GAP INC.

Gap Inc. Second Quarter Fiscal 2026 Conference Call Prepared Remarks
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Shirley Martin – Senior Director of Investor Relations, Gap Inc.

Good afternoon, everyone. Welcome to Gap Inc.'s Second Quarter Fiscal 2026 Earnings Conference Call.

Before we begin, I'd like to remind you that the information made available on this conference call contains forward-looking statements that are subject to risks that could cause our actual results to be materially different.

For information on factors that could cause our actual results to differ materially from any forward-looking statements, please refer to the cautionary statements contained in our latest earnings release, the risk factors described in the company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 17, 2026, and other filings with the Securities and Exchange Commission, all of which are available on gapinc.com.

These forward-looking statements are based on information as of today, August 27th, 2026 and we assume no obligation to publicly update or revise our forward-looking statements.

Our latest earnings release and the accompanying materials available on gapinc.com also include descriptions and, where available, reconciliations of financial measures not consistent with Generally Accepted Accounting Principles. All market share data referenced today will be from Circana's US Apparel Consumer service for the 12 months ending July 2026, unless otherwise stated.

Joining me on the call today are our Chief Executive Officer, Richard Dickson, and Chief Financial Officer, Katrina O'Connell.

With that, I'll turn the call over to Richard…

Richard Dickson – Chief Executive Officer, Gap Inc.

Thanks, Shirley. And good afternoon, everyone.

In the second quarter, while the company exceeded our profit expectations, we delivered a net sales decline of 2% with mixed performance on the top-line across the portfolio. While not the revenue outcome we wanted, continued operational and financial rigor contributed to gross margin strength. We also maintained market share reflecting the continued resonance of our brand portfolio.

The Gap brand delivered another exceptional quarter, with comparable sales increasing 10%, and Banana Republic continued to build momentum posting its fifth consecutive quarter of positive comps. Athleta's topline remained pressured, though we saw encouraging improvement in inventory productivity.

At Old Navy, as we previewed on last quarter's call, seasonal categories continued to weigh on performance. While we took actions to address this, as the quarter progressed, we also experienced a slowdown in traffic which led to a modest miss versus our expectations.

While this is disappointing, I have confidence in our plans to improve performance in the second half. Over the past quarter, Katrina and I have been deeply involved with the Old Navy team in conducting a thorough review of the business. We have a clear understanding of where our execution fell short and have moved quickly to strengthen our plans, the details of which I will get into in a few minutes. Based on August trends, we are also encouraged by the improvement we are seeing and we're focused on delivering for the second half.

Beyond our near-term priorities, we continued to make long-term investments to advance our next phase of growth. We continue to expand Beauty and Accessories, while building our Fashiontainment and Technology platforms to deepen customer engagement, strengthen our brands, and enhance our operations.

We also demonstrated our commitment to shareholder returns, through our dividend and meaningful share repurchases in the quarter, reflecting both the strength of our balance sheet and our confidence in the long-term opportunity.

As we factor in our second quarter performance, we are narrowing our full-year revenue outlook. At the same time, we are raising our margin and EPS outlook, as Katrina will share shortly. We are confident in the roadmap we have put in place for the second half and remain focused on disciplined execution and delivering further improvement.

Turning now to our detailed second quarter results by brand…

Starting with Old Navy. In the second quarter, Old Navy's comparable sales declined 4%. As we previewed last quarter, we expected the women's summer seasonal assortment to pressure performance and that played out largely as anticipated, accounting for approximately three points of the comp pressure in the quarter. In particular, we experienced declines in dresses, shorts and swim, where we made some assortment and pricing decisions that impacted our value equation.

What we did not anticipate was the degree to which our marketing would fall short in driving traffic.

We are not satisfied with this result and have responded quickly. As we move into the third quarter, the headwind from summer categories becomes much less significant. This gives us a clear runway for improvement as key categories like Denim, Active, Sweaters and Knits drive the business. Additionally, as we sharpen fashion content and pricing, we believe our Fall assortment will provide an improved value equation.

- In Denim, we are solidly positioned as the 3rd largest denim brand in the country. With great quality denim for the whole family at highly attractive price points, we are building Old Navy as a denim destination. Following strong first half performance, denim will grow in importance during the second half as we build on the momentum we are seeing in newer silhouettes like low-rise and baggy, while introducing more fashion and choice, all at a great value.
- In Knits, legacy franchises remain healthy, while we chase into untapped growth in newer franchises like Hug and Heavyweight.
- In Active, Old Navy is the fifth largest brand in the country. With the success we've had and continued innovation, this Fall, we are amplifying our presence in the category with the introduction of Old Navy Sport. Beginning with an elevated merchandising experience, including

approximately 40 shop-in-shops in select stores and storytelling centered on technical innovation and style at an incredible value, Old Navy Sport will become Old Navy's active brand.
- In Beauty, building on our successful pilot last Fall, this week, we launched our Old Navy Beauty Co. collection nationwide, expanding Old Navy into a destination for everyday essentials from style to beauty.
- And next month we are expanding our partnership with Fanatics, bringing our first exclusive collection of licensed sports merchandise to customers at Old Navy's signature value, enabling us to capitalize on key moments in the sports calendar, beginning with Football season.

In addition to product, we have rewired our marketing strategy to improve traffic trends. Our Fall denim campaign featuring music artist and television personality Cardi B launched earlier this month and is off to a good start, driving improvement in traffic. Building on its success, this week, we launched Cardi's Cardi, extending the reach and relevance of the campaign into Knits.

In addition, as we build excitement and momentum for Back-to-School, we have partnered with leading digital creator, MrBeast, on a multi-part content series highlighting the incredible style, expression and value in Old Navy's Back-to-School collection.

With improved execution in August, we have seen the business pick up, reinforcing our confidence in the actions we are taking. We are clear on the path forward and believe we can drive stronger results from here.

As we execute on our Fall plans, we separately announced this afternoon that we are advancing a planned leadership transition with the appointment of Michael Francis as Old Navy's new Brand President and CEO, succeeding Haio Barbeito, effective Monday, November 2nd. Haio is working closely with Michael in an advisory capacity to ensure a smooth transition.

I want to thank Haio for his leadership and contributions to Old Navy in strengthening the foundation of the brand, scaling our strategic categories and positioning the business for a new phase of growth. Since the beginning of our transformation, Old Navy has grown its annual revenue by nearly half a billion dollars, further strengthening its position as the #1 specialty apparel brand and retailer in the U.S.

As we look ahead to the brand's next phase, Michael's deep expertise in customer-centric brand building and track record of strong commercial execution will be instrumental in unlocking the brand's full potential and I am confident that now is the right time for him to step into this role. Michael has a proven ability to connect creativity, culture and commerce in ways that will energize the business. I've seen this firsthand as we have worked closely together to develop our plans for the second half and position Old Navy to capture the significant opportunity we see ahead.

Now moving on to Gap…

Gap delivered another excellent quarter. Comparable sales increased 10%, marking its eleventh consecutive quarter of positive comps.

As we continue to strengthen product and storytelling through big ideas and culturally relevant narratives, we are deepening customer engagement and further strengthening the brand. That momentum is reflected in the continued expansion of our customer file and yet another quarter of lower discounting. We also continue to gain market share.

Importantly, Gap brand's momentum continues to be broad-based. Women's led performance in the quarter, while Men's continued to deliver solid results. Kids & Baby also accelerated, as customers continued to respond positively to our more elevated product aesthetic.

By category, Denim and Fleece once again drove the business, underscoring the continued strength of our destination categories.

Gap continues to solidify its cultural relevance with customers, connecting fashion and creativity through compelling collaborations and partnerships. In the second quarter, we teamed up with Hailey Bieber – one of fashion's most influential tastemakers – to reimagine two of Gap's signature denim silhouettes for a new generation. The Hailey Jean sold out quickly while driving strong traffic and a meaningful halo across the broader business. This was a great start and there's more to come.

As we look ahead, we are building on our success in elevating our core categories, while also now investing in growth accelerators to expand Gap's relevance across more aspects of consumers' lifestyles.

- We ended the second quarter relaunching our iconic Gap Fragrance line. Early customer response has been encouraging, reinforcing both our heritage and our confidence in the long-term opportunity in Beauty.
- And, we are expanding into Gap Accessories, beginning with Bags, launching with Fashion Week in September.

Marketing continues to resonate playing into Gap's heritage in music, with the latest release of "Denim On My Own," featuring musician Malcolm Todd in Gap Denim in a reinterpretation of Robyn's iconic "Dancing on My Own."

In addition, we continue to elevate the customer experience. Our store remodel program remains on track with upgraded stores outperforming the rest of the fleet. We expect to complete approximately 35 remodels this year, bringing roughly one-quarter of our North America specialty fleet into our latest concept by year end.

I'm incredibly proud of the Gap team and what they continue to accomplish. Quarter after quarter, they have demonstrated that when great product is paired with compelling storytelling and disciplined execution, it creates a powerful flywheel of customer engagement and brand momentum. As we enter the third quarter, we have an exciting pipeline of product innovation, culturally relevant collaborations and brand activations that position Gap to continue its momentum.

Moving on to Banana Republic…

Banana Republic delivered another quarter of progress, with comparable sales increasing 3%, marking the brand's fifth consecutive quarter of positive comparable sales growth. The quarter reflected broad-based strength across both the Men's and Women's businesses as customers responded positively, with categories like outerwear, sweaters, and denim, as well our linen fabrications performing well.

Throughout the quarter, Banana Republic continued to celebrate its heritage as a brand for the Modern Explorer through elevated product and travel-inspired storytelling. Through our Portugal series and partnership with National Geographic host Antoni Porowski, we reinforced linen as the season's hero fabric. And our curated Archive Drop successfully introduced Banana Republic's heritage to a younger customer through iconic styles.

Banana Republic is demonstrating continued progress while becoming increasingly distinctive in the marketplace. Upgraded stores like Century City and Tyson's are delivering a better shopping experience resulting in customers spending more when they shop with us.

As Banana Republic enters its next chapter, we were excited to welcome Donald Kohler as the brand's new President and CEO in July. Since joining, Donald has hit the ground running, and his combination of operational excellence, merchandising expertise, and brand-building instincts gives me great confidence in the opportunities ahead. Under his leadership, we believe Banana Republic is well positioned to build on its progress.

Now turning to Athleta...

Athleta's performance in the second quarter remained challenged, with comparable sales declining 12%. During the quarter, we proactively managed inventory tightly while testing and learning selectively with new product launches. This resulted in better inventory productivity with early signs of customer acceptance of newer product like the Journey travel collection, launched last quarter.

As we continue to evolve our assortment, our priorities are clear. We are increasing newness, reducing reliance on promotions, and seeking to rebuild customer engagement through better product and stronger storytelling. We have also strengthened the organization with new talent across Digital and Merchandising to improve execution over time.

With our turnaround efforts still in the early stages, we are continuing to take a measured and disciplined approach to inventory and marketing investments as we continue to assess customer response in the second half. While this approach may limit top-line improvement in the near term, we believe it is important to rebuild the business on a stronger foundation for sustainable growth.

Before I turn the call over to Katrina, with August marking three years since I took on the role of CEO at Gap Inc, I want to take a moment to reflect on our transformation journey so far. We are pleased with the progress we've made, while recognizing there is more work ahead. We made a choice to perform while we transform and the metrics that matter reinforce that we have made fundamental improvements in the business.

We are on track to deliver our third year of positive sales growth led by our focus on strategic categories. As a portfolio, we have gained meaningful market share. We are delivering some of our strongest gross margins in 25 years, and we have significantly improved the strength of our balance sheet, while returning meaningful cash to our shareholders.

I want to thank our team for the progress we've made and their commitment to becoming a high-performing company. We've built a stronger foundation, with greater financial and operational rigor. But we know there is more to unlock, and we have conviction in our ability to do so by executing with greater consistency, agility, and discipline as we continue our transformation journey.

With that, I'll turn the call over to Katrina to walk you through our financial results and updated outlook for fiscal 2026…

Katrina O'Connell – Chief Financial Officer, Gap Inc.

Thank you, Richard, and thanks everyone for joining us this afternoon.

In the second quarter, we remained focused on performing while we transform. While revenue results were mixed across brands, at the company level, we continued to deliver across several other key metrics.

We achieved a strong gross margin result led by disciplined pricing and inventory management. We maintained SG&A rigor while balancing investments in growth accelerators and capabilities to fuel our future. And with the strength of our balance sheet, we opportunistically accelerated share repurchases while maintaining a healthy dividend and continuing to invest capital to support our business.

While Old Navy underperformed, we've clearly identified the drivers and have taken targeted action to strengthen execution in the second half. Quarter-to-date, we are encouraged by the improvement we are seeing in the business, which reinforces that we are on the right track. At the same time, we remain highly confident in Gap's momentum and Banana Republic's consistency, while we continue rebuilding Athleta.

As we factor in our second quarter performance, we are narrowing our full-year revenue outlook, with net sales growth now expected in the range of 1% to 1.5%. At the same time, we are raising our outlook for adjusted operating margin and earnings per share — the details of which I will share shortly.

As outlined in this afternoon's earnings release, our second quarter results and full-year 2026 outlook for adjusted gross margin and operating margin exclude a cost-of-goods-sold adjustment tied to an expected net recovery of tariffs previously paid under the International Emergency Economic Powers Act. Our adjusted earnings per share outlook also excludes the related interest impact. Separately, as previously discussed, our full-year adjusted SG&A, operating profit, and earnings per share outlook exclude the net gain from a legal settlement and the offsetting charitable donation made in the first quarter.

Now onto our results...

Net sales of $3.7 billion decreased 2% year over year with comparable sales down 1%. As I previewed last quarter, the spread between net sales and comparable sales included the impact of lapping revenue recognized last year related to the structure of our credit card agreement.

By brand, Gap delivered another outstanding quarter — net sales up 9%, comparable sales up 10% — driven by culturally relevant storytelling in destination categories like denim, fleece, and kids and baby Old Navy net sales and comparable sales declined 4%, as expected softness in the women's seasonal assortment was compounded by traffic slowing as the quarter progressed.

Banana Republic had a solid quarter — net sales up 1%, comparable sales up 3% — with balanced performance across men's and women's, supported by stronger marketing and brand storytelling.

Athleta net sales and comparable sales declined 12%, and we remain focused on disciplined execution as we rebuild the brand profitably.

AUR again grew across our brands with Gap brand also delivering positive traffic and unit growth, providing a clear example of the broad-based strength the reinvigoration playbook can deliver.

Let's continue to the balance of the P&L...

Reported gross margin for the quarter was 52.8%. Adjusted gross margin of 41.4% increased 20 basis points versus last year. Adjusted merchandise margin expanded 80 basis points, driven primarily by the Gap brand, with a partial offset from Old Navy where we were more promotional. As previewed, merchandise margins included approximately 30 basis points of benefit associated with our tariff mitigation actions. We also experienced a slight headwind from the credit card dynamic and higher fuel costs. ROD deleveraged 60 basis points, better than expected with timing of certain occupancy expenses shifting into the third quarter.

SG&A for the quarter was $1.3 billion or 34.3% of net sales, deleveraging 90 basis points. As previewed, the deleverage to last year was driven by the timing of investments in growth accelerators and capabilities.

Second quarter reported operating margin was 18.5%. The adjusted operating margin was 7.1%, down 70 basis points compared to last year as gross margin expansion was primarily offset by the timing of investments, as I just outlined.

Reported earnings per share were $1.38. Adjusted earnings per share were $0.52 versus last year's earnings per share of $0.57.

Before I move on to the details of our cash flow and balance sheet, I would like to reiterate our capital allocation framework. Our approach remains disciplined, leveraging the strength of our balance sheet and robust cash profile to enhance long-term shareholder value.

1. Our first priority remains investing in the business through high returning capital investments. Second quarter capital expenditures were $154 million, bringing year-to-date investments to $289 million. We continue to expect approximately $650 million for the full year, primarily for new stores and remodels at Gap and Old Navy, along with technology and supply chain investments.
2. Our second priority is to pay a growing dividend. We paid $62 million in dividends in the second quarter, and the Board has approved a third quarter dividend of $0.175 per share.
3. And our third priority is share repurchases to drive earnings accretion. In addition to completing the previously announced accelerated share repurchase program, we repurchased an additional $200 million of stock in the open market in the quarter, bringing year-to-date repurchases to over $600 million or 26 million shares. Approximately $400 million remains under our current authorization.

We ended the quarter with $2.5 billion of cash, cash equivalents and short-term investments on our balance sheet, up slightly to last year. Year-to-date, net cash from operating activities was $550 million and year-to-date free cash flow was $261 million.

Inventory discipline remains a priority: quarter-end inventory at cost was flat year over year. On a unit basis, inventory was up 4%, reflecting higher in-transit inventory largely tied to geopolitical disruptions. Now let me turn to our outlook.

Our outlook reflects continued disciplined execution as we work toward a third consecutive year of profitable sales growth. As always, we're taking a balanced view — factoring in what we currently see in the consumer and macro environment, which is largely unchanged, while remaining mindful of potential volatility ahead in energy prices and U.S. tariffs.

Before I get into the details, I want to provide an update on our tariff assumptions.

Let me unpack the moving pieces around tariff rates and then I will walk you through how we are factoring this into our gross margin outlook for the year, which remains largely unchanged.

Our prior outlook in May assumed 10% tariff rate from February 24 through July 24 under Section 122 before returning to a high-teens tariff rate for the balance of the year. Following the Section 301 announcement on July 23, 2026, we are now extending that 10% assumption through the end of August, which provides approximately $15 million of incremental net tariff relief to the year, which will be realized primarily in the fourth quarter.

If the current rate of 10% rate holds through the end of the third quarter, we estimate it would provide an additional $35 million of benefit to the year.

Turning to the specifics of our outlook for fiscal 2026…

Starting with revenue. As noted earlier, we now expect full-year net sales growth of 1% to 1.5%, with comparable sales roughly in-line.

By brand, at Old Navy, as a result of a slightly more challenging second quarter, we now assume comparable sales are flat to down 1%, with sequential improvement in the second half as our targeted actions take hold.

With the momentum we are seeing at the Gap brand, we now expect comp growth in the high-single to low double-digit range. Banana Republic is expected to post another year of growth with comps in the low single-digits. And at Athleta, we are taking a measured approach to inventory buys as we introduce more newness in the back half, allowing us the flexibility to read and react to new product receptivity. While the teams are striving to do better, our outlook for Athleta assumes full-year trends remain similar to the first half.

Turning to gross margin...

We are raising our adjusted gross margin outlook as we incorporate incremental tariff relief from Section 301, as referenced earlier. We now assume our adjusted gross margin will be up slightly versus the prior year. Tariffs are now expected to be a slight benefit incorporating our largely unchanged view of the net impact of IEEPA tariffs, the Section 122 benefit that we have reserved and the more recent Section 301 benefit of approximately 10 basis points that we are flowing through. Outside of this, our margin outlook is unchanged. Merchandise margins are expected to expand year over year reflecting a balanced plan of higher AURs through better sell-throughs and lower discounting, while ROD is expected to deleverage approximately 50 basis.

Moving on to SG&A. We remain committed to delivering $150 million in cost savings this year as part of our ongoing push for efficiency — part of that will offset inflation, with the remainder funding growth initiatives. Consistent with prior guidance, we expect full-year adjusted SG&A as a percentage of sales to be roughly flat year over year, with leverage in the second half as we lap last year's spending on strategic-initiatives and elevated incentive compensation, which was weighted toward the third and, more heavily, fourth quarters last year.

Taking this altogether, we're pleased to be raising our adjusted operating margin outlook slightly to 7.4% to 7.6% for the full year, versus 7.3% last year, reflecting continued rigor and discipline across the P&L in addition to tariff benefits related to Section 301.

Adjusted interest income is now expected to be approximately $20 million skewed to the fourth quarter given the expected tariff refund. And we expect a tax rate in the range of 25% to 26%.

Adjusted EPS is now expected to be $2.35 to $2.45, up 10% to 15% versus last year, an increase from our prior outlook, reflecting our improved gross margin outlook and a lower weighted average share count of 367 million shares following second quarter repurchase activity.

Now, let me turn to our outlook for the third quarter of fiscal 2026…

The quarter is off to a good start supported by a sequential improvement at Old Navy. With this in mind, we expect net sales in the third quarter to increase 1.5% to 2.5% year-over-year, with comparable sales under pacing net sales by approximately 50 basis points. Our current trend supports the low end of our outlook but with a range of outcomes by brand that could deliver better. This assumes continued strength at Gap, and growth at Banana Republic, with Athleta trending similar to our first half performance.

For Old Navy, we expect a comp range of roughly flat to down 1%. Current trends are in line with the range, reflecting meaningful sequential improvement to our second quarter performance as the impact of the challenged summer seasonal product abates and new Fall marketing and product resonates more strongly. Peak selling periods are still ahead and as newer initiatives like ON Sport, Beauty and Fanatics launch and build through the quarter, we see the potential for further improvement.

We expect the third quarter gross margin to be up 25 to 75 basis points compared to last year’s gross margin of 42.4%. Tariffs are expected to be an approximately 150 basis point benefit, with 50 basis points related to lower rates under Section 122 and the balance driven by our mitigation strategies. Consistent with prior expectations, half of the relief from Section 122 is expected to fund higher fuel costs.

With regards to the balance of our merchandise margin profile, we expect the margin to be flat to down modestly as we leverage margin strength in the Gap brand, in addition to the remaining half of the Section 122 benefit to make assortment and pricing adjustments at Old Navy to strengthen second half performance. We believe the brands Fall assortment now better reflects the category mix, fashion balance and value proposition that our customers look to us for, which is supporting our confidence in a sequential recovery in the second half.

ROD is expected to deleverage approximately 60 basis points.

Last, we are planning for SG&A as a percentage of net sales to leverage slightly as we continue to exercise expense discipline while lapping slightly higher third quarter incentive compensation last year.

In closing, our outlook reflects our best assessment of the business today and we are focused on disciplined execution. With peak selling periods still ahead and exciting new initiatives building, we're driving for continued improvement in the second half.

Across the organization, our teams are operating with urgency and a clear determination to win.
I remain confident in our strategy and in our ability to deliver sustainable value for our shareholders.

With that, we'll open the line for questions. Operator?