

Gap's Net Rises 3.9%; 2005 Profit to Beat Estimates (Update2)
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(Adds investor comment in 10th paragraph.)

By Greg Wiles

Feb. 24 (Bloomberg) -- Gap Inc., the largest U.S. clothing chain, said fourth-quarter earnings rose a better-than-expected 3.9 percent on the smallest sales increase in almost three years. The retailer said profit this year will rise more than analysts' estimates.

Net income increased to \$370 million, or 40 cents a share, San Francisco-based Gap said in a statement today. Sales in the three months ended Jan. 29 rose 0.3 percent to \$4.9 billion. The company may restate earnings to correct how it accounts for leases and said its board authorized the repurchase of \$1.5 billion of its shares.

Gap, while doing well with items such as velvet women's blazers and faux-fur lined vests, cut prices on fleece and down jackets when sales faltered in November and early December. Chief Executive Paul Pressler bought back shares while investing in initiatives aimed at boosting growth, including a chain that will debut this year. Sales at stores open at least a year declined 3 percent.

"The same-store sales numbers sort of speak for themselves, but at the same time they have an opportunity to turn themselves around," said Mike Koskuba, who helps manage about \$1.2 billion at Victory Newbridge, a New York-based unit of Keybank National Corp., owner of 3.37 million Gap shares. "Everyone knows that the operating model hasn't been up to what they'd like it to be."

Gap was expected to earn 37 cents a share, the average estimate of 28 analysts surveyed by Thomson Financial. The company said in a preliminary report on Feb. 3 profit was 36 cents to 38 cents a share. Fourth-quarter profit a year earlier was \$355.8 million, or 37 cents.

Shares of Gap rose 98 cents, or 4.6 percent, to \$22.26 in extended trading. They earlier added 11 cents to \$21.28 at 4 p.m. in New York Stock Exchange composite trading. The results were released after the close of regular trading.

Dividend Increase

The company forecast earnings this year will rise to \$1.41 a share to \$1.45 a share. That compares with \$1.39 in the Thomson survey and net income of \$1.20 last fiscal year.

Gap said it expects to call a \$1.37 billion convertible bond in late March. Chief Financial Officer Byron Pollitt told analysts on a conference call the company expects that most of the bondholders will opt to take shares.

The share repurchase follows a \$1 billion program last year in which the company bought back 48 million shares. The board also plans to double the company's annual dividend to 18 cents a share.

"They're pumping up the dividend, which is what we like to see," said Jeffrey Malcom, who helps manage \$220 million at Towson, Maryland-based Horan Capital Management, including shares of Gap.

The company said it will open 175 stores this year, 75 of which will be Old Navy locations. It will close 135 stores, resulting in a 2 percent gain in store square footage, Gap said.

Possible Restatement

Pressler, 48, has been closing unprofitable stores and looking for ways to increase sales at remaining locations while buying back debt, since joining the retailer in September 2002. Standard & Poor's on Feb. 10 raised Gap's credit rating to investment grade after cutting it to junk in February 2002.

Gap had \$4.08 billion in cash and short-term investments at the end of the fourth quarter.

The company is reviewing its lease accounting practices in keeping with a recent clarification by the U.S. Securities and Exchange Commission. Other retailers including Starbucks Corp. and Target Corp. are recalculating results.

Gap said the adjustments may reduce pretax profit for recent years by a total of \$170 million to \$200 million. The company said a restatement will have no effect on its cash or revenue.

Pressler is adding new versions of existing brands, including its GapBody intimate apparel and fashions in women's petite sizes at Banana Republic. The retailer is scheduled to introduce a fragrance line in GapBody locations next month, while Banana Republic will open in Japan in the second half of the year.

The company is scheduled to unveil a new chain aimed at women over 35 years of age later this year.

Of 28 analysts tracked by Bloomberg, nine rate Gap a ``buy'' and 19 rate it ``hold.''

--Editors: Wright, Todd.

Story illustration: For profiles of Gap's top managers and directors, see {GPS US <Equity> MGMT <GO>}. For a series of Bloomberg functions relating to the company's earnings and stock performance, see {GPS US <Equity> CNP11042050105 <GO>}. Press the Space bar to pause, the Go key to continue.

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