

LEAR CORP  
Form 10-Q  
May 04, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

☒

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended **March 31, 2007**.

☐

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

**Commission file number: 1-11311**

**LEAR CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**13-3386776**

(I.R.S. Employer Identification No.)

**21557 Telegraph Road, Southfield, MI**

(Address of principal executive offices)

**48033**

(Zip code)

**(248) 447-1500**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of April 27, 2007, the number of shares outstanding of the registrant's common stock was 76,667,114 shares.

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LEAR CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2007

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**LEAR CORPORATION**

**PART I FINANCIAL INFORMATION**

**ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**INTRODUCTION TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

We have prepared the condensed consolidated financial statements of Lear Corporation and subsidiaries, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, for the year ended December 31, 2006.

The financial information presented reflects all adjustments (consisting of normal recurring adjustments) which are, in our opinion, necessary for a fair presentation of the results of operations and cash flows and statements of financial position for the interim periods presented. These results are not necessarily indicative of a full year's results of operations.

**LEAR CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In millions, except share data)

	March 31, 2007	December 31, 2006
	(Unaudited)	
<b>ASSETS</b>		
<i>CURRENT ASSETS:</i>		
Cash and cash equivalents	\$ 330.4	\$ 502.7
Accounts receivable	2,412.7	2,006.9
Inventories	599.0	581.5
Current assets of business held for sale	38.3	427.8
Other	317.6	371.4
	<hr/>	<hr/>
Total current assets	3,698.0	3,890.3
	<hr/>	<hr/>
<i>LONG-TERM ASSETS:</i>		
Property, plant and equipment, net	1,425.9	1,471.7
Goodwill, net	2,006.6	1,996.7
Other	530.5	491.8
	<hr/>	<hr/>
Total long-term assets	3,963.0	3,960.2
	<hr/>	<hr/>
	\$ 7,661.0	\$ 7,850.5
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<i>CURRENT LIABILITIES:</i>		
Short-term borrowings	\$ 11.5	\$ 39.3
Accounts payable and drafts	2,480.3	2,317.4
Accrued liabilities	1,152.8	1,099.3
Current liabilities of business held for sale	16.7	405.7
Current portion of long-term debt	26.4	25.6
	<hr/>	<hr/>
Total current liabilities	3,687.7	3,887.3
	<hr/>	<hr/>
<i>LONG-TERM LIABILITIES:</i>		
Long-term debt	2,431.8	2,434.5
Long-term liabilities of business held for sale	21.6	48.5
Other	827.4	878.2
	<hr/>	<hr/>
Total long-term liabilities	3,280.8	3,361.2
	<hr/>	<hr/>
<i>STOCKHOLDERS' EQUITY:</i>		
Common stock, \$0.01 par value, 150,000,000 shares authorized; 82,166,506 shares and 81,984,306 shares issued as of March 31, 2007 and December 31, 2006, respectively	0.7	0.7
Additional paid-in capital	1,357.3	1,338.1
Common stock held in treasury, 5,508,097 shares as of March 31, 2007, and 5,732,316 shares as of December 31, 2006, at cost	(201.9)	(210.2)
Retained deficit	(308.0)	(362.5)
Accumulated other comprehensive loss	(155.6)	(164.1)
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Total stockholders' equity	692.5	602.0
	<u>                    </u>	<u>                    </u>
	\$ 7,661.0	\$ 7,850.5
	<u>                    </u>	<u>                    </u>

The accompanying notes are an integral part of these condensed consolidated balance sheets.

## LEAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited; in millions, except per share data)

	Three Months Ended	
	March 31, 2007	April 1, 2006
Net sales	\$ 4,406.1	\$ 4,678.5
Cost of sales	4,095.2	4,459.3
Selling, general and administrative expenses	126.5	165.0
Loss on divestiture of Interior business	25.6	
Interest expense	51.5	47.7
Other (income) expense, net	25.0	(8.3)
Income before provision (benefit) for income taxes and cumulative effect of a change in accounting principle	82.3	14.8
Provision (benefit) for income taxes	32.4	(0.2)
Income before cumulative effect of a change in accounting principle	49.9	15.0
Cumulative effect of a change in accounting principle		2.9
Net income	\$ 49.9	\$ 17.9
Basic net income per share:		
Income before cumulative effect of a change in accounting principle	\$ 0.65	\$ 0.22
Cumulative effect of a change in accounting principle		0.05
Basic net income per share	\$ 0.65	\$ 0.27
Diluted net income per share:		
Income before cumulative effect of a change in accounting principle	\$ 0.64	\$ 0.22
Cumulative effect of a change in accounting principle		0.04
Diluted net income per share	\$ 0.64	\$ 0.26

The accompanying notes are an integral part of these condensed consolidated statements.

## LEAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited; in millions)

	Three Months Ended	
	March 31, 2007	April 1, 2006
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 49.9	\$ 17.9
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Cumulative effect of a change in accounting principle		(2.9)
Loss on divestiture of Interior business	25.6	
Depreciation and amortization	74.5	97.8
Net change in recoverable customer engineering and tooling	23.8	128.6
Net change in working capital items	(150.4)	(235.8)
Net change in sold accounts receivable	(38.9)	38.1
Other, net	(26.3)	(4.3)
Net cash provided by (used in) operating activities	(41.8)	39.4
<b>Cash Flows from Investing Activities:</b>		
Additions to property, plant and equipment	(29.2)	(92.6)
Divestiture of Interior business	(57.3)	
Other, net	(28.6)	27.9
Net cash used in investing activities	(115.1)	(64.7)
<b>Cash Flows from Financing Activities:</b>		
Long-term debt repayments, net	(3.6)	(6.1)
Short-term debt repayments, net	(11.0)	
Dividends paid		(16.8)
Proceeds from exercise of stock options	5.7	
Increase (decrease) in drafts	(13.5)	1.1
Net cash used in financing activities	(22.4)	(21.8)
Effect of foreign currency translation	7.0	10.7
<b>Net Change in Cash and Cash Equivalents</b>	<b>(172.3)</b>	<b>(36.4)</b>
<b>Cash and Cash Equivalents as of Beginning of Period</b>	<b>502.7</b>	<b>207.6</b>
<b>Cash and Cash Equivalents as of End of Period</b>	<b>\$ 330.4</b>	<b>\$ 171.2</b>
<b>Changes in Working Capital Items:</b>		
Accounts receivable	\$ (434.2)	\$ (428.2)
Inventories	(20.6)	14.0
Accounts payable	224.5	103.9
Accrued liabilities and other	79.9	74.5

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Net change in working capital items	\$ (150.4)	\$ (235.8)
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**Supplementary Disclosure:**

Cash paid for interest	\$ 36.9	\$ 26.6
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Cash paid for income taxes	\$ 45.7	\$ 42.9
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The accompanying notes are an integral part of these condensed consolidated statements.



**LEAR CORPORATION AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Basis of Presentation**

The condensed consolidated financial statements include the accounts of Lear Corporation ( Lear or the Parent ), a Delaware corporation and the wholly owned and less than wholly owned subsidiaries controlled by Lear (collectively, the Company ). In addition, Lear consolidates variable interest entities in which it bears a majority of the risk of the entities potential losses or stands to gain from a majority of the entities expected returns. Investments in affiliates in which Lear does not have control, but does have the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method.

The Company and its affiliates design and manufacture complete automotive seat systems, electrical distribution systems and select electronic products. Through the first quarter of 2007, the Company also supplied automotive interior systems and components, including instrument panels and cockpit systems, headliners and overhead systems, door panels and flooring and acoustic systems (Note 3, Divestiture of Interior Business ). The Company s main customers are automotive original equipment manufacturers. The Company operates facilities worldwide.

Certain amounts in the prior period s financial statements have been reclassified to conform to the presentation used in the quarter ended March 31, 2007.

**(2) Merger Agreement**

On February 9, 2007, the Company entered into an Agreement and Plan of Merger (the Merger Agreement ) with AREP Car Holdings Corp., a Delaware corporation ( Parent ), and AREP Car Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Parent ( Merger Sub ). Under the terms of the Merger Agreement, Merger Sub would be merged with and into the Company, and as a result, the Company would continue as the surviving corporation and a wholly owned subsidiary of Parent. Parent and Merger Sub are affiliates of Carl C. Icahn.

Pursuant to the Merger Agreement, as of the effective time of the merger, each issued and outstanding share of common stock of the Company, other than shares (i) owned by Parent, Merger Sub or any subsidiary of Parent and (ii) owned by any shareholders who are entitled to and who have properly exercised appraisal rights under Delaware law, will be canceled and automatically converted into the right to receive \$36.00 in cash, without interest.

The Merger Agreement contains provisions pursuant to which the Company was permitted to solicit alternative acquisition proposals for forty-five days after the date of the Merger Agreement (the Solicitation Period ) and continue ongoing discussions or negotiations thereafter. The Solicitation Period ended on March 26, 2007, and no alternative acquisition proposals have been received as of the date of this Report. The Company may terminate the Merger Agreement under certain circumstances, including if its board of directors determines in good faith that it has received a Superior Proposal (as defined in the Merger Agreement) and otherwise complies with certain terms of the Merger Agreement. In connection with such termination, and in certain other limited circumstances, the Company would be required to pay a fee of \$85.2 million to Parent plus up to \$15.0 million of Parent s out-of-pocket expenses (including fees and expenses of financing sources, counsel, accountants, investment bankers, experts and consultants) relating to the Merger Agreement.

Parent has obtained debt financing commitments for the transaction contemplated by the Merger Agreement. Consummation of the merger is not subject to a financing condition, but is subject to other conditions, including receipt of the affirmative vote of the holders of a majority of the outstanding shares of the Company s common stock, antitrust approvals and other customary closing conditions.

In connection with the execution of the Merger Agreement, the Company entered into a voting agreement with Icahn Partners LP, Icahn Partners Master Fund LP, Koala Holding Limited Partnership and High River Limited Partnership. In the aggregate, such holders beneficially own approximately 16% of the Company s outstanding common stock. Pursuant to the voting agreement, such holders agreed to vote in favor of the merger and, subject to certain exceptions, not to dispose of any shares of common stock prior to consummation of the merger. Such holders have also agreed to vote in favor of a Superior Proposal under certain circumstances. In addition, American Real Estate Partners, L.P. has provided a limited guaranty in favor of the Company with respect to the performance by Parent and Merger Sub of certain payment obligations under the Merger Agreement.

If presented, the transaction contemplated by the Merger Agreement will be voted on by shareholders of record as of May 14, 2007, at the Company s annual stockholders meeting, which has been scheduled for June 27, 2007.

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For further information regarding the Merger Agreement, please refer to the Merger Agreement and certain related documents, which are incorporated by reference as exhibits to this Report.

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

## (3) Divestiture of Interior Business

On March 31, 2007, the Company completed the transfer of substantially all of the assets of the Company's North American interior business (as well as its interests in two China joint ventures and \$27.4 million of cash) to International Automotive Components Group North America, Inc. and International Automotive Components Group North America, LLC (together, IAC North America), in exchange for a 25% equity interest in IAC North America and warrants for an additional 7% of the current outstanding equity of IAC North America. In addition, under the terms of the divestiture agreement, the Company has agreed to fund up to an additional \$40 million to IAC North America, in the event that IAC North America does not meet certain financial targets in 2007. The legal transfer of certain assets included in this transaction is subject to the satisfaction of certain post-closing conditions. In connection with this transaction, IAC North America assumed the ordinary course liabilities of the Company's North American interior business, and the Company retained certain pre-closing liabilities, including pension and postretirement healthcare liabilities incurred through the closing date of the transaction.

The Company recorded a loss on divestiture of interior business of \$606.9 million in the fourth quarter of 2006 and an additional charge of \$29.4 million in the first quarter of 2007, including \$6.2 million recorded as cost of sales, \$2.0 million recorded as selling, general and administrative expenses and \$21.2 million recorded as loss on divestiture of interior business. Approximately \$22.5 million of the first quarter 2007 charge represented cash costs. As of March 31, 2007, the beneficial ownership interests of certain less than wholly owned subsidiaries were transferred to IAC North America, however, as described above, the transfer of legal ownership is subject to the satisfaction of certain post-closing conditions. Accordingly, these assets and liabilities remain classified as held for sale on the Company's condensed consolidated balance sheet as of March 31, 2007. A summary of the major classes of the assets and liabilities of the Company's North American interior business that are classified as held for sale in the Company's condensed consolidated balance sheets are shown below (in millions):

	March 31, 2007	December 31, 2006
Cash and cash equivalents	\$ 12.8	\$ 19.2
Accounts receivable	17.3	284.5
Inventories	3.9	69.2
Other current assets	4.3	54.9
Current assets of business held for sale	\$ 38.3	\$ 427.8
Accounts payable and drafts	\$ 8.4	\$ 323.7
Accrued liabilities	5.4	79.8
Current portion of long-term debt	2.9	2.2
Current liabilities of business held for sale	16.7	405.7
Long-term debt	18.2	19.6
Other long-term liabilities	3.4	28.9
Long-term liabilities of business held for sale	21.6	48.5
Total liabilities of business held for sale	\$ 38.3	\$ 454.2

The Company did not account for the divestiture of its North American interior business as a discontinued operation due to its continuing involvement with IAC North America. The Company's investment in IAC North America is accounted for under the equity method of

accounting.

The divestiture of the Company's North American interior business substantially completes the disposition of the Company's interior business. On October 16, 2006, the Company completed the contribution of substantially all of its European interior business to International Automotive Components Group, LLC ( "IAC Europe" ), in exchange for a one-third equity interest in IAC Europe. In connection with this transaction, the Company recorded a loss on divestiture of interior business of \$33.5 million, of which \$4.4 million was recorded in the first quarter of 2007 and \$29.1 million was recorded in 2006.

#### **(4) Stock-Based Compensation**

On January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ( "SFAS" ) No. 123(R), "Share-Based Payment," using the modified prospective transition method and recognized income of \$2.9 million as a cumulative

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

effect of a change in accounting principle related to a change in accounting for forfeitures. There was no income tax effect resulting from this adoption. SFAS No. 123(R) requires the estimation of expected forfeitures at the grant date and the recognition of compensation cost only for those awards expected to vest. Previously, the Company accounted for forfeitures as they occurred. In the first quarters of 2007 and 2006, there were no outstanding unvested awards for which no compensation cost was recognized as the Company adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for all employee awards granted after January 1, 2003.

**(5) Restructuring**

In order to address unfavorable industry conditions, the Company began to implement consolidation and census actions in the second quarter of 2005. These actions are part of a comprehensive restructuring strategy intended to (i) better align the Company's manufacturing capacity with the changing needs of its customers, (ii) eliminate excess capacity and lower the operating costs of the Company and (iii) streamline the Company's organizational structure and reposition its business for improved long-term profitability.

The Company currently expects to incur pretax costs of approximately \$300 million, in connection with the restructuring actions, although all aspects of the restructuring actions have not been finalized. Such costs include employee termination benefits, asset impairment charges and contract termination costs, as well as other incremental costs resulting from the restructuring actions. These incremental costs principally include equipment and personnel relocation costs. The Company also expects to incur incremental manufacturing inefficiency costs at the operating locations impacted by the restructuring actions during the related restructuring implementation period. Restructuring costs are recognized in the Company's consolidated financial statements in accordance with accounting principles generally accepted in the United States. Generally, charges are recorded as elements of the restructuring strategy are finalized. Actual costs recorded in the Company's consolidated financial statements may vary from current estimates.

In connection with the Company's restructuring actions, the Company recorded net charges of \$13.6 million in the first quarter of 2007, including \$11.1 million recorded as cost of sales and \$2.5 million recorded as selling, general and administrative expenses. The first quarter 2007 charges consist of employee termination benefits of \$24.1 million, fixed asset impairment charges of \$0.4 million, net contract termination costs of \$(12.7) million and other costs of \$1.8 million. Employee termination benefits were recorded based on existing union and employee contracts, statutory requirements and completed negotiations. Asset impairment charges relate to the disposal of machinery and equipment with carrying values of \$0.4 million in excess of related estimated fair values. Contract termination costs include lease cancellation costs, the repayment of various government-sponsored grants and a net pension and other postretirement benefit plan curtailment gain of \$13.9 million.

A summary of the first quarter 2007 restructuring charges, excluding the net pension and other postretirement benefit plan curtailment gain of \$13.9 million is shown below (in millions):

	Accrual as of December 31, 2006	2007 Charges	2007 Utilization		Accrual as of March 31, 2007
			Cash	Non-cash	
Employee termination benefits	\$ 36.4	\$ 24.1	\$ (36.9)	\$	\$ 23.6
Asset impairments		0.4		(0.4)	
Contract termination costs	3.4	1.2	(1.4)		3.2
Other related costs		1.8	(1.8)		
<b>Total</b>	<b>\$ 39.8</b>	<b>\$ 27.5</b>	<b>\$ (40.1)</b>	<b>\$ (0.4)</b>	<b>\$ 26.8</b>

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)**(6) Inventories**

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Finished goods and work-in-process inventories include material, labor and manufacturing overhead costs. A summary of inventories is shown below (in millions):

	March 31, 2007	December 31, 2006
Raw materials	\$ 439.9	\$ 439.9
Work-in-process	36.2	35.6
Finished goods	122.9	106.0
Inventories	\$ 599.0	\$ 581.5

**(7) Property, Plant and Equipment**

Property, plant and equipment is stated at cost. Depreciable property is depreciated over the estimated useful lives of the assets, principally using the straight-line method. A summary of property, plant and equipment is shown below (in millions):

	March 31, 2007	December 31, 2006
Land	\$ 132.6	\$ 133.5
Buildings and improvements	607.5	559.1
Machinery and equipment	2,024.1	2,081.3
Construction in progress	22.0	12.0
Total property, plant and equipment	2,786.2	2,785.9
Less accumulated depreciation	(1,360.3)	(1,314.2)
Net property, plant and equipment	\$ 1,425.9	\$ 1,471.7

Depreciation expense was \$73.2 million and \$96.6 million in the three months ended March 31, 2007 and April 1, 2006, respectively.

Costs associated with the repair and maintenance of the Company's property, plant and equipment are expensed as incurred. Costs associated with improvements which extend the life, increase the capacity or improve the efficiency or safety of the Company's property, plant and equipment are capitalized and depreciated over the remaining life of the related asset.

**(8) Goodwill**

A summary of the changes in the carrying amount of goodwill, by reportable operating segment, for the three months ended March 31, 2007, is shown below (in millions):

Seating	Electronic and Electrical	Total
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Balance as of January 1, 2007	\$ 1,060.7	\$ 936.0	\$ 1,996.7
Foreign currency translation and other	7.6	2.3	9.9
Balance as of March 31, 2007	\$ 1,068.3	\$ 938.3	\$ 2,006.6

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

## (9) Long-Term Debt

A summary of long-term debt and the related weighted average interest rates, including the effect of hedging activities described in Note 19, Financial Instruments, is shown below (in millions):

	March 31, 2007		December 31, 2006	
	Long-Term Debt	Weighted Average Interest Rate	Long-Term Debt	Weighted Average Interest Rate
Primary Credit Facility	\$ 997.0	7.49%	\$ 997.0	7.49%
8.50% Senior Notes, due 2013	300.0	8.50%	300.0	8.50%
8.75% Senior Notes, due 2016	600.0	8.75%	600.0	8.75%
5.75% Senior Notes, due 2014	399.4	5.635%	399.3	5.635%
8.125% Euro-denominated Senior Notes, due 2008	74.2	8.125%	73.3	8.125%
8.11% Senior Notes, due 2009	41.4	8.11%	41.4	8.11%
Zero-coupon Convertible Senior Notes, due 2022	0.7	4.75%	3.6	4.75%
Other	45.5	7.03%	45.5	7.06%
	<u>2,458.2</u>		<u>2,460.1</u>	
Current portion	(26.4)		(25.6)	
Long-term debt	<u>\$ 2,431.8</u>		<u>\$ 2,434.5</u>	

*Primary Credit Facility*

The Company's Primary Credit Facility consists of an Amended and Restated Credit and Guarantee Agreement, which provides for maximum revolving borrowing commitments of \$1.7 billion and a term loan facility of \$1.0 billion. As of March 31, 2007 and December 31, 2006, the Company had \$997.0 million in borrowings outstanding under the Primary Credit Facility, all of which were outstanding under the term loan facility. There were no revolving borrowings outstanding.

The Company's obligations under the Primary Credit Facility are secured by a pledge of all or a portion of the capital stock of certain of its subsidiaries, including substantially all of its first-tier subsidiaries, and are partially secured by a security interest in the Company's assets and the assets of certain of its domestic subsidiaries. In addition, the Company's obligations under the Primary Credit Facility are guaranteed, on a joint and several basis, by certain of its subsidiaries, which are primarily domestic subsidiaries and all of which are directly or indirectly 100% owned by the Company.

The Primary Credit Facility contains certain affirmative and negative covenants, including (i) limitations on fundamental changes involving the Company or its subsidiaries, asset sales and restricted payments, (ii) a limitation on indebtedness with a maturity shorter than the term loan facility, (iii) a limitation on aggregate subsidiary indebtedness to an amount which is no more than 4% of consolidated total assets, (iv) a limitation on aggregate secured indebtedness to an amount which is no more than \$100 million and (v) requirements that the Company maintain a leverage ratio of not more than 4.0 to 1, as of March 31, 2007, with decreases over time and an interest coverage ratio of not less than 2.50 to 1 with increases over time.

The leverage and interest coverage ratios, as well as the related components of their computation, are defined in the Primary Credit Facility. The leverage ratio is calculated as the ratio of consolidated indebtedness to consolidated operating profit. For the purpose of the covenant calculation, (i) consolidated indebtedness is generally defined as reported debt, net of cash and excludes transactions related to the Company's asset-backed securitization and factoring facilities and (ii) consolidated operating profit is generally defined as net income excluding income taxes, interest



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expense, depreciation and amortization expense, other income and expense, minority interests in income of subsidiaries in excess of net equity earnings in affiliates, certain restructuring and other non-recurring charges, extraordinary gains and losses and other specified non-cash items. Consolidated operating profit is a non-GAAP financial measure that is presented not as a measure of operating results, but rather as a measure used to determine covenant compliance under the Company's Primary Credit Facility. The interest coverage ratio is calculated as the ratio of consolidated operating profit to consolidated interest expense. For the purpose of the covenant calculation, consolidated interest expense is generally defined as interest expense plus any discounts or expenses related to the Company's asset-backed securitization facility less amortization of deferred finance fees and interest income. As of March 31, 2007, the Company was in compliance with all covenants set forth in the Primary Credit Facility. The Company's leverage and interest coverage ratios were 2.3 to 1 and 4.6 to 1, respectively.

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

Reconciliations of (i) consolidated indebtedness to reported debt, (ii) consolidated operating profit to income before provision for income taxes and (iii) consolidated interest expense to reported interest expense are shown below (in millions):

	<b>March 31, 2007</b>
	<hr/>
Consolidated indebtedness	\$ 2,139.3
Cash and cash equivalents	330.4
	<hr/>
Reported debt	\$ 2,469.7
	<hr/>
	<b>Three Months Ended March 31, 2007</b>
	<hr/>
Consolidated operating profit	\$ 266.6
Depreciation and amortization	(74.5)
Consolidated interest expense	(45.3)
Costs related to divestiture of interior business	(33.8)
Other expense, net (excluding certain amounts related to asset-backed securitization facility)	(26.3)
Restructuring charges	(15.8)
Other excluded items	27.0
Other non-cash items	(15.6)
	<hr/>
Income before provision for income taxes	\$ 82.3
	<hr/>
Consolidated interest expense	\$ 45.3
Certain amounts related to asset-backed securitization facility	1.3
Amortization of deferred financing fees	2.3
Bank facility and other fees	2.6
	<hr/>
Reported interest expense	\$ 51.5
	<hr/>

The Primary Credit Facility also contains customary events of default, including an event of default triggered by a change of control of the Company. The senior notes due 2013 and 2016 (having an aggregate principal amount outstanding of \$900 million as of March 31, 2007) provide holders of the notes the right to require the Company to repurchase all or any part of their notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest, upon a change of control (as defined in the indenture governing the notes). The transaction contemplated by the Merger Agreement with affiliates of American Real Estate Partners, L.P. would not constitute a change of control for these purposes (Note 2, Merger Agreement). The indentures governing the Company's other senior notes do not contain a change of control repurchase obligation.

The Company's senior notes also contain covenants restricting the ability of the Company and its subsidiaries to incur liens and to enter into sale and leaseback transactions. As of March 31, 2007, the Company was in compliance with all covenants and other requirements set forth in its senior notes.

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All of the Company's senior notes are guaranteed by the same subsidiaries that guarantee the Primary Credit Facility. In the event that any such subsidiary ceases to be a guarantor under the Primary Credit Facility, such subsidiary will be released as a guarantor of the senior notes. The Company's obligations under the senior notes are not secured by the pledge of the assets or capital stock of any of its subsidiaries.

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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## (10) Pension and Other Postretirement Benefit Plans

*Net Periodic Benefit Cost*

The components of the Company's net periodic benefit cost are shown below (in millions):

	Pension		Other Postretirement	
	Three Months Ended		Three Months Ended	
	March 31, 2007	April 1, 2006	March 31, 2007	April 1, 2006
Service cost	\$ 8.0	\$ 12.6	\$ 2.9	\$ 3.2
Interest cost	10.4	10.8	3.7	3.7
Expected return on plan assets	(10.2)	(9.7)		
Amortization of actuarial loss	0.8	1.8	1.1	1.4
Amortization of transition obligation			0.2	0.2
Amortization of prior service cost	1.1	1.3	(0.9)	(0.9)
Curtailment gain, net	(36.9)		(13.4)	
Special termination benefits	5.7	0.1	0.8	0.1
Net periodic benefit cost (gain)	\$ (21.1)	\$ 16.9	\$ (5.6)	\$ 7.7

In the first quarter of 2007, the Company recorded a pension plan curtailment gain of \$36.4 million and an other postretirement benefit plan curtailment gain of \$14.7 million. The pension plan curtailment gain resulted from the suspension of the accrual of defined benefits related to the Company's U.S. salaried defined benefit pension plan as the Company elected to freeze its U.S. salaried defined benefit plan effective December 31, 2006. The other postretirement benefit plan curtailment gain resulted from employee terminations associated with a facility closure in 2006. As both curtailment gains were incurred subsequent to the Company's defined benefit plan measurement date of September 30, 2006, they were recorded in the first quarter of 2007. The Company recognized additional net pension and other postretirement benefit costs of \$5.2 million and \$1.3 million, respectively, related to other restructuring actions and the divestiture of the Company's North American interior business.

*Contributions*

Employer contributions to the Company's domestic and foreign pension plans for the three months ended March 31, 2007, were approximately \$9.5 million, in aggregate. The Company expects to contribute an additional \$45 million to \$50 million, in aggregate, to its domestic and foreign pension portfolios in 2007.

## (11) Cost of Sales and Selling, General and Administrative Expenses

Cost of sales includes material, labor and overhead costs associated with the manufacture and distribution of the Company's products. Distribution costs include inbound freight costs, purchasing and receiving costs, inspection costs, warehousing costs and other costs of the Company's distribution network. Selling, general and administrative expenses include selling, research and development and administrative costs not directly associated with the manufacture and distribution of the Company's products.

## (12) Other (Income) Expense, Net

Other (income) expense includes state and local non-income taxes, foreign exchange gains and losses, fees associated with the Company's asset-backed securitization and factoring facilities, minority interests in consolidated subsidiaries, equity in net income of affiliates, gains and

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losses on the sales of assets and other miscellaneous income and expense. A summary of other (income) expense, net is shown below (in millions):

	<b>March 31, 2007</b>	<b>April 1, 2006</b>
Other expense	\$ 28.6	\$ 18.4
Other income	(3.6)	(26.7)
Other (income) expense, net	\$ 25.0	\$ (8.3)

For the first quarter of 2007, other expense includes a loss of \$3.9 million related to the acquisition of the minority interest in an affiliate. For the first quarter of 2006, other income includes gains of \$25.9 million related to the sales of the Company's interests in two affiliates.

**LEAR CORPORATION AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
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**(13) Income Taxes**

The provision for income taxes was \$32.4 million in the first quarter of 2007, representing an effective tax rate of 39.4%, as compared to a benefit for income taxes of \$0.2 million, representing an effective tax rate of negative 1.4%, in the first quarter of 2006. The provision for income taxes in the first quarter of 2007 was impacted by costs of \$33.8 million related to the divestiture of the Company's interior business, for a significant portion of which no tax benefit was provided as it was incurred in the United States. This was offset by the impact of the U.S. salaried pension plan curtailment gain of \$36.4 million, for which no tax expense was provided. The provision for income taxes in the first quarter of 2007 was also impacted by a portion of the Company's restructuring charges and costs related to the Merger Agreement, for which no tax benefit was provided as the charges were incurred in certain countries for which no tax benefit is likely to be realized due to a history of operating losses in those countries. Excluding these items, the effective tax rate in the first quarter of 2007 approximated the U.S. federal statutory income tax rate of 35% adjusted for income taxes on foreign earnings, losses and remittances, foreign valuation allowances, the U.S. valuation allowance, tax credits, income tax incentives and other permanent items. Further, the Company's current and future provision for income taxes is significantly impacted by the recognition of valuation allowances in certain countries, particularly the United States. The Company intends to maintain these allowances until it is more likely than not that the deferred tax assets will be realized. The Company's future income tax expense will include no tax benefit with respect to U.S. losses and no tax expense with respect to U.S. income until the allowance is eliminated. Accordingly, income taxes are impacted by the U.S. valuation allowance and the mix of earnings among jurisdictions. The benefit for income taxes in the first quarter of 2006 includes a one-time tax benefit of \$8.6 million resulting from a tax audit resolution and court rulings in certain jurisdictions. The benefit for income taxes in the first quarter of 2006 was also impacted by gains on the sales of the Company's interests in two U.S. affiliates, for which no tax expense was recognized, and a portion of the Company's restructuring charges, for which no tax benefit was provided as the charges were incurred in certain countries for which no tax benefit is likely to be realized due to a history of operating losses in those countries.

On January 1, 2007 the Company adopted the provisions of Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of FIN 48, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on the cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue.

The Company recognized the cumulative impact of adopting FIN 48 as a \$4.5 million decrease to its liability for unrecognized tax benefits with a corresponding decrease to the Company's retained deficit balance as of January 1, 2007. As of January 1, 2007, the Company's gross unrecognized tax benefits were \$148.6 million (including interest and penalties), of which \$114.9 million, if recognized, would affect the Company's effective tax rate. The gross unrecognized tax benefits differ from the amount that would affect the effective tax rate due primarily to the impact of the valuation allowance.

The Company continues to recognize both interest and penalties accrued with respect to unrecognized tax benefits as income tax expense. As of January 1, 2007 the Company had recorded reserves for the payment of interest and penalties in the amount of \$28.6 million. During the three months ended March 31, 2007, the Company recognized an increase in liability for gross interest and penalties of approximately \$4.4 million.

The Company operates in multiple jurisdictions throughout the world, and its tax returns are periodically audited or subject to review by both domestic and foreign tax authorities. The Company considers its significant tax jurisdictions to include Canada, Germany, Hungary, Mexico, Poland, Spain and the United States. The Company or its subsidiaries remain subject to income tax examination in certain U.S. state and local jurisdictions for years after 1998, in Germany, Mexico and Poland for years after 2000, in Spain for years after 2001 and in the U.S. federal jurisdiction, Canada and Hungary for years after 2002.

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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## (14) Net Income Per Share

Basic net income per share is computed using the weighted average common shares outstanding during the period. Diluted net income per share includes the dilutive effect of common stock equivalents using the average share price during the period, as well as shares issuable upon conversion of the Company's outstanding zero-coupon convertible senior notes. A summary of shares outstanding is shown below:

	Three Months Ended	
	March 31, 2007	April 1, 2006
Weighted average common shares outstanding	76,410,482	67,216,992
Dilutive effect of common stock equivalents	1,579,369	724,075
Diluted shares outstanding	77,989,851	67,941,067

Diluted net income per share \$ 0.64 \$ 0.26

Shares issuable upon conversion of the Company's outstanding zero-coupon convertible debt and the effect of certain common stock equivalents, including options, restricted stock units, performance units and stock appreciation rights, were excluded from the computation of diluted shares outstanding for the three months ended March 31, 2007 and April 1, 2006, as inclusion would have resulted in antidilution. A summary of these options and their exercise prices, as well as these restricted stock units and stock appreciation rights, is shown below:

	Three Months Ended	
	March 31, 2007	April 1, 2006
<b>Options</b>		
Antidilutive options	2,236,780	2,907,005
Exercise price	\$35.93 - \$55.33	\$22.12 - \$55.33
<b>Restricted stock units</b>		821,237
<b>Performance units</b>		48,563
<b>Stock appreciation rights</b>	642,285	1,138,114

## (15) Comprehensive Income

Comprehensive income is defined as all changes in a Company's net assets except changes resulting from transactions with stockholders. It differs from net income in that certain items currently recorded in equity are included in comprehensive income. A summary of comprehensive income is shown below (in millions):

	Three Months Ended	
	March 31, 2007	April 1, 2006
Net income	\$ 49.9	\$ 17.9
Other comprehensive income (loss):		
Derivative instruments and hedging activities	(5.0)	(5.8)
Foreign currency translation adjustment	13.5	15.6

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Other comprehensive income	8.5	9.8
Comprehensive income	\$ 58.4	\$ 27.7

## **(16) Pre-Production Costs Related to Long-Term Supply Agreements**

The Company incurs pre-production engineering, research and development ( ER&D ) and tooling costs related to the products produced for its customers under long-term supply agreements. The Company expenses all pre-production ER&D costs for which reimbursement is not contractually guaranteed by the customer. In addition, the Company expenses all pre-production tooling costs related to customer-owned tools for which reimbursement is not contractually guaranteed by the customer or for which the customer has not provided a non-cancelable right to use the tooling. During the first quarters of 2007 and 2006, the Company capitalized \$22.4 million and \$38.8 million, respectively, of pre-production ER&D costs for which reimbursement is contractually guaranteed by the customer. In addition, during the first quarters of 2007 and 2006, the Company capitalized \$42.5 million and \$173.9 million, respectively, of pre-production tooling costs related to customer-owned tools for which reimbursement is contractually guaranteed by the customer or for which the customer has provided a non-cancelable right to use the tooling. These amounts are included in other



## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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current and long-term assets in the condensed consolidated balance sheets. During the first quarters of 2007 and 2006, the Company collected \$91.6 million and \$298.5 million, respectively, of cash related to ER&D and tooling costs.

During the first quarter of 2007, the Company did not capitalize any Company-owned tooling. During the first quarter of 2006, the Company capitalized \$1.4 million of Company-owned tooling. Amounts capitalized as Company-owned tooling are included in property, plant and equipment, net in the condensed consolidated balance sheets.

The classification of recoverable customer engineering and tooling is shown below (in millions):

	March 31, 2007	December 31, 2006
Current	\$ 61.4	\$ 87.7
Long-term	112.8	116.2
Recoverable customer engineering and tooling	\$ 174.2	\$ 203.9

Gains and losses related to ER&D and tooling projects are reviewed on an aggregated program basis. Net gains on projects are deferred and recognized over the life of the long-term supply agreement. Net losses on projects are recognized as costs are incurred.

**(17) Legal and Other Contingencies**

As of March 31, 2007 and December 31, 2006, the Company had recorded reserves for pending legal disputes, including commercial disputes and other matters, of \$21.3 million and \$18.0 million, respectively. Such reserves reflect amounts recognized in accordance with accounting principles generally accepted in the United States and typically exclude the cost of legal representation. Product warranty liabilities are recorded separately from legal liabilities, as described below.

*Commercial Disputes*

The Company is involved from time to time in legal proceedings and claims, including, without limitation, commercial or contractual disputes with its suppliers, competitors and customers. These disputes vary in nature and are usually resolved by negotiations between the parties.

On January 29, 2002, Seton Company ( Seton ), one of the Company's leather suppliers, filed a suit alleging that the Company had breached a purported agreement to purchase leather from Seton for seats for the life of the General Motors GMT 800 program. Seton filed the lawsuit in the U.S. District Court for the Eastern District of Michigan seeking compensatory and exemplary damages totaling approximately \$96.5 million, plus interest, on breach of contract and promissory estoppel claims. In May 2005, this case proceeded to trial, and the jury returned a \$30.0 million verdict against the Company. On September 27, 2005, the Court denied the Company's post-trial motions challenging the judgment and granted Seton's motion to award prejudgment interest in the amount of approximately \$4.7 million. On October 4, 2006, the Sixth Circuit Court of Appeals affirmed the judgment of the trial court. On October 18, 2006, the Company filed a Petition for Rehearing with the court which was denied on November 16, 2006. On December 7, 2006, the Court of Appeals issued a mandate indicating that the order affirming the judgment was final. In December 2006, the Company paid the principal and all remaining interest on the judgment.

On January 26, 2004, the Company filed a patent infringement lawsuit against Johnson Controls Inc. and Johnson Controls Interiors LLC (together, JCI) in the U.S. District Court for the Eastern District of Michigan alleging that JCI's garage door opener products infringed certain of the Company's radio frequency transmitter patents. JCI counterclaimed seeking a declaratory judgment that the subject patents are invalid and unenforceable, and that JCI is not infringing these patents. JCI also has filed motions for summary judgment asserting that its garage door opener products do not infringe the Company's patents and that one of the Company's patents is invalid and unenforceable. The Company is vigorously pursuing its claims against JCI. A trial date has not been scheduled.

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After the Company filed its patent infringement action against JCI, affiliates of JCI sued one of the Company's vendors and certain of the vendor's employees in Ottawa County, Michigan Circuit Court on July 8, 2004, alleging misappropriation of trade secrets and disclosure of confidential information. The suit alleges that the defendants misappropriated and shared with the Company trade secrets involving JCI's universal garage door opener product. JCI seeks to enjoin the defendants from selling or attempting to sell a competing product, as well as compensatory damages and attorney fees. The Company is not a defendant in this lawsuit; however, the agreements between the Company and the defendants contain customary indemnification provisions. The Company does not believe that its garage door opener product benefited from any allegedly misappropriated trade secrets or technology. However, JCI has

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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sought discovery of certain information which the Company believes is confidential and proprietary, and the Company has intervened in the case as a non-party for the limited purpose of protecting its rights with respect to JCI's discovery efforts. The trial has been rescheduled to October 2007.

On June 13, 2005, The Chamberlain Group (Chamberlain) filed a lawsuit against the Company and Ford Motor Company (Ford) in the Northern District of Illinois alleging patent infringement. Two counts were asserted against the Company and Ford based upon two Chamberlain rolling-code garage door opener system patents. Two additional counts were asserted against Ford only (not the Company) based upon different Chamberlain patents. The Chamberlain lawsuit was filed in connection with the marketing of the Company's universal garage door opener system, which competes with a product offered by JCI. JCI obtained technology from Chamberlain to operate its product. In October 2005, JCI joined the lawsuit as a plaintiff along with Chamberlain. In October 2006, Ford was dismissed from the suit. JCI and Chamberlain have filed a motion for a preliminary injunction, and on March 30, 2007, the Court issued a decision granting plaintiffs' motion for a preliminary injunction but did not enter an injunction at that time. In response, the Company filed a motion seeking to stay the effectiveness of any injunction that may be entered and General Motors Corporation (GM) moved to intervene. On April 25, 2007, the court granted GM's motion to intervene, entered a preliminary injunction order that exempts the Company's existing GM programs and denied the Company's motion to stay the effectiveness of the preliminary injunction order pending appeal. On April 27, 2007, the Company filed its notice of appeal from the granting of the preliminary injunction and the denial of its motion to stay its effectiveness. No trial date has been set by the district court.

*Product Liability Matters*

In the event that use of the Company's products results in, or is alleged to result in, bodily injury and/or property damage or other losses, the Company may be subject to product liability lawsuits and other claims. In addition, the Company is a party to warranty-sharing and other agreements with its customers relating to its products. These customers may pursue claims against the Company for contribution of all or a portion of the amounts sought in connection with product liability and warranty claims. The Company can provide no assurances that it will not experience material claims in the future or that it will not incur significant costs to defend such claims. In addition, if any of the Company's products are, or are alleged to be, defective, the Company may be required or requested by its customers to participate in a recall or other corrective action involving such products. Certain of the Company's customers have asserted claims against the Company for costs related to recalls or other corrective actions involving its products. In certain instances, the allegedly defective products were supplied by tier II suppliers against whom the Company has sought or will seek contribution. The Company carries insurance for certain legal matters, including product liability claims, but such coverage may be limited. The Company does not maintain insurance for product warranty or recall matters.

The Company records product warranty liabilities based on its individual customer agreements. Product warranty liabilities are recorded for known warranty issues when amounts related to such issues are probable and reasonably estimable. In certain product liability and warranty matters, the Company may seek recovery from its suppliers that supply materials or services included within the Company's products that are associated with the related claims.

A summary of the changes in product warranty liabilities for the three months ended March 31, 2007, is shown below (in millions):

Balance as of January 1, 2007	\$ 40.9
Expense	1.4
Income related to favorable settlements	(2.7)
Settlements	(5.8)
Foreign currency translation and other	(1.2)
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Balance as of March 31, 2007	\$ 32.6
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*Environmental Matters*

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The Company is subject to local, state, federal and foreign laws, regulations and ordinances which govern activities or operations that may have adverse environmental effects and which impose liability for clean-up costs resulting from past spills, disposals or other releases of hazardous wastes and environmental compliance. The Company's policy is to comply with all applicable environmental laws and to maintain an environmental management program based on ISO 14001 to ensure compliance. However, the Company currently is, has been and in the future may become the subject of formal or informal enforcement actions or procedures.

The Company has been named as a potentially responsible party at several third-party landfill sites and is engaged in the cleanup of hazardous waste at certain sites owned, leased or operated by the Company, including several properties acquired in its 1999 acquisition of UT Automotive, Inc. ( UT Automotive ). Certain present and former properties of UT Automotive are subject to

**LEAR CORPORATION AND SUBSIDIARIES**

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environmental liabilities which may be significant. The Company obtained agreements and indemnities with respect to certain environmental liabilities from United Technologies Corporation ( UTC ) in connection with its acquisition of UT Automotive. UTC manages and directly funds these environmental liabilities pursuant to its agreements and indemnities with the Company.

As of March 31, 2007 and December 31, 2006, the Company had recorded reserves for environmental matters of \$2.8 million and \$3.2 million, respectively. While the Company does not believe that the environmental liabilities associated with its current and former properties will have a material adverse effect on its business, consolidated financial position, results of operations or cash flows, no assurances can be given in this regard.

One of the Company's subsidiaries and certain predecessor companies were named as defendants in an action filed by three plaintiffs in August 2001 in the Circuit Court of Lowndes County, Mississippi, asserting claims stemming from alleged environmental contamination caused by an automobile parts manufacturing plant located in Columbus, Mississippi. The plant was acquired by the Company as part of its acquisition of UT Automotive in May 1999 and sold almost immediately thereafter, in June 1999, to Johnson Electric Holdings Limited ( Johnson Electric ). In December 2002, 61 additional cases were filed by approximately 1,000 plaintiffs in the same court against the Company and other defendants relating to similar claims. In September 2003, the Company was dismissed as a party to these cases. In the first half of 2004, the Company was named again as a defendant in these same 61 additional cases and was also named in five new actions filed by approximately 150 individual plaintiffs related to alleged environmental contamination from the same facility. The plaintiffs in these actions are persons who allegedly were either residents and/or owned property near the facility or worked at the facility. In November 2004, two additional lawsuits were filed by 28 plaintiffs (individuals and organizations), alleging property damage as a result of the alleged contamination. Each of these complaints seeks compensatory and punitive damages.

All of the plaintiffs subsequently dismissed their claims for health effects and personal injury damages and the cases proceeded with approximately 280 plaintiffs alleging property damage claims only. In March 2005, the venue for these lawsuits was transferred from Lowndes County, Mississippi, to Lafayette County, Mississippi. In April 2005, certain plaintiffs filed an amended complaint alleging negligence, nuisance, intentional tort and conspiracy claims and seeking compensatory and punitive damages.

In the first quarter of 2006, co-defendant UTC entered into a settlement agreement with the plaintiffs. During the third quarter of 2006, the Company and co-defendant Johnson Electric entered into a settlement memorandum with the plaintiffs' counsel outlining the terms of a global settlement, including establishing the requisite percentage of executed settlement agreements and releases that were required to be obtained from the individual plaintiffs for a final settlement to proceed. Since November 2006, the Company has reached a final settlement with respect to approximately 85% of the plaintiffs involving aggregate payments of \$875,000 and is in the process of attempting to resolve the remaining claims.

UTC, the former owner of UT Automotive, and Johnson Electric have each sought indemnification for losses associated with the Mississippi claims from the Company under the respective acquisition agreements, and the Company has claimed indemnification from them under the same agreements. In the first quarter of 2006, UTC filed a lawsuit against the Company in the State of Connecticut Superior Court, District of Hartford, seeking declaratory relief and indemnification from the Company for the settlement amount, attorney fees, costs and expenses UTC paid in settling and defending the Columbus, Mississippi lawsuits. In the second quarter of 2006, the Company filed a motion to dismiss this matter and filed a separate action against UTC and Johnson Electric in the State of Michigan, Circuit Court for the County of Oakland, seeking declaratory relief and indemnification from UTC or Johnson Electric for the settlement amount, attorney fees, costs and expenses the Company has paid, or will pay, in settling and defending the Columbus, Mississippi lawsuits. During the fourth quarter of 2006, UTC agreed to dismiss the lawsuit filed in the State of Connecticut Superior Court, District of Hartford and agreed to proceed with the lawsuit filed in the State of Michigan, Circuit Court for the County of Oakland. During the first quarter of 2007, Johnson Electric and UTC each filed counter-claims against the Company seeking declaratory relief and indemnification from the Company for the settlement amount, attorney fees, costs and expenses each has paid or will pay in settling and defending the Columbus, Mississippi lawsuits. To date, no company admits to, or has been found to have, an obligation to fully defend and indemnify any other. The Company intends to vigorously pursue its claims against UTC and Johnson Electric and believes that it is entitled to indemnification from either UTC or Johnson Electric for its losses. However, the ultimate outcome of these matters is unknown.

*Other Matters*

In January 2004, the Securities and Exchange Commission (the SEC ) commenced an informal inquiry into the Company's September 2002 amendment of its 2001 Form 10-K. The amendment was filed to report the Company's employment of relatives of



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certain of its directors and officers and certain related party transactions. The SEC's inquiry does not relate to the Company's consolidated financial statements. In February 2005, the staff of the SEC informed the Company that it proposed to recommend to the SEC that it issue an administrative cease and desist order as a result of the Company's failure to disclose the related party transactions in question prior to the amendment of its 2001 Form 10-K. The Company expects to consent to the entry of the order as part of a settlement of this matter.

In April 2006, a former employee of the Company filed a purported class action lawsuit in the U.S. District Court for the Eastern District of Michigan against the Company, members of its Board of Directors, members of its Employee Benefits Committee (the "EBC") and certain members of its human resources personnel alleging violations of the Employment Retirement Income Security Act ("ERISA") with respect to the Company's retirement savings plans for salaried and hourly employees. In the second quarter of 2006, the Company was served with three additional purported class action ERISA lawsuits, each of which contained similar allegations against the Company, members of its Board of Directors, members of its EBC and certain members of its senior management and its human resources personnel. At the end of the second quarter of 2006, the court entered an order consolidating these four lawsuits as *In re: Lear Corp. ERISA Litigation*. During the third quarter of 2006, plaintiffs filed their consolidated complaint, which alleges breaches of fiduciary duties substantially similar to those alleged in the four individually filed lawsuits. The consolidated complaint continues to name certain current and former members of the Board of Directors and the EBC and certain members of senior management and adds certain other current and former members of the EBC. The consolidated complaint generally alleges that the defendants breached their fiduciary duties to plan participants in connection with the administration of the Company's retirement savings plans for salaried and hourly employees. The fiduciary duty claims are largely based on allegations of breaches of the fiduciary duties of prudence and loyalty and of over-concentration of plan assets in the Company's common stock. The plaintiffs purport to bring these claims on behalf of the plans and all persons who were participants in or beneficiaries of the plans from October 21, 2004, to the present and seek to recover losses allegedly suffered by the plans. The complaints do not specify the amount of damages sought. During the fourth quarter of 2006, the defendants filed a motion to dismiss all defendants and all counts in the consolidated complaint. The filings related to the motion to dismiss have been made, but the Court has not yet ruled on the motion. No determination has been made that a class action can be maintained, and there have been no decisions on the merits of the cases. The Company intends to vigorously defend the consolidated lawsuit.

On March 1, 2007, a purported class action ERISA lawsuit was filed on behalf of participants in the Company's 401(k) plans. The lawsuit was filed in the United States District Court for the Eastern District of Michigan and alleges that the Company, members of its Board of Directors, and members of the Employee Benefits Committee (collectively, the "Lear Defendants") breached their fiduciary duties to the participants in the 401(k) plans by approving the Agreement and Plan of Merger (the "Merger Agreement") with AREP Car Holdings Corp. and AREP Car Acquisition Corp. (collectively the "AREP Entities"). On March 8, 2007, the plaintiff filed a motion for expedited discovery to support a potential motion for preliminary injunction to enjoin the Merger Agreement. The Lear Defendants filed an opposition to the motion for expedited discovery on March 22, 2007. Plaintiff filed a reply on April 11, 2007. On April 18, 2007, the Judge denied plaintiff's motion for expedited discovery. On March 15, 2007, the plaintiff requested that the case be reassigned to the Judge overseeing *In re: Lear Corp. ERISA Litigation* (described above). The Lear Defendants have opposed the reassignment. On March 22, 2007, the Lear Defendants filed a motion to dismiss all counts of the complaint against the Lear Defendants. Plaintiff also filed a motion for preliminary injunction and expedited briefing schedule on April 10, 2007. The Lear Defendants' opposition brief is due May 10, 2007. The Court has not set a hearing date on either of these motions.

Between February 9, 2007 and February 21, 2007, certain stockholders filed six purported class action lawsuits against the Company, certain members of the Company's Board of Directors and American Real Estate Partners, L.P. and certain of its affiliates (collectively, "AREP"). Three of the lawsuits were filed in the Delaware Court of Chancery and have since been consolidated into a single action. Three of the lawsuits were filed in Michigan Circuit Court; those too have since been consolidated into a single action. The class action complaints, which are substantially similar, generally allege that the Merger Agreement unfairly limits the process of selling the Company and that certain members of the Company's Board of Directors have breached their fiduciary duties in connection with the Merger Agreement and have acted with conflicts of interest in approving the Merger Agreement. The lawsuits seek to enjoin the merger, to invalidate the Merger Agreement and to enjoin the operation of certain provisions of the Merger Agreement, a declaration that certain members of the Company's Board of Directors breached their fiduciary duties in approving the Merger Agreement and an award of unspecified damages or rescission in the event that the proposed merger with AREP is completed. On February 23, 2007, the plaintiffs in the consolidated Delaware action filed a consolidated amended complaint, a motion for expedited proceedings and a motion to preliminarily enjoin the transactions contemplated by the Merger Agreement. On March 27, 2007, the plaintiffs in the consolidated Delaware action filed a consolidated second amended complaint. On May 9, 2007, the court overseeing the consolidated Michigan action will hear the Company's motion to dismiss that action. A hearing on the plaintiffs

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motion for preliminary injunction in the consolidated Delaware action is scheduled for June 6, 2007, and a trial is scheduled for the fourth quarter of 2007. The Company believes that the lawsuits are without merit and intends to defend against them vigorously.

Although the Company records reserves for legal, product warranty and environmental matters in accordance with SFAS No. 5, Accounting for Contingencies, the outcomes of these matters are inherently uncertain. Actual results may differ significantly from current estimates.

The Company is involved in certain other legal actions and claims arising in the ordinary course of business, including, without limitation, commercial disputes, intellectual property matters, personal injury claims, tax claims and employment matters. Although the outcome of any legal matter cannot be predicted with certainty, the Company does not believe that any of these other legal proceedings or matters in which the Company is currently involved, either individually or in the aggregate, will have a material adverse effect on its business, consolidated financial position, results of operations or cash flows.

**(18) Segment Reporting**

Historically, the Company has had three reportable operating segments: seating, electronic and electrical and interior. The seating segment includes seat systems and components thereof. The electronic and electrical segment includes electronic products and electrical distribution systems, primarily wire harnesses and junction boxes, interior control and entertainment systems and wireless systems. The interior segment includes instrument panels and cockpit systems, headliners and overhead systems, door panels, flooring and acoustic systems and other interior products (Note 3, Divestiture of Interior Business). The Other category includes unallocated costs related to corporate headquarters, geographic headquarters and the elimination of intercompany activities, none of which meets the requirements of being classified as an operating segment.

The Company evaluates the performance of its operating segments based primarily on (i) revenues from external customers, (ii) income (loss) before loss on divestiture of interior business, interest expense, other (income) expense, provision (benefit) for income taxes and cumulative effect of a change in accounting principle (segment earnings) and (iii) cash flows, being defined as segment earnings less capital expenditures plus depreciation and amortization. A summary of revenues from external customers and other financial information by reportable operating segment is shown below (in millions):

## Three Months Ended March 31, 2007

	Seating	Electronic and Electrical	Interior	Other	Consolidated
Revenues from external customers	\$ 2,994.2	\$ 788.7	\$ 623.2	\$	\$ 4,406.1
Segment earnings	197.1	17.5	8.8	(39.0)	184.4
Depreciation and amortization	40.8	28.3	1.3	4.1	74.5
Capital expenditures	20.2	8.6	0.1	0.3	29.2
Total assets	4,371.0	2,277.7	134.7	877.6	7,661.0

## Three Months Ended April 1, 2006

	Seating	Electronic and Electrical	Interior	Other	Consolidated
Revenues from external customers	\$ 2,992.5	\$ 787.3	\$ 898.7	\$	\$ 4,678.5
Segment earnings	125.9	53.1	(59.5)	(65.3)	54.2
Depreciation and amortization	40.4	26.8	24.8	5.8	97.8
Capital expenditures	36.8	15.7	33.1	7.0	92.6
Total assets	4,170.6	2,178.1	1,511.1	621.5	8,481.3



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For the three months ended March 31, 2007, segment earnings include restructuring charges of (\$4.7) million, \$17.9 million and \$0.4 million in the seating and electronic and electrical segments and in the other category, respectively. For the three months ended April 1, 2006, segment earnings include restructuring charges of \$15.1 million, \$2.0 million and \$5.8 million in the seating, electronic and electrical and interior segments, respectively (Note 5, Restructuring ).

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

A reconciliation of consolidated segment earnings to consolidated income before provision (benefit) for income taxes and cumulative effect of a change in accounting principle is shown below (in millions):

	Three Months Ended	
	March 31, 2007	April 1, 2006
Segment earnings	\$ 184.4	\$ 54.2
Loss on divestiture of Interior business	25.6	
Interest expense	51.5	47.7
Other (income) expense, net	25.0	(8.3)
Income before provision (benefit) for income taxes and cumulative effect of a change in accounting principle	\$ 82.3	\$ 14.8

**(19) Financial Instruments**

Certain of the Company's European and Asian subsidiaries periodically factor their accounts receivable with financial institutions. Such receivables are factored without recourse to the Company and are excluded from accounts receivable in the condensed consolidated balance sheets. As of March 31, 2007 and December 31, 2006, the amount of factored receivables was \$219.9 million and \$256.3 million, respectively. The Company cannot provide any assurances that these factoring facilities will be available or utilized in the future.

*Asset-Backed Securitization Facility*

The Company and several of its U.S. subsidiaries sell certain accounts receivable to a wholly-owned, consolidated, bankruptcy-remote special purpose corporation (Lear ASC Corporation) under an asset-backed securitization facility (the "ABS facility"). In turn, Lear ASC Corporation transfers undivided interests in up to \$150 million of the receivables to bank-sponsored commercial-paper conduits. As of March 31, 2007 and December 31, 2006, accounts receivable totaling \$445.4 million and \$568.6 million, respectively, had been transferred to Lear ASC Corporation, but no undivided interests in the receivables were transferred to the conduits. As such, these retained interests are included in accounts receivable in the condensed consolidated balance sheets as of March 31, 2007 and December 31, 2006. In the first quarter of 2006, a discount on the sale of receivables of \$1.6 million was recognized and is reflected in other (income) expense, net in the condensed consolidated statement of income.

The Company retains a subordinated ownership interest in the pool of receivables sold to Lear ASC Corporation. This retained interest is recorded at fair value, which is generally based on a discounted cash flow analysis. The Company continues to service the transferred receivables for an annual servicing fee. The conduit investors and Lear ASC Corporation have no recourse to the Company or its subsidiaries for the failure of the accounts receivable obligors to pay timely on the accounts receivable.

The following table summarizes certain cash flows received from and paid to Lear ASC Corporation (in millions):

	Three Months Ended	
	March 31, 2007	April 1, 2006
Proceeds from collections reinvested in securitizations	\$ 932.7	\$ 1,071.6

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Servicing fees received

1.2

1.5

*Derivative Instruments and Hedging Activities*

Forward foreign exchange, futures and option contracts The Company uses forward foreign exchange, futures and option contracts to reduce the effect of fluctuations in foreign exchange rates on short-term, foreign currency denominated intercompany transactions and other known foreign currency exposures. Gains and losses on the derivative instruments are intended to offset gains and losses on the hedged transaction in an effort to reduce the earnings volatility resulting from fluctuations in foreign exchange rates. The principal currencies hedged by the Company include the Mexican peso and the Hungarian forint, as well as the Euro and other European currencies. Forward foreign exchange, futures and option contracts are accounted for as cash flow hedges when the hedged item is a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. As of March 31, 2007, contracts designated as cash flow hedges with \$380.4 million of notional amount were outstanding with maturities of less than nine months. As of March 31, 2007, the fair market value of these contracts was approximately \$9.4 million. As of March 31, 2007,

**LEAR CORPORATION AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

other foreign currency derivative contracts that did not qualify for hedge accounting with \$439.8 million of notional amount were outstanding. These foreign currency derivative contracts consist principally of cash transactions between three and thirty days, hedges of intercompany loans and hedges of certain other balance sheet exposures. As of March 31, 2007, the fair market value of these contracts was approximately \$1.6 million.

**Interest rate swap contracts** The Company uses interest rate swap contracts to manage its exposure to fluctuations in interest rates. Interest rate swap contracts which fix the interest payments of certain variable rate debt instruments or fix the market rate component of anticipated fixed rate debt instruments are accounted for as cash flow hedges. Interest rate swap contracts which hedge the change in fair market value of certain fixed rate debt instruments are accounted for as fair value hedges. As of March 31, 2007, contracts representing \$800.0 million of notional amount were outstanding with maturity dates of August 2007 through September 2011. All of these contracts modify the variable rate characteristics of the Company's variable rate debt instruments, which are generally set at three-month LIBOR rates. These contracts convert variable rate obligations into fixed rate obligations with a weighted average interest rate of 4.902%. The fair market value of all outstanding interest rate swap contracts is subject to changes in value due to changes in interest rates. As of March 31, 2007, the fair market value of these contracts was approximately negative \$5.0 million.

**Commodity swap contracts** The Company uses derivative instruments including financially settled forward, swap and option contracts to manage its exposure to fluctuations in certain commodity prices. All derivative instruments are currently designated as cash flow hedges, as the hedged item is a forecasted transaction. Gains and losses on the derivative instruments are intended to offset gains and losses on the hedged transaction in an effort to reduce the earnings volatility resulting from fluctuations in commodity prices. As of March 31, 2007, the fair market value of these commodity instruments was \$1.1 million with maturity dates through December 2008.

As of March 31, 2007 and December 31, 2006, net gains of approximately \$9.8 million and \$14.7 million, respectively, related to derivative instruments and hedging activities were recorded in accumulated other comprehensive loss. In the three months ended March 31, 2007 and April 1, 2006, net gains of \$3.6 million and \$1.6 million, respectively, related to the Company's hedging activities were reclassified from accumulated other comprehensive loss into earnings. During the twelve month period ending March 29, 2008, the Company expects to reclassify into earnings net gains of approximately \$11.5 million recorded in accumulated other comprehensive loss. Such gains will be reclassified at the time the underlying hedged transactions are realized. During the three months ended March 31, 2007 and April 1, 2006, amounts recognized in the condensed consolidated statements of income related to changes in the fair value of cash flow and fair value hedges excluded from the effectiveness assessments and the ineffective portion of changes in the fair value of cash flow and fair value hedges were not material.

**Non-U.S. dollar financing transactions** The Company designated its previously outstanding Euro-denominated senior notes (Note 9, Long-Term Debt) as a net investment hedge of long-term investments in its Euro-functional subsidiaries. As of March 31, 2007, the amount recorded in accumulated other comprehensive loss related to the effective portion of the net investment hedge of foreign operations was approximately negative \$148.0 million. Such amount will be included in accumulated other comprehensive loss until the Company liquidates its related net investment in its designated foreign operations.

**(20) Accounting Pronouncements**

*Financial Instruments*

The FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140. This statement resolves issues related to the application of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to beneficial interests in securitized assets. The provisions of this statement are to be applied prospectively to all financial instruments acquired or issued during fiscal years beginning after September 15, 2006. The effects of adoption were not significant.

The FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140. This statement requires that all servicing assets and liabilities be initially measured at fair value. The provisions of this statement are to be applied prospectively to all servicing transactions beginning after September 15, 2006. The effects of adoption were not significant.

*Fair Value Measurements*

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The FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of this statement are to generally be

**LEAR CORPORATION AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

applied prospectively in fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this statement on its financial statements.

*Pension and Other Postretirement Benefits*

The FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106 and 132(R). The Company adopted the funded status recognition provisions of SFAS No. 158 as of December 31, 2006.

This statement also requires the measurement of defined benefit plan asset and liabilities as of the annual balance sheet date. Currently, the Company measures its plan assets and liabilities using an early measurement date of September 30, as allowed by the original provisions of SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. The measurement date provisions of SFAS No. 158 are effective for fiscal years ending after December 15, 2008. The Company is currently evaluating the measurement date provisions of this statement.

*Fair Value Option*

The FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* including an amendment of FASB Statement No. 115. This statement allows entities to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The provisions of this statement are effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact of this statement on its financial statements.

## LEAR CORPORATION AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

## (21) Supplemental Guarantor Condensed Consolidating Financial Statements

March 31, 2007					
	Parent	Guarantors	Non-guarantors	Eliminations	Consolidated
(Unaudited; in millions)					
<b>ASSETS</b>					
<i>CURRENT ASSETS:</i>					
Cash and cash equivalents	\$ 100.0	\$ 6.2	\$ 224.2	\$	\$ 330.4
Accounts receivable	26.5	333.9	2,052.3		2,412.7
Inventories	14.5	128.7	455.8		599.0
Current assets of business held for sale			38.3		38.3
Other	33.8	19.8	264.0		317.6
Total current assets	174.8	488.6	3,034.6		3,698.0
<i>LONG-TERM ASSETS:</i>					
Property, plant and equipment, net	199.4	284.9	941.6		1,425.9
Goodwill, net	454.5	551.1	1,001.0		2,006.6
Investments in subsidiaries	3,890.6	2,343.1		(6,233.7)	
Other	237.8	24.4	268.3		530.5
Total long-term assets	4,782.3	3,203.5	2,210.9	(6,233.7)	3,963.0
	\$ 4,957.1	\$ 3,692.1	\$ 5,245.5	\$ (6,233.7)	\$ 7,661.0
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>					
<i>CURRENT LIABILITIES:</i>					
Short-term borrowings	\$	\$	\$ 11.5	\$	\$ 11.5
Accounts payable and drafts	148.0	399.5	1,932.8		2,480.3
Accrued liabilities	310.7	193.9	648.2		1,152.8
Current liabilities of business held for sale			16.7		16.7
Current portion of long-term debt	6.0		20.4		26.4
Total current liabilities	464.7	593.4	2,629.6		3,687.7
<i>LONG-TERM LIABILITIES:</i>					
Long-term debt	2,411.2				

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For the Direct reportable segment, our net sales for fiscal 2011 increased \$261 million, or 20 percent, compared with

fiscal 2010. The increase was due to the growth in our online business across all brands and the incremental sales related to the introduction of international online sales in fiscal 2010.

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

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

#### Cost of Goods Sold and Occupancy Expenses

(\$ in millions)	Fiscal Year				
	2012	2011	2010		
Cost of goods sold and occupancy expenses	\$9,480	\$9,275	\$8,775		
Gross profit	\$6,171	\$5,274	\$5,889		
Cost of goods sold and occupancy expenses as a percentage of net sales	60.6	% 63.8	% 59.8	%	
Gross margin	39.4	% 36.2	% 40.2	%	

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

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



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

Cost of goods sold and occupancy expenses increased 4.0 percentage points in fiscal 2011 compared with fiscal 2010. Cost of goods sold increased 3.7 percentage points in fiscal 2011 compared with fiscal 2010. The increase in cost of goods sold as a percentage of net sales was primarily driven by increased cost of merchandise primarily due to higher cotton prices.

Occupancy expenses increased 0.3 percentage points in fiscal 2011 compared with fiscal 2010. The increase in occupancy expenses as a percentage of net sales was primarily driven by lower net sales for the Stores reportable segment without a corresponding decrease in occupancy expenses, partially offset by higher net sales for the Direct reportable segment without a corresponding increase in occupancy expenses.

## Operating Expenses and Operating Margin

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

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

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

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

## Interest Expense (Reversal)

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

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

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

## Income Taxes

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

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



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

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

Liquidity and Capital Resources

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

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

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

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

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

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

Cash Flows from Operating Activities

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

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

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

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



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

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

**Cash Flows from Investing Activities**

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

- \$50 million of net purchases of short-term investments in fiscal 2012 compared with \$100 million of net maturities in fiscal 2011;

- \$129 million used for the acquisition of Intermix in fiscal 2012; and

- \$111 million more property and equipment purchases in fiscal 2012 compared with fiscal 2011.

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

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

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

**Cash Flows from Financing Activities**

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

\$1.6 billion of proceeds from our issuance of long-term debt in fiscal 2011; and

\$400 million of payments of long-term debt in fiscal 2012; partially offset by

\$1.1 billion less repurchases of common stock in fiscal 2012 compared with fiscal 2011.

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

\$1.6 billion of proceeds from our issuance of long-term debt in fiscal 2011; partially offset by

\$133 million more repurchases of common stock in fiscal 2011 compared with fiscal 2010.

**Free Cash Flow**

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

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

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



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### Long-Term Debt

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

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

### Credit Facilities

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

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

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

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

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

#### Dividend Policy

In determining whether and at what level to declare a dividend, we consider a number of factors including sustainability, operating performance, liquidity, and market conditions.

We increased our annual dividend, which had been \$0.45 per share for fiscal 2011, to \$0.50 per share for fiscal 2012. We intend to increase our annual dividend to \$0.60 per share for fiscal 2013.



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## Share Repurchases

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

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

## Contractual Cash Obligations

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

(\$ in millions)	Payments Due by Period				Total
	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	
Long-term debt (1)	\$—	\$—	\$—	\$1,250	\$1,250
Interest payments on long-term debt	74	149	149	260	632
Liabilities for unrecognized tax benefits (2)	7	—	—	—	7
Operating leases (3)	1,093	1,993	1,337	1,709	6,132
Purchase obligations and commitments (4)	3,029	190	12	—	3,231
Total contractual cash obligations	\$4,203	\$2,332	\$1,498	\$3,219	\$11,252

(1) Represents principal maturities, excluding interest. See Note 5 of Notes to Consolidated Financial Statements.

Excludes \$102 million of long-term liabilities recorded in lease incentives and other long-term liabilities in the

(2) Consolidated Balance Sheet as of February 2, 2013, as the amount relates to uncertain tax positions and we are not able to reasonably estimate when cash payments will occur.

(3) Excludes maintenance, insurance, taxes, and contingent rent obligations. See Note 11 of Notes to Consolidated Financial Statements for discussion of our operating leases.

(4) Represents estimated open purchase orders to purchase inventory as well as commitments for products and services used in the normal course of business.

## Commercial Commitments

We have commercial commitments, not reflected in the table above, that were incurred in the normal course of business to support our operations, including standby letters of credit of \$97 million (of which \$30 million was issued under the Facility), surety bonds of \$38 million, and bank guarantees of \$12 million outstanding as of February 2, 2013.

## Other Cash Obligations Not Reflected in the Consolidated Balance Sheet (Off-Balance Sheet Arrangements)

The majority of our contractual obligations relate to operating leases for our stores. Future minimum lease payments represent commitments under non-cancelable operating leases and are disclosed in the table above with additional information provided in Item 8, Financial Statements and Supplementary Data, Note 11 of Notes to Consolidated Financial Statements.

Our other off-balance sheet arrangements are disclosed in Item 8, Financial Statements and Supplementary Data, Note 15 of Notes to Consolidated Financial Statements.

## Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with GAAP requires management to adopt accounting policies and make significant judgments and estimates to develop amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough

process to review the application of our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large, global corporation. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and the receipt of new or better information.

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Our significant accounting policies can be found in Item 8, Financial Statements and Supplementary Data, Note 1 of Notes to Consolidated Financial Statements. The policies and estimates discussed below include the financial statement elements that are either judgmental or involve the selection or application of alternative accounting policies and are material to our financial statements. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit and Finance Committee of our Board of Directors, which has reviewed our disclosure relating to critical accounting policies and estimates in this annual report on Form 10-K.

### Merchandise Inventory

We value inventory at the lower of cost or market ("LCM"), with cost determined using the weighted-average cost method. We review our inventory levels in order to identify slow-moving merchandise and broken assortments (items no longer in stock in a sufficient range of sizes or colors) and we primarily use markdowns to clear merchandise. We record an adjustment to inventory when future estimated selling price is less than cost. Our LCM adjustment calculation requires management to make assumptions to estimate the selling price and amount of slow-moving merchandise and broken assortments subject to markdowns, which is dependent upon factors such as historical trends with similar merchandise, inventory aging, forecasted consumer demand, and the promotional environment. In addition, we estimate and accrue shortage for the period between the last physical count and the balance sheet date. Our shortage estimate can be affected by changes in merchandise mix and changes in actual shortage trends. Historically, actual shortage has not differed materially from our estimates.

We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate our LCM or inventory shortage adjustments. However, if estimates regarding consumer demand are inaccurate or actual physical inventory shortage differs significantly from our estimate, our operating results could be affected. We have not made any material changes in the accounting methodology used to calculate our LCM or inventory shortage adjustments in the past three fiscal years.

### Impairment of Long-Lived Assets, Goodwill, and Intangible Assets

We review the carrying amount of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Events that result in an impairment review include the decision to close a store, corporate facility, or distribution center, or a significant decrease in the operating performance of the long-lived asset. Long-lived assets are considered impaired if the estimated undiscounted future cash flows of the asset or asset group are less than the carrying amount. For impaired assets, we recognize a loss equal to the difference between the carrying amount of the asset or asset group and its estimated fair value. The estimated fair value of the asset or asset group is based on estimated discounted future cash flows of the asset or asset group using a discount rate commensurate with the risk. The asset group is defined as the lowest level for which identifiable cash flows are available, which for retail stores is at the store level. Our estimate of future cash flows requires management to make assumptions and to apply judgment, including forecasting future sales and expenses and estimating useful lives of the assets. These estimates can be affected by factors such as future store results, real estate demand, and economic conditions that can be difficult to predict. We have not made any material changes in the methodology to assess and calculate impairment of long-lived assets in the past three fiscal years. We recorded a charge for the impairment of long-lived assets of \$8 million, \$16 million, and \$8 million for fiscal 2012, 2011, and 2010, respectively.

We also review the carrying amount of goodwill and other indefinite-lived intangible assets for impairment annually and whenever events or changes in circumstances indicate that it is more likely than not that the carrying amount may not be recoverable. Events that result in an impairment review include significant changes in the business climate, declines in our operating results, or an expectation that the carrying amount may not be recoverable.

In connection with the acquisitions of Athleta in September 2008 and Intermix in December 2012, we allocated \$99 million and \$85 million of the respective purchase prices to goodwill. The carrying amount of goodwill was \$184 million as of February 2, 2013. We review goodwill for impairment by first assessing qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If it is

determined that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, it is unnecessary to perform the two-step goodwill impairment test. If it is determined that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, the first step of the two-step goodwill impairment test is required to compare the fair value of the reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the second step of the two-step goodwill impairment test is required to measure the goodwill impairment loss. The second step includes hypothetically valuing all the tangible and intangible assets of the reporting unit as if the reporting unit had been acquired in a business combination. Then, the implied fair value of the reporting unit's goodwill is compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the goodwill, we recognize an impairment loss in an amount equal to the excess, not to exceed the carrying amount.

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A reporting unit is an operating segment or a business unit one level below that operating segment, for which discrete financial information is prepared and regularly reviewed by segment management. We have deemed our Direct operating segment to be the reporting unit at which goodwill is tested for Athleta and for fiscal 2012, we have identified Intermix as the reporting unit at which goodwill is tested for Intermix. During the fourth quarter of fiscal 2012, we completed our annual impairment testing of goodwill and we did not recognize any impairment charges. We determined that as of the date of our annual impairment review, the fair value of goodwill attributable to Athleta significantly exceeded its carrying amount, and it is not more likely than not that the fair value of the Direct reporting unit is less than its carrying amount. The fair value of the goodwill attributable to Intermix, as determined on December 31, 2012 (the date of acquisition), is equal to its carrying amount as of February 2, 2013.

In connection with the acquisitions of Athleta in September 2008 and Intermix in December 2012, we allocated \$54 million and \$38 million of the respective purchase prices to trade names. The carrying amount of the trade names was \$92 million as of February 2, 2013. A trade name is considered impaired if the estimated fair value of the trade name is less than the carrying amount. If a trade name is considered impaired, we recognize a loss equal to the difference between the carrying amount and the estimated fair value of the trade name. The fair value of the trade names is determined using the relief from royalty method. During the fourth quarter of fiscal 2012, we completed our annual impairment review of the trade names and we did not recognize any impairment charges. The fair value of the Athleta trade name significantly exceeded its carrying amount as of the date of our annual impairment review. The fair value of the Intermix trade name, as determined on December 31, 2012 (the date of acquisition), is equal to its carrying amount as of February 2, 2013.

These analyses require management to make assumptions and to apply judgment, including forecasting future sales and expenses, and selecting appropriate discount rates and royalty rates, which can be affected by economic conditions and other factors that can be difficult to predict.

We do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions we use to calculate impairment losses of long-lived assets, goodwill, and intangible assets. However, if actual results are not consistent with our estimates and assumptions used in the calculations, we may be exposed to impairment losses that could be material.

## Revenue Recognition

While revenue recognition for the Company does not involve significant judgment, it represents an important accounting policy. We recognize revenue and the related cost of goods sold at the time the products are received by the customers. For store sales, revenue is recognized when the customer receives and pays for the merchandise at the register, primarily with either cash, debit card, or credit card. For sales from our online and catalog business, revenue is recognized at the time we estimate the customer receives the merchandise. We record an allowance for estimated returns based on our historical return patterns and various other assumptions that management believes to be reasonable.

We sell merchandise to franchisees under multi-year franchise agreements. We recognize revenue from sales to franchisees at the time merchandise ownership is transferred to the franchisee, which generally occurs when the merchandise reaches the franchisee's pre-designated turnover point. We also receive royalties from franchisees based on a percentage of the total merchandise purchased by the franchisee, net of any refunds or credits due them. Royalty revenue is recognized when merchandise ownership is transferred to the franchisee.

We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate our sales return reserve. However, if the actual rate of sales returns increases significantly, our operating results could be adversely affected. We have not made any material changes in the accounting methodology used to estimate future sales returns in the past three fiscal years.

## Unredeemed Gift Cards, Gift Certificates, and Credit Vouchers

Upon issuance of a gift card, gift certificate, or credit voucher, a liability is established for its cash value. The liability is relieved and net sales are recorded upon redemption by the customer. Over time, some portion of these instruments is not redeemed ("breakage"). We determine breakage income for gift cards, gift certificates, and credit vouchers based

on historical redemption patterns. Breakage income is recorded in other income, which is a component of operating expenses in the Consolidated Statements of Income, when we can determine the portion of the liability where redemption is remote, which is three years after the gift card, gift certificate, or credit voucher is issued. When breakage income is recorded, a liability is recognized for any legal obligation to remit the unredeemed portion to relevant jurisdictions. Our gift cards, gift certificates, and credit vouchers do not have expiration dates.

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We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate our breakage income. However, if the actual rate of redemption for gift cards, gift certificates, and credit vouchers increases significantly, our operating results could be adversely affected. We have not made any material changes in the accounting methodology used to estimate breakage income in the past three fiscal years.

### Income Taxes

We record a valuation allowance against our deferred tax assets when it is more likely than not that some portion or all of such deferred tax assets will not be realized. In determining the need for a valuation allowance, management is required to make assumptions and to apply judgment, including forecasting future income, taxable income, and the mix of income or losses in the jurisdictions in which we operate. Our effective tax rate in a given financial statement period may also be materially impacted by changes in the mix and level of income or losses, changes in the expected outcome of audits, or changes in the deferred tax valuation allowance.

At any point in time, many tax years are subject to or in the process of being audited by various taxing authorities. To the extent our estimates of settlements change or the final tax outcome of these matters is different from the amounts recorded, such differences will impact the income tax provision in the period in which such determinations are made. Our income tax expense includes changes in our estimated liability for exposures associated with our various tax filing positions. Determining the income tax expense for these potential assessments requires management to make assumptions that are subject to factors such as proposed assessments by tax authorities, changes in facts and circumstances, issuance of new regulations, and resolution of tax audits.

We believe the judgments and estimates discussed above are reasonable. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to losses or gains that could be material.

### Recent Accounting Pronouncements

See Item 8, Financial Statements and Supplementary Data, Note 1 of Notes to Consolidated Financial Statements for recent accounting pronouncements, including the expected dates of adoption and estimated effects on our Consolidated Financial Statements.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

#### Derivative Financial Instruments

We operate in foreign countries, which exposes us to market risk associated with foreign currency exchange rate fluctuations. Our risk management policy is to hedge the following using foreign exchange forward contracts: (1) a significant portion of forecasted merchandise purchases denominated primarily in U.S. dollars made by our international subsidiaries whose functional currencies are their local currencies; (2) forecasted intercompany royalty payments; (3) forecasted intercompany revenue transactions related to merchandise sold from our regional purchasing entity, whose functional currency is the U.S. dollar, to certain international subsidiaries in their local currencies; and (4) intercompany obligations that bear foreign exchange risk. We also use foreign exchange forward contracts to hedge the net assets of international subsidiaries to offset the foreign currency translation and economic exposures related to our investment in the subsidiaries. These contracts are entered into with large, reputable financial institutions that are monitored for counterparty risk. The principal currencies hedged against changes in the U.S. dollar are British pounds, Canadian dollars, Euro, and Japanese yen. Our use of derivative financial instruments represents risk management; we do not enter into derivative financial contracts for trading purposes. Additional information is presented in Item 8, Financial Statements and Supplementary Data, Note 8 of Notes to Consolidated Financial Statements. Our derivative financial instruments are recorded in the Consolidated Balance Sheets at fair value as of the balance sheet dates. As of February 2, 2013, we had foreign exchange forward contracts outstanding related to our forecasted merchandise purchases for foreign operations, forecasted intercompany royalty payments, forecasted intercompany revenue transactions, and intercompany obligations that bear foreign exchange risk to buy the notional amounts of \$988 million and 31 million British pounds. As of February 2, 2013, we had foreign exchange forward contracts outstanding to hedge the net assets of our subsidiaries in the notional amount of 25 million Euro.

We have performed a sensitivity analysis as of February 2, 2013 based on a model that measures the impact of a hypothetical 10 percent adverse change in the level of foreign currency exchange rates to U.S. dollars (with all other

variables held constant) on our underlying exposure, net of derivative financial instruments. The foreign currency exchange rates used in the model were based on the spot rates in effect as of February 2, 2013. The sensitivity analysis indicated that a hypothetical 10 percent adverse movement in foreign currency exchange rates would have an unfavorable impact on the underlying cash flow exposure, net of our foreign exchange derivative financial instruments, of \$33 million as of February 2, 2013.



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Long-Term Debt

In April 2011, we issued \$1.25 billion aggregate principal amount of 5.95 percent Notes due April 2021 and received proceeds of \$1.24 billion in cash, net of underwriting and other fees. Interest is payable semi-annually on April 12 and October 12 of each year and commenced on October 12, 2011. The Notes are not subject to interest rate risk, as they have a fixed interest rate.

Cash Equivalents

We have highly liquid fixed and variable income investments classified as cash equivalents, which are placed primarily in money market funds, time deposits, and commercial paper. These investments are classified as held-to-maturity based on our positive intent and ability to hold the securities to maturity. We value these investments at their original purchase prices plus interest that has accrued at the stated rate. The value of our investments is not subject to material interest rate risk. However, changes in interest rates would impact the interest income derived from our investments. We earned interest income of \$6 million in fiscal 2012.

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Item 8. Financial Statements and Supplementary Data.

THE GAP, INC.

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Report of Independent Registered Public Accounting Firm  
To the Board of Directors and Stockholders of The Gap, Inc.:

We have audited the accompanying consolidated balance sheets of The Gap, Inc. and subsidiaries (the "Company") as of February 2, 2013 and January 28, 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three fiscal years in the period ended February 2, 2013. We also have audited the Company's internal control over financial reporting as of February 2, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Gap, Inc. and subsidiaries as of February 2, 2013 and January 28, 2012, and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 2, 2013, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the

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Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2013, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Deloitte & Touche LLP

San Francisco, California

March 26, 2013

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CONSOLIDATED BALANCE SHEETS

(\$ and shares in millions except par value)	February 2, 2013	January 28, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,460	\$ 1,885
Short-term investments	50	—
Merchandise inventory	1,758	1,615
Other current assets	864	809
Total current assets	4,132	4,309
Property and equipment, net	2,619	2,523
Other long-term assets	719	590
Total assets	\$ 7,470	\$ 7,422
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturities of debt	\$ —	\$ 59
Accounts payable	1,144	1,066
Accrued expenses and other current liabilities	1,092	998
Income taxes payable	108	5
Total current liabilities	2,344	2,128
Long-term liabilities:		
Long-term debt	1,246	1,606
Lease incentives and other long-term liabilities	986	933
Total long-term liabilities	2,232	2,539
Commitments and contingencies (see Notes 11 and 15)		
Stockholders' equity:		
Common stock \$0.05 par value		
Authorized 2,300 shares and Issued 1,106 shares for all periods presented;	55	55
Outstanding 463 and 485 shares		
Additional paid-in capital	2,864	2,867
Retained earnings	13,259	12,364
Accumulated other comprehensive income	181	229
Treasury stock at cost (643 and 621 shares)	(13,465)	) (12,760
Total stockholders' equity	2,894	2,755
Total liabilities and stockholders' equity	\$ 7,470	\$ 7,422

See Accompanying Notes to Consolidated Financial Statements

Table of ContentsTHE GAP, INC.  
CONSOLIDATED STATEMENTS OF INCOME

	Fiscal Year		
(\$ and shares in millions except per share amounts)	2012	2011	2010
Net sales	\$ 15,651	\$ 14,549	\$ 14,664
Cost of goods sold and occupancy expenses	9,480	9,275	8,775
Gross profit	6,171	5,274	5,889
Operating expenses	4,229	3,836	3,921
Operating income	1,942	1,438	1,968
Interest expense (reversal)	87	74	(8
Interest income	(6	) (5	) (6
Income before income taxes	1,861	1,369	1,982
Income taxes	726	536	778
Net income	\$ 1,135	\$ 833	\$ 1,204
Weighted-average number of shares—basic	482	529	636
Weighted-average number of shares—diluted	488	533	641
Earnings per share—basic	\$ 2.35	\$ 1.57	\$ 1.89
Earnings per share—diluted	\$ 2.33	\$ 1.56	\$ 1.88
Cash dividends declared and paid per share	\$ 0.50	\$ 0.45	\$ 0.40

See Accompanying Notes to Consolidated Financial Statements

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## THE GAP, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Net income	\$ 1,135	\$ 833	\$ 1,204
Other comprehensive income (loss), net of tax:			
Foreign currency translation, net of tax (tax benefit) of \$-, \$(2), and \$6	(71	) 24	37
Change in fair value of derivative financial instruments, net of tax (tax benefit) of \$18, \$(8), and \$(19)	28	(11	) (31
Reclassification adjustment for realized (gains) losses on derivative financial instruments, net of (tax) tax benefit of \$(4), \$20, and \$14	(5	) 31	24
Other comprehensive income (loss), net of tax	(48	) 44	30
Comprehensive income	\$ 1,087	\$ 877	\$ 1,234

See Accompanying Notes to Consolidated Financial Statements

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## THE GAP, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(\$ and shares in millions)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balance as of January 30, 2010	1,106	\$55	\$2,935	\$10,815	\$ 155	(430 )	\$(9,069 )	\$4,891
Net income				1,204				1,204
Foreign currency translation, net of tax of \$6					37			37
Change in fair value of derivative financial instruments, net of tax benefit of \$(19)					(31 )			(31 )
Reclassification adjustment for realized losses on derivative financial instruments, net of tax benefit of \$14					24			24
Repurchases of common stock						(96 )	(1,956 )	(1,956 )
Reissuance of treasury stock under share-based compensation plans, net of shares withheld for employee taxes			(89 )			8	159	70
Tax benefit from exercise of stock options and vesting of stock units			11					11
Share-based compensation, net of estimated forfeitures			82					82
Cash dividends				(252 )				(252 )
Balance as of January 29, 2011	1,106	55	2,939	11,767	185	(518 )	(10,866 )	4,080
Net income				833				833
Foreign currency translation, net of tax benefit of \$(2)					24			24
Change in fair value of derivative financial instruments, net of tax benefit of \$(8)					(11 )			(11 )
Reclassification adjustment for realized losses on derivative financial instruments, net of tax benefit of \$20					31			31
Repurchases of common stock						(111 )	(2,096 )	(2,096 )
Reissuance of treasury stock under share-based compensation plans, net of shares withheld for employee taxes			(140 )			8	202	62
Tax benefit from exercise of stock options and vesting of stock units			10					10
			58					58



Share-based compensation, net of estimated forfeitures								
Cash dividends				(236 )				(236 )
Balance as of January 28, 2012	1,106	55	2,867	12,364	229	(621 )	(12,760 )	2,755
Net income				1,135				1,135
Foreign currency translation, net of tax of \$-					(71 )			(71 )
Change in fair value of derivative financial instruments, net of tax of \$18					28			28
Reclassification adjustment for realized gains on derivative financial instruments, net of tax of \$(4)					(5 )			(5 )
Repurchases of common stock						(34 )	(1,026 )	(1,026 )
Reissuance of treasury stock under share-based compensation plans, net of shares withheld for employee taxes			(147 )			12	321	174
Tax benefit from exercise of stock options and vesting of stock units			33					33
Share-based compensation, net of estimated forfeitures			111					111
Cash dividends				(240 )				(240 )
Balance as of February 2, 2013	1,106	\$55	\$2,864	\$13,259	\$ 181	(643 )	\$(13,465)	\$2,894
See Accompanying Notes to Consolidated Financial Statements								

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## THE GAP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)	Fiscal Year		
	2012	2011	2010
Cash flows from operating activities:			
Net income	\$1,135	\$833	\$1,204
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	559	592	648
Amortization of lease incentives	(76)	) (86	) (86 )
Share-based compensation	113	58	77
Tax benefit from exercise of stock options and vesting of stock units	33	10	11
Excess tax benefit from exercise of stock options and vesting of stock units	(34)	) (13	) (11 )
Non-cash and other items	11	74	55
Deferred income taxes	(37)	) (11	) 93
Changes in operating assets and liabilities:			
Merchandise inventory	(143)	) 4	(127 )
Other current assets and other long-term assets	(44)	) (101	) (87 )
Accounts payable	91	11	(7 )
Accrued expenses and other current liabilities	68	(45)	) (141 )
Income taxes payable, net of prepaid and other tax-related items	146	(91)	) 66
Lease incentives and other long-term liabilities	114	128	49
Net cash provided by operating activities	1,936	1,363	1,744
Cash flows from investing activities:			
Purchases of property and equipment	(659)	) (548	) (557 )
Purchases of short-term investments	(200)	) (50	) (475 )
Maturities of short-term investments	150	150	600
Acquisition of business	(129)	) —	—
Other	(6)	) (6	) 3
Net cash used for investing activities	(844)	) (454	) (429 )
Cash flows from financing activities:			
Proceeds from issuance of short-term debt	—	16	6
Payments of short-term debt	(19)	) —	(3 )
Proceeds from issuance of long-term debt	—	1,646	—
Payments of long-term debt issuance costs	—	(11)	) —
Payments of long-term debt	(400)	) —	—
Proceeds from issuances under share-based compensation plans, net of withholding tax payments of \$147, \$140, and \$88	174	62	70
Repurchases of common stock	(1,030)	) (2,092	) (1,959 )
Excess tax benefit from exercise of stock options and vesting of stock units	34	13	11
Cash dividends paid	(240)	) (236	) (252 )
Net cash used for financing activities	(1,481)	) (602	) (2,127 )
Effect of foreign exchange rate fluctuations on cash and cash equivalents	(36)	) 17	25
Net increase (decrease) in cash and cash equivalents	(425)	) 324	(787 )
Cash and cash equivalents at beginning of period	1,885	1,561	2,348
Cash and cash equivalents at end of period	\$1,460	\$1,885	\$1,561
Non-cash investing activities:			
Purchases of property and equipment not yet paid at end of period	\$74	\$61	\$59
Supplemental disclosure of cash flow information:			

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Cash paid for interest during the period	\$83	\$45	\$1
Cash paid for income taxes during the period	\$582	\$599	\$677
See Accompanying Notes to Consolidated Financial Statements			

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### Notes to Consolidated Financial Statements

For the Fiscal Years Ended February 2, 2013, January 28, 2012, and January 29, 2011

#### Note 1. Organization and Summary of Significant Accounting Policies

##### Organization

The Gap, Inc., a Delaware Corporation, is a global retailer offering apparel, accessories, and personal care products for men, women, children, and babies under the Gap, Old Navy, Banana Republic, Piperlime, Athleta, and Intermix brands. We have Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, and beginning in November 2010, China and Italy. We also have franchise agreements with unaffiliated franchisees to operate Gap and Banana Republic stores in Asia, Australia, Eastern Europe, Latin America, the Middle East, and Africa. In addition, our products are available to customers online in over 80 countries.

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

##### Principles of Consolidation

The Consolidated Financial Statements include the accounts of The Gap, Inc. and its subsidiaries. All intercompany transactions and balances have been eliminated.

##### Fiscal Year and Presentation

Our fiscal year is a 52-week or 53-week period ending on the Saturday closest to January 31. The fiscal year ended February 2, 2013 (fiscal 2012) consisted of 53 weeks. The fiscal years ended January 28, 2012 (fiscal 2011) and January 29, 2011 (fiscal 2010) consisted of 52 weeks.

##### Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

##### Cash and Cash Equivalents and Short-Term Investments

Cash includes funds deposited in banks as well as amounts in transit from banks for customer credit card and debit card transactions that process in less than seven days. The majority of these amounts are processed within five business days.

All highly liquid investments with original maturities of 91 days or less are classified as cash equivalents. Highly liquid investments with original maturities of greater than 91 days that will mature less than one year from the balance sheet date are classified as short-term investments. Our cash equivalents and short-term investments are placed primarily in money market funds, time deposits, and commercial paper and are classified as held-to-maturity based on our positive intent and ability to hold the securities to maturity. We value these investments at their original purchase prices plus interest that has accrued at the stated rate. Income related to these securities is recorded in interest income in the Consolidated Statements of Income.

##### Restricted Cash

Restricted cash consists primarily of cash that serves as collateral for our insurance obligations. Any cash that is legally restricted from use is classified as restricted cash. If the purpose of restricted cash relates to acquiring a long-term asset, liquidating a long-term liability, or is otherwise unavailable for a period longer than one year from the balance sheet date, the restricted cash is included in other long-term assets. Otherwise, restricted cash is included in other current assets in the Consolidated Balance Sheets.

##### Merchandise Inventory

We value inventory at the lower of cost or market, with cost determined using the weighted-average cost method. We record an adjustment when future estimated selling price is less than cost. We review our inventory levels in order to identify slow-moving merchandise and broken assortments (items no longer in stock in a sufficient range of sizes or colors) and use markdowns to clear merchandise. In addition, we estimate and accrue shortage for the period between the last physical count and the balance sheet date.

Table of Contents**Derivative Financial Instruments**

Derivative financial instruments are recorded at fair value in the Consolidated Balance Sheets as other current assets, other long-term assets, accrued expenses and other current liabilities, or lease incentives and other long-term liabilities.

For derivative financial instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative financial instruments is reported as a component of other comprehensive income ("OCI") and is recognized in income in the period in which the underlying transaction occurs. For derivative financial instruments that are designated and qualify as net investment hedges, the effective portion of the gain or loss on the derivative financial instruments is reported as a component of OCI and is reclassified into income in the period or periods during which the hedged subsidiary is either sold or liquidated (or substantially liquidated). Gains and losses on the derivative financial instruments representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, if any, are recognized in current income. For derivative financial instruments not designated as hedging instruments, the gain or loss on the derivative financial instruments is recorded in operating expenses in the Consolidated Statements of Income. Cash flows from derivative financial instruments are classified as cash flows from operating activities in the Consolidated Statements of Cash Flows.

**Property and Equipment**

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Estimated useful lives are as follows:

Category	Term
Leasehold improvements	Shorter of lease term or economic life, up to 15 years
Furniture and equipment	Up to 15 years
Buildings and building improvements	Up to 39 years
Software	3 to 7 years

When assets are sold or retired, the cost and related accumulated depreciation are removed from the accounts, with any resulting gain or loss recorded in operating expenses in the Consolidated Statements of Income. Costs of maintenance and repairs are expensed as incurred.

**Lease Rights, Key Money, and Favorable Lease Assets**

Lease rights are costs incurred to acquire the right to lease a specific property. A majority of our lease rights are related to premiums paid to landlords. Key money is the amount of funds paid to a landlord or tenant to acquire the rights of tenancy under a commercial property lease for a property located in France. These rights can be subsequently sold by us to a new tenant or the amount of key money paid can potentially be recovered from the landlord should the landlord refuse to allow the automatic right of renewal to be exercised. Lease rights and key money are recorded at cost and are amortized over the corresponding lease term. Lease rights and key money are recorded in other long-term assets in the Consolidated Balance Sheets, net of related amortization.

In connection with our acquisition of Intermix, we acquired favorable lease assets as a result of leases with terms that were considered favorable relative to market terms for similar leases as of the date of acquisition. The favorable lease assets will be recognized as rent expense in cost of goods sold and occupancy expenses in the Consolidated Statements of Income over the remaining term of the leases.

**Insurance and Self-Insurance**

We use a combination of insurance and self-insurance for a number of risk management activities including workers' compensation, general liability, and employee-related health care benefits, a portion of which is paid by our employees. Undiscounted liabilities associated with these risks are estimated based primarily on actuarially-determined amounts and are accrued in part by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions.



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### Asset Retirement Obligations

An asset retirement obligation represents a legal obligation associated with the retirement of a tangible long-lived asset that is incurred upon the acquisition, construction, development, or normal operation of that long-lived asset. The Company's asset retirement obligations are primarily associated with leasehold improvements that we are contractually obligated to remove at the end of a lease to comply with the lease agreement. We recognize asset retirement obligations at the inception of a lease with such conditions if a reasonable estimate of fair value can be made. The asset retirement obligation is recorded in accrued expenses and other current liabilities and lease incentives and other long-term liabilities in the Consolidated Balance Sheets and is subsequently adjusted for changes in estimated asset retirement obligations. The associated estimated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over its useful life.

### Treasury Stock

We account for treasury stock under the cost method, using the first-in, first-out flow assumption, and we include treasury stock as a component of stockholders' equity.

### Revenue Recognition

We recognize revenue and the related cost of goods sold at the time the products are received by the customers. Revenue is recognized for store sales when the customer receives and pays for the merchandise at the register. For sales through online and catalog orders, we estimate and defer recognition of revenue and the related product costs for shipments that are in-transit to the customer. Revenue is recognized at the time we estimate the customer receives the product, which is typically within a few days of shipment. Amounts related to shipping and handling that are billed to customers are recorded in net sales, and the related costs are recorded in cost of goods sold and occupancy expenses in the Consolidated Statements of Income. Revenues are presented net of estimated returns and any taxes collected from customers and remitted to governmental authorities. Allowances for estimated returns are recorded based on estimated margin using our historical return patterns.

We sell merchandise to franchisees under multi-year franchise agreements. We recognize revenue from sales to franchisees at the time merchandise ownership is transferred to the franchisee, which generally occurs when the merchandise reaches the franchisee's pre-designated turnover point. These sales are recorded in net sales, and the related cost of goods sold is recorded in cost of goods sold and occupancy expenses in the Consolidated Statements of Income. We also receive royalties from franchisees based on a percentage of the total merchandise purchased by the franchisee, net of any refunds or credits due them. Royalty revenue is recognized when merchandise ownership is transferred to the franchisee and is recorded in net sales in the Consolidated Statements of Income.

### Classification of Expenses

Cost of goods sold and occupancy expenses include the following:

- the cost of merchandise;
- inventory shortage and valuation adjustments;
- freight charges;
- shipping and handling costs;
- costs associated with our sourcing operations, including payroll and related benefits;
- production costs;
- insurance costs related to merchandise; and
- rent, occupancy, depreciation, and amortization related to our store operations, distribution centers, and certain corporate functions.

Operating expenses include the following:

- payroll and related benefits (for our store operations, field management, distribution centers, and corporate functions);
- marketing;
- general and administrative expenses;
- costs to design and develop our products;



- merchandise handling and receiving in distribution centers;
- distribution center general and administrative expenses;
- rent, occupancy, depreciation, and amortization for our corporate facilities; and

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### Other expenses (income).

The classification of expenses varies across the apparel retail industry. Accordingly, our cost of goods sold and occupancy expenses and operating expenses may not be comparable to those of other companies. Merchandise handling and receiving expenses and distribution center general and administrative expenses recorded in operating expenses were \$231 million, \$224 million, and \$226 million in fiscal 2012, 2011, and 2010, respectively.

### Rent Expense

Minimum rent expense is recognized over the term of the lease. We recognize minimum rent starting when possession of the property is taken from the landlord, which normally includes a construction period prior to the store opening. When a lease contains a predetermined fixed escalation of the minimum rent, we recognize the related rent expense on a straight-line basis and record the difference between the recognized rent expense and the amounts payable under the lease as a short-term or long-term deferred rent liability. We also receive tenant allowances upon entering into certain leases, which are recorded as a short-term or long-term tenant allowance liability and amortized using the straight-line method as a reduction to rent expense over the term of the lease. A co-tenancy failure by our landlord during the lease term may result in a reduction of the required cash payments made to the landlord for the duration of the co-tenancy failure and is recorded as a reduction to rent expense as the reduced cash payments are made. Future payments for common area maintenance, insurance, real estate taxes, and other occupancy costs the Company is obligated to make are excluded from minimum lease payments.

Certain leases provide for contingent rents that are not measurable at inception. These contingent rents are primarily based on a percentage of sales that are in excess of a predetermined level and/or rent increase based on a change in the consumer price index or fair market value. These amounts are excluded from minimum rent and are included in the determination of rent expense when it is probable that the expense has been incurred and the amount can be reasonably estimated.

### Impairment of Long-Lived Assets

We review the carrying amount of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Events that result in an impairment review include the decision to close a store, corporate facility, or distribution center, or a significant decrease in the operating performance of the long-lived asset. Long-lived assets are considered impaired if the estimated undiscounted future cash flows of the asset or asset group are less than the carrying amount. For impaired assets, we recognize a loss equal to the difference between the carrying amount of the asset or asset group and its estimated fair value, which is recorded in operating expenses in the Consolidated Statements of Income. The estimated fair value of the asset or asset group is based on discounted future cash flows of the asset or asset group using a discount rate commensurate with the risk. The asset group is defined as the lowest level for which identifiable cash flows are available, which for retail stores is at the store level.

### Goodwill and Intangible Assets

We review the carrying amount of goodwill and other indefinite-lived intangible assets for impairment annually and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Events that result in an impairment review include significant changes in the business climate, declines in our operating results, or an expectation that the carrying amount may not be recoverable. We assess potential impairment by considering present economic conditions as well as future expectations.

We review goodwill for impairment by first assessing qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If it is determined that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, it is unnecessary to perform the two-step goodwill impairment test. If it is determined that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, the first step of the two-step goodwill impairment test is required to compare the fair value of the reporting unit to its carrying amount, including goodwill. If the carrying amount of the

reporting unit exceeds its fair value, the second step of the two-step goodwill impairment test is required to measure the goodwill impairment loss. The second step includes hypothetically valuing all the tangible and intangible assets of the reporting unit as if the reporting unit had been acquired in a business combination. Then, the implied fair value of the reporting unit's goodwill is compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the goodwill, we recognize an impairment loss in an amount equal to the excess, not to exceed the carrying amount.

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A trade name is considered impaired if the estimated fair value of the trade name is less than the carrying amount. If a trade name is considered impaired, we recognize a loss equal to the difference between the carrying amount and the estimated fair value of the trade name. The fair value of a trade name is determined using the relief from royalty method, which requires management to make assumptions and to apply judgment, including forecasting future sales and expenses, and selecting appropriate discount rates and royalty rates.

Goodwill and other indefinite-lived intangible assets, including the trade names, are recorded in other long-term assets in the Consolidated Balance Sheets.

### Lease Losses

The decision to close a store, corporate facility, or distribution center can result in accelerated depreciation and amortization over the revised remaining useful lives of the associated long-lived assets. In addition, upon exiting leased premises, we record a charge and corresponding lease loss reserve equal to the incremental amount of the present value of the net future obligation greater than the remaining rent-related deferred balances. The net future obligation is determined as the remaining contractual rent obligations less the amount for which we are able to or expect to be able to sublease the properties. We estimate the amount for which we expect to be able to sublease the properties based on the status of our efforts to sublease vacant office space and stores, a review of real estate market conditions, our projections for sublease income, and our assumptions regarding sublease commencement. Lease losses are recorded in operating expenses in the Consolidated Statements of Income.

### Pre-Opening Costs

Pre-opening and start-up activity costs, which include rent and occupancy, supplies, advertising, and payroll expenses incurred prior to the opening of a new store or other facility, are expensed in the period in which they occur.

### Advertising

Costs associated with the production of advertising, such as writing, copy, printing, and other costs, are expensed as incurred. Costs associated with communicating advertising that has been produced, such as television and magazine costs, are expensed when the advertising event takes place. Advertising expense was \$653 million, \$548 million, and \$516 million in fiscal 2012, 2011, and 2010, respectively, and is recorded in operating expenses in the Consolidated Statements of Income.

Prepaid catalog expense consists of the cost to prepare, print, and distribute catalogs. Such costs are amortized over their expected period of future benefit, which is approximately one to five months.

### Share-Based Compensation

Share-based compensation expense for stock options and other stock awards is determined based on the grant-date fair value. We use the Black-Scholes-Merton option-pricing model to determine the fair value of stock options, which requires the input of subjective assumptions regarding the expected term, expected volatility, dividend yield, and risk-free interest rate. For units granted whereby one share of common stock is issued for each unit as the unit vests ("Stock Units"), the fair value is determined based on the Company's stock price on the date of grant less future expected dividends during the vesting period. For stock options and Stock Units, we recognize share-based compensation cost net of estimated forfeitures and revise the estimates in subsequent periods if actual forfeitures differ from the estimates. We estimate the forfeiture rate based on historical experience as well as expected future behavior. Share-based compensation expense is recorded primarily in operating expenses in the Consolidated Statements of Income over the period during which the employee is required to provide service in exchange for stock options and Stock Units.

### Unredeemed Gift Cards, Gift Certificates, and Credit Vouchers

Upon issuance of a gift card, gift certificate, or credit voucher, a liability is established for its cash value. The liability is relieved and net sales are recorded upon redemption by the customer. Over time, some portion of these instruments is not redeemed. We determine breakage income for gift cards, gift certificates, and credit vouchers based on historical

redemption patterns. Breakage income is recorded in other income, which is a component of operating expenses in the Consolidated Statements of Income, when we can determine the portion of the liability where redemption is remote. Based on our historical information, three years after the gift card, gift certificate, or credit voucher is issued, we can determine the portion of the liability where redemption is remote. When breakage income is recorded, a liability is recognized for any legal obligation to remit the unredeemed portion of gift certificates and credit vouchers to relevant jurisdictions. Our gift cards, gift certificates, and credit vouchers do not have expiration dates.

Table of Contents**Credit Cards**

We have credit card agreements (the “Agreements”) with third parties to provide our customers with private label credit cards and/or co-branded credit cards (collectively, the “Credit Cards”). Each private label credit card bears the logo of Gap, Old Navy, or Banana Republic and can be used at any of our U.S. or Canadian store locations and online. The co-branded credit card is a VISA credit card bearing the logo of Gap, Old Navy, or Banana Republic and can be used everywhere VISA credit cards are accepted. A third-party financing company is the sole owner of the accounts issued under the Credit Card programs, and this third party absorbs the losses associated with non-payment by the cardholder and a portion of any fraudulent usage of the accounts. We receive cash from the third-party financing company in accordance with the Agreements and based on usage of the Credit Cards. We also receive payment from Visa U.S.A. Inc. in accordance with the Agreements and based on specified transactional fees. We recognize income for such cash receipts when the amounts are fixed or determinable and collectibility is reasonably assured, which is generally the time at which the actual usage of the Credit Cards or specified transaction occurs. The income is recorded in other income, which is a component of operating expenses in our Consolidated Statements of Income.

The Credit Card programs offer incentives to cardholders in the form of reward certificates upon the cumulative purchase of an established amount. The cost associated with reward points and certificates is accrued as the rewards are earned by the cardholder and is recorded in cost of goods sold and occupancy expenses in the Consolidated Statements of Income. Other administrative costs related to the Credit Card programs, including payroll, marketing expenses, and other direct costs, are recorded in operating expenses in the Consolidated Statements of Income.

**Earnings per Share**

Basic earnings per share is computed as net income divided by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is computed as net income divided by the weighted-average number of common shares outstanding for the period including common stock equivalents. Common stock equivalents consist of shares subject to share-based awards with exercise prices less than the average market price of our common stock for the period, to the extent their inclusion would be dilutive. Stock options and other stock awards that contain performance conditions are not included in the calculation of common stock equivalents until such performance conditions have been achieved.

**Foreign Currency**

Our international subsidiaries primarily use local currencies as the functional currency and translate their assets and liabilities at the current rate of exchange in effect at the balance sheet date. Revenue and expenses from their operations are translated using the monthly average exchange rates in effect during the period in which the transactions occur. The resulting gains and losses from translation are recorded in the Consolidated Statements of Comprehensive Income and in accumulated OCI in the Consolidated Statements of Stockholders’ Equity. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the local functional currency are included in the Consolidated Statements of Income. The aggregate transaction gains and losses included in the Consolidated Statements of Income were as follows:

(\$ in millions)	Fiscal Year		
	2012	2011	2010
Foreign currency transaction losses	\$(3	) \$(7	) \$(1

**Comprehensive Income**

In the first quarter of fiscal 2012, we adopted the revised requirements issued by the Financial Accounting Standards Board (“FASB”) to present comprehensive income in a separate statement. Comprehensive income is comprised of net income and other gains and losses affecting equity that are excluded from net income. The components of OCI consist of foreign currency translation gains and losses, net of tax, changes in the fair value of derivative financial instruments, net of tax, and reclassification adjustments for realized gains and losses on derivative financial instruments, net of tax.

#### Income Taxes

Deferred income taxes are recorded for temporary differences between the tax basis of assets and liabilities and their reported amounts in the Consolidated Financial Statements. A valuation allowance is established against deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

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Our income tax expense includes changes in our estimated liability for exposures associated with our various tax filing positions. At any point in time, many tax years are subject to or in the process of being audited by various taxing authorities. To the extent our estimates of settlements change or the final tax outcome of these matters is different from the amounts recorded, such differences will impact the income tax provision in the period in which such determinations are made.

The Company recognizes interest related to unrecognized tax benefits in interest expense and penalties related to unrecognized tax benefits in operating expenses in the Consolidated Statements of Income.

## Recent Accounting Pronouncements

In July 2012, the FASB issued an accounting standards update (“ASU”) to simplify the manner in which entities may test indefinite-lived intangible assets for impairment. The ASU permits an entity to first assess qualitative factors to determine whether events and circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform a quantitative impairment test. The ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. We will adopt the provisions of the ASU in the first quarter of fiscal 2013. We do not expect the adoption of the ASU to have a material impact on our Consolidated Financial Statements.

In February 2013, the FASB issued an ASU that requires enhanced disclosures around the amounts reclassified out of accumulated other comprehensive income. The amendments do not change the requirements for reporting net income or other comprehensive income. The ASU requires an entity to present information about significant reclassifications out of accumulated other comprehensive income and their corresponding effects on the respective line items in net income. The ASU is effective for annual and interim reporting periods beginning after December 15, 2012 and as such, we will adopt the disclosure provisions in the first quarter of fiscal 2013.

## Note 2. Additional Financial Statement Information

## Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents and short-term investments consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Cash (1)	\$942	\$876
Bank certificates of deposit and time deposits	304	685
Money market funds	189	224
Domestic commercial paper	25	100
Cash equivalents	518	1,009
Cash and cash equivalents	\$1,460	\$1,885
Bank certificates of deposit and time deposits	\$50	\$—
Short-term investments	\$50	\$—

(1) Cash includes \$71 million and \$59 million of amounts in transit from banks for customer credit card and debit card transactions as of February 2, 2013 and January 28, 2012, respectively.

We did not record any impairment charges on our cash equivalents or short-term investments in fiscal 2012, 2011, or 2010.



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## Other Current Assets

Other current assets consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Accounts receivable	\$ 331	\$ 297
Current portion of deferred tax assets	220	205
Prepaid minimum rent and occupancy expenses	147	144
Prepaid income taxes	60	101
Derivative financial instruments	49	12
Prepaid catalog expenses	4	2
Restricted cash	—	6
Other	53	42
Other current assets	\$ 864	\$ 809

## Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Leasehold improvements	\$3,131	\$3,168
Furniture and equipment	2,464	2,463
Land, buildings, and building improvements	1,101	1,096
Software	1,078	960
Construction-in-progress	136	96
Property and equipment, at cost	7,910	7,783
Less: Accumulated depreciation	(5,291)	(5,260)
Property and equipment, net of accumulated depreciation	\$2,619	\$2,523

Depreciation expense for property and equipment was \$554 million, \$586 million, and \$639 million for fiscal 2012, 2011, and 2010, respectively.

Interest of \$6 million and \$4 million related to assets under construction was capitalized in fiscal 2012 and 2011, respectively. No interest related to assets under construction was capitalized in fiscal 2010.

We recorded a charge for the impairment of long-lived assets related to our Stores reportable segment of \$8 million, \$16 million, and \$8 million for fiscal 2012, 2011, and 2010, respectively, which is recorded in operating expenses in the Consolidated Statements of Income.

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## Other Long-Term Assets

Other long-term assets consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Long-term income tax-related assets	\$244	\$258
Goodwill	184	99
Trade names	92	54
Lease rights, key money, and favorable lease assets, net of accumulated amortization of \$144 and \$140	31	22
Deferred compensation plan assets	27	22
Restricted cash	11	11
Other indefinite-lived intangible assets	6	—
Intangible assets subject to amortization, net of accumulated amortization of \$15 and \$14	3	1
Derivative financial instruments	2	1
Other	119	122
Other long-term assets	\$719	\$590

Both the cost and accumulated amortization of lease rights and key money are impacted by fluctuations in foreign currency exchange rates. Amortization expense associated with lease rights and key money was \$4 million, \$4 million, and \$5 million in fiscal 2012, 2011, and 2010, respectively.

In connection with our acquisition of Intermix, we acquired favorable lease assets of \$10 million which will be recognized as rent expense in cost of goods sold and occupancy expenses in the Consolidated Statements of Income over the remaining term of the leases. There was no material rent expense recognized related to the favorable lease assets in fiscal 2012.

## Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Accrued compensation and benefits	\$369	\$292
Unredeemed gift cards, gift certificates, and credit vouchers, net of breakage	232	228
Short-term deferred rent and tenant allowances	93	104
Insurance liabilities	72	70
Sales return allowance	27	21
Accrued advertising	26	26
Credit card reward points and certificates liability	18	14
Derivative financial instruments	14	14
Short-term asset retirement obligations	6	9
Short-term lease loss reserve	5	5
Other	230	215
Accrued expenses and other current liabilities	\$1,092	\$998

The activity related to short-term asset retirement obligations includes adjustments to the asset retirement obligation balance and fluctuations in foreign currency exchange rates. The activity was not material for fiscal 2012 or 2011. No other individual items accounted for greater than five percent of total current liabilities as of February 2, 2013 or January 28, 2012.

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## Lease Incentives and Other Long-Term Liabilities

Lease incentives and other long-term liabilities consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Long-term deferred rent, tenant allowances, and unfavorable lease liabilities	\$750	\$705
Long-term income tax-related liabilities	132	129
Long-term asset retirement obligations	49	47
Deferred compensation plan liabilities	27	22
Long-term lease loss reserve	1	4
Other	27	26
Lease incentives and other long-term liabilities	\$986	\$933

The activity related to long-term asset retirement obligations includes adjustments to the asset retirement obligation balance and fluctuations in foreign currency exchange rates. The activity was not material for fiscal 2012 or 2011. In connection with our acquisition of Intermix, we assumed unfavorable lease liabilities of \$20 million as a result of leases with terms that were considered unfavorable relative to market terms for similar leases as of the date of acquisition. The unfavorable lease liabilities will be recognized as a reduction of rent expense in cost of goods sold and occupancy expenses in the Consolidated Statements of Income over the remaining term of the leases. There was no material amount recognized in cost of goods sold and occupancy expenses related to the unfavorable lease liabilities in fiscal 2012.

## Accumulated Other Comprehensive Income

Accumulated OCI consists of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Foreign currency translation, net of tax	\$158	\$229
Accumulated changes in fair value of derivative financial instruments, net of tax	23	—
Accumulated other comprehensive income	\$181	\$229

## Sales Return Allowance

A summary of activity in the sales return allowance account is as follows:

(\$ in millions)	February 2, 2013	January 28, 2012	January 29, 2011
Balance at beginning of fiscal year	\$21	\$22	\$22
Additions	845	720	712
Returns	(839)	(721)	(712)
Balance at end of fiscal year	\$27	\$21	\$22

The amount of additions and returns for fiscal 2011 have been corrected in the table above to \$720 million and \$721 million, respectively, to appropriately reflect sales return allowance activities during fiscal 2011. This correction did not have any impact on the Consolidated Financial Statements for any period reported.

## Note 3. Acquisition

On December 31, 2012, we acquired all of the outstanding capital stock of Intermix, a multi-brand retailer of luxury and contemporary women's apparel and accessories based in New York, New York, for an aggregate purchase price of \$129 million in cash. The acquisition will allow us to extend our portfolio of brands and further penetrate the higher-end apparel market with an established brand.

The results of operations for Intermix since the date of acquisition are not material to the Consolidated Statements of Income. In addition, the impact of the acquisition on the Company's results of operations, as if the acquisition had been completed on the first day of fiscal 2011, is not significant.



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The preliminary purchase price allocation as of December 31, 2012 was as follows:

(\$ in millions)

Goodwill	\$85
Trade name	38
Intangible assets subject to amortization	3
Net assets acquired	3
Total purchase price	\$129

The purchase price allocation above is subject to adjustments as the fair values are finalized.

All of the assets and liabilities acquired, including goodwill, have been allocated to the Direct reportable segment.

None of the goodwill acquired is deductible for tax purposes.

See Note 4 of Notes to Consolidated Financial Statements for disclosures about goodwill and intangible assets.

#### Note 4. Goodwill and Intangible Assets

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

(\$ in millions)	February 2, 2013	January 28, 2012
Goodwill	\$184	\$99
Trade names	\$92	\$54
Other indefinite-lived intangible assets	\$6	\$—
Intangible assets subject to amortization	\$18	\$15
Less: Accumulated amortization	(15)	(14)
Intangible assets subject to amortization, net	\$3	\$1

#### Goodwill

As discussed in Note 3 of Notes to Consolidated Financial Statements, we preliminarily allocated \$85 million to goodwill as part of our acquisition of Intermix on December 31, 2012. During fiscal 2012, 2011, and 2010, there were no changes in the \$99 million carrying amount of goodwill related to Athleta. The goodwill associated with both Athleta and Intermix is allocated to the Direct reportable segment.

During the fourth quarter of fiscal 2012, we completed our annual impairment test of goodwill and we did not recognize any impairment charges.

#### Other Intangible Assets

As discussed in Note 3 of Notes to Consolidated Financial Statements, we allocated \$38 million to trade name and \$3 million to intangible assets subject to amortization in connection with our acquisition of Intermix. The intangible assets subject to amortization related to Intermix consist of customer relationships and a non-compete agreement that will be amortized over a period of four years and one year, respectively. There was no material amortization expense recognized in operating expenses in the Consolidated Statement of Income in fiscal 2012 related to Intermix's intangible assets subject to amortization. The future amortization expense associated with Intermix's intangible assets subject to amortization is \$2 million in fiscal 2013 and immaterial amounts in each of the following three fiscal years. During fiscal 2012, 2011, and 2010, there were no changes in the \$54 million carrying amount of Athleta's trade name. Athleta's intangible assets subject to amortization of \$15 million, consisting primarily of customer relationships, were fully amortized in fiscal 2012. Amortization expense for Athleta's intangible assets subject to amortization was \$1 million, \$2 million, and \$4 million for fiscal 2012, 2011, and 2010, respectively, and it is recorded in operating expenses in the Consolidated Statements of Income.

During the fourth quarter of fiscal 2012, we completed our annual impairment test of trade names and we did not recognize any impairment charges.

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## Note 5. Long-Term Debt

Long-term debt consists of the following:

(\$ in millions)	February 2, 2013	January 28, 2012
Notes	\$ 1,246	\$ 1,246
Term loan	—	400
Total long-term debt	1,246	1,646
Less: Current portion	—	(40 )
Total long-term debt, less current portion	\$ 1,246	\$ 1,606

In April 2011, we issued \$1.25 billion aggregate principal amount of 5.95 percent Notes due April 2021 and received proceeds of \$1.24 billion in cash, net of underwriting and other fees of \$11 million. The net proceeds were available for general corporate purposes, including repurchases of our common stock. Interest is payable semi-annually on April 12 and October 12 of each year and commenced on October 12, 2011. We have an option to call the Notes in whole or in part at any time, subject to a make-whole premium. The Notes agreement is unsecured and does not contain any financial covenants. The amount recorded in long-term debt in the Consolidated Balance Sheets for the Notes is equal to the aggregate principal amount of the Notes, net of the unamortized discount. As of February 2, 2013 and January 28, 2012, the estimated fair value of the Notes was \$1.41 billion and \$1.19 billion, respectively, and was based on the quoted market price of the Notes (level 1 inputs) as of the last business day of the respective fiscal year. In April 2011, we also entered into a \$400 million, five-year, unsecured term loan due April 2016, which was funded in May 2011. Repayments of \$40 million were payable on April 7 of each year, commencing on April 7, 2012, with a final repayment of \$240 million due on April 7, 2016. In addition, interest was payable at least quarterly based on an interest rate equal to LIBOR plus a margin based on our long-term senior unsecured credit ratings. The average interest rate during fiscal 2012 and 2011 was 2 percent. In April 2012, we repaid \$40 million on the term loan and in August 2012, we repaid the remaining \$360 million reducing the outstanding balance on the term loan to zero. The estimated fair value of the term loan was \$400 million as of January 28, 2012. The carrying amount of the term loan as of January 28, 2012 approximated its fair value, as the interest rate varied depending on quoted market rates (level 1 inputs) and our credit rating.

## Note 6. Credit Facilities

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

In conjunction with our financings in April 2011, we obtained long-term senior unsecured credit ratings from Moody's and Fitch. Moody's assigned a rating of Baa3, and Fitch assigned a rating of BBB-. Standard & Poor's continued to rate us BB+. As of February 2, 2013, there were no changes in these credit ratings. Any future reduction in the Moody's or Standard & Poor's ratings would increase any future interest expense if we were to draw on the Facility.

The China Facilities are two separate agreements to make unsecured revolving credit facilities available for our operations in China; they are uncommitted and are available for borrowings, overdraft borrowings, and the issuance of bank guarantees. The 196 million Chinese yuan China Facilities expired in October 2012 and they were subsequently renewed with an increased availability of 250 million Chinese yuan (\$40 million as of February 2, 2013) and no expiration date. As of February 2, 2013, there were no borrowings under the China Facilities. There were 24 million Chinese yuan (\$4 million as of February 2, 2013) in bank guarantees related to store leases under the China Facilities as of February 2, 2013. The China Facility agreements do not contain any financial covenants. As of January 28, 2012, there were borrowings of \$19 million under the China Facilities, which were recorded in current maturities of debt in the Consolidated Balance Sheet.



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Trade letters of credit represent a payment undertaking guaranteed by a bank on our behalf to pay a vendor a given amount of money upon presentation of specific documents demonstrating that merchandise has shipped. Vendor payables are recorded in the Consolidated Balance Sheets at the time of merchandise title transfer, although the letters of credit are generally issued prior to the title transfer. As of February 2, 2013, we had a \$50 million, two-year, unsecured letter of credit agreement with an expiration date of September 2014. As of February 2, 2013, we had no material trade letters of credit issued under this letter of credit agreement.

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

**Note 7. Fair Value Measurements**

There were no purchases, sales, issuances, or settlements related to recurring level 3 measurements during fiscal 2012 or 2011. There were no transfers into or out of level 1 and level 2 during fiscal 2012 or 2011.

**Financial Assets and Liabilities**

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

(\$ in millions)	February 2, 2013	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	\$518	\$189	\$ 329	\$—
Short-term investments	50	—	50	—
Derivative financial instruments	51	—	51	—
Deferred compensation plan assets	27	27	—	—
Total	\$646	\$216	\$ 430	\$—
Liabilities:				
Derivative financial instruments	\$14	\$—	\$ 14	\$—

(\$ in millions)	January 28, 2012	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	\$1,009	\$224	\$ 785	\$—
Short-term investments	—	—	—	—
Derivative financial instruments	13	—	13	—
Deferred compensation plan assets	22	22	—	—
Total	\$1,044	\$246	\$ 798	\$—
Liabilities:				
Derivative financial instruments	\$14	\$—	\$ 14	\$—

We have highly liquid investments classified as cash equivalents and short-term investments, which are placed primarily in money market funds, time deposits, and commercial paper. These investments are classified as



held-to-maturity based on our positive intent and ability to hold the securities to maturity. We value these investments at their original purchase prices plus interest that has accrued at the stated rate.

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

We maintain the Gap Inc. Deferred Compensation Plan ("DCP"), which allows eligible employees to defer compensation up to a maximum amount. Plan investments are recorded at market value and are designated for the DCP. The fair value of the Company's DCP assets is determined based on quoted market prices, and the assets are recorded in other long-term assets in the Consolidated Balance Sheets.

### Nonfinancial Assets

As discussed in Note 2 of Notes to Consolidated Financial Statements, we recorded a charge for the impairment of long-lived assets of \$8 million, \$16 million, and \$8 million in fiscal 2012, 2011, and 2010, respectively. The impairment charge reduced the then carrying amount of the applicable long-lived assets of \$11 million, \$21 million, and \$12 million to their fair value of \$3 million, \$5 million, and \$4 million during fiscal 2012, 2011, and 2010, respectively. The fair value of the long-lived assets was determined using level 3 inputs and the valuation techniques discussed in Note 1 of Notes to Consolidated Financial Statements.

As discussed in Note 2 of Notes of Consolidated Financial Statements, we acquired favorable lease assets in connection with our acquisition of Intermix. There were no impairment charges recorded for favorable lease assets in fiscal 2012. The fair value of the favorable lease assets was determined using the with-and-without method, with inputs that included discount rates and annual market rent escalation factors (level 3 inputs).

As discussed in Note 4 of Notes to Consolidated Financial Statements, there were no impairment charges recorded for goodwill or other indefinite-lived intangible assets for fiscal 2012, 2011, or 2010.

### Note 8. Derivative Financial Instruments

We operate in foreign countries, which exposes us to market risk associated with foreign currency exchange rate fluctuations. Our risk management policy is to hedge a portion of our transactions related to merchandise purchases for foreign operations and certain intercompany transactions using foreign exchange forward contracts. The principal currencies hedged against changes in the U.S. dollar are British pounds, Canadian dollars, Euro, and Japanese yen. We do not enter into derivative financial contracts for trading purposes.

### Cash Flow Hedges

We designate the following foreign exchange forward contracts as cash flow hedges: (1) forward contracts used to hedge forecasted merchandise purchases and related costs denominated primarily in U.S. dollars made by our international subsidiaries whose functional currencies are their local currencies; (2) forward contracts used to hedge forecasted intercompany royalty payments denominated in Japanese yen and Canadian dollars received by entities whose functional currencies are U.S. dollars; and (3) forward contracts used to hedge forecasted intercompany revenue transactions related to merchandise sold from our regional purchasing entity, whose functional currency is the U.S. dollar, to certain international subsidiaries in their local currencies of Euro and British pounds. The foreign exchange forward contracts entered into to hedge forecasted merchandise purchases and related costs, intercompany royalty payments, and intercompany revenue transactions generally have terms of up to 18 months.

During fiscal 2011, we entered into and settled treasury rate lock agreements in anticipation of issuing our 5.95 percent fixed-rate Notes of \$1.25 billion in April 2011. Prior to the issuance of the Notes, we were subject to changes in interest rates, and we therefore locked into fixed-rate coupons to hedge against the interest rate fluctuations. The gain related to the treasury lock agreements is reported as a component of OCI and is recognized in income over the life of the Notes.

There were no material amounts recorded in income for fiscal 2012, 2011, or 2010 as a result of hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or the discontinuance of cash flow hedges because

the forecasted transactions were no longer probable.

#### Net Investment Hedges

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

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There were no amounts recorded in income for fiscal 2012, 2011, or 2010 as a result of hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or the discontinuance of net investment hedges.

**Other Derivatives Not Designated as Hedging Instruments**

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

**Outstanding Notional Amounts**

As of February 2, 2013 and January 28, 2012, we had foreign exchange forward contracts outstanding in the following notional amounts:

(notional amounts in millions)	February 2, 2013	January 28, 2012
U.S. dollars (1)	\$988	\$873
British pounds	£31	£31
Japanese yen	¥—	¥2,564
Euro	€25	€16

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

**Contingent Features**

We had no derivative financial instruments with credit-risk-related contingent features underlying the agreements as of February 2, 2013 or January 28, 2012.

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## Quantitative Disclosures about Derivative Financial Instruments

The fair values of foreign exchange forward contracts are as follows:

(\$ in millions)	February 2, 2013	January 28, 2012
Derivatives designated as cash flow hedges:		
Other current assets	\$41	\$9
Other long-term assets	\$2	\$1
Accrued expenses and other current liabilities	\$10	\$10
Lease incentives and other long-term liabilities	\$—	\$—
Derivatives designated as net investment hedges:		
Other current assets	\$—	\$—
Other long-term assets	\$—	\$—
Accrued expenses and other current liabilities	\$1	\$—
Lease incentives and other long-term liabilities	\$—	\$—
Derivatives not designated as hedging instruments:		
Other current assets	\$8	\$3
Other long-term assets	\$—	\$—
Accrued expenses and other current liabilities	\$3	\$4
Lease incentives and other long-term liabilities	\$—	\$—
Total derivatives in an asset position	\$51	\$13
Total derivatives in a liability position	\$14	\$14

Substantially all of the unrealized gains and losses from designated cash flow hedges as of February 2, 2013 will be recognized in income within the next 12 months at the then-current values, which may differ from the fair values as of February 2, 2013 shown above.

See Note 7 of Notes to Consolidated Financial Statements for disclosures on the fair value measurements of our derivative financial instruments.

The effective portion of gains and losses on foreign exchange forward contracts in cash flow hedging and net investment hedging relationships recorded in OCI and the Consolidated Statements of Income, on a pre-tax basis, are as follows:

(\$ in millions)	Fiscal Year		
	2012	2011	2010
Derivatives in cash flow hedging relationships:			
Gain (loss) recognized in other comprehensive income	\$46	\$(20)	\$(50)
Gain (loss) reclassified into cost of goods sold and occupancy expenses	\$5	\$(46)	\$(33)
Gain (loss) reclassified into operating expenses	\$4	\$(5)	\$(5)

## Derivatives in net investment hedging relationships:

Loss recognized in other comprehensive income	\$—	\$(1)	\$(5)
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For fiscal 2012, 2011 and 2010, there were no amounts of gain or loss reclassified from OCI into income for derivative financial instruments in net investment hedging relationships, as we did not sell or liquidate (or substantially liquidate) any of our hedged subsidiaries during the periods.

During fiscal 2011, there was a gain of \$1 million recognized in OCI related to treasury rate lock agreements, which is recognized in income over the life of the 5.95 percent Notes.



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Gains and losses on foreign exchange forward contracts not designated as hedging instruments recorded in the Consolidated Statements of Income, on a pre-tax basis are as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Gain recognized in operating expenses	\$5	\$7	\$8

## Note 9. Common Stock

## Common and Preferred Stock

The Company is authorized to issue 2.3 billion shares of common stock. We are also authorized to issue 60 million shares of Class B common stock, which is convertible into shares of common stock on a share-for-share basis.

Transfer of the Class B shares is restricted. In addition, the holders of the Class B common stock have six votes per share on most matters and are entitled to a lower cash dividend. No Class B shares have been issued as of February 2, 2013.

The Company is authorized to issue 30 million shares of one or more series of preferred stock, which has a par value of \$0.05 per share, and to establish at the time of issuance the issue price, dividend rate, redemption price, liquidation value, conversion features, and such other terms and conditions of each series (including voting rights) as the Board of Directors deems appropriate, without further action on the part of the stockholders. No preferred shares have been issued as of February 2, 2013.

## Share Repurchases

Share repurchase activity is as follows:

	Fiscal Year		
(\$ and shares in millions except average per share cost)	2012	2011	2010
Number of shares repurchased	34	111	96
Total cost	\$1,026	\$2,096	\$1,956
Average per share cost including commissions	\$29.89	\$18.88	\$20.44

In November 2009, the Board of Directors authorized \$500 million for share repurchases, which was fully utilized by the end of March 2010. In connection with this authorization, we entered into purchase agreements with individual members of the Fisher family (related-party transactions). The Fisher family shares were purchased at the same weighted-average market price that we paid for share repurchases in the open market. During fiscal 2010, approximately 0.5 million shares were repurchased for \$10 million from the Fisher family subject to these agreements. Between February 2010 and February 2012, the Board of Directors authorized a total of \$5.25 billion for share repurchases, all of which was completed by the end of December 2012. In January 2013, we announced that the Board of Directors approved a new \$1 billion share repurchase authorization, of which \$975 million was remaining as of February 2, 2013. We have not entered into purchase agreements with members of the Fisher family in connection with these authorizations.

All of the share repurchases in fiscal 2012 were paid for as of February 2, 2013. All except \$4 million of total share repurchases in fiscal 2011 were paid for as of January 28, 2012.

## Note 10. Share-Based Compensation

Share-based compensation expense is as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Stock units	\$92	\$39	\$59
Stock options	17	15	14
Employee stock purchase plan	4	4	4
Share-based compensation expense	113	58	77
Less: Income tax benefit	(44)	(23)	(31)
Share-based compensation expense, net of tax	\$69	\$35	\$46

No material share-based compensation expense was capitalized in fiscal 2012, 2011, or 2010.





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There were no material modifications made to our outstanding stock options and other stock awards in fiscal 2012, 2011, or 2010.

## General Description of Stock Option and Other Stock Award Plans

The 1996 Stock Option and Award Plan (the “1996 Plan”) was established on March 26, 1996 and amended and restated on January 28, 2003. The 1996 Plan was further amended and restated on January 24, 2006 and renamed the 2006 Long-Term Incentive Plan (the “2006 Plan”). The 2006 Plan was amended and restated on August 20, 2008. The 2006 Plan was further amended and restated on May 17, 2011 and renamed the 2011 Long-Term Incentive Plan (the “2011 Plan”). Under the 2011 Plan, nonqualified stock options and other stock awards are granted to officers, directors, eligible employees, and consultants at exercise prices or initial values equal to the fair market value of the Company’s common stock at the date of grant or as determined by the Compensation and Management Development Committee of the Board of Directors (the “Committee”).

The 2002 Stock Option Plan (the “2002 Plan”) was established on January 1, 1999. The 2002 Plan empowered the Committee to award nonqualified stock options to non-officer employees. On May 9, 2006, the 2002 Plan was discontinued, and those awards then outstanding continued to be subject to the terms of the 2002 Plan under which they were granted. Pursuant to the 2011 Plan, any shares (not to exceed 28,019,786 shares) that otherwise would have been returned to the 2002 Plan after May 9, 2006 on account of expiration, cancellation, or forfeiture of awards granted are available for grant under the 2011 Plan.

As of February 2, 2013, there were 216,586,781 shares that have been authorized for issuance under the 2011 Plan, including those shares available for issuance under the 2002 Plan, which have or may become available for issuance under the 2011 Plan.

All shares related to stock options and other stock awards are issued from treasury stock.

## Stock Units

Under the 2011 Plan, Stock Units are granted to employees and members of the Board of Directors. Vesting generally occurs over a period of three to four years of continued service by the employee in equal annual installments. Vesting is immediate in the case of members of the Board of Directors. In some cases, vesting is subject to the attainment of a pre-determined financial target (“Performance Shares”). Performance Shares generally vest over a period of three to four years.

At the end of each reporting period, we evaluate the probability that the Performance Shares will vest. We record share-based compensation expense on an accelerated basis based on the grant-date fair value and the probability that the pre-determined financial target will be achieved.

A summary of Stock Unit activity under the 2011 Plan for fiscal 2012 is as follows:

	Shares	Weighted-Average Grant-Date Fair Value
Balance as of January 28, 2012	7,937,101	\$18.74
Granted	3,798,940	\$25.00
Granted, with vesting subject to performance conditions	2,105,971	\$24.84
Vested	(2,922,254)	) \$17.08
Forfeited	(1,554,323)	) \$21.82
Balance as of February 2, 2013	9,365,435	\$22.62

A summary of additional information about Stock Units is as follows:

	Fiscal Year		
	2012	2011	2010
Weighted-average fair value per share of Stock Units granted	\$24.95	\$20.19	\$21.84
Grant-date fair value of Stock Units vested (in millions)	\$50	\$58	\$58

The aggregate intrinsic value of unvested Stock Units as of February 2, 2013 was \$309 million.



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As of February 2, 2013, there was \$92 million (before any related tax benefit) of unrecognized share-based compensation, adjusted for estimated forfeitures, related to unvested Stock Units, which is expected to be recognized over a weighted-average period of 2.04 years. Total unrecognized share-based compensation may be adjusted for future changes in estimated forfeitures.

**Stock Units Granted Based on Performance Metrics**

Under the 2011 Plan, some Stock Units are granted to certain employees only after the achievement of pre-determined performance metrics. Once the Stock Unit is granted, vesting is then subject to continued service by the employee, and expense is recognized over a period of three years on an accelerated basis.

At the end of each reporting period, we evaluate the probability that Stock Units will be granted. We record share-based compensation expense based on the probability that the performance metrics will be achieved, with an offsetting increase to current liabilities. We revalue the liability at the end of each reporting period and record an adjustment to share-based compensation expense as required, based on the probability that the performance metrics will be achieved. Upon achievement of the performance metrics, a Stock Unit is granted. At that time, the associated liability is reclassified to stockholders' equity.

Out of 3,798,940 Stock Units granted in fiscal 2012, 235,451 Stock Units were granted based on satisfaction of performance metrics.

The liability related to potential Stock Units based on performance metrics, which is recorded in accrued expenses and other current liabilities in the Consolidated Balance Sheets, was \$3 million and \$1 million as of February 2, 2013 and January 28, 2012, respectively.

**Stock Options**

We have stock options outstanding under the 2011 Plan and the 2002 Plan. Stock options generally expire 10 years from the grant date, three months after employee termination, or one year after the date of an employee's retirement or death, if earlier. Vesting generally occurs over a period of four years of continued service by the employee, with 25 percent vesting on each of the four anniversary dates.

The fair value of stock options issued during fiscal 2012, 2011, and 2010 was estimated on the date of grant using the following assumptions:

	Fiscal Year				
	2012	2011	2010		
Expected term (in years)	4.6	4.9	4.8		
Expected volatility	33.6	% 30.6	% 29.0	%	%
Dividend yield	2.1	% 2.1	% 1.8	%	%
Risk-free interest rate	1.0	% 2.3	% 2.7	%	%

A summary of stock option activity under the 2011 Plan and the 2002 Plan for fiscal 2012 is as follows:

	Shares	Weighted-Average Exercise Price
Balance as of January 28, 2012	20,597,538	\$19.10
Granted	2,467,175	\$26.52
Exercised	(9,454,063)	) \$18.93
Forfeited/Expired	(810,295)	) \$20.43
Balance as of February 2, 2013	12,800,355	\$20.56

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A summary of additional information about stock options is as follows:

	Fiscal Year		
	2012	2011	2010
Weighted-average fair value per share of stock options granted	\$6.35	\$5.28	\$5.57
Aggregate intrinsic value of stock options exercised (in millions)	\$94	\$19	\$19
Fair value of stock options vested (in millions)	\$15	\$15	\$15

Information about stock options outstanding, vested or expected to vest, and exercisable as of February 2, 2013 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares as of February 2, 2013	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number of Shares as of February 2, 2013	Weighted-Average Exercise Price
\$11.77 - \$16.44	2,817,605	4.60	\$15.01	1,981,010	\$15.36
\$16.90 - \$19.68	3,127,468	4.54	\$18.92	2,644,343	\$18.94
\$19.72 - \$21.79	3,176,244	5.86	\$21.60	1,435,212	\$21.42
\$21.88 - \$25.09	3,281,788	7.85	\$24.21	596,340	\$22.90
\$27.43 - \$36.10	397,250	9.70	\$34.50	750	\$28.41
	12,800,355	5.89	\$20.56	6,657,655	\$18.77
Vested or expected to vest as of February 2, 2013	11,376,064	5.61	\$20.32		

The aggregate intrinsic value of options outstanding, options vested or expected to vest, and options exercisable as of February 2, 2013 was \$160 million, \$144 million, and \$95 million, respectively. Stock options exercisable as of February 2, 2013 had a weighted-average remaining contractual life of 4.15 years.

#### Employee Stock Purchase Plan

Under our Employee Stock Purchase Plan ("ESPP"), eligible U.S. employees are able to purchase our common stock at 85 percent of the closing price on the New York Stock Exchange on the last day of the three-month purchase periods. Accordingly, compensation expense is recognized for an amount equal to the 15 percent discount. Employees pay for their stock purchases through payroll deductions at a rate equal to any whole percentage from 1 percent to 15 percent. There were 960,930, 1,357,769, and 1,301,167 shares issued under the ESPP in fiscal 2012, 2011, and 2010, respectively. As of February 2, 2013, there were 5,064,960 shares reserved for future issuances under the ESPP.

#### Note 11. Leases

We lease most of our store premises and some of our corporate facilities and distribution centers. These operating leases expire at various dates through 2030. Most store leases have a five-year base period and include options that allow us to extend the lease term beyond the initial base period, subject to terms agreed upon at lease inception. Some leases also include early termination options, which can be exercised under specific conditions.

We also lease certain equipment under operating leases that expire at various dates through 2018.

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The aggregate minimum non-cancelable annual lease payments under leases in effect on February 2, 2013 are as follows:

(\$ in millions)

Fiscal Year	
2013	\$1,093
2014	1,069
2015	924
2016	753
2017	584
Thereafter	1,709
Total minimum lease commitments	\$6,132

The total minimum lease commitment amount above does not include minimum sublease rent income of \$31 million receivable in the future under non-cancelable sublease agreements.

Rent expense related to our store premises, corporate facilities, and distribution centers under operating leases is as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Minimum rent expense	\$1,104	\$1,072	\$1,009
Contingent rent expense	123	123	125
Less: Sublease income	(4	) (8	) (5
Total	\$1,223	\$1,187	\$1,129

In addition to rent expense related to our store premises, corporate facilities, and distribution centers as noted above, we had rent expense related to equipment under operating leases of \$2 million, \$4 million, and \$3 million for fiscal 2012, 2011, and 2010, respectively.

We had lease loss reserves of \$6 million and \$9 million as of February 2, 2013 and January 28, 2012, respectively. Lease losses were \$3 million, \$4 million, and \$3 million for fiscal 2012, 2011, and 2010, respectively. Remaining lease payments associated with our lease loss reserve are expected to be paid over the various remaining lease terms through 2021. Based on our current assumptions as of February 2, 2013, we expect our lease payments, net of sublease income, to result in a total net cash outlay of approximately \$13 million for the remaining lease terms.

#### Note 12. Income Taxes

For financial reporting purposes, components of income before income taxes are as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
United States	\$1,692	\$1,253	\$1,686
Foreign	169	116	296
Income before income taxes	\$1,861	\$1,369	\$1,982

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The provision for income taxes consists of the following:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Current:			
Federal	\$617	\$419	\$476
State	56	37	75
Foreign	90	91	134
Total current	763	547	685
Deferred:			
Federal	(37	) 14	94
State	(6	) (6	) (5
Foreign	6	(19	) 4
Total deferred	(37	) (11	) 93
Total provision	\$726	\$536	\$778

Except as noted below and where required by U.S. tax law, no provision has been made for U.S. income taxes on the undistributed earnings of our foreign subsidiaries as we intend to utilize those earnings in our foreign operations for an indefinite period of time. Such undistributed earnings and profits, as calculated pursuant to provisions in the U.S. Internal Revenue Code and related Treasury Regulations, of foreign subsidiaries as of February 2, 2013 and January 28, 2012 were approximately \$1.7 billion and \$1.5 billion, respectively. Cash balances in these foreign subsidiaries are substantially lower than these earnings and profits. If we had not intended to utilize the undistributed earnings in our foreign operations for an indefinite period of time, the deferred tax liability as of February 2, 2013 and January 28, 2012 would have been approximately \$237 million and \$225 million, respectively.

In fiscal 2012, we assessed the forecasted cash needs and overall financial position of our foreign subsidiaries. As a result, we determined that approximately \$54 million of undistributed earnings was in excess of the amount we expect to utilize in the operations of our Canadian subsidiaries for an indefinite period of time, and accordingly, we have established a deferred tax liability for U.S. income taxes with respect to such earnings as of February 2, 2013 and we have recorded related tax expense of \$5 million.

The difference between the effective tax rate and the U.S. federal tax rate is as follows:

	Fiscal Year		
	2012	2011	2010
Federal tax rate	35.0	% 35.0	% 35.0
State income taxes, less federal benefit	2.7	2.2	3.5
Tax impact of foreign operations	2.0	2.1	1.3
Other	(0.7	) (0.1	) (0.5
Effective tax rate	39.0	% 39.2	% 39.3

In fiscal 2012, we changed the presentation of our effective tax rate reconciliation to reflect the impact of state and foreign tax credits and other related items in the corresponding line items in the table. Previously, these items were included in Other within the table. The reconciliations for fiscal 2011 and 2010 have been conformed to reflect these changes in presentation.

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Deferred tax assets (liabilities) consist of the following:

(\$ in millions)	February 2, 2013	January 28, 2012	
Deferred tax assets:			
Deferred rent	\$136	\$137	
Accrued payroll and related benefits	124	66	
Nondeductible accruals	79	74	
Inventory capitalization and other adjustments	66	65	
Depreciation	—	18	
State and foreign net operating losses ("NOLs")	37	36	
Fair value of derivative financial instruments included in accumulated OCI	—	(5	)
Other	100	83	
Total deferred tax assets	542	474	
Valuation allowance	(56	) (39	)
Total deferred tax liabilities	(59	) (15	)
Net deferred tax assets	\$427	\$420	
Current portion (included in other current assets)	\$220	\$205	
Non-current portion (included in other long-term assets)	207	215	
Total	\$427	\$420	

As of February 2, 2013, we had approximately \$50 million state and \$137 million foreign NOL carryovers in multiple taxing jurisdictions that could be utilized to reduce the tax liabilities of future years. The tax-effected NOL was approximately \$3 million for state and \$34 million for foreign as of February 2, 2013. We provided a valuation allowance of approximately \$1 million and \$33 million against the deferred tax asset related to the state and foreign NOLs, respectively. The state losses expire between fiscal 2022 and fiscal 2023, approximately \$106 million of the foreign losses expire between fiscal 2013 and fiscal 2021, and \$31 million of the foreign losses do not expire.

The activity related to our unrecognized tax benefits is as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Balance at beginning of fiscal year	\$102	\$67	\$132
Increases related to current year tax positions	10	10	10
Prior year tax positions:			
Increases	10	31	15
Decreases	(12	) (2	) (74
Cash settlements	(4	) (2	) (4
Expiration of statute of limitations	3	(1	) (14
Foreign currency translation	—	(1	) 2
Balance at end of fiscal year	\$109	\$102	\$67

Of the \$109 million, \$102 million, and \$67 million of total unrecognized tax benefits as of February 2, 2013, January 28, 2012, and January 29, 2011, respectively, approximately \$29 million, \$25 million, and \$5 million (net of the federal benefit on state issues), respectively, represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods. During fiscal 2012 and 2011, interest expense of \$5 million and \$6 million, respectively, was recognized in the Consolidated Statements of Income relating to tax liabilities. During fiscal 2010, an interest expense reversal of \$15 million was recognized in the Consolidated Statement of Income. As of February 2, 2013 and January 28, 2012, the Company had total accrued interest related to the unrecognized tax benefits of \$33 million and \$29 million, respectively. There were no accrued penalties related to the unrecognized tax benefits as of February 2, 2013 or January 28, 2012.





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The Company conducts business globally, and as a result, files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Canada, France, Hong Kong, Japan, India, and the United Kingdom. We are no longer subject to U.S. federal income tax examinations for fiscal years before 2009, and with few exceptions, we are also no longer subject to U.S. state, local, or non-U.S. income tax examinations for fiscal years before 2007.

The Company engages in continual discussions with taxing authorities regarding tax matters in the various U.S. and foreign jurisdictions. It is reasonably possible that we will recognize a decrease in gross unrecognized tax benefits within the next 12 month of up to \$50 million, primarily due to the possible completion of several advance pricing agreements and the closing of audits. If we do recognize such a decrease, the net impact on the Consolidated Statement of Income would be a benefit to our income taxes of approximately \$10 million.

**Note 13. Employee Benefit Plans**

We have two qualified defined contribution retirement plans, the GapShare 401(k) Plan and the GapShare Puerto Rico Plan (the "Plans"), which are available to employees who meet the eligibility requirements. The Plans permit eligible employees to make contributions up to the maximum limits allowable under the applicable Internal Revenue Codes. Under the Plans, we match, in cash, all or a portion of employees' contributions under a predetermined formula. Our contributions vest immediately. Our matching contributions to the Plans were \$37 million, \$36 million, and \$36 million in fiscal 2012, 2011, and 2010, respectively.

We maintain the Gap Inc. DCP, which allows eligible employees and non-employee directors to defer compensation up to a maximum amount. Plan investments are recorded at market value and are designated for the DCP. The fair value of the Company's DCP assets is determined based on quoted market prices. As of February 2, 2013 and January 28, 2012, the assets related to the DCP were \$27 million and \$22 million, respectively, and were recorded in other long-term assets in the Consolidated Balance Sheets. As of February 2, 2013 and January 28, 2012, the corresponding liabilities related to the DCP were \$27 million and \$22 million, respectively, and were recorded in lease incentives and other long-term liabilities in the Consolidated Balance Sheets. We match all or a portion of employees' contributions under a predetermined formula. Plan investments are elected by the participants, and investment returns are not guaranteed by the Company. Our matching contributions to the DCP in fiscal 2012, 2011, and 2010 were not material.

**Note 14. Earnings per Share**

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

	Fiscal Year		
(shares in millions)	2012	2011	2010
Weighted-average number of shares—basic	482	529	636
Common stock equivalents	6	4	5
Weighted-average number of shares—diluted	488	533	641

There were no material shares with an anti-dilutive effect on earnings per share for fiscal 2012. The above computations of weighted-average number of shares—diluted exclude 12 million and 11 million shares related to stock options and other stock awards for fiscal 2011 and 2010, respectively, as their inclusion would have an anti-dilutive effect on earnings per share.

**Note 15. Commitments and Contingencies**

Our future purchase obligations and commitments as of February 2, 2013 are as follows:

	Payments Due by Period				
(\$ in millions)	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	Total
Purchase obligations and commitments (1)	\$3,029	\$190	\$12	\$—	\$3,231

(1) Represents estimated open purchase orders to purchase inventory as well as commitments for products and services used in the normal course of business.



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In January 2006, we entered into a non-exclusive services agreement with IBM under which IBM operates certain significant aspects of our IT infrastructure. The services agreement expires in March 2016, and we have the right to renew it for up to three additional years. We have various options to terminate the agreement, and we pay IBM a combination of fixed and variable charges, with the variable charges fluctuating based on our actual consumption of services. IBM also has certain termination rights in the event of our material breach of the agreement and failure to cure. We paid \$95 million, \$107 million, and \$118 million to IBM for fixed charges in fiscal 2012, 2011, and 2010, respectively. Based on the current projection of service needs, we expect to pay approximately \$267 million to IBM over the remaining term of the contract.

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

In January 2012, we were released from our reinsurance pool for workers' compensation, general liability, and automobile liability and no longer have any related obligations as of February 2, 2013.

As a multinational company, we are subject to various Actions arising in the ordinary course of our business. Many of these Actions raise complex factual and legal issues and are subject to uncertainties. As of February 2, 2013, actions filed against us included commercial, intellectual property, customer, employment, and data privacy claims, including class action lawsuits. The plaintiffs in some Actions seek unspecified damages or injunctive relief, or both. Actions are in various procedural stages, and some are covered in part by insurance. As of February 2, 2013 and January 28, 2012, we recorded a liability for the estimated loss if the outcome of an Action is expected to result in a loss that is considered probable and reasonably estimable. The liability recorded as of February 2, 2013 and January 28, 2012 was not material for any individual Action or in total. Subsequent to February 2, 2013 and through our filing date of March 26, 2013, no information has become available that indicates a material change to our estimate is required.

We cannot predict with assurance the outcome of Actions brought against us. Accordingly, developments, settlements, or resolutions may occur and impact income in the quarter of such development, settlement, or resolution. However, we do not believe that the outcome of any current Action would have a material effect on our Consolidated Financial Statements taken as a whole.

#### Note 16. Segment Information

We identify our operating segments according to how our business activities are managed and evaluated. All of our operating segments sell a group of similar products – apparel, accessories, and personal care products. As of February 2, 2013, we have two reportable segments:

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

**Direct** – The Direct reportable segment includes the results of our online brands, as well as Piperlime and Athleta. Intermix is also a component of the Direct reportable segment; however, its results since the date of acquisition are immaterial.

The accounting policies for each of our operating segments are the same as those described in Note 1 of Notes to Consolidated Financial Statements.

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

(\$ in millions)	Gap	Old Navy	Banana Republic	Franchise (3)	Other (4)	Total	Percentage of Net Sales	
Fiscal 2012								
U.S. (1)	\$3,323	\$4,945	\$2,171	\$—	\$—	\$10,439	67	%
Canada	352	410	216	—	—	978	6	
Europe	691	—	66	63	—	820	5	
Asia	1,062	9	148	86	—	1,305	9	
Other regions	—	—	—	182	—	182	1	
Total Stores reportable segment	5,428	5,364	2,601	331	—	13,724	88	
Direct reportable segment (2)	537	748	247	—	395	1,927	12	
Total	\$5,965	\$6,112	\$2,848	\$331	\$395	\$15,651	100	%
Sales growth	5	% 8	% 8	% 17	% 31	% 8	%	
(\$ in millions)	Gap	Old Navy	Banana Republic	Franchise (3)	Other (4)	Total	Percentage of Net Sales	
Fiscal 2011								
U.S. (1)	\$3,231	\$4,644	\$2,060	\$—	\$—	\$9,935	68	%
Canada	333	392	193	—	—	918	6	
Europe	702	—	54	69	—	825	6	
Asia	966	—	131	79	—	1,176	8	
Other regions	—	—	—	135	—	135	1	
Total Stores reportable segment	5,232	5,036	2,438	283	—	12,989	89	
Direct reportable segment (2)	433	638	188	—	301	1,560	11	
Total	\$5,665	\$5,674	\$2,626	\$283	\$301	\$14,549	100	%
Sales growth (decline)	(1	)% (4	)% 2	% 45	% 22	% (1	)%	
(\$ in millions)	Gap	Old Navy	Banana Republic	Franchise (3)	Other (4)	Total	Percentage of Net Sales	
Fiscal 2010								
U.S. (1)	\$3,454	\$4,945	\$2,084	\$—	\$—	\$10,483	71	%
Canada	341	427	190	—	—	958	7	
Europe	703	—	36	47	—	786	5	
Asia	872	—	118	59	—	1,049	7	
Other regions	—	—	—	89	—	89	1	
Total Stores reportable segment	5,370	5,372	2,428	195	—	13,365	91	
Direct reportable segment (2)	365	533	155	—	246	1,299	9	
Total	\$5,735	\$5,905	\$2,583	\$195	\$246	\$14,664	100	%
Sales growth	2	% 2	% 5	% 38	% 32	% 3	%	

(1) U.S. includes the United States and Puerto Rico.

In July 2010, we began selling products online to customers in select countries outside the U.S. using a U.S.-based third party that provides logistics and fulfillment services. In August 2010, we began selling products online to customers in select countries outside the U.S. utilizing our own logistics and fulfillment capabilities. Online sales shipped from distribution centers located outside the U.S. were \$172 million (\$117 million for Canada, \$50 million for Europe, and \$5 million for Japan), \$127 million (\$89 million for Canada and \$38 million for Europe), and \$42 million (\$30 million for Canada and \$12 million for Europe) in fiscal 2012, 2011, and 2010, respectively.

Franchise sales were \$331 million (\$289 million for Gap and \$42 million for Banana Republic), \$283 million (3)(\$247 million for Gap and \$36 million for Banana Republic), and \$195 million (\$171 million for Gap and \$24 million for Banana Republic) in fiscal 2012, 2011, and 2010, respectively.

(4)Includes Piperlime and Athleta.

Gap and Banana Republic outlet retail sales are reflected within the respective results of each brand.

#### Financial Information for Reportable Segments

Operating income is a primary measure of profit we use to make decisions on allocating resources to our operating segments and to assess the operating performance of each operating segment. It is defined as income before interest expense, interest income, and income taxes. Corporate expenses are allocated to each operating segment and recorded in operating income on a rational and systematic basis.

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Reportable segment assets presented below include those assets that are directly used in, or allocable to, that segment's operations. Total assets for the Stores reportable segment primarily consist of merchandise inventory, the net book value of store assets, and prepaid expenses and receivables related to store operations. Total assets for the Direct reportable segment primarily consist of merchandise inventory, the net book value of IT and distribution center assets, and the net book value of goodwill and intangible assets as a result of the acquisitions of Athleta and Intermix. We do not allocate corporate assets to our operating segments. Unallocated corporate assets primarily include cash and cash equivalents, short-term investments, the net book value of corporate property and equipment, and tax-related assets. Reportable segment capital expenditures are direct purchases of property and equipment by that segment. Unallocated capital expenditures primarily consist of corporate purchases of property and equipment.

Selected financial information by reportable segment and reconciliations to our consolidated totals are as follows:

	Fiscal Year		
(\$ in millions)	2012	2011	2010
Operating income:			
Stores	\$1,508	\$1,095	\$1,666
Direct	434	343	302
Operating income	\$1,942	\$1,438	\$1,968
Depreciation and amortization expense:			
Stores	\$496	\$533	\$584
Direct	63	59	64
Depreciation and amortization expense	\$559	\$592	\$648
Purchases of property and equipment:			
Stores	\$364	\$362	\$391
Direct	89	70	55
Unallocated	206	116	111
Purchases of property and equipment	\$659	\$548	\$557
(\$ in millions)	February 2, 2013	January 28, 2012	
Segment assets:			
Stores	\$3,407	\$3,315	
Direct	886	591	
Unallocated	3,177	3,516	
Total assets	\$7,470	\$7,422	
Long-lived assets, excluding long-term derivative financial instruments in an asset position and long-term deferred tax assets, by geographic location are as follows:			
(\$ in millions)	February 2, 2013	January 28, 2012	
U.S. (1)	\$2,488	\$2,245	
Canada	196	191	
Total North America	2,684	2,436	
Other regions	445	462	
Total long-lived assets	\$3,129	\$2,898	

(1)U.S. includes the United States and Puerto Rico.

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Net sales by region are allocated based on the location in which the sale was originated. Store sales are allocated based on the location of the store, and online sales are allocated based on the location of the distribution center from which the products were shipped. Net sales by geographic location are as follows:

(\$ in millions)	Fiscal Year		
	2012	2011	2010
U.S. (1)	\$12,194	\$11,368	\$11,740
Canada	1,095	1,007	988
Total North America	13,289	12,375	12,728
Other regions	2,362	2,174	1,936
Total net sales	\$15,651	\$14,549	\$14,664

(1) U.S. includes the United States and Puerto Rico.

## Note 17. Quarterly Information (Unaudited)

Selected quarterly and annual operating results are as follows:

(\$ in millions except per share amounts)	13 Weeks Ended	13 Weeks Ended	13 Weeks Ended	14 Weeks Ended	53 Weeks Ended
	April 28, 2012	July 28, 2012	October 27, 2012	February 2, 2013	February 2, 2013 (fiscal 2012)
Net sales	\$3,487	\$3,575	\$3,864	\$4,725	\$15,651
Gross profit	\$1,375	\$1,427	\$1,593	\$1,776	\$6,171
Net income	\$233	\$243	\$308	\$351	\$1,135
Earnings per share—basic (1)	\$0.48	\$0.50	\$0.64	\$0.74	\$2.35
Earnings per share—diluted (1)	\$0.47	\$0.49	\$0.63	\$0.73	\$2.33

(\$ in millions except per share amounts)	13 Weeks Ended	13 Weeks Ended	13 Weeks Ended	13 Weeks Ended	52 Weeks Ended
	April 30, 2011	July 30, 2011	October 29, 2011	January 28, 2012	January 28, 2012 (fiscal 2011)
Net sales	\$3,295	\$3,386	\$3,585	\$4,283	\$14,549
Gross profit	\$1,304	\$1,251	\$1,314	\$1,405	\$5,274
Net income	\$233	\$189	\$193	\$218	\$833
Earnings per share—basic (1)	\$0.40	\$0.35	\$0.38	\$0.45	\$1.57
Earnings per share—diluted (1)	\$0.40	\$0.35	\$0.38	\$0.44	\$1.56

(1) Earnings per share was computed individually for each of the periods presented; therefore, the sum of the earnings per share amounts for the quarters may not equal the total for the year.

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Annual Report on Form 10-K. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Management conducted an assessment of our internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework. Based on the assessment, management concluded that as of February 2, 2013, our internal control over financial reporting is effective. The Company's internal control over financial reporting as of February 2, 2013 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the Company's fourth quarter of fiscal 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item is incorporated herein by reference to the sections entitled "Nominees for Election as Directors," "Corporate Governance—Audit and Finance Committee," and "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2013 Proxy Statement. See also Part I, Item 1 in the section entitled "Executive Officers of the Registrant."

The Company has adopted a code of ethics, our Code of Business Conduct, which applies to all employees including our principal executive officer, principal financial officer, controller, and persons performing similar functions. Our Code of Business Conduct is available on our website, gapinc.com, under "Investors, Corporate Compliance, Code of Business Conduct." Any amendments and waivers to the code will also be available on the website.

Item 11. Executive Compensation.

The information required by this item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Corporate Governance—Compensation and Management Development Committee," and "Executive Compensation and Related Information" in the 2013 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this item is incorporated herein by reference to the sections entitled "Executive Compensation and Related Information—Equity Compensation Plan Information" and "Beneficial Ownership of Shares" in the 2013 Proxy Statement.



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Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this item is incorporated herein by reference to the sections entitled “Other Information” and “Corporate Governance—Director Independence” in the 2013 Proxy Statement.

Item 14. Principal Accounting Fees and Services.

The information required by this item is incorporated herein by reference to the section entitled “Principal Accounting Firm Fees” in the 2013 Proxy Statement.

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Part IV

Item 15. Exhibits, Financial Statement Schedules.

1. Financial Statements: See “Index to Consolidated Financial Statements” in Part II, Item 8 of this Form 10-K.
2. Financial Statement Schedules: Schedules are included in the Consolidated Financial Statements or notes of this Form 10-K or are not required.
3. Exhibits: The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE GAP, INC.

Date: March 26, 2013

By /s/ GLENN K. MURPHY  
Glenn K. Murphy  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

Date: March 26, 2013

By /s/ SABRINA L. SIMMONS  
Sabrina L. Simmons  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 26, 2013

By /s/ ADRIAN D. P. BELLAMY  
Adrian D. P. Bellamy, Director

Date: March 26, 2013

By /s/ DOMENICO DE SOLE  
Domenico De Sole, Director

Date: March 26, 2013

By /s/ ROBERT J. FISHER  
Robert J. Fisher, Director

Date: March 26, 2013

By /s/ WILLIAM S. FISHER  
William S. Fisher, Director

Date: March 26, 2013

By /s/ ISABELLA D. GOREN  
Isabella D. Goren, Director

Date: March 26, 2013

By /s/ BOB L. MARTIN  
Bob L. Martin, Director

Date: March 26, 2013

By /s/ JORGE P. MONTTOYA  
Jorge P. Montoya, Director

Date: March 26, 2013

By /s/ GLENN K. MURPHY  
Glenn K. Murphy, Director

Date: March 26, 2013

By /s/ MAYO A. SHATTUCK III  
Mayo A. Shattuck III, Director

Date: March 26, 2013

By /s/ KATHERINE TSANG



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Exhibit Index

- 1.1 Underwriting Agreement, dated April 7, 2011 in connection with the offering of \$1,250,000,000 aggregate principal amount of Registrant's 5.95% Notes due 2021, filed as Exhibit 1.1 to Registrant's Form 8-K on April 12, 2011, Commission File No. 1-7562.
- 3.1 Registrant's Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1 to Registrant's Annual Report on Form 10-K for the year ended January 30, 1993, Commission File No. 1-7562.
- 3.2 Certificate of Amendment of Amended and Restated Certificate of Incorporation, filed as Exhibit 3.2 to Registrant's Annual Report on Form 10-K for year ended January 29, 2000, Commission File No. 1-7562.
- 3.3 Amended and Restated Bylaws of the Company (effective February 17, 2011), filed as Exhibit 3(ii) to Registrant's Form 8-K on February 18, 2011, Commission File No. 1-7562.
- 4.1 Indenture, dated September 1, 1997, between Registrant and Harris Trust Company of California, filed as Exhibit 4 to Registrant's Form 10-Q for the quarter ended November 1, 1997, Commission File No. 1-7562.
- 4.2 Indenture, dated November 21, 2001, between Registrant and The Bank of New York, filed as Exhibit 4.2 to Registrant's Annual Report on Form 10-K for the year ended February 2, 2002, Commission File No. 1-7562.
- 4.3 Indenture, dated as of April 12, 2011, by and between Registrant and Wells Fargo Bank, National Association, as Trustee, filed as Exhibit 4.1 to Registrant's Form 8-K on April 12, 2011, Commission File No. 1-7562.
- 4.4 First Supplemental Indenture, dated as of April 12, 2011, relating to the issuance of \$1,250,000,000 aggregate principal amount of Registrant's 5.95% Notes due 2021, filed as Exhibit 4.2 to Registrant's Form 8-K on April 12, 2011, Commission File No. 1-7562.
- 4.5 Form of Registrant's 5.95% Notes due 2021, included as Exhibit A to First Supplemental Indenture, filed as Exhibit 4.2 to Registrant's Form 8-K on April 12, 2011, Commission File No. 1-7562.
- 10.1 3-Year LC Agreement dated as of May 6, 2005 among The Gap, Inc., LC Subsidiaries, and HSBC Bank USA, National Association (formerly HSBC Bank USA), as LC Issuer, filed as Exhibit 10.2 to the Registrant's Form 10-Q for the quarter ended May 1, 2010, Commission File No. 1-7562.
- 10.2 Letter Amendment No. 1 to the 3-Year Letter of Credit Agreement with HSBC Bank USA, National Association dated May 18, 2007, filed as Exhibit 10.3 to Registrant's Form 8-K on May 24, 2007, Commission File No. 1-7562.
- 10.3 Letter Amendment No. 2 to the 3-Year Letter of Credit Agreement with HSBC Bank USA, National Association dated September 21, 2010, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended October 30, 2010, Commission File No. 1-7562.
- 10.4 Letter Amendment No. 3 to the 3-Year Letter of Credit Agreement with HSBC Bank USA, National Association dated August 24, 2012, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended

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October 27, 2012, Commission File No. 1-7562.

10.5 Letter Agreement dated April 1, 2008 regarding the 3-Year Letter of Credit Agreement with HSBC Bank USA, National Association, filed as Exhibit 10.8 to Registrant's Form 10-Q for the quarter ended May 3, 2008, Commission File No. 1-7562.

10.6 3-Year LC Agreement dated as of May 6, 2005 among The Gap, Inc., LC Subsidiaries, and Citibank, N.A., as LC Issuer, filed as Exhibit 10.3 to the Registrant's Form 10-Q for the quarter ended May 1, 2010, Commission File No. 1-7562.

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- 10.7 Letter Amendment No. 1 to the 3-Year Letter of Credit Agreement with Citibank, N.A. dated May 18, 2007, filed as Exhibit 10.2 to Registrant's Form 8-K on May 24, 2007, Commission File No. 1-7562.
- 10.8 Letter Agreement dated April 1, 2008 regarding the 3-Year Letter of Credit Agreement with Citicorp USA Inc., filed as Exhibit 10.7 to Registrant's Form 10-Q for the quarter ended May 3, 2008, Commission File No. 1-7562.
- 10.9 Letter Agreement dated September 21, 2010 terminating the 3-Year Letter of Credit Agreement with Citicorp USA Inc., filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended October 30, 2010, Commission File No. 1-7562.
- 10.10 Term Loan and Revolving Credit Agreement dated April 7, 2011, filed as Exhibit 10.1 to Registrant's Form 8-K on April 7, 2011, Commission File No. 1-7562. (1)
- 10.11 Amendment No. 1 to Term Loan and Revolving Credit Agreement dated April 25, 2011, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562. (1)
- 10.12 First Amended and Restated Master Services Agreement between Registrant and IBM, dated as of March 2, 2009, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended May 2, 2009, Commission File No. 1-7562. (1)

EXECUTIVE COMPENSATION PLANS AND ARRANGEMENTS

- 10.13 Executive Management Incentive Compensation Award Plan, filed as Appendix A to Registrant's definitive proxy statement for its annual meeting of stockholders held on May 18, 2010, Commission File No. 1-7562.
- 10.14 The Gap, Inc. Executive Deferred Compensation Plan, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No.1-7562.
- 10.15 Amendment to Executive Deferred Compensation Plan – Freezing of Plan Effective December 31, 2005, filed as Exhibit 10.1 to Registrant's Form 8-K on November 8, 2005, Commission File No. 1-7562.
- 10.16 Amendment to Executive Deferred Compensation Plan – Merging of Plan into the Supplemental Deferred Compensation Plan, filed as Exhibit 10.29 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
- 10.17 Amendment to Executive Deferred Compensation Plan – Suspension of Pending Merger into Supplemental Deferred Compensation Plan, filed as Exhibit 10.30 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
- 10.18 Amendment to Executive Deferred Compensation Plan – Merging of Plan into the Deferred Compensation Plan, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended October 31, 2009, Commission File No. 1-7562.
- 10.19 Deferred Compensation Plan, amended and restated effective September 1, 2011, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended October 29, 2011, Commission File No. 1-7562.
- 10.20

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Supplemental Deferred Compensation Plan, filed as Exhibit 4.1 to the Company's Registration Statement on Form S-8, dated November 29, 2005, Commission File No. 333-129986.

10.21 First Amendment to Supplemental Deferred Compensation Plan, filed as Exhibit 10.32 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.

10.22 Second Amendment to Supplemental Deferred Compensation Plan – Merging of Executive Deferred Compensation Plan into the Plan and Name Change to Deferred Compensation Plan, filed as Exhibit 10.33 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.



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10.23	Third Amendment to Supplemental Deferred Compensation Plan – Suspension of Pending Merging of Executive Deferred Compensation Plan into the Plan and Name Change to Deferred Compensation Plan, filed as Exhibit 10.34 to Registrant’s Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
10.24	Fourth Amendment to Supplemental Deferred Compensation Plan – Merging of Executive Deferred Compensation Plan into the Plan and Name Change to Deferred Compensation Plan, filed as Exhibit 10.2 to Registrant’s Form 10-Q for the quarter ended October 31, 2009, Commission File No. 1-7562.
10.25	1981 Stock Option Plan, filed as Exhibit 4.1 to Registrant’s Registration Statement on Form S-8, Commission File No. 33-54690.
10.26	Management Incentive Restricted Stock Plan II, filed as Exhibit 4.1 to Registrant’s Registration Statement on Form S-8, Commission File No. 33-54686.
10.27	1996 Stock Option and Award Plan, filed as Exhibit A to Registrant’s definitive proxy statement for its annual meeting of stockholders held on May 21, 1996, Commission File No. 1-7562.
10.28	Amendment Number 1 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.1 to Registrant’s Form 10-Q for the quarter ended August 2, 1997, Commission File No. 1-7562.
10.29	Amendment Number 2 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.15 to Registrant’s Form 10-K for the year ended January 31, 1998, Commission File No. 1-7562.
10.30	Amendment Number 3 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.1 to Registrant’s Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.
10.31	Amendment Number 4 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.3 to Registrant’s Form 10-Q for the quarter ended July 29, 2000, Commission File No. 1-7562.
10.32	Amendment Number 5 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.13 to Registrant’s Form 10-K for the year ended February 3, 2001, Commission File No. 1-7562.
10.33	Amendment Number 6 to Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.1 to Registrant’s Form 10-Q for the quarter ended May 5, 2001, Commission File No. 1-7562.
10.34	1996 Stock Option and Award Plan (As Amended and Restated Effective as of January 28, 2003), filed as Appendix C to Registrant’s definitive proxy statement for its annual meeting of stockholders held on May 14, 2003, Commission File No. 1-7562.
10.35	Form of Non-Qualified Stock Option Agreement for employees under Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.5 to Registrant’s Form 10-Q for the quarter ended August 2, 1997, Commission File No. 1-7562.
10.36	Form of Non-Qualified Stock Option Agreement for directors under Registrant’s 1996 Stock Option and Award Plan, filed as Exhibit 10.6 to Registrant’s Form 10-Q for the quarter ended August 2, 1997, Commission File No. 1-7562.
10.37	

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Form of Non-Qualified Stock Option Agreement for consultants under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.

10.38 Form of Non-Qualified Stock Option Agreement for employees in France under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.

10.39 Form of Non-Qualified Stock Option Agreement for international employees under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.

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- 10.40 Form of Non-Qualified Stock Option Agreement for employees in Japan under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.7 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.
- 10.41 Form of Stock Option Agreement for employees under the UK Sub-plan to the U.S. Stock Option and Award Plan, filed as Exhibit 10.8 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.
- 10.42 Form of Non-Qualified Stock Option Agreement for directors effective April 3, 2001 under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended May 5, 2001, Commission File No. 1-7562.
- 10.43 Form of Non-Qualified Stock Option Agreement under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended November 3, 2001, Commission File No. 1-7562.
- 10.44 Form of Stock Award Agreement under Registrant's 1996 Stock Option and Award Plan filed as Exhibit 10.2 to Registrant's Form 8-K on January 27, 2005, Commission File No. 1-7562.
- 10.45 Form of Stock Award Agreement under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.2 to Registrant's Form 8-K on March 16, 2005, Commission File No. 1-7562.
- 10.46 Form of Stock Award Agreement under Registrant's 1996 Stock Option and Award Plan, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended October 29, 2005, Commission File No. 1-7562.
- 10.47 UK Employee Stock Purchase Plan, filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-8, Commission File No. 333-47508.
- 10.48 2002 Stock Option Plan, as amended, (formerly the 1999 Stock Option Plan as amended and Stock Up On Success, The Gap, Inc.'s Stock Option Bonus Program) filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-8, Commission File No. 333-103128.
- 10.49 Form of Non-Qualified Stock Option Agreement under Registrant's 2002 Stock Option Plan (formerly the 1999 Stock Option Plan as amended), filed as Exhibit 4.6 to Registrant's Registration Statement on Form S-8, Commission File No. 333-76523.
- 10.50 Form of Domestic Non-Qualified Stock Option Agreement under Registrant's 2002 Stock Option Plan, as amended, filed as Exhibit 4.6 to Registrant's Registration Statement on Form S-8, Commission File No. 333-72921.
- 10.51 Form of International Non-Qualified Stock Option Agreement under Registrant's 2002 Stock Option Plan, as amended, filed as Exhibit 4.7 to Registrant's Registration Statement on Form S-8, Commission File No. 333-72921.
- 10.52 Non-Employee Director Retirement Plan, dated October 27, 1992, filed as Exhibit 10.43 to Registrant's Annual Report on Form 10-K for the year ended January 30, 1993, Commission File No. 1-7562.

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- 10.53 Amendment, authorized as of August 20, 2008, to Nonemployee Director Retirement Plan, dated October 27, 1992, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended November 1, 2008, Commission File No. 1-7562.
- 10.54 Statement Regarding Non-Employee Director Retirement Plan, filed as Exhibit 10.25 to Registrant's Form 10-K for the year ended January 31, 1998, Commission File No. 1-7562.
- 10.55 Nonemployee Director Deferred Compensation Plan, filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-8, Commission File No. 333-36265.

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- 10.56 Amendment Number 1 to Registrant's Nonemployee Director Deferred Compensation Plan, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended October 31, 1998, Commission File No. 1-7562.
- 10.57 Amendment Number 2 to Registrant's Nonemployee Director Deferred Compensation Plan, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended July 29, 2000, Commission File No. 1-7562.
- 10.58 Amendment Number 3 to Registrant's Nonemployee Director Deferred Compensation Plan, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended May 5, 2001, Commission File No. 1-7562.
- 10.59 Nonemployee Director Deferred Compensation Plan, as amended and restated on October 30, 2001, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended November 3, 2001, Commission File No. 1-7562.
- 10.60 Nonemployee Director Deferred Compensation Plan, as amended and restated on December 9, 2003, filed as Exhibit 10.35 to Registrant's Form 10-K for the year ended January 31, 2004, Commission File No. 1-7562.
- 10.61 Form of Discounted Stock Option Agreement under the Nonemployee Director Deferred Compensation Plan, filed as Exhibit 4.5 to Registrant's Registration Statement on Form S-8, Commission File No. 333-36265.
- 10.62 Form of Non-Qualified Stock Option Agreement for directors effective April 3, 2001 under Registrant's Nonemployee Director Deferred Compensation Plan, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended May 5, 2001, Commission File No. 1-7562.
- 10.63 Nonemployee Director Deferred Compensation Plan – Suspension of Plan Effective January 6, 2005, filed as Exhibit 10.1 to Registrant's Form 8-K on January 7, 2005, Commission File No. 1-7562.
- 10.64 Nonemployee Director Deferred Compensation Plan – Termination of Plan Effective September 27, 2005, filed as Exhibit 10.1 to Registrant's Form 8-K on September 28, 2005, Commission File No. 1-7562.
- 10.65 2006 Long-Term Incentive Plan, filed as Appendix B to Registrant's definitive proxy statement for its annual meeting of stockholders held on May 9, 2006, Commission File No. 1-7562.
- 10.66 2006 Long-Term Incentive Plan, as amended and restated effective August 20, 2008, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended November 1, 2008, Commission File No. 1-7562.
- 10.67 Amendment No. 1 to Registrant's 2006 Long-Term Incentive Plan, filed as Exhibit 10.62 to Registrant's Form 10-K for the year ended February 3, 2007, Commission File No. 1-7562.
- 10.68 2011 Long-Term Incentive Plan, filed as Appendix A to Registrant's definitive proxy statement for its annual meeting of stockholders held on May 17, 2011, Commission File No. 1-7562.
- 10.69 Form of Non-Qualified Stock Option Agreement for Executives under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.1 to Registrant's Form 8-K on March 23, 2006, Commission File No. 1-7562.
- 10.70 Form of Non-Qualified Stock Option Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.8 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562.

- 10.71 Form of Non-Qualified Stock Option Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.9 to Registrant's Form 10-Q for the quarter ended July 28, 2012, Commission File No. 1-7562.
- 10.72\* Form of Non-Qualified Stock Option Agreement under the 2011 Long-Term Incentive Plan.
- 10.73 Form of Stock Award Agreement for Executives under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.2 to Registrant's Form 8-K on March 23, 2006, Commission File No. 1-7562.

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10.74	Form of Non-Qualified Stock Option Agreement for Chief Executive Officer under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.3 to Registrant's Form 8-K on March 23, 2006, Commission File No. 1-7562.
10.75	Form of Stock Award Agreement for Chief Executive Officer under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.4 to Registrant's Form 8-K on March 23, 2006, Commission File No. 1-7562.
10.76	Form of Stock Unit Agreement and Stock Unit Deferral Election Form for Nonemployee Directors under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.5 to Registrant's Form 8-K on March 23, 2006, Commission File No. 1-7562.
10.77	Form of Stock Unit Agreement and Stock Unit Deferral Election Form for Nonemployee Directors under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended July 29, 2006, Commission File No. 1-7562.
10.78	Form of Performance Share Agreement for Executives under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.2 to Registrant's Form 8-K on July 26, 2007, Commission File No. 1-7562.
10.79	Form of Performance Share Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.9 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562.
10.80	Form of Performance Share Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.8 to Registrant's Form 10-Q for the quarter ended July 28, 2012, Commission File No. 1-7562.
10.81	Form of Performance Unit Award Agreement under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended November 3, 2007, Commission File No. 1-7562.
10.82	Form of Performance Share Agreement under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended November 3, 2007, Commission File No. 1-7562.
10.83	Form of Performance Share Agreement under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended May 1, 2010, Commission File No. 1-7562.
10.84	Form of Performance Share Agreement under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.1 to Registrant's Form 8-K on March 11, 2011, Commission File No. 1-7562.
10.85*	Form of Performance Share Agreement under the 2011 Long-Term Incentive Plan.
10.86	Form of Restricted Stock Unit Award Agreement under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended November 3, 2007, Commission File No. 1-7562.
10.87	Form of Restricted Stock Unit Award Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.7 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562.
10.88	Form of Restricted Stock Unit Award Agreement under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.10 to Registrant's Form 10-Q for the quarter ended July 28, 2012, Commission File No. 1-7562.

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- 10.89\* Form of Restricted Stock Unit Award Agreement under the 2011 Long-Term Incentive Plan.
- 10.90 Form of Director Stock Unit Agreement and Stock Unit Deferral Election Form under the 2006 Long-Term Incentive Plan, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended November 3, 2007, Commission File No. 1-7562.
- 10.91 Form of Director Stock Unit Agreement and Stock Unit Deferral Election Form under the 2011 Long-Term Incentive Plan, filed as Exhibit 10.10 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562.



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10.92	Summary of Revised Timing of Annual Board Member Stock Unit Grants, effective August 20, 2008, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended November 1, 2008, Commission File No. 1-7562.
10.93	Agreement with Art Peck dated January 31, 2011, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended April 30, 2011, Commission File No. 1-7562.
10.94	Amendment to Agreement with Art Peck dated November 4, 2011, and confirmed on November 15, 2011, filed as Exhibit 10.91 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.
10.95	Amendment to Post-Termination Benefits with Art Peck dated May 31, 2012, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
10.96*	Agreement with Art Peck dated October 29, 2012, and confirmed on November 9, 2012.
10.97	Agreement with Eva Sage-Gavin dated March 16, 2007, and confirmed on March 27, 2007, filed as Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended May 5, 2007, Commission File No. 1-7562.
10.98	Amendment to Agreement with Eva Sage-Gavin dated November 23, 2008, and confirmed on November 10, 2008, filed as Exhibit 10.101 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
10.99	Amendment to Agreement with Eva Sage-Gavin dated November 4, 2011, and confirmed on January 3, 2012, filed as Exhibit 10.94 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.
10.100	Amendment to Post-Termination Benefits with Eva Sage-Gavin dated May 24, 2012, filed as Exhibit 10.8 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
10.101	CEO Performance Share Agreement dated May 4, 2012, filed as Exhibit 10.1 to Registrant's Form 8-K on May 4, 2012, Commission File No. 1-7562.
10.102	Amended and Restated Employment Agreement by and between Glenn Murphy and the Company, dated December 1, 2008 and confirmed on December 1, 2008, filed as Exhibit 10.106 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
10.103	Modification to Amended and Restated Employment Agreement by and between Glenn Murphy and the Company dated February 9, 2009, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended May 2, 2009, Commission File No. 1-7562.
10.104	Agreement with Sabrina L. Simmons dated February 4, 2008, and confirmed on February 6, 2008, filed as Exhibit 10.1 to Registrant's Form 8-K on February 12, 2008, Commission File No. 1-7562.
10.105	Amendment to Agreement with Sabrina Simmons dated November 23, 2008, and confirmed on December 22, 2008, filed as Exhibit 10.110 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
10.106	

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Amendment to Agreement with Sabrina L. Simmons dated November 4, 2011, and confirmed on January 5, 2012, filed as Exhibit 10.99 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.

- 10.107 Agreement for Post-Termination Benefits with Sabrina Simmons dated May 31, 2012, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
- 10.108 Agreement with Tom Wyatt dated August 21, 2008, and confirmed on September 25, 2008, filed as Exhibit 10.4 to Registrant's Form 10-Q for the quarter ended May 2, 2009, Commission File No. 1-7562.

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10.109	Amendment to Agreement with Tom Wyatt dated November 23, 2008, and confirmed on December 9, 2008, filed as Exhibit 10.112 to Registrant's Form 10-K for the year ended January 31, 2009, Commission File No. 1-7562.
10.110	Amendment to Agreement with Tom Wyatt dated November 4, 2011 and confirmed on November 16, 2011, filed as Exhibit 10.102 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.
10.111	Agreement with Tom Keiser dated November 18, 2009, and confirmed on November 20, 2009, filed as Exhibit 10.103 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.
10.112	Amendment to Agreement with Tom Keiser dated November 4, 2011, and confirmed on December 7, 2011, filed as Exhibit 10.104 to Registrant's Form 10-K for the year ended January 28, 2012, Commission File No. 1-7562.
10.113	Agreement for Post-Termination Benefits with Tom Keiser dated May 31, 2012, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
10.114	Agreement with Stefan Larsson dated April 26, 2012, and confirmed on April 27, 2012, filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended October 27, 2012, Commission File No. 1-7562.
10.115	Amendment to Agreement with Stefan Larsson dated September 12, 2012, and confirmed on September 17, 2012, filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended October 27, 2012, Commission File No. 1-7562.
10.116	Amendment to Agreement with Stefan Larsson dated October 29, 2012, and confirmed on November 6, 2012, filed as Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended October 27, 2012, Commission File No. 1-7562.
10.117*	Amended Service Agreement with Stephen Sunnucks dated June 10, 2009.
10.118*	Amendment to the Amended Service Agreement with Stephen Sunnucks dated August 25, 2011.
10.119*	Amendment to the Amended Service Agreement with Stephen Sunnucks dated May 30, 2012.
10.120*	Agreement with Stephen Sunnucks dated October 31, 2012, and confirmed on November 1, 2012.
10.121*	Agreement for Post-Termination Benefits with Jack Calhoun dated June 9, 2012.
10.122	Agreement for Post-Termination Benefits with Michelle Banks dated May 23, 2012, filed as Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
10.123	Agreement for Post-Termination Benefits with Colin Funnell dated June 3, 2012, filed as Exhibit 10.7 to Registrant's Form 10-Q for the quarter ended April 28, 2012, Commission File No. 1-7562.
10.124	Summary of Changes to Non-employee Director Compensation effective February 15, 2008, filed as Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended May 3, 2008, Commission File No. 1-7562.

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- 10.125 Summary of Changes to Non-employee Director Compensation, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended May 2, 2009, Commission File No. 1-7562.
- 10.126 Summary of Changes to Executive Compensation Arrangements, filed as Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended May 3, 2008, Commission File No. 1-7562.
- 10.127 Summary of Changes to Executive Compensation Arrangements, filed as Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended May 2, 2009, Commission File No. 1-7562.

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10.128	Description of Arrangement with Glenn Murphy for Corporate Jet Usage and Reimbursement for Commercial Travel, filed as Exhibit 101 to Registrant's Form 10-K for the year ended February 2, 2008, Commission File No. 1-7562.
12*	Ratio of Earnings to Fixed Charges
14	Code of Business Conduct, filed as Exhibit 14 to Registrant's Form 10-K for the year ended January 30, 2010, Commission File No. 1-7562.
21*	Subsidiaries of Registrant
23*	Consent of Independent Registered Public Accounting Firm
31.1*	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer of The Gap, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002)
31.2*	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer of The Gap, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002)
32.1*	Certification of the Chief Executive Officer of The Gap, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of the Chief Financial Officer of The Gap, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	The following materials from The Gap, Inc.'s Annual Report on Form 10-K for the year ended February 2, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.

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(1) Pursuant to a request for confidential treatment, portions of this Exhibit have been redacted and have been provided separately to the Securities and Exchange Commission.

\* Filed herewith