we use foreign exchange forward contracts to hedge our market risk exposure associated with foreign currency exchange rate fluctuations for certain intercompany balances denominated in currencies other than the functional currency of the entity with the intercompany balance. The gain or loss on the derivative financial instruments, as well as the remeasurement of the underlying intercompany balances, is recorded in operating expenses in the Condensed Consolidated Statements of Income in the same period and generally offset.

We generate intercompany activity each month, and as such, we generally enter into foreign exchange forward contracts on a monthly basis to hedge intercompany balances that bear foreign exchange risk. These foreign exchange forward contracts generally settle in less than 12 months.

Outstanding Notional Amounts

As of April 30, 2011, January 29, 2011, and May 1, 2010, we had foreign exchange forward contracts outstanding to sell various currencies related to our forecasted merchandise purchases and forecasted intercompany royalty payments and to buy the following notional amounts:

(notional amounts in millions)	April 30, 2011	January 29, 2011	May 1, 2010
U.S. dollars (1)	$ 1,020	$ 1,025	$ 705
British pounds	£ 47	£ 54	£ 18

(1) The principal currencies hedged against changes in the U.S. dollar were Japanese yen, Canadian dollars, and British pounds.

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As of April 30, 2011, January 29, 2011, and May 1, 2010, we had foreign exchange forward contracts outstanding to hedge the net assets of our Japanese subsidiary in the following notional amounts:

(notional amounts in millions)	April 30, 2011	January 29, 2011	May 1, 2010
Japanese yen	¥ 3,000	¥ 3,000	¥ 7,125

As of April 30, 2011, January 29, 2011, and May 1, 2010, we had foreign exchange forward contracts outstanding to buy the following currencies related to our intercompany balances that bear foreign exchange risk:

(notional amounts in millions)	April 30, 2011	January 29, 2011	May 1, 2010
U.S. dollars	$ 6	$ 12	$ 2
British pounds	£ 1	£	£
Japanese yen	¥ 5,056	¥ 3,238	¥ 3,238
Euro	14		

Contingent Features

We had no derivative financial instruments with credit-risk-related contingent features underlying the agreements as of April 30, 2011, January 29, 2011, or May 1, 2010.

Quantitative Disclosures about Derivative Financial Instruments

The fair values of asset and liability derivative financial instruments are as follows:

	April 30, 2011			
	Asset Derivatives		Liability Derivatives	
($ in millions)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Foreign exchange forward contracts	Other current assets	$	Accrued expenses and other current liabilities	$ 51
Foreign exchange forward contracts	Other long-term assets	1	Lease incentives and other long-term liabilities	8
Total derivatives designated as cash flow hedges		1		59
Derivatives designated as net investment hedges:				
Foreign exchange forward contracts	Other current assets	2	Accrued expenses and other current liabilities	3
Foreign exchange forward contracts	Other long-term assets		Lease incentives and other long-term liabilities	
Total derivatives designated as net investment hedges		2		3
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	Other current assets	1	Accrued expenses and	6

			other current liabilities	
Foreign exchange forward contracts	Other long-term assets		Lease incentives and other long-term liabilities	1
Total derivatives not designated as hedging instruments		1		7
Total derivative instruments		$ 4		$ 69

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($ in millions)	January 29, 2011 Asset Derivatives Balance Sheet Location	Fair Value	Liability Derivatives Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Foreign exchange forward contracts	Other current assets	$	Accrued expenses and other current liabilities	$ 30
Foreign exchange forward contracts	Other long-term assets	2	Lease incentives and other long-term liabilities	2
Total derivatives designated as cash flow hedges		2		32
Derivatives designated as net investment hedges:				
Foreign exchange forward contracts	Other current assets		Accrued expenses and other current liabilities	
Foreign exchange forward contracts	Other long-term assets		Lease incentives and other long-term liabilities	
Total derivatives designated as net investment hedges				
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	Other current assets	2	Accrued expenses and other current liabilities	5
Foreign exchange forward contracts	Other long-term assets		Lease incentives and other long-term liabilities	
Total derivatives not designated as hedging instruments		2		5
Total derivative instruments		$ 4		$ 37

($ in millions)	May 1, 2010 Asset Derivatives Balance Sheet Location	Fair Value	Liability Derivatives Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Foreign exchange forward contracts	Other current assets	$ 9	Accrued expenses and other current liabilities	$ 18
Foreign exchange forward contracts	Other long-term assets	1	Lease incentives and other long-term liabilities	
Total derivatives designated as cash flow hedges		10		18
Derivatives designated as net investment hedges:				
Foreign exchange forward contracts	Other current assets	4	Accrued expenses and other current liabilities	
Foreign exchange forward contracts	Other long-term assets		Lease incentives and	

			other long-term liabilities	
Total derivatives designated as net investment hedges		4		
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	Other current assets	3	Accrued expenses and current liabilities	3
Foreign exchange forward contracts	Other long-term assets		Lease incentives and other long-term liabilities	
Total derivatives not designated as hedging instruments		3		3
Total derivative instruments		$ 17		$ 21

Substantially all of the unrealized gains and losses from designated cash flow hedges as of April 30, 2011 will be recognized in income within the next 12 months at the then current values, which may differ from the fair values as of April 30, 2011 shown above.

See Note 4 of Notes to Condensed Consolidated Financial Statements for disclosures on the fair value measurements of our derivative financial instruments.

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The effects of derivative financial instruments on other comprehensive income (OCI) and the Condensed Consolidated Statements of Income, on a pre-tax basis, are as follows:

($ in millions)	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) 13 Weeks Ended April 30, 2011	May 1, 2010
Derivatives in cash flow hedging relationships:		
Foreign exchange forward contracts	$ (40)	$ 3
Treasury rate lock agreements	1	
	$ (39)	$ 3

($ in millions)	Amount and Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 13 Weeks Ended April 30, 2011	May 1, 2010
Derivatives in cash flow hedging relationships:		
Foreign exchange forward contracts - Cost of goods sold and occupancy expenses	$ (9)	$ (8)
Foreign exchange forward contracts - Operating expenses	(1)	
	$ (10)	$ (8)

($ in millions)	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) 13 Weeks Ended April 30, 2011	May 1, 2010
Derivatives in net investment hedging relationships:		
Foreign exchange forward contracts	$	$ (2)

($ in millions)	Amount and Location of Gain (Loss) Recognized in Income on Derivatives 13 Weeks Ended April 30, 2011	May 1, 2010
Derivatives not designated as hedging instruments:		
Foreign exchange forward contracts - Operating expenses	$ (5)	$ 2

For the thirteen weeks ended April 30, 2011 and May 1, 2010, there were no amounts of gain or loss reclassified from accumulated OCI into income for derivative financial instruments in net investment hedging relationships, as we did not sell or liquidate (or substantially liquidate) any of our hedged subsidiaries during the periods.

See Note 8 of Notes to Condensed Consolidated Financial Statements for components of comprehensive income, which includes changes in fair value of derivative financial instruments, net of tax, and reclassification adjustments for realized gains and losses on derivative financial instruments, net of tax.

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Note 6. Share Repurchases

Share repurchase activity is as follows:

	0000000	0000000
	13 Weeks Ended	
($ and shares in millions except average per share cost)	**April 30, 2011**	**May 1, 2010**
Number of shares repurchased	24.8	14.3
Total cost	$ 548	$ 296
Average per share cost including commissions	$ 22.09	$ 20.63

In November 2009, the Board of Directors authorized $500 million for share repurchases, which was fully utilized by the end of March 2010. In connection with this authorization, we entered into purchase agreements with individual members of the Fisher family (related party transactions). The Fisher family shares were purchased at the same weighted-average market price that we paid for share repurchases in the open market. During the thirteen weeks ended May 1, 2010, approximately 0.5 million shares were repurchased for $10 million from the Fisher family subject to these agreements.

In February 2010, we announced that the Board of Directors authorized $1 billion for share repurchases, which was fully utilized by the end of August 2010. In August 2010, we announced that the Board of Directors authorized an additional $750 million for share repurchases, which was fully utilized by the end of March 2011. In February 2011, we announced a new $2 billion share repurchase authorization, of which $509 million was utilized through April 30, 2011. We have not entered into purchase agreements with members of the Fisher family in connection with these authorizations.

All except $30 million of total share repurchases were paid for as of April 30, 2011. All of the share repurchases were paid for as of January 29, 2011 and May 1, 2010.

Note 7. Share-Based Compensation

Share-based compensation expense recognized in the Condensed Consolidated Statements of Income, primarily in operating expenses, is as follows:

	13 Weeks Ended	
($ in millions)	**April 30, 2011**	**May 1, 2010**
Stock units	$ 12	$ 22
Stock options	4	4
Employee stock purchase plan	1	1
Share-based compensation expense	17	27
Less: Income tax benefit	(6)	(10)
Share-based compensation expense, net of tax	$ 11	$ 17

Note 8. Comprehensive Income

Comprehensive income is comprised of net income and other gains and losses affecting equity that are excluded from net income. The components of OCI consist of foreign currency translation gains and losses, net of tax, changes in the fair value of derivative financial instruments, net of tax, and reclassification adjustments for realized gains and losses on derivative financial instruments, net of tax.

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Comprehensive income, net of tax, consists of the following:

($ in millions)	April 30, 13 Weeks Ended April 30, 2011	April 30, May 1, 2010
Net income	$ 233	$ 302
Foreign currency translation, net of tax (tax benefit) of $(1) and $-	33	(15)
Change in fair value of derivative financial instruments, net of tax (taxbenefit) of $(15) and $2	(24)	1
Reclassification adjustment for realized losses on derivative financial instruments, net of tax benefit of $4 and $3	6	5
Comprehensive income, net of tax	$ 248	$ 293

Note 9. Income Taxes

The Company conducts business globally, and as a result, files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Canada, France, Hong Kong, Japan, and the United Kingdom. We are no longer subject to U.S. federal income tax examinations for fiscal years before 2007, and with few exceptions, we are also no longer subject to U.S. state, local, or non-U.S. income tax examinations for fiscal years before 2001.

As of April 30, 2011, we do not anticipate any significant increases or decreases in total gross unrecognized tax benefits within the next 12 months.

Except where required by U.S. tax law, no provision has been made for U.S. income taxes on the undistributed earnings of our foreign subsidiaries when we intend to utilize those earnings in foreign operations for an indefinite period of time.

During the thirteen weeks ended May 1, 2010, we recognized an interest expense reversal of $11 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 review conducted by the Internal Revenue Service (IRS) with respect to the Company s federal income tax returns and refund claims for fiscal 2001 through 2004.

Note 10. Earnings Per Share

Weighted-average number of shares used for earnings per share is as follows:

(shares in millions)	April 30, 13 Weeks Ended April 30, 2011	April 30, May 1, 2010
Weighted-average number of shares - basic	583	668
Common stock equivalents	5	8
Weighted-average number of shares - diluted	588	676

The above computations of weighted-average number of shares diluted exclude 5 million and 6 million shares related to stock options and other stock awards for the thirteen weeks ended April 30, 2011 and May 1, 2010, respectively, as their inclusion would have an antidilutive effect on earnings per share.

Note 11. Commitments and Contingencies

We have assigned certain store and corporate facility leases to third parties as of April 30, 2011. Under these arrangements, we are secondarily liable and have guaranteed the lease payments of the new lessees for the remaining portion of our original lease obligations at various dates through 2019. The maximum potential amount of future lease payments we could be required to make is approximately $20 million as of April 30, 2011. We recognize a liability for such guarantees when events or changes in circumstances indicate that the loss is probable and the amount of such loss can be reasonably estimated. There was no material liability recorded for the guarantees as of April 30, 2011, January 29, 2011, and May 1, 2010.

We are a party to a variety of contractual agreements under which we may be obligated to indemnify the other party for certain matters. These contracts primarily relate to our commercial contracts, operating leases, trademarks, intellectual property, financial agreements, and various other agreements. Under these contracts, we may provide certain routine indemnifications relating to representations and warranties (e.g., ownership of assets, environmental or tax indemnifications), or personal injury matters. The terms of these indemnifications range in duration and may not be explicitly defined. Generally, the maximum obligation under such indemnifications is not explicitly stated, and as a result, the overall amount of these obligations cannot be reasonably estimated. Historically, we have not made significant payments for these indemnifications. We believe that if we were to incur a loss in any of these matters, the loss would not have a material effect on our financial condition or results of operations.

As party to a reinsurance pool for workers compensation, general liability, and automobile liability, we have guarantees with a maximum exposure of $14 million as of April 30, 2011. We are currently in the process of winding down our participation in the reinsurance pool.

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. As of April 30, 2011, actions filed against us included commercial, intellectual property, customer, employment, and data privacy claims, including class action lawsuits. The plaintiffs in some Actions seek unspecified damages or injunctive relief, or both. Actions are in various procedural stages, and some are covered in part by insurance. As of April 30, 2011, January 29, 2011, and May 1, 2010, we recorded a liability for the estimated loss if the outcome of an Action is expected to result in a loss that is considered probable and reasonably estimable. The amount of liability as of April 30, 2011, January 29, 2011, and May 1, 2010 was not material for any individual Action or in total. Subsequent to April 30, 2011, no information has become available that indicates a material change to our estimate is required.

We cannot predict with assurance the outcome of Actions brought against us. Accordingly, adverse developments, settlements, or resolutions may occur and negatively 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 adverse effect on our results of operations, cash flows, or financial position taken as a whole.

Note 12. Segment Information

We identify our operating segments according to how our business activities are managed and evaluated. All of our operating segments sell a group of similar products apparel, accessories, and personal care products. We have two reportable segments:

Stores The Stores reportable segment includes the results of the retail stores for Gap, Old Navy, and Banana Republic. We have aggregated the results of all Stores operating segments into one reportable segment because we believe the operating segments have similar economic characteristics.

Direct The Direct operating segment includes the results for our online brands, both domestic and international. Due to the different distribution method associated with the Direct operating segment, Direct is considered a reportable segment.

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Net sales by brand, region, and reportable segment are as follows:

($ in millions)

13 Weeks Ended April 30, 2011	**Gap**	**Old Navy**	**Banana Republic**	**Other (3)**	**Total**	**Percentage of Net Sales**
U.S. (1)	$ 743	$ 1,097	$ 460	$	$ 2,300	70%
Canada	70	88	43		201	6
Europe	161		11	15	187	5
Asia	190		24	16	230	7
Other regions				29	29	1
Total Stores reportable segment	1,164	1,185	538	60	2,947	89
Direct reportable segment (2)	96	140	41	71	348	11
Total	$ 1,260	$ 1,325	$ 579	$ 131	$ 3,295	100%
Sales Growth (Decline)	(1)%	(4)%	1%	28%	(1)%	

($ in millions)

13 Weeks Ended May 1, 2010	**Gap**	**Old Navy**	**Banana Republic**	**Other (3)**	**Total**	**Percentage of Net Sales**
U.S. (1)	$ 788	$ 1,163	$ 468	$	$ 2,419	73%
Canada	73	92	41		206	6
Europe	156		7	11	174	5
Asia	180		24	13	217	7
Other regions				18	18	
Total Stores reportable segment	1,197	1,255	540	42	3,034	91
Direct reportable segment (2)	79	122	34	60	295	9
Total	$ 1,276	$ 1,377	$ 574	$ 102	$ 3,329	100%
Sales Growth	5%	6%	7%			