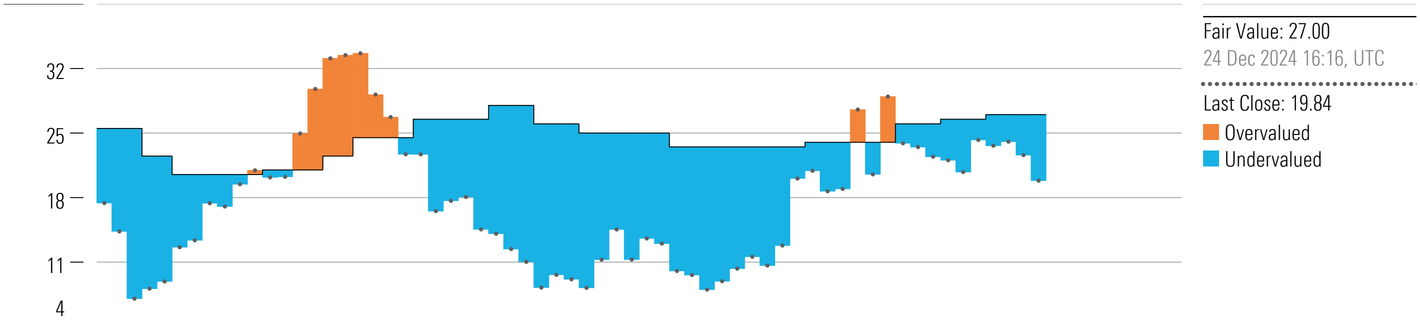
Morningstar Equity Analyst Report | Report as of 7 Mar 2025 00:43, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC.

Gap Inc GAP ★★★★ 6 Mar 2025 22:40, UTC

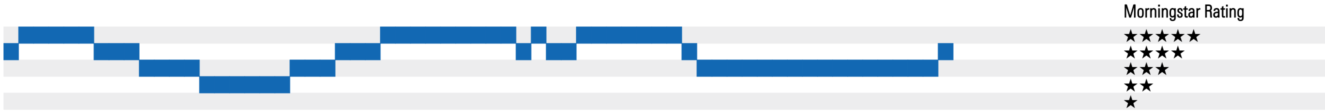
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
19.84 USD 5 Mar 2025	27.00 USD 24 Dec 2024 16:16, UTC	0.73	7.35 USD Bil 6 Mar 2025	None	Small Blend	Very High	Standard	5 Mar 2025 06:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD	
	0.96	0.67	0.45	0.87	0.88	0.73	Price/Fair Value
	15.57	-10.19	-32.86	90.69	15.88	-15.40	Total Return %

Morningstar Rating



Total Return % as of 05 Mar 2025. Last Close as of 05 Mar 2025. Fair Value as of 24 Dec 2024 16:16, UTC.

Contents

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The primary analyst covering this company does not own its stock.

[1]The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Gap Earnings: Entering 2025 With Momentum After Positive Holiday Results; Shares Attractive

Analyst Note David Swartz, Senior Equity Analyst, 7 Mar 2025

We intend to lift our $27 per share fair value estimate by a mid-single-digit rate after Gap revealed fourth-quarter results and a 2025 outlook above our expectations. Although we rate Gap as no-moat firm due to its years of struggles, CEO Richard Dickson has made progress in restoring some relevance to its four brands. Its financial stability has also improved as it achieved free cash flow to equity above $1 billion for the second consecutive year in 2024. Gap's shares rose by about 18% in March 6 postmarket trading but remain attractive.

In a quarter that was one week shorter than in the prior year, Gap posted 3% comparable sales growth, and its total sales were 2% above our estimate. Old Navy (53% of sales) matched our forecast with 3% same-store sales growth while Gap Global (24%) and Banana Republic (13%) outperformed with comparable sales growth of 7% and 4%, respectively. Signaling improved merchandising and marketing, Gap reports that each of these brands achieved share gains in 2024. Meanwhile, Athleta (10%) has had inconsistent performance in an attractive category, but its 2% comparable sales drop was close to our estimate. In the long run, we think upgrades in fashion and operations will allow it to lead Gap with mid-single-digit annual sales growth.

Aided by sales outperformance and lower raw material costs, Gap's gross and operating margins of 38.9% and 6.2%, respectively, beat our estimates by 90 and 150 basis points. Consequently, its earnings

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Sector	Industry
Consumer Cyclical	Apparel Retail

Business Description

Gap retails apparel, accessories, and personal-care products under the Gap, Old Navy, Banana Republic, and Athleta brands. Old Navy generates more than half of Gap's sales. The firm also operates e-commerce sites, outlet stores, and specialty stores under various Gap names. Gap operates approximately 2,500 stores in North America, Europe, and Asia and franchises about 1,000 more in Asia, Europe, Latin America, and other regions. Gap was founded in 1969 and is based in San Francisco.

per share of $0.54 was $0.17 above our projection. For 2025, Gap guided to sales and operating income growth of 1%-2% and 8%-10%, respectively. Although the sales outlook aligns with our estimate, the operating profit guidance implies an operating margin of roughly 8% versus our 7% forecast. Gap consistently achieved adjusted operating margins above 8% prior to the pandemic, but we do not think it can return to historical levels as competition in the retail apparel market has intensified.

Business Strategy & Outlook David Swartz, Senior Equity Analyst, 24 Dec 2024

We believe Gap's family of brands lacks an intangible asset or cost advantage that would provide an economic moat. The company has experienced years of inconsistent results. Still, Gap has fair liquidity, and we view its Old Navy chain as a solid business. According to Euromonitor, it is the largest individual apparel brand by retail sales in the United States, and, despite ongoing issues, we view Gap's goal of $10 billion in annual sales for Old Navy (up from $8.2 billion in 2023) as achievable by the end of this decade. The concept, though, faces considerable competition in the discount apparel space and already has more than 1,250 North America stores, so much of its future growth is expected to come from stores in smaller, unproven markets. As we are wary of the potential of these markets, we do not view Gap's stated goal of 2,000 Old Navy stores in North America as reasonable. Rather, we forecast it will have just over 1,450 locations in 10 years.

We do not believe Gap's once-powerful Gap and Banana Republic brands have competitive advantages, either. According to a 2019 presentation, Old Navy was generating about 80% of Gap's operating profit even before the pandemic. Now, with scores of Gap and Banana Republic stores having been closed over the past few years, we think the brands are permanently diminished. Moreover, while a necessary move, we doubt that downsizing will improve Gap's overall margins very much. The firm says that it can reach 10% operating margins in about three years, but we forecast Gap's long-term operating margins at 7.5%.

Further, we do not think Athleta has achieved a competitive advantage. Athleta has grown to more than $1.3 billion in annual sales from just $249 million in 2012. However, at less than 10% of Gap's total revenue, Athleta is not large or time-proven enough to provide a moat for Gap, in our view. Moreover, while the brand benefits from a strong "athleisure" trend, its recent results have been inconsistent and far short of those of direct competitor narrow-moat Lululemon.

Bulls Say David Swartz, Senior Equity Analyst, 24 Dec 2024

- Old Navy is the largest apparel brand in terms of retail sales in the US (Euromonitor). It competes in the discount apparel sector, which has been healthier than other areas of apparel retail.
- Gap's debt is manageable, and it has no maturities until 2029. The firm generates free cash flow that will be used for dividends and share repurchases.
- Gap generated $5.5 billion in online sales in 2023 (37% of its total sales). Its digital operations help

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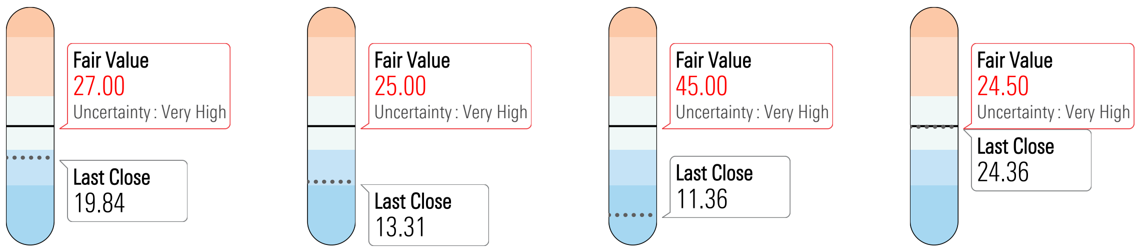
Competitors

	Gap Inc GAP	Macy's Inc M	Kohl's Corp KSS	Nordstrom Inc JWN



	Gap Inc GAP	Macy's Inc M	Kohl's Corp KSS	Nordstrom Inc JWN
Economic Moat	None	None	None	None
Currency	USD	USD	USD	USD
Fair Value	27.00 24 Dec 2024 16:16, UTC	25.00 25 Aug 2023 15:03, UTC	45.00 4 Dec 2024 20:10, UTC	24.50 23 Dec 2024 17:17, UTC
1-Star Price	47.25	43.75	78.75	42.88
5-Star Price	13.50	12.50	22.50	12.25
Assessment	Undervalued 6 Mar 2025	Undervalued 6 Mar 2025	Undervalued 6 Mar 2025	Fairly Valued 6 Mar 2025
Morningstar Rating	★★★★6 Mar 2025 22:40, UTC	★★★★6 Mar 2025 22:40, UTC	★★★★★6 Mar 2025 22:39, UTC	★★★6 Mar 2025 22:39, UTC
Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst
Capital Allocation	Standard	Standard	Standard	Standard
Price/Fair Value	0.73	0.53	0.25	1.00
Price/Sales	0.50	0.16	0.08	0.27
Price/Book	2.38	0.89	0.33	3.53
Price/Earning	9.19	4.01	5.12	11.23
Dividend Yield	3.02%	5.22%	17.61%	3.12%
Market Cap	7.35 Bil	3.67 Bil	1.25 Bil	4.03 Bil
52-Week Range	18.54—30.75	12.60—22.10	10.91—29.60	16.79—24.99
Investment Style	Small Blend	Small Value	Small Value	Small Value

offset the declining productivity of its stores.

Bears Say David Swartz, Senior Equity Analyst, 24 Dec 2024

- Athleta has gone from being a bright spot to a source of concern as its recent results have badly trailed those of Lululemon and some other peer brands.
- We believe Old Navy generates most of Gap's operating profit, but its same-store sales have been inconsistent due, in part, to merchandising issues. The ultimate success of Gap's turnaround plan for the brand is uncertain.
- Banana Republic and Gap Global lack relevance after years of downsizing and disappointing results.

Economic Moat David Swartz, Senior Equity Analyst, 24 Dec 2024

We assign a no-moat rating to Gap as we do not believe any of its three largest apparel retail chains—Gap Global, Old Navy, and Banana Republic—has established a competitive advantage in the form of an intangible brand asset or cost-based edge. While these three retailers are well known (each has awareness above 90% in the US, according to a YouGov poll), we do not think they have the differentiated product or brand strength for premium pricing. While Gap is a share leader in some categories, it is highly dependent on basic apparel like T-shirts, jeans, shorts, polo shirts, and sweaters. Moreover, we do not believe Gap has any cost advantage as its outsourced production process is like that of competitors. As evidence that Gap lacks a competitive edge, its operating margins and returns on invested capital have generally declined since 2013. Over the past five years (including 2024), its annual adjusted operating margins have averaged about 3% and its adjusted ROICs including goodwill have averaged 9%. Over the next five years (2025-29), we forecast Gap's adjusted ROIC including goodwill will average 19%, above our 11% weighted average cost of capital estimate, but below historical highs.

We believe competitive pressures have forced Gap to respond with increased spending and promotions, thereby reducing its profitability. In its late 1990s heyday, the firm recorded gross margins in the mid-40s, but the average over the past decade has been about 37%. Further, Gap's annual adjusted operating margins averaged 12% in 2009-15, but have since been much lower. We believe the company, with more than 2,500 company-operated stores worldwide, is less efficient than some others. It has invested heavily in its e-commerce and supply chain over the past decade, having consistently spent more than $600 million (or 4% of sales) on average annual capital expenditures. Nonetheless, Gap has suffered margin compression, suggesting these investments have not improved efficiency enough to hold off competition. Among other issues, Gap operates hundreds of stores in US malls that are suffering declines in customer traffic. Many mall-based apparel retailers have downsized or gone out of business completely, and we believe many US malls may close in the next five years. We forecast Gap's operating margins will stabilize at 7.5% in the long term despite the closure of hundreds of low-performing company-owned stores. We forecast Gap's long-term SG&A expenses at 32.5% of sales, up from the mid-20s a decade ago, as we believe its costs have permanently increased due to competition, lower productivity, and e-commerce fulfillment expenses. We think the increased prominence of outlet and fast fashion stores has eroded any competitive advantage that Gap may have once had. Moreover, many of Gap's e-commerce and traditional rivals offer deals that are difficult and expensive for it to match.

We do not believe Old Navy has earned an economic moat. Founded as an outlet concept in 1994, Old Navy reached $1 billion in sales in just four years, reportedly the first clothing retailer to do so in such a short time. Since then, Old Navy has eclipsed Gap Global and grown to be its largest brand by far. Old Navy, which sells low-priced clothing for the whole family, operates about 1,250 stores in North America. While the brand is well known in the region, we do not believe it provides a brand intangible asset. We believe its customers can find similar merchandize at many other stores. Old Navy faces increasing competition from other off-price apparel retailers, traditional department stores, mass-market stores (like wide-moat Walmart), and e-commerce. Moreover, many apparel retailers (including Gap itself) have opened outlet and factory stores to supplement their full-price businesses. We do not believe the Old Navy brand is strong enough to keep shoppers from going to these stores.

We do not think Old Navy has a cost advantage. Although it is a low-price chain with generally efficient production, Old Navy is a traditional apparel retailer that uses third-party manufacturers to produce its apparel. We believe some of its competitors achieve cost advantages that it cannot. Some fast fashion retailers, including no-moat H&M, Shein, narrow-moat Inditex, and Fast Retailing's Uniqlo, have production models that differ greatly from that of Old Navy. Inditex's Zara, for example, operates a company-controlled production and distribution system that allows for a production of new styles in a few weeks and delivery of finished goods to its more than 10,000 worldwide stores in less than 48 hours. We do not believe Old Navy can match the prices and profit margins of these fast fashion competitors. Further, Old Navy competes with firms, including wide-moats Ross and TJX's T.J. Maxx, that purchase large amounts of unsold clothing at deep discounts and resell it at low prices. These chains often carry brands viewed as more desirable than Old Navy. As with fast fashion, we believe the clearance business model allows for a cost advantage that Old Navy does not have.

We view Old Navy's inconsistent same-store sales as evidence that it does not have a competitive advantage. While Old Navy has been Gap's biggest success story, its recent results have been inconsistent. While the firm plans to operate as many as 2,000 Old Navy stores in North America (about 760 more than today), we do not expect this will happen in at least the next 10 years. As apparel sales shift to digital channels, we do not view a two thirds increase in Old Navy's store base in a decade as economically viable. Moreover, most of the new Old Navy stores are targeted for smaller markets (populations of less than 200,000) than those of the existing stores, which we view as less desirable. Old Navy also plans to open stores in existing markets, thereby possibly taking sales from existing stores.

Gap's namesake chain has long been in decline and lacks a competitive advantage. Gap Global, the segment that includes Gap-branded stores, has struggled to achieve positive comparable sales growth over the past 10 years. Further, Gap Global's same-store sales dropped 5% or more in five of those years. We believe Gap (and its specialty sub-brand stores) are in decline because competition is increasing, and its product is not differentiated. Gap has, in some sense, been troubled for more than two decades as specialty chains, mass merchants, and others have relentlessly offered styles to draw shoppers from Gap and the malls that house many of its stores. Meanwhile, fast fashion chains like Uniqlo, Zara, and H&M have opened thousands of stores worldwide that offer apparel merchandise at price points that Gap cannot match. Gap also faces e-commerce competition from retailers like Amazon and Shein and from innovative concepts like Nuuly. We do not believe Gap has the brand strength to hold off its innumerable competitors.

We view the struggles of Gap Global in its largest market, North America, as evidence that it lacks an economic moat. Between 2013 and 2023, Gap Global's North America sales dropped to $2.8 billion from $4.2 billion. Gap has opened a handful of stores (mainly outlets) over the past few years, but it has closed far more. Its North America store base declined 51% between the end of 2013 and the end of 2023 (to 472 stores from 968 stores). Many of the closed stores were Gap's smaller specialty stores, such as babyGap and GapKids. These closures were likely necessary but have failed to reverse the sales trends. Meanwhile, ravaged by changes in consumers' shopping behavior, many US malls may close in the next few years, leading to consistent downsizing of the Gap Global fleet. We forecast Gap Global's total North America store base will decline to fewer than 400 stores by the end of 2028, causing annual sales declines. We do not think Gap Global can reclaim its past glory in North America and think its brand has been permanently damaged.

We think Gap's Banana Republic Group lacks a competitive advantage. Banana Republic sells upscale apparel and home goods at generally higher price points than Gap or Old Navy. Its average unit retail price is about $35 versus $12 and $20 for Old Navy and Gap Global, respectively. However, we do not believe it has any significant pricing power over similar brands. Banana Republic is highly dependent on the North America market (about 95% of total sales) and competes directly against department stores like no-moats Nordstrom and Macy's, e-commerce, discount apparel stores, specialty stores like J. Crew, and many others. Banana Republic, like Gap, has significant exposure to struggling malls. Many mall-based apparel retailers that target the same customers as Banana Republic have either gone out of business or are downsizing. Banana Republic stores have suffered weak same-store sales, having reported positive same-store sales growth in just three of the past nine years even though scores of weaker locations have closed. Specifically, between 2015 and 2023, Banana Republic's global company-owned store base dropped to 443 from 663. Many of the closures have been among the full-price stores as the number of off-price factory stores has grown.

We do not think Gap's emerging Athleta brand is strong or time-proven enough to contribute to an economic moat for the company. Athleta is a brand and chain of retail stores that specializes in athletic apparel for women. It has been a bright spot for Gap, having grown over the past nine years to more than $1.3 billion in sales in 2023 from $249 million in 2012. Moreover, at more than $50, it has the highest average unit retail price of Gap's brands. Its store base has grown to 271 stores from 65 stores at the end of 2013. We think Athleta, like close rival Lululemon and others, benefits from the current athleisure trend. Athleta, though, accounts for less than 10% of Gap's total sales. We view it as an inferior brand to Lululemon, which is approximately 7 times larger (in terms of sales), has an international business, and has much higher organic growth. We think narrow-moat Lululemon's brand provides a competitive advantage as the firm achieves premium pricing. Its leggings, for example, are typically priced about 20% higher than similar offerings from Athleta. We do not think Athleta provides Gap with a competitive advantage.

Gap's international woes support our opinion that it lacks a competitive edge. The company both operates and franchises about 1,000 (combined) stores in Asia, Europe, and other regions. However, in 2021, Gap closed its physical its stores in the United Kingdom and Ireland and franchised its stores in Italy and France. We think it has largely abandoned growth plans in Europe (which accounted for about 3% of prepandemic sales) due to the presence of highly efficient and established local competitors like H&M and Zara. We think these retailers have stronger knowledge of local markets. Gap is also pulling back in Asia, having sold its 89 Gap stores in China for just $50 million and transitioned them to franchises. The company entered China in 2010, years behind rivals like Uniqlo, H&M, and Zara, and struggled to operate efficiently amid high competition. As for Old Navy, we no longer think it has any opportunity in Asia as it closed all its 15 or so stores in China in early 2020 after having previously exited in Japan in late 2016. North America accounted for 95% of Gap's 2023 sales (up from 84% in 2016), and we expect this percentage to rise even higher due to the dispositions in Europe and China.

We believe Gap's competitive position is being eroded by changes in technology and consumer behavior. The apparel industry has been upended by digital native concepts like Shein, Temu, no-moat Urban Outfitters' Nuuly, and ThredUp. In some cases, these platforms offer discounted Gap merchandise. ThredUp, for example, offers hundreds of thousands of Gap items, likely supplied by the firm itself and consumers. While these services may allow Gap to clear excess inventory, they may also cannibalize sales and reduce prices. We believe the company has limited response to the threat from online services with seemingly limitless options and inventories.

We do not believe Gap has a moat based on a brand intangible asset, cost advantage, or any other source. Gap, like many apparel retailers and producers, outsources its production, primarily to manufacturers in Asia, and we do not think it can negotiate lower prices to achieve a cost advantage. While Gap has invested to increase the speed of its supply chain, its declining operating margins suggest no material cost improvement. We do not believe it has achieved as much improvement in the speed of its supply chain as it had anticipated five years ago. Moreover, many of Gap's competitors are making similar investments in technology. Further, we do not think the firm has a moat based on efficient scale, as the market size and potential for return has not impeded the entrance of other competitors. Finally, there is no network effect in apparel retail and switching costs are nonexistent.

Fair Value and Profit Drivers David Swartz, Senior Equity Analyst, 24 Dec 2024

We are lifting our fair value estimate on Gap's shares to $27 from $26.50 as there are signs of a turnaround under CEO Richard Dickson. In 2024's third quarter, Gap's 2% sales increase outpaced our 1% estimate even though Old Navy (56% of sales) was affected by weather issues and had sales growth of only 1%. Considering margins, the firm's 9.3% operating margin was 140 basis points above our estimate due to lower raw material costs, sales leverage, and higher pricing. Based on this result and Gap's guidance, we are maintaining our 2024 sales growth estimate at about 1%, but lifting our EPS forecast to $2.03 from $1.86. For 2025, we forecast 2% sales growth and $2.11 in EPS (both unchanged from our last update). Our fair value estimate implies a 2025 P/E of 13 times and an enterprise value/EBITDA of 6 times. In the long term, we forecast yearly sales growth of around 2%-3% and operating margins that reach 7.5% in 2026, up from 4% in 2023 and a projected 7% this year.

We expect Gap Global and Banana Republic will downsize, while Old Navy will open stores. We anticipate the number of company-owned Gap Global stores worldwide to fall to 459 stores in 2033 from 606 at the end of 2023. Further, between 2023 and 2033, we estimate the number of Banana Republic stores to decline to 342 stores from 443. We forecast long-term same-store sales growth of 1% for each brand. For Old Navy, we forecast 1,455 stores at the end of 2033, up from 1,243 at the end of 2023, and 2% comparable sales growth. We view Gap's goal for $10 billion in Old Navy sales as achievable in 2029. Finally, we anticipate the number of Athleta stores will rise to 395 at the end of 2033, up from 270 at the end of 2023. Athleta's sales growth has stalled, and we forecast flat sales in 2024. However, we think it will return to positive sales growth rates of 4%-7% over the next few years as it improves its merchandising and as the market for women's athleisure grows.

Risk and Uncertainty David Swartz, Senior Equity Analyst, 24 Dec 2024

We assign Gap a Very High Morningstar Uncertainty Rating. Over the past decade, the firm has had no sales growth, and its profit margins have declined. Recently, like many other apparel retailers and manufacturers, it has struggled with inconsistent spending on apparel amid higher interest rates and inflation.

Gap is exposed to changes in the retail landscape in North America (95% of 2023 sales) and other regions. The firm operates more than 2,500 stores and has about 1,000 franchises worldwide. On a consolidated basis, Gap has consistently reported same-store sales growth below 2% over the past 10 years. In the US and other countries, e-commerce has taken share from physical retail and the pandemic may accelerate this trend. Gap has also been affected by the growth of discount apparel chains and outlets. With many Gap Global and Banana Republic stores in malls suffering from declining customer traffic, we think Gap has limited flexibility to deal with these threats. The company's company-owned worldwide store base has contracted every year since 2015.

Adding to its instability, Gap has had high management turnover over the past two decades. After supply chain and merchandising woes, Sonia Syngal was forced out as CEO in summer 2022. Then, after a search that lasted about an entire year, she was replaced in the position by Richard Dickson, a former executive at narrow-moat Mattel. Early results are positive, but it remains to be seen if he can make the necessary changes in operations and strategy to improve Gap's competitiveness.

Gap's free cash flow generation has been underwhelming for years, and it has been even more inconsistent since the pandemic. While its liquidity is fair, its share repurchases have slowed.

We do not believe Gap faces material environmental, social, and governance, or ESG, risks. However, like other apparel manufacturers, it has been involved in controversies regarding the treatment and rights of workers in its supply chain.

Capital Allocation David Swartz, Senior Equity Analyst, 24 Dec 2024

We assign a Standard Morningstar Capital Allocation Rating to Gap. There has been considerable turmoil at the company. Former CEO Art Peck, who had worked at Gap since 2005, was fired in November 2019 because of poor results and the botched execution of a proposed Old Navy spinoff (which was later scrapped). In March 2020, Sonia Syngal, former CEO of Old Navy, became CEO of the entire company, but she resigned under pressure in 2022. One year later, in mid-2023, former Mattel executive Richard Dickson was named Gap's permanent CEO. Dickson was credited with revitalizing Barbie at Mattel. He also has experience in the apparel industry from prior positions at multibrand firm The Jones Group and Bloomingdale's. His most pressing issue has been to fix Old Navy, which accounts for more than half of Gap's revenue. We have not observed any significant changes to Gap's capital allocation policies under Dickson.

We anticipate Gap's capital expenditures to average 3.7% of sales over the next decade, just below its 4% 10-year historical average. The firm plans reasonably large investments in e-commerce, a faster supply chain, and new Old Navy and Athleta stores. We do not view these investments as cumbersome as the firm, in general, operates with a conservative balance sheet, having been in a net cash position for most of the past 10 years. At the end of 2019, for example, it had $1.65 billion in cash and investments versus $1.25 billion in long-term debt. The firm did issue $2.25 billion in notes at interest rates above 8% when the pandemic hit in 2020. However, it has since retired this debt and issued new long-term debt at interest rates below 4% with the earliest maturity coming in 2029. We view this debt as very manageable, as we estimate Gap will produce about $840 million in average annual free cash flow to the firm over the next 10 years.

We think Gap has a solid record of returning cash to shareholders. The company has repurchased about $15 billion in shares since 2004, resulting in a share count reduction of more than 60%. Over the next 10 years, we forecast another $4.7 billion in repurchases. Gap is also a consistent issuer of dividends. The firm paid out about 56% of its adjusted earnings as dividends in the five years preceding 2020, and we forecast it will pay out about 30% of its earnings as dividends in the long run. In the past, Gap has likely reduced shareholder value by repurchasing shares at prices above our fair value estimates. In 2013 and 2014, for example, the firm repurchased nearly $2.2 billion in stock when the shares were mostly trading at levels above our fair value estimates and not reached since.

We think Gap has had mixed success with its acquisitions. Gap acquired women's athletic apparel brand Athleta for $150 million in 2008. The company had less than $100 million in revenue at the time. Since then, Gap has built Athleta into a brand with 270 stores and more than $1.3 billion in annual sales. Gap had much less success with luxury retailer Intermix, which it acquired for $130 million (about

$4 million per store) at the end of 2012 but sold for a nominal amount in 2021. It also sold its 139 store Janie and Jack children's clothing label for an undisclosed sum in 2021. Gap had acquired Janie and Jack from Gymboree after it went bankrupt in early 2019 for just $69 million, or roughly $500,000 per store. Given its recent history, we do not expect Gap will acquire any clothing retailers in the foreseeable future.

Analyst Notes Archive

Gap Earnings: Improving Profitability Provides Confidence in Turnaround; Shares Slightly Undervalued David Swartz,Senior Equity Analyst,30 Aug 2024

Overcoming a tough North American apparel market, Gap reported solid second-quarter results. Since joining the company last year, CEO Richard Dickson has implemented changes in personnel, merchandising, marketing, and operations that have reinvigorated its brands. Most importantly, Old Navy, which accounted for 57% of the quarter's sales and is the main driver of profits, has returned to comparable sales growth (5% in the period). We expect to lift our $26 fair value estimate by a low-single-digit percentage, leaving shares a bit undervalued. Although we rate Gap as a no-moat company, we think it has strengths, including the high awareness of its brands and their appeal to many demographic groups.Led by Old Navy, Gap outperformed our 3% estimate with 5% sales growth in the quarter. However, its sales growth would have roughly matched our forecast if not for a one-time boost related to its credit card agreement. Gap Global (21% of sales) had 3% same-store sales growth and, according to the company, gained share. We think the brand benefits from fashion trends (denim and looser pants), new advertising, and the closure of low-performing stores. Banana Republic (13% of sales) and Athleta (9%) had weaker comparable sales of flat and down 3%, respectively, but promising changes are in process. In the long run, we forecast Athleta's sales to grow at a 5% annual rate as athleisure expands. Given its high price points, Athleta's improved performance would benefit Gap's margins.Gap's 42.6% gross margin was up 5 percentage points and beat our estimate by 2 points. The unusual credit card gain contributed some benefit, but most of the increase was due to low raw material costs and merchandise pricing. With operating expenses close to our forecast, Gap's 7.9% operating margin was 240 basis points above our estimate. The company intends to reduce operating costs over time, which we think is reasonable.

Gap Earnings: Good Feelings Abound as Dickson's Plans Bring Quick Results; Shares Fairly Valued David Swartz,Senior Equity Analyst,31 May 2024

No-moat Gap's shares soared 23% in May 30 postmarket trading as first-quarter sales and profitability surpassed expectations despite uneven consumer demand for apparel. Although CEO Richard Dickson has a lot of work to do to generate consistent sales growth at each of Gap's four brands while operating more efficiently, his personnel, product, and operating changes have already reinvigorated a company that had been floundering for years. We expect to lift our $24 fair value estimate on Gap's shares by a high-single-digit percentage, but they are fully valued after the move.Gap outpaced our flat estimate with 3% sales growth in the quarter as each brand posted positive same-store sales growth. Old Navy (57% of sales) matched our 3% same-store sales estimate, while Athleta (10% of sales) achieved 5% comparable sales growth, its best result in over two years. As Old Navy and Athleta are Gap's highest-margin and highest-potential brands, we think they must return to consistent sales growth.Gap's 41.2% gross margin in the quarter beat our estimate by nearly 3 percentage points due to lower commodity prices, improved inventory control, and leverage on rent, occupancy, and depreciation expenses. The combination of a strong gross margin and operating costs close to our forecast resulted in a 6.1% operating margin that was 440 basis points above our estimate. For the full year, Gap lifted its operating income annual growth guidance to mid-40% from low-to-mid teens previously, implying an operating margin of about 6%. We expect to increase our pre-report 4.7% forecast to around this level. In the medium term, we think Gap can achieve operating margins of 7%-8%. This projection is based on mid-single-digit annual sales growth for Athleta and Old Navy and low-single-digit sales declines for Gap Global and Banana Republic as both brands' store bases continue to shrink.

Gap Earnings: Margin Improvement Demonstrates Potential if Sales Improve; Shares Attractive David Swartz,Senior Equity Analyst,8 Mar 2024

Gap's results beat our expectations in Richard Dickson's first full quarter as CEO. While strong sales growth at highest-potential brands Old Navy and Athleta is elusive, the improvement in profitability supports our forecast of 7.5% operating margins by 2027. We do not expect to make any material change to our fair value estimate of $24 per share, keeping shares undervalued after they rose 6% in aftermarket trading on March 7. We rate Gap as a no-moat firm due to years of mismanagement and intense competition in apparel retail, but we are encouraged that Dickson appears to be tackling problems with changes in merchandising, management, and logistics.Gap's 1% total fourth-quarter sales growth eclipsed our flat estimate as comparable sales at Old Navy (53% of sales) increased 2%. Although a pedestrian result against an easy comparison, Gap's management said Old Navy gained share in key categories as the overall apparel market was weak. Meanwhile, Gap's other three brands suffered sales declines, but Gap Global (23% of sales) beat our 2% estimate with 4% comparable sales growth. For 2024, Gap guided to flat sales on a 52-week basis overall, marginally below our forecast, as apparel demand is soft and as Banana Republic and Athleta sales are expected to remain challenged. Dickson is implementing new plans for each of Gap's brands, but consistent sales growth is unlikely before 2025 due to market conditions.More positively, Gap's 38.9% quarterly gross margin increased by 530 basis points, surpassing our 36% estimate, benefiting from lower shipping and input costs and reduced promotions. This outperformance led to a 5% operating margin, 2 percentage points above our estimate. Gap's expense cutting has progressed slower than we had expected, but its 2024 operating cost guidance matches our projection. To meet our 7.5% medium-term operating margin estimate, the firm needs stronger sales to leverage occupancy and other costs.

Gap Earnings: Nice Start to New CEO's Tenure as Old Navy and Margins Outperform; Shares Undervalued David Swartz,Senior Equity Analyst,17 Nov 2023

Gap delivered third-quarter sales and earnings above our expectations, providing a dose of optimism in CEO Richard Dickson's first quarter at the helm. While there is much work to be done, we think these results demonstrate that the firm's efforts to cut costs and close underperforming stores while investing in its brands will bring a return to positive sales growth and mid-single-digit operating margins over the next two or so years. Gap's shares rallied by 16% in Nov. 16 post-market trading on the report but remain well below our $23.50 fair value estimate, which we expect to raise by a low-single-digit rate. Although we assign a no-moat rating to Gap due to its chronic underperformance and the competitiveness of the U.S. apparel market, we believe it has strengths, such as the high awareness of its brands and their value proposition to consumers.Gap's consolidated same-store sales fell 2% in the quarter, but this was better than our forecast for a 5% drop. The bright spot was Old Navy, as it eked out 1% same-store sales growth, above our negative 6% estimate and its first positive comparable sales quarter in over two years. Gap's management claims that Old Navy has gained share for the past three quarters in a row as its merchandising changes and marketing are generating positive responses. As Gap's largest brand (56% of sales) and its main generator of operating income, Old Navy's performance is critical to our projections for overall margin improvement. We forecast 2% comparable sales growth for the brand in the long run.Gap's 41.3% gross margin beat our estimate by 260 basis points and its 6.8% adjusted operating margin eclipsed our forecast by 350 basis points. Gap's gross margin benefitted from lower input costs, sales leverage, and less discounting, while its operating margin was aided by the ongoing cost cuts, expected to generate $550 million in annual savings when complete. Adjusted EPS reached $0.59, far higher than our $0.21 estimate.

Gap Earnings: Sales Growth Elusive but Signs of Margin Improvement Greet New CEO; Shares Undervalued David Swartz,Senior Equity Analyst,25 Aug 2023

Gap suffered same-store sales declines in each of its four banners in the second quarter, but cost-cutting brought a 3.4% adjusted operating margin that was 170 basis points above our forecast. As we do not think Gap can cut its way to prosperity, generating sales growth at Old Navy and Gap's other segments will be the priority for new CEO Richard Dickson. Unfortunately, it will likely take time for progress on this front to be apparent given that inflation and other factors are depressing consumer spending on apparel this year. That said, we do not expect to make any material change to our $23.50 fair value estimate on Gap and view shares as very undervalued. Although we rate it as a no-moat company, we think Gap has strengths, including Old Navy's historically strong sales growth and profitability and Athleta's potential in the women's activewear space. Moreover, despite its struggles, Gap has no near-term debt maturities and is poised for significant free cash flow improvement; its free

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Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
19.84 USD 5 Mar 2025	27.00 USD 24 Dec 2024 16:16, UTC	0.73	7.35 USD Bil 6 Mar 2025	None	Small Blend	Very High	Standard	5 Mar 2025 06:00, UTC

cash flow to equity improved by more than $900 million in the first half of 2023, and we believe Gap will continue to pay its dividend (6% current yield).Gap's $0.34 in adjusted EPS in the quarter was $0.25 above our forecast due to margin outperformance, but its total sales fell 8%, short of our forecast for a 7% drop. The biggest problem was Old Navy (55% of total sales), which suffered a 6% comparable sales decline as its largely low-income customer base pulled back on spending. We believe Old Navy is fixable and will return to sales growth within the next year as recent merchandising efforts take hold. We are less confident in a near-term turnaround in Athleta (10% of sales) as it is clearly not keeping pace with narrow-moat Lululemon and others in its space, but a new brand leader provides some hope. Our long-term forecast for Gap to achieve 7.5% operating margins, up from the low single digits presently, is partly based on Old Navy and Athleta returning to sales growth.

Gap: CEO Appointment Is Positive, but Old Navy and Other Challenges Await; Shares Very Undervalued David Swartz,Senior Equity Analyst,26 Jul 2023

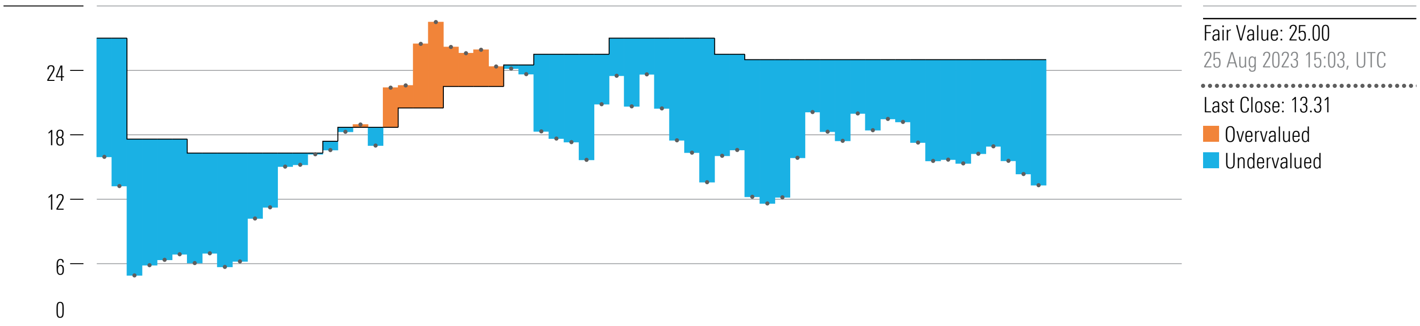
No-moat Gap has named Richard Dickson, president and chief operating officer at narrow-moat Mattel, as its CEO. Gap has been without a permanent CEO for an entire year, having been led on an interim basis by Bob Martin, who remains as chairman. Dickson was credited with revitalizing Barbie, Hot Wheels, and other brands at Mattel and has apparel industry experience at multi-brand owner The Jones Group and upscale department store Bloomingdale's. At Gap, he will face serious challenges, including recent underperformance at Old Navy and Athleta, and the chronic search for relevance at Gap Global and Banana Republic. Realistically, Gap has struggled to find consistency since former CEO Mickey Drexler was fired more than 20 years ago.We do not think Gap's current share price, well below our $23.50 fair value estimate, reflects its opportunities for profit growth. To his credit, Martin has not been standing still, having brought in several new leaders, improved Gap's inventory, and cut costs. We forecast improving, although modest, profitability in 2023's second half. In the medium term, we think Gap can lift its operating margins from less than 3% in 2023 (expected) to 7.5% in 2027 as Gap Global and Banana Republic are downsized and higher-margin Athleta and Old Navy become larger.We do not anticipate any significant changes in Gap's capital allocation under Dickson and are maintaining our Standard rating. Despite its weak earnings, we forecast the firm will generate sufficient free cash flow to continue to fund its $0.15 per share quarterly dividend (6% current yield). However, we do think it will hold off on further share repurchases until its earnings improve in 2025.

Morningstar Equity Analyst Report | Report as of 7 Mar 2025 00:43, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 14 of 24

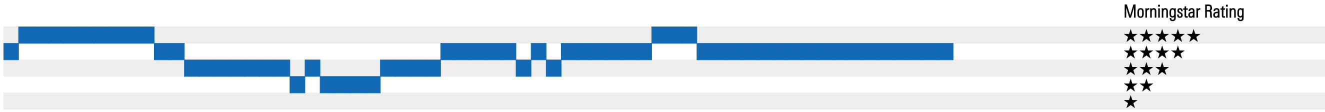
Gap Inc GAP ★★★★ 6 Mar 2025 22:40, UTC

Competitors Price vs. Fair Value

Macy's Inc M

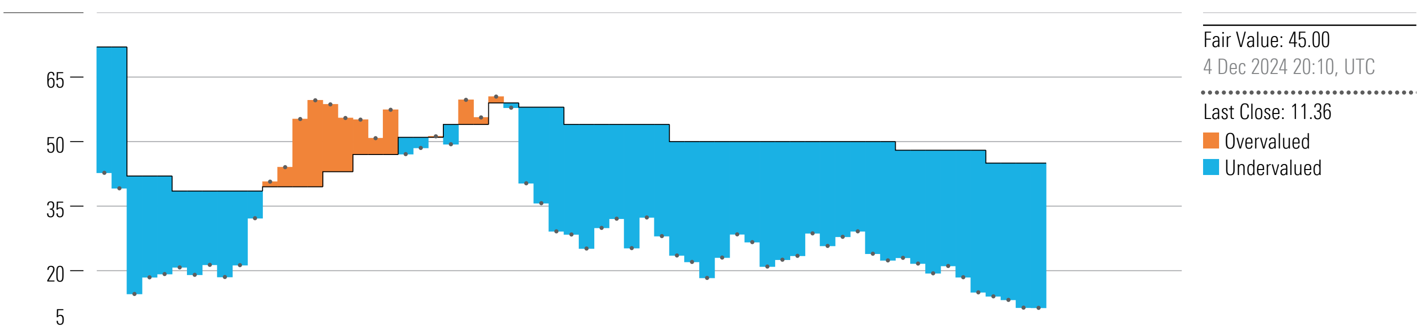


	2020	2021	2022	2023	2024	YTD	
	0.69	1.16	0.76	0.80	0.68	0.53	Price/Fair Value
	-31.60	135.38	-18.72	0.64	-12.40	-21.38	Total Return %

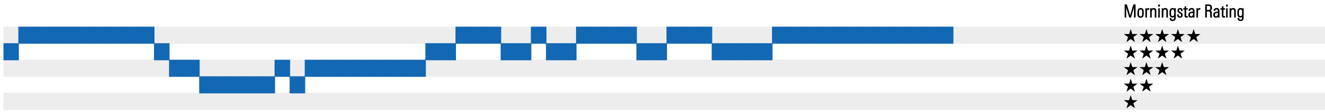


Total Return % as of 05 Mar 2025. Last Close as of 05 Mar 2025. Fair Value as of 25 Aug 2023 15:03, UTC.

Kohl's Corp KSS



	2020	2021	2022	2023	2024	YTD	
	1.03	0.91	0.47	0.57	0.31	0.25	Price/Fair Value
	-18.76	23.84	-44.83	21.50	-44.07	-19.09	Total Return %



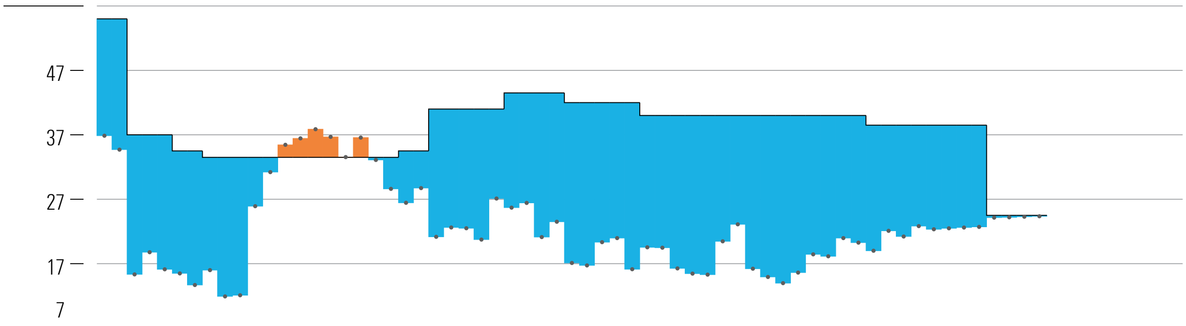
Total Return % as of 05 Mar 2025. Last Close as of 05 Mar 2025. Fair Value as of 4 Dec 2024 20:10, UTC.

Morningstar Equity Analyst Report | Report as of 7 Mar 2025 00:43, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC.

Gap Inc GAP ★★★★ 6 Mar 2025 22:40, UTC

Competitors Price vs. Fair Value

Nordstrom Inc JWN

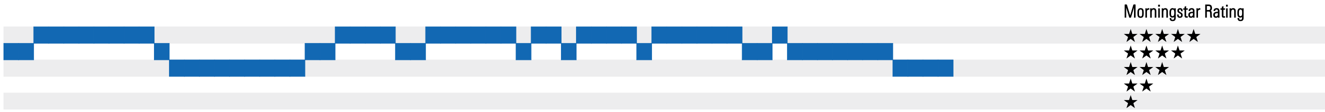


Fair Value: 24.50
23 Dec 2024 17:17, UTC

Last Close: 24.36
Overvalued
Undervalued

	2020	2021	2022	2023	2024	YTD
Price/Fair Value	0.93	0.55	0.38	0.46	0.99	1.00
Total Return %	-22.84	-27.52	-25.29	19.02	35.01	0.87

Morningstar Rating



Total Return % as of 05 Mar 2025. Last Close as of 05 Mar 2025. Fair Value as of 23 Dec 2024 17:17, UTC.

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Gap Inc GAP ★★★★ 6 Mar 2025 22:40, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
19.84 USD 5 Mar 2025	27.00 USD 24 Dec 2024 16:16, UTC	0.73	7.35 USD Bil 6 Mar 2025	None	Small Blend	Very High	Standard	5 Mar 2025 06:00, UTC

Morningstar Historical Summary

Financials as of 31 Oct 2024

Fiscal Year, ends 31 Jan	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD	TTM
Revenue (USD Bil)	16	16	16	16	17	16	14	17	16	15	11	15
Revenue Growth %	1.8	-3.9	-1.8	2.2	4.6	-1.2	-15.8	20.8	-6.3	-4.7	3.3	2.7
EBITDA (USD Mil)	2,652	2,122	1,792	2,057	1,973	1,161	-403	994	489	1,168	1,304	1,674
EBITDA Margin %	16.1	13.4	11.6	13.0	11.9	7.1	-2.9	6.0	3.1	7.8	11.9	11.0
Operating Income (USD Mil)	2,083	1,524	1,191	1,479	1,362	574	-862	810	-69	560	853	1,067
Operating Margin %	12.7	9.7	7.7	9.3	8.2	3.5	-6.3	4.9	-0.4	3.8	7.8	7.0
Net Income (USD Mil)	1,262	920	676	848	1,003	351	-665	256	-202	502	638	823
Net Margin %	7.7	5.8	4.4	5.4	6.1	2.1	-4.8	1.5	-1.3	3.4	5.8	5.4
Diluted Shares Outstanding (Mil)	440	413	400	396	388	378	374	383	367	376	383	384
Diluted Earnings Per Share (USD)	2.87	2.23	1.69	2.14	2.59	0.93	-1.78	0.67	-0.55	1.34	1.67	2.16
Dividends Per Share (USD)	0.88	0.92	0.92	0.92	0.97	0.97	0.00	0.60	0.60	0.60	0.45	0.60

Valuation as of 28 Feb 2025

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Recent Qtr	TTM
Price/Sales	0.6	0.6	0.9	0.6	0.4	0.5	0.4	0.3	0.5	0.6	0.6	0.6
Price/Earnings	10.1	13.4	15.7	10.8	8.3	-7.0	13.2	75.2	188.7	10.9	10.9	10.5
Price/Cash Flow	5.9	5.4	8.9	7.5	5.0	5.9	13.0	277.8	5.0	5.8	5.8	5.5
Dividend Yield %	3.68	4.1	2.7	3.72	5.49	1.2	2.73	5.05	2.87	2.54	2.54	2.65
Price/Book	3.8	3.3	4.4	2.8	1.8	3.2	2.4	1.6	3.2	2.8	2.8	2.7
EV/EBITDA	4.0	4.3	7.3	4.7	6.8	11.1	-29.5	9.7	24.4	10.4	0.0	0.0

Operating Performance / Profitability as of 31 Oct 2024

Fiscal Year, ends 31 Jan	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD	TTM
ROA %	16.2	12.1	9.0	10.9	12.5	3.2	-4.9	1.9	-1.7	4.5	—	7.2
ROE %	41.8	33.3	24.8	28.0	30.0	10.2	-22.4	9.6	-8.2	20.8	—	29.4
ROIC %	29.7	22.1	16.9	20.6	22.5	4.6	-5.2	4.0	-1.7	6.2	—	9.8
Asset Turnover	2.1	2.1	2.1	2.0	2.1	1.5	1.0	1.3	1.3	1.3	—	1.3

Financial Leverage

Fiscal Year, ends 31 Jan	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Recent Qtr	TTM
Debt/Capital %	30.9	34.0	30.1	28.4	26.0	67.1	72.3	67.0	70.6	65.1	60.7	—
Equity/Assets %	38.8	34.1	38.2	39.4	44.1	24.2	19.0	21.3	19.6	23.5	26.4	—
Total Debt/EBITDA	0.5	0.8	0.7	0.6	0.6	6.6	-19.0	6.3	12.3	4.7	4.2	—
EBITDA/Interest Expense	35.4	35.9	23.9	27.8	27.0	15.3	-2.1	5.9	5.5	13.0	19.2	18.2

Morningstar Analyst Historical/Forecast Summary as of 24 Dec 2024

Financials

			Estimates		
Fiscal Year, ends 3 Feb 2024	2023	2024	2025	2026	2027
Revenue (USD Mil)	15,616	14,889	15,003	15,287	15,566
Revenue Growth %	-6.3	-4.7	0.8	1.9	1.8
EBITDA (USD Mil)	534	1,128	1,566	1,577	1,689
EBITDA Margin %	3.4	7.6	10.4	10.3	10.9
Operating Income (USD Mil)	-6	606	1,044	1,055	1,167
Operating Margin %	0.0	4.1	7.0	6.9	7.5
Net Income (USD Mil)	-145	536	779	777	880
Net Margin %	-0.9	3.6	5.2	5.1	5.7
Diluted Shares Outstanding (Mil)	367	376	383	368	353
Diluted Earnings Per Share(USD)	-0.40	1.43	2.03	2.11	2.49
Dividends Per Share(USD)	0.60	0.60	0.60	0.65	0.70

Forward Valuation

			Estimates		
	2023	2024	2025	2026	2027
Price/Sales	0.3	0.5	0.5	0.5	0.5
Price/Earnings	-32.5	13.2	9.6	9.2	7.8
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	4.6	3.2	3.1	3.3	3.6
Price/Book	2.1	2.7	2.4	2.2	2.0
EV/EBITDA	19.6	9.9	6.8	6.7	6.3

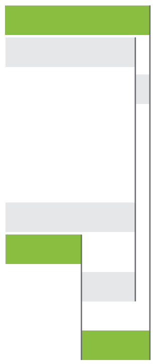
Morningstar Equity Analyst Report | Report as of 7 Mar 2025 00:43, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC.

Gap Inc GAP ★★★★ 6 Mar 2025 22:40, UTC

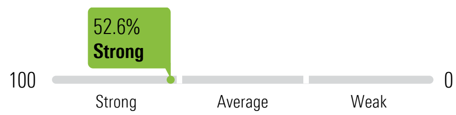
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
19.84 USD 5 Mar 2025	27.00 USD 24 Dec 2024 16:16, UTC	0.73	7.35 USD Bil 6 Mar 2025	None	Small Blend	Very High	Standard	5 Mar 2025 06:00, UTC

ESG Risk Rating Breakdown

Exposure		
Company Exposure[1]	30.7	
– Manageable Risk	27.6	
Unmanageable Risk[2]	**3.0**	
Management		
Manageable Risk	27.6	
– Managed Risk[3]	14.5	
Management Gap[4]	**13.1**	
Overall Unmanaged Risk	**16.1**	



● Subject ○ Subindustry (27.0)



- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management measures a company's ability to manage ESG risks through its commitments and actions
- Management assesses a company's efficiency on ESG programs, practices, and policies
- Management score ranges from 0-100% showing how much manageable risk a company is managing

ESG Risk Rating

ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 52.6% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of Mar 05, 2025. Highest Controversy Level is as of Feb 08, 2025. Sustainalytics Subindustry: Retail Apparel. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 05 Mar 2025

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure			Management			ESG Risk Rating		
Gap Inc	30.7 | Low	0	55+	52.6 | Strong	100	0	16.1 | Low	0	40+
Macy's Inc	37.8 | Medium	0	55+	49.9 | Average	100	0	20.6 | Medium	0	40+
Kohl's Corp	34.6 | Low	0	55+	51.7 | Strong	100	0	18.1 | Low	0	40+
Ross Stores Inc	26.3 | Low	0	55+	38.9 | Average	100	0	17.0 | Low	0	40+
Nordstrom Inc	35.9 | Medium	0	55+	56.7 | Strong	100	0	17.2 | Low	0	40+

Morningstar Equity Analyst Report | Report as of 7 Mar 2025 00:43, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 18 of 24

Appendix
Historical Morningstar Rating

Gap Inc GAP 6 Mar 2025 22:40, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	—	—	★★★★	★★★	★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★★	★★★★	★★★	★★★	★★★	★★	★★	★★	★★	★★	★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★

Macy's Inc M 6 Mar 2025 22:40, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
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★★	★★	★★	★★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
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Kohl's Corp KSS 6 Mar 2025 22:39, UTC

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Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
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★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★

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Dec 2025 —	Nov 2025 —	Oct 2025 —	Sep 2025 —	Aug 2025 —	Jul 2025 —	Jun 2025 —	May 2025 —	Apr 2025 —	Mar 2025 ★★★	Feb 2025 ★★★	Jan 2025 ★★★
Dec 2024 ★★★	Nov 2024 ★★★★	Oct 2024 ★★★★	Sep 2024 ★★★★	Aug 2024 ★★★★	Jul 2024 ★★★★	Jun 2024 ★★★★	May 2024 ★★★★	Apr 2024 ★★★★★	Mar 2024 ★★★★	Feb 2024 ★★★★	Jan 2024 ★★★★★
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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

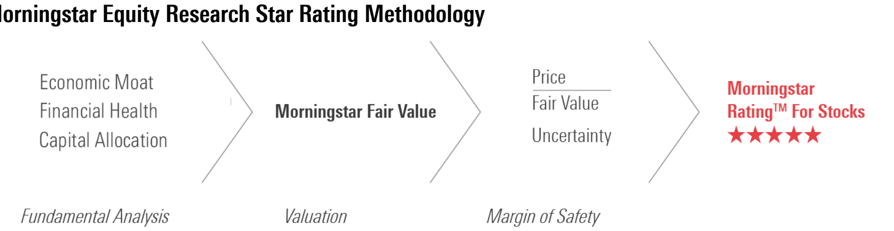
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future outcomes for the intrinsic value of a company, and any-

Morningstar Equity Research Star Rating Methodology



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thing that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

Qualitative Analysis Uncertainty Ratings	Margin of Safety ★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

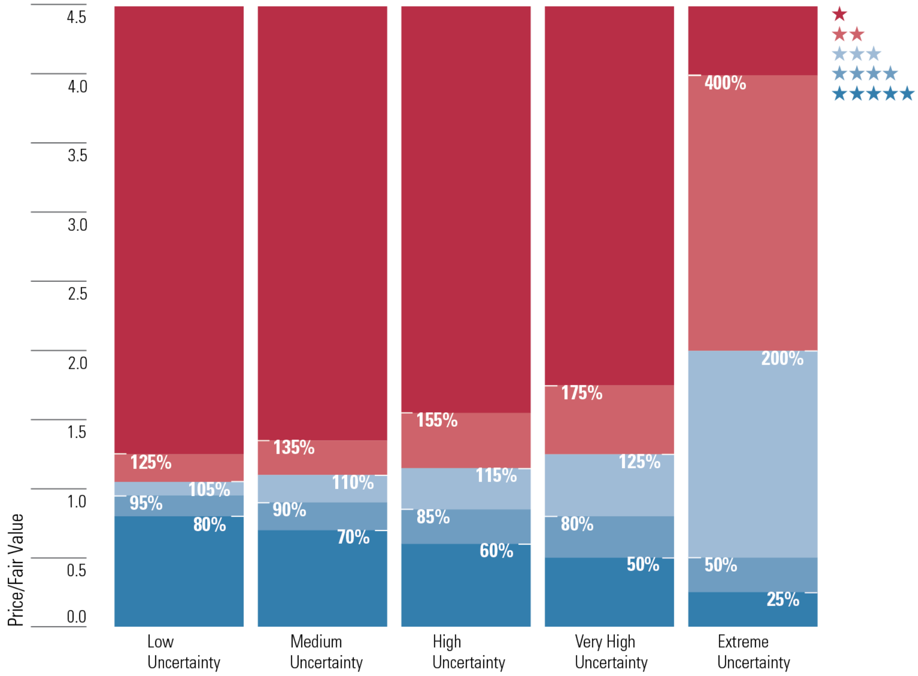
4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com

Morningstar Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider compan-

Research Methodology for Valuing Companies

ies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

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Sustainalytics ESG Risk Rating Assessment: The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

Ratings should not be used as the sole basis in evaluating a company or security. Ratings involve unknown risks and uncertainties which may cause our expectations not to occur or to differ significantly from what was expected and should not be considered an offer or solicitation to buy or sell a security.

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